TEGETA MOTORS LLC
Georgia, Retail

Corporate profile

Tegeta Motors LLC (Tegeta) is a Georgian retailer specialising in the sale of cars, car parts and special vehicles. The company has a large footprint in Georgia with 20 service centres and five retail outlets spread across every region. Thanks to numerous commercial agreements with international leaders in the automotive sector, Tegeta has developed swiftly in most of its retail segments.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	3.6x	2.9x	3.7x	2.7x
SaD/EBITDA	2.9x	2.9x	2.3x	2.6x
Scope-adjusted FFO/SaD	24%	23%	31%	24%
FOCF/SaD	-6%	-9%	7%	3%

Rating rationale

Scope Ratings has today confirmed its BB-/Stable issuer rating on Georgia-based Tegeta Motors LLC and resolved the review for a possible downgrade. The BB- senior unsecured debt rating has also been confirmed.

The ratings were placed under review in May 2020, mainly due to the potential effects of the Covid-19 pandemic on Tegeta's financial risk profile, including its liquidity situation. The potential implications for Tegeta's business risk profile were not as significant for the ratings in our view, assuming an only temporary decline in demand. We have confirmed the ratings based on ample visibility regarding our base case projections. The resulting key credit metrics are not likely to trigger our rating-change drivers.

We expect Tegeta's overall top line to remain in the positive growth area in the short-to-medium term, benefiting from buses and heavy vehicles tender revenue backlogs and only limited cautious spending patterns for new cars. According to Tegeta's management, results for the first nine months of 2020 show an overall increase in sales of about 7%, in a year-on-year comparison. This is a much stronger top-line performance than initially expected, including a period which was significantly burdened by the closure of a large number of business operations (all non-food retailers), which only gradually reopened after May.

Diversification remains the weakest part of Tegeta's business risk. While the Nagorno-Karabakh conflict may negatively affect the company's geographical diversification risk, it would not change our assessment of its business risk.

We believe that Tegeta will be able to keep profitability margins at around 9%. Profitability will be supported by a flexible cost structure, temporary cost containment during the pandemic (reduced marketing costs) and a temporary personal income tax break from the government. However, these factors will be partially offset by pressure on operating margins from price-sensitive demand on the Georgian market and forex risk.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	BB-

Analysts

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Related Methodology

Corporate Rating Methodology

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Tegeta’s financial risk profile (rated BB) is likely to improve in 2020, benefiting from sound operating performance and only limited cautious spending on the company’s products. Our former concern that Tegeta’s credit quality could suffer badly in 2020 has therefore been allayed. We understand that Tegeta will focus on growth opportunities over the next few years. Significant working capital and capital expenditure requirements hamper Tegeta’s operating cash flow generation potential. Annual expected capex of around GEL 30m in 2021-2022, as confirmed by management, does not leave room for deleveraging. Our rating case incorporates positive free operating cash flows in 2021-2022. We expect leverage, expressed by funds from operations (FFO)/Scope adjusted debt (SaD) to remain in the area of 30% (2021E: 24%; 2022E: 25%).

Tegeta’s liquidity is inadequate based on the measures in our Corporates methodology. Although we expect free operating cash flow to be positive in 2020-2022, it appears insufficient to fully cover (re)-financing needs. Despite the bullet repayment structure of the GEL 30m bond issued in 2019, liquidity is weakened by relatively high short-term debt (around 25% of reported gross debt) and restricted cash positions.

Although our base case is more conservative than that of Tegeta’s management, the resulting key credit metrics do not violate ratio guidelines. We have therefore confirmed the ratings and resolved the review for a possible downgrade.

Outlook and rating-change drivers

Rating Outlook

The Stable Outlook reflects our expectations that Tegeta’s financial risk profile will not deteriorate in the short-to-medium term as the impact of the Covid-19 pandemic appears to be softer than initially anticipated, reflected in expected positive free operating cash flows in 2020.

Rating upside

A positive rating action could be warranted if Tegeta achieves FFO/SaD of above 30% on a sustained basis or improves liquidity. The latter may be achieved via the successful delivery/supply of bus and truck tenders and a faster than expected recovery of automotive product sales.

Rating downside

A negative rating action is possible if credit metrics deteriorate, as indicated by negative free operating cash flow (FOCF)/SaD for a sustained period. Weak financial performance could be triggered by an extended Covid-19 effect, delayed tender deliveries or higher-than-expected capital expenditure.

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant share of the Georgian market, leading to high profitability for a retailer • Award of public tenders diversifying source of revenues • Relatively good credit metrics	• Low geographical diversification with main presence in Georgia • Execution risks linked to activity in emerging markets; especially for activities connected to public tender offers • Limited size in an international context • Investment programme restrains free cash generation

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Diversification • FFO/SaD of over 30% or improved liquidity	• Negative free operating cash flows

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	3.6x	2.9x	3.7x	2.7x
SaD/EBITDA	2.9x	2.9x	2.3x	2.6x
Scope-adjusted FFO/SaD	24%	23%	31%	24%
FOCF/SaD	-6%	-9%	7%	3%
Scope-adjusted EBITDA in GEL m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	38	46	69	59
Operating lease payment in respective year	5	0	0	0
Other	0	0	0	0
Scope-adjusted EBITDA	43	46	69	59
Scope funds from operations in GEL m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	38	46	69	59
less: (net) cash interest as per cash flow statement	-10	-15	-18	-21
less: cash tax paid as per cash flow statement	-2	-1	-2	-1
add: depreciation component operating leases	4	0	0	0
Other	-1	-1	-1	-1
Scope FFO	30	30	49	37
Scope-adjusted debt in GEL m	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	102	131	160	156
Cash, cash equivalents	0	0	0	0
Leasing adjustment	20	0	0	0
SaD	122	131	160	156

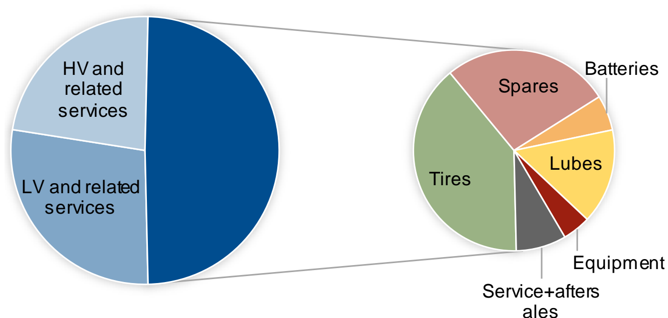
Business risk profile

Competitive position – overview

We expect Tegeta's overall top line to remain in the positive growth area, benefiting from buses and heavy vehicles tender backlogs and a relatively fast sales rebound in the Light Vehicles business line.

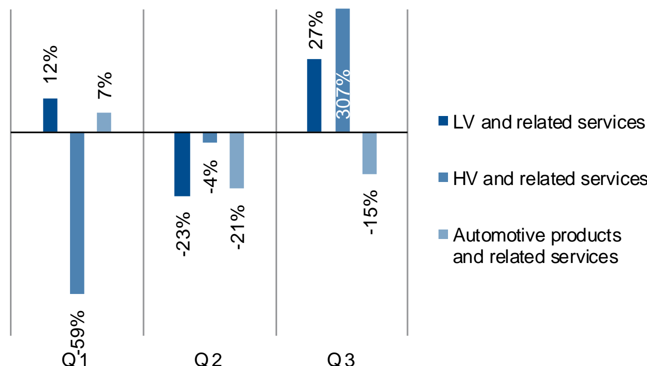
We expect car sales in Georgia to drop significantly in 2020 due to the adverse effect of the Covid-19 pandemic on the purchasing power of Georgian citizens. However, Tegeta's management has not observed cautious spending patterns on new car sales. Excluding the effect of the two months of lockdown, when customers were physically unable to purchase cars, Light Vehicles business line sales stayed at the same level as in 2019. The Automotive Products business line is highly likely to take the biggest hit from the Covid-19 pandemic. This is mainly due to constrained business operation during the lockdown and the bottlenecking of the supply chain. However, gradual recovery trends can be already identified. We anticipate that sales in this business line will recover fully from early next year.

Figure 1: Tegeta's sales split, 9M 2020[1]



Source: Tegeta, Scope

Figure 2: Tegeta's quarterly sales growth, YoY 2020



Source: Tegeta, Scope

Resilient business model

Top-line performance is much stronger than initially expected, including a period which was significantly burdened by the closure of a large number of business operations (all non-food retailers), which only gradually reopened after May.

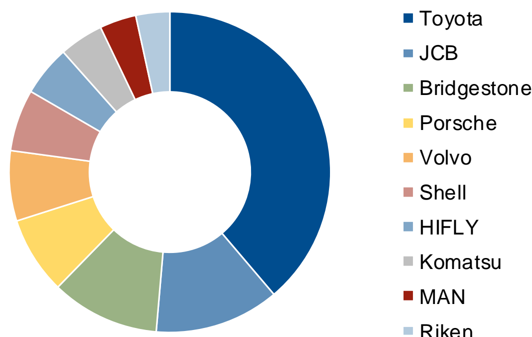
Tegeta's relatively strong local market position allows it to benefit from exclusivity contracts with world-leading brands in the automotive industry. Georgia's fragmented automotive sector characteristics means that most of Tegeta's competitors have limited financial flexibility. Tegeta therefore has a competitive advantage during this period.

Diversification remains weak

Diversification remains the weakest part of Tegeta's business risk profile. While the Nagorno-Karabakh conflict may negatively affect the company's geographical diversification or expansion plans, it would not change our assessment of Tegeta's business risk.

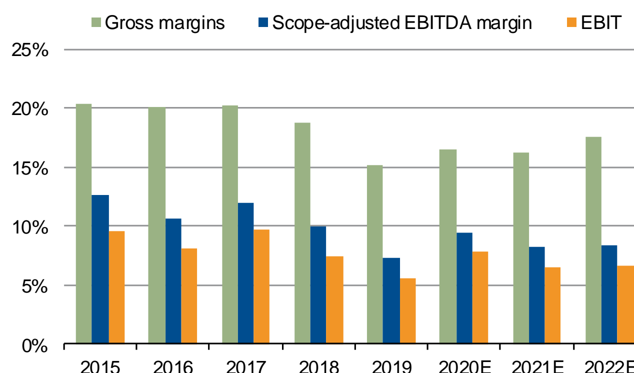
[1] HV-Heavy Vehicle
LV-Light Vehicle

Figure 3: Top 10 brands as of H1 2020



Source: Tegeta, Scope estimates

Figure 4: Operating margin trends, Tegeta



Source: Tegeta, Scope estimates

Relatively high profitability compared to our rated retail sector peers

We believe that Tegeta will be able to keep profitability margins at around 9%. These will be supported by: i) relatively higher tender margins; ii) a flexible cost structure with limited cost of delay; iii) temporary cost containments during the pandemic (reduced marketing costs); and iv) the scale effect. However, these positive factors are partially constrained by price-sensitive demand on the Georgian retail market.

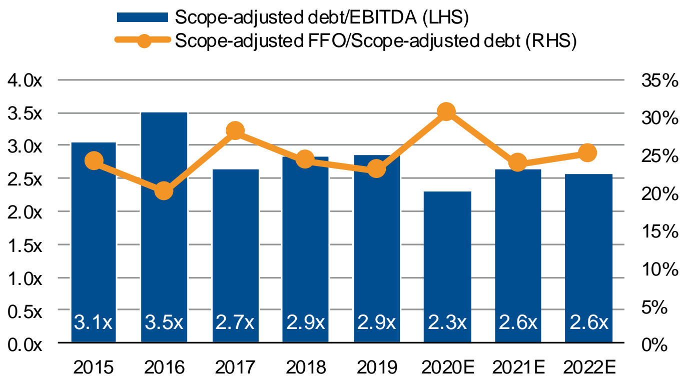
Financial risk profile

- Our conservative assumptions reflect still-limited visibility on the impact of the Covid-19 pandemic on sales of automotive products and related services as well as additional tender-related revenues.
- Our conservative forecasts see reported gross debt remaining at the current amount in the short-to-medium term.
- Net present value of operating lease obligations added to SaD (pre-2019 because Tegeta implemented IFRS 16 as of 1 January 2019).
- The amount of available cash is not netted in our calculation of SaD.
- No pension adjustments.

Better-than-expected credit metrics

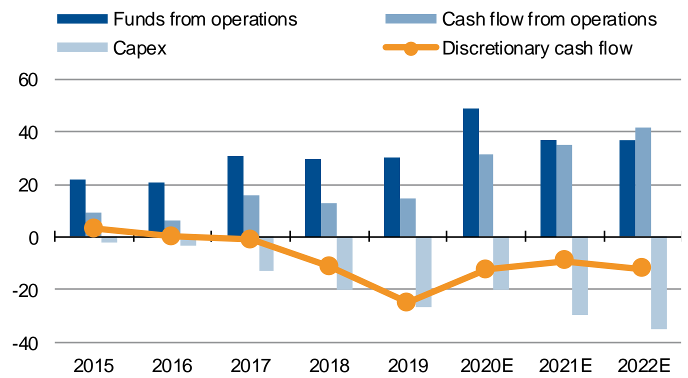
Tegeta’s financial risk profile (rated BB) is likely to improve in 2020, benefiting from sound operating performance and only limited cautious spending on the company’s products. Our former concern that Tegeta’s credit quality could suffer badly in 2020 is therefore allayed. We understand that Tegeta will focus on growth opportunities over the next few years. Significant working capital and capital expenditure requirements hamper Tegeta’s operating cash flow generation potential. Annual expected capex of around GEL 25-35m in 2021-2022, as confirmed by management, does not leave room for deleveraging. Our rating case incorporates free operating cash flows remaining positive in 2021-2022 and an increase in leverage (2021E: 24%; 2022E: 25%).

Figure 5: Leverage



Source: Tegeta, Scope estimates

Figure 6: Cash flow generation



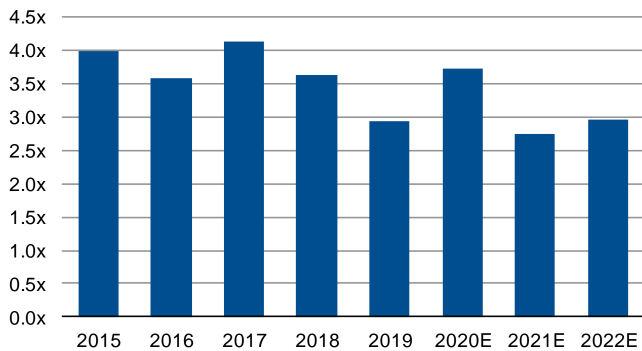
Source: Tegeta, Scope estimates

Furthermore, Tegeta's bond prospectus includes financial covenants referring to leverage (4.0x). We therefore do not expect any significant changes in the company's future capital investment programme, nor do we expect any debt-financed acquisitions.

Weak liquidity

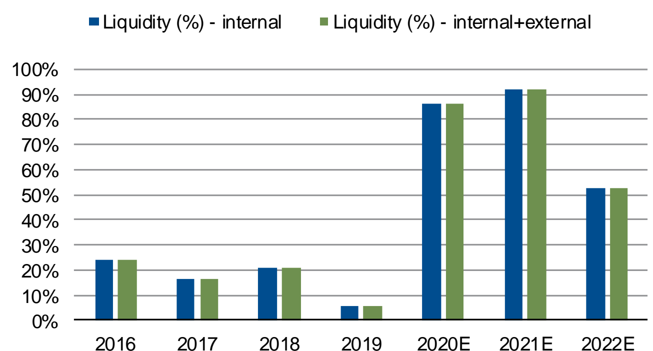
Tegeta's liquidity is inadequate based on the measures in our Corporates methodology. Although we expect free operating cash flow to be positive in 2020-2022, it appears insufficient to fully cover (re)-financing needs. Despite the bullet repayment structure of the GEL 30m bond issued in 2019, liquidity is weakened by relatively high short-term debt (around 25% of reported gross debt) and existing restricted cash positions.

Figure 7: EBITDA cash coverage



Source: Tegeta, Scope estimates

Figure 8: Liquidity profile



Source: Tegeta, Scope estimates

Although our base case is more conservative than that of Tegeta's management, the resulting key credit metrics do not violate ratio guidelines. We have therefore confirmed the ratings and resolved the review for a possible downgrade. Our sensitivity analysis on EBITDA variation for FY 2021 indicates that better-than-expected performance is in line with our positive rating-change driver thresholds.

Table 1: EBITDA variation for the year 2021

Base Case	Sensitivity Analyses of 2021 based on EBITDA Change								
EBITDA interest cover (x)	-40%	-30%	-20%	-10%	0	10%	20%	30%	40%
2.74x	1.6x	1.9x	2.2x	2.5x	2.7x	3.0x	3.3x	3.6x	3.8x
SaD/EBITDA (x)	-40%	-30%	-20%	-10%	0	10%	20%	30%	40%
2.63x	4.4x	3.8x	3.3x	2.9x	2.6x	2.4x	2.2x	2.0x	1.9x
FFO/SaD (%)	-40%	-30%	-20%	-10%	0	10%	20%	30%	40%
23.80%	8.60%	12.40%	16.20%	20.00%	23.80%	27.60%	31.40%	35.20%	39.00%
FOCF/SaD (%)	-40%	-30%	-20%	-10%	0	10%	20%	30%	40%
3.00%	-12.20%	-8.40%	-4.60%	-0.80%	3.00%	6.80%	10.60%	14.40%	18.20%
Liquidity (%)	-40%	-30%	-20%	-10%	0	10%	20%	30%	40%
0.92x	0.4x	0.5x	0.7x	0.8x	0.9x	1.0x	1.2x	1.3x	1.4x

Source: Tegeta, Scope estimates

Slightly improved forex dependence

We anticipate that the continued devaluation of the Georgian currency against the euro/US dollar, is likely to have an adverse effect on Tegeta's operating cash flows in the short-to-medium term. We regard positively the partial mitigation of forex risk due to: i) euro-denominated tenders; ii) the partial refinancing of existing euro-denominated loans in 2020; and iii) the existing currency hedging strategy.

Supplementary rating drivers no longer impact the rating. We have incorporated emerging market and execution risk factors into the financial risk profile.

Long-term debt rating

Average recovery prospects

We confirm the senior unsecured debt category at BB- which includes the GEL 30m (ISIN GE2700603790) bond. We expect an 'average' recovery, which equalises the rating for the bond with the issuer rating. Our recovery expectations are based on an expected enterprise value of around GEL 146m in a hypothetical default scenario after 2022.

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