JSC Nikora
Georgia, Retail and Consumer Products

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2021	2022	2023E	2024E
Scope-adjusted EBITDA/interest cover	3.6x	5.0x	5.2x	5.1x
Scope-adjusted debt/EBITDA	3.0x	2.0x	2.1x	2.1x
Scope-adjusted funds from operations/debt	24%	39%	38%	37%
Scope-adjusted free operating cash flow /debt	1%	8%	-10%	-12%

Rating rationale

The rating action reflects our view that JSC Nikora will maintain a solid operating performance and moderate credit metrics due to its organic growth expansion. The rating action also incorporates the group's huge investment plans to develop its fast-moving consumer goods (FMCG) capacities and retail outreach that will constrain improvements to liquidity and free operating cash flow.

The rating reflects the issuer's business risk profile (assessed at BB-), benefitting from its strong position in Georgia's retail and consumer goods markets, comparatively high profitability, and vertical integrated business model. The assessment is limited by the issuer's small size and low geographical diversification (sole exposure to the Georgian market).

JSC Nikora's financial risk profile, (assessed at BB-), reflects a solid EBITDA growth that has led to improved credit metrics, with Scope-adjusted debt/EBITDA decreasing to 2.0x and funds from operations/debt reaching above 30%. Nevertheless, the financial profile is still limited by the negative free operating cash flow and inadequate liquidity due to the high investment and the reliance on short-term credit lines.

Outlook and rating-change drivers

The Stable Outlook reflects our view that JSC Nikora will continue its expansion strategy with related investments. We note that the investments are dependent on available financing and will only be carried out if profitability is not affected. Credit metrics are expected to remain stable, with Scope-adjusted debt/EBITDA between 2.0x - 2.5x and Scope-adjusted fund from operations/debt above 30%. The foreign currency risk is reflected in the tighter debt thresholds compared to other companies. We expect that high interest rates are likely to decline in the medium to long term as local inflation rapidly eases, helping to keep interest cover close to 5.0x.

A positive rating is considered unlikely but could be justified if the company grows significantly outside Georgia, while credit metrics remain at least in line with rating guidelines and liquidity improves sustainably.

A negative rating action could result from a deterioration in credit metrics indicated by Scope-adjusted funds from operations/debt falling below 30% or Scope-adjusted debt/EBITDA rising above 2.5x on a sustained basis. Such weak financial performance could be triggered by a slowdown in sales momentum, putting operating profitability under pressure.

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies and Related Research

General Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2023

Consumer Products Rating Methodology; November 2022

Sovereign and Public Sector rating report on Republic of Georgia; August 2023

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Bloomberg: RESP SCOP

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
01 Sep 2023	Affirmation	BB-/Stable
01 Sep 2022	Outlook change	BB-/Stable
02 Sep 2021	Outlook change	BB-/Negative

Positive rating drivers

- Subsidiary Nikora Trade's top position in Georgia's retail market and high profitability for a retailer despite inventory shrinkage and obsolete inventory costs (negative ESG rating driver)
- Integrated consumer goods business model with Nikora Trade
- Although small within the group, Nikora FMCG is one of the largest organised food producers in Georgia
- High EBITDA cash conversion benefitting from bargaining power on local market
- Modest leverage constrained by foreign exchange risk

Negative rating drivers

- Cash flow cover remaining under pressure due to significant capex and lease repayments
- Limited diversification outside of Georgia
- Inadequate liquidity
- Highly concentrated supply chain (mainly Ukraine and Russia)
- Significant foreign exchange risk as almost all raw materials are imported while sales are in Georgian lari

Positive rating-change drivers

- Liquidity improves sustainably
- Significantly growth outside Georgia
- Credit metrics remain at least in line with rating guidelines

Negative rating-change drivers

- Scope-adjusted debt/EBITDA sustained above 2.5x
- Scope-adjusted funds from operations/debt sustained below 30%
- Liquidity to remain inadequate

Corporate profile

JSC Nikora is a holding company focused on the import, production and distribution of food. It is active solely in Georgia. Its most significant holding is top Georgian food retailer Nikora Trade. Around 40% of Nikora Trade's purchases are made from integrated suppliers within the Nikora group. JSC Nikora has more than 8,000 employees.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**LTM 2023**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	3.6x	5.0x	5.9x	5.2x	5.1x	4.9x
Scope-adjusted debt/EBITDA	3.0x	2.0x	1.8x	2.1x	2.1x	2.2x
Scope-adjusted funds from operations/debt	24%	39%	46%	38%	37%	35%
Scope-adjusted free operating cash flow/debt	1%	78%	-3%	-10%	-12%	0%
Scope-adjusted EBITDA in GEL m						
EBITDA	80,477	118,077	137,346	136,718	165,581	180,468
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**80,477**	**118,077**	**137,346**	**136,718**	**165,581**	**180,468**
Funds from operations in GEL m						
Scope-adjusted EBITDA	80,477	118,077	137,346	136,718	165,581	180,468
less: (net) cash interest paid	-22,521	-23,642	-23,160	-26,527	-32,602	-36,978
less: cash tax paid per cash flow statement	-1,062	-1,143	-1,245	-1,956	-1,810	-2,217
Funds from operations	**56,894**	**93,292**	**112,941**	**108,236**	**131,170**	**141,273**
Free operating cash flow in GEL m						
Funds from operations	56,894	93,292	112,941	108,236	131,170	141,273
Change in working capital	-2,016	9,945	-8,550	2,766	-1,716	-8,166
Non-operating cash flow[1]	-1,764	-1,568	-9,840	0	0	0
less: capital expenditure (net)	-26,362	-58,905	-76,636	-108,105	-141,523	-98,342
less: operating lease payments (amortization)	-23,152	-23,095	-22,683	-25,409	-25,804	-26,093
less: dividends (preferred shares)	-988	-1,373	-1,373	-6,082	-5,254	-7,562
Free operating cash flow	**2,612**	**18,296**	**-6,141**	**-28,593**	**-43,128**	**1,111**
Net cash interest paid in GEL m						
Net cash interest per cash flow statement	22,521	23,642	23,160	26,527	32,602	36,978
Change in other items	0	0	0	0	0	0
Net cash interest paid	**22,521**	**23,642**	**23,160**	**26,527**	**32,602**	**36,978**
Scope-adjusted debt in GEL m						
Reported gross financial debt	241,519	240,105	244,336	288,084	350,186	399,104
less: cash and cash equivalents	0	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted debt	**241,519**	**240,105**	**244,336**	**288,084**	**350,186**	**399,104**
Cash for information purposes only	20,462	39,804	22,340	25,187	7,060	13,171

[1] Provisions and others non-operating cash flow before operating cash flow from operations.

Table of Content

Environmental, social and governance (ESG) profile[2]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Regulatory and reputational risk

The government of Georgia will likely put increasing pressure on unregulated retailers. While stricter food safety standards and regulations might put the operating environment under pressure, we do not expect this to happen quickly. Further, any regulatory action will likely benefit Nikora Trade by weakening the unorganised market, thereby increasing the issuer's market share.

Environmental risk

To reduce pollution and harm to the environment, the group uses energy-efficient and environment-friendly equipment for its shopping facilities, such as refrigerators using new-generation freon and less electricity, LED lighting and energy-saving stoves. freon and less electricity; energy-saving LED lighting systems; Energy-saving stoves.

Clarity and transparency

Our previous rating actions flagged transparency issues including the ability to communicate and the timeliness of financial disclosures. We note that information flows between management and Scope have since improved. Further, our concerns over governance and transparency have faded.

Efficiencies

Inventory shrinkage and obsolete inventory still equate to 2% of sales and decrease gross margins. The cost to manage the food supply chain is too high; the company is seeking to address this by integrating SAP enterprise resource planning systems to track and organise stock and improve working capital management. Better access to available stock will increase operating efficiency.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BB-

Credit-supportive blended industry risk profile: BBB+

JSC Nikora's industry risk profile (assessed at BBB+) benefits from a blended industry risk of non-cyclical retail (assessed at BBB) and non-durable consumer products (assessed at A), which both have low cyclicality, low-to-medium barriers to entry and low substitution risk.

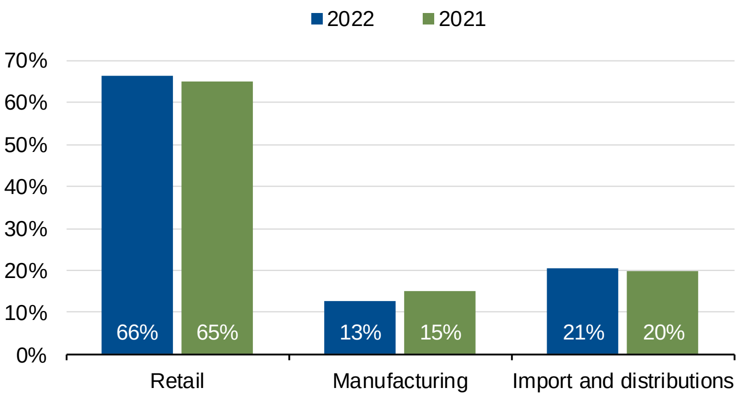
Dominant in Georgian retail (consumer products)

Nikora's competitive position continues to benefit from its ownership of subsidiaries that in Georgia are key producers of consumer goods with high brand recognition. JSC Nikora's business had solid momentum throughout 2022, benefitting from: i) sustained private consumption after wage growth outpaced inflation; ii) favourable macro conditions with a constant inflow of workers and consumers from Russia, Belarus and Ukraine; and ii) management's ability to maintain margins despite high local inflation.

Limited size

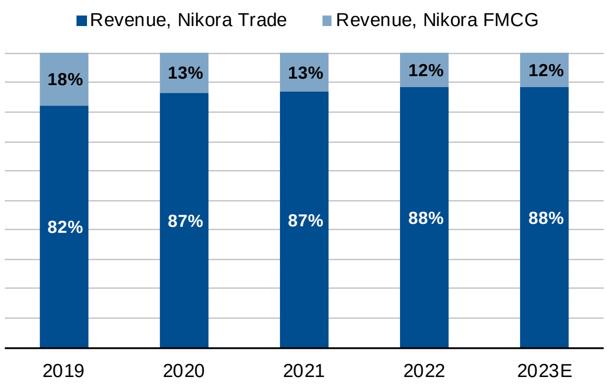
The market position assessment is still constrained by group's small size (GEL 1,012m in revenue for FY 2022) at the European level, which is the main negative driver of the business risk profile. However, its size is still significant compared to Georgian peers.

Figure 1: JSC Nikora unconsolidated revenues by business unit 2021 2022 (%)



Sources: Nikora, Scope

Figure 2: JSC Nikora's revenues distribution by business unit 2019-2023E (%)



Sources: Nikora, Scope

Regulatory environment

We expect any changes in food retail regulation in Georgia to only happen slowly. Furthermore, changes are likely to benefit JSC Nikora by weakening unorganised competitors and thereby consolidating its market share (neutral ESG rating driver).

High concentration in Nikora Trade

Subsidiary Nikora Trade is undergoing a massive investment plan to expand its store network, which we will lead to growth of the group's consumer goods activities. Even so, the group has a high dependency on Nikora Trade as around 60% of Nikora consumer good's sales are linked to intra-group sales.

Geographical diversification remains weak

Geographical diversification remains the other major weakness of the group's business risk profile. The issuer is only active in Georgia, increasing its exposure to geopolitical risk and currency exchange rate volatility upon other currencies such as EUR and USD. The vertically integrated group structure, however, does improve the diversification assessment.

Country growth outlook and inflation supports market conditions

Georgia has a positive growth outlook with GPD expected at 7.5%, which has strengthened the conditions in JSC Nikora's markets. The Georgian economy has recovered strongly from covid impacts, with 10.5% GDP growth in 2021 and 10.1% in 2022. Since the Ukraine conflict escalated in 2022, immigration and financial inflows from neighbouring countries have increased domestic demand.

Headline inflation with strong declining

Georgia's headline inflation also declined markedly over recent months to 1.5% YoY in May 2023, from the 13.9% YoY peak in January 2022. This was supported by easing energy and commodity prices after they surged in the wake of the full-scale invasion of Ukraine, along with a tighter monetary policy and a stronger lari. Core inflation was higher at 3.9% in May 2023 but has also receded closer to the 3% longer-run inflation target. Inflationary pressures are party due to the labour market, with nominal wage growth of 18.7% YoY as of Q1 2023. After raising its policy rate by 300 bp in total to reach 11% in the year to March 2022, the National Bank of Georgia is starting to exit its tight monetary policy this May with a 50 bp rate cut.

Latent external geopolitical risk due to small size of economy

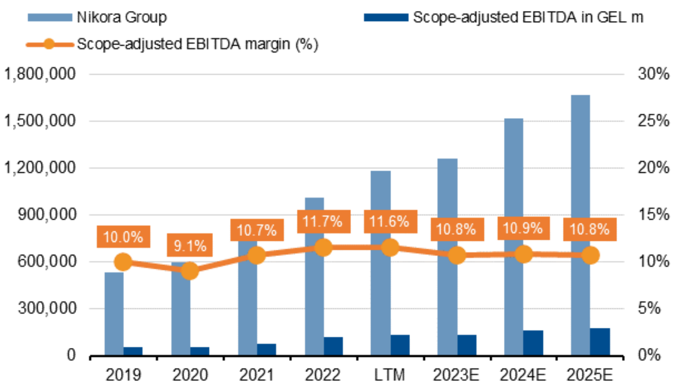
Nevertheless, we highlight the country's challenges related to i) heightened geopolitical risks following Russia's full-scale invasion of Ukraine due to Georgia's dependence on exports and tourism from both countries; ii) the vulnerability to external shocks due to the Georgian economy's small size and high reliance on external financing; and iii) the financial-stability risk associated with dollarisation in the economy. We also highlight the country's dependency on Russian, Ukrainian and Belarusian markets for the imports of primary food products, risking disruption to supply chains.

Limited visibility on supply chain sustainability

As of August 2023, the group's management has confirmed no significant disruption in supply chains as main suppliers continue to deliver. The issuer has been able to bring new suppliers from South America, Poland, and Turkey, that are treated as backup in case bordering countries cannot deliver the needed raw materials.

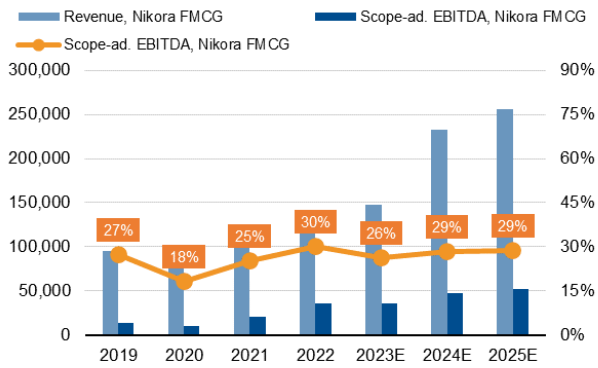
Our base case includes stable gross margin development and no major supply chain disruptions. However, we highlight a sudden substitution of supply chain could still significantly hamper the company's operating performance.

Figure 3: JSC Nikora consolidated operating performance (2018-2025E)



Sources: Nikora, Scope estimates

Figure 4: JSC Nikora's FMCG financial overview



Sources: Nikora, Scope estimates

Comfortable operating profitability

We expect that Nikora can keep profitability margins comfortable into the medium term. H1 2023 results support this view: revenues grew at double-digits and interim EBITDA reached 11% of revenues.

Our base case sees Scope-adjusted EBITDA margin of above 10.5% in the short to medium term. Our view is supported by: i) historically good management of cost of goods sold, which has stabilised gross margins at 29% of revenues; and ii) the issuer's significant investment into organic growth over the next three years by developing its retail and FMCG arms, which should enhance bargaining power and may create synergies and higher margins; and iii) the Georgian economy's solid momentum.

Financial risk profile: BB-

Adjustments and assumptions

Our key adjustments are:

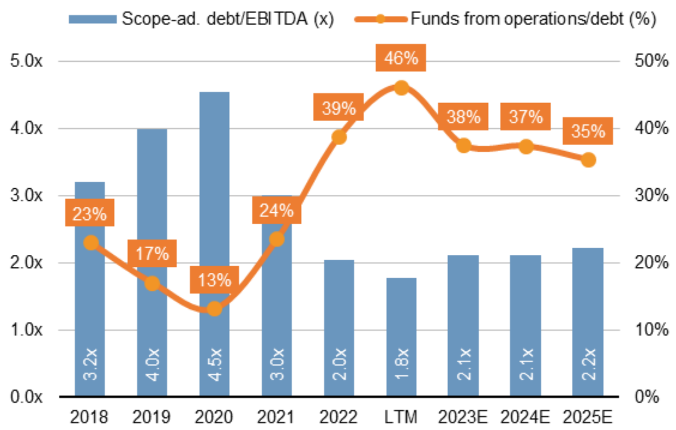
- Inclusion in gross debt of short- and long-term lease obligations
- Exclusion of available cash and cash equivalents from Scope-adjusted debt as the cash could still become restricted if supplier terms change or the supply chain is disrupted.
- Free operating cash flow adjusted by lease repayments, capex and dividends on preference shares.

Improved leverage metrics backed by Scope-adjusted EBITDA growth

Nikora's financial risk profile, reflects a sustained operating performance that has reinforced credit metrics, with solid Scope-adjusted EBITDA growth and the cash conversion cycle reflected in substantial cash flow.

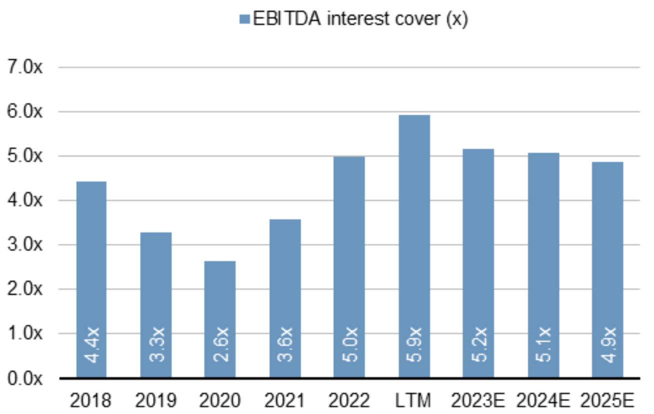
Leverage, exemplified by Scope-adjusted debt/EBITDA, decreased for a second consecutive year to 2.0x from 3.0x in 2021, a result of the solid performance of Nikora Trade and FMCG activities. The other leverage metric, funds from operation/debt, also improved to reach 39% from 24% in 2021.

Figure 5: Leverage metrics



Sources: Nikora, Scope estimates

Figure 6: Debt protection



Sources: Nikora, Scope estimates

H1 2023 leverage below 2.0x

H1 2023 leverage has been sustained at around 2.0x thanks to solid Scope-adjusted EBITDA boosted by strong business momentum. Our base case foresees leverage metrics remaining stable into the medium term, with a Scope-adjusted debt/EBITDA of 2.0x-2.5x and a funds from operations/debt of above 30%.

Organic growth and investments supporting credit metrics stability

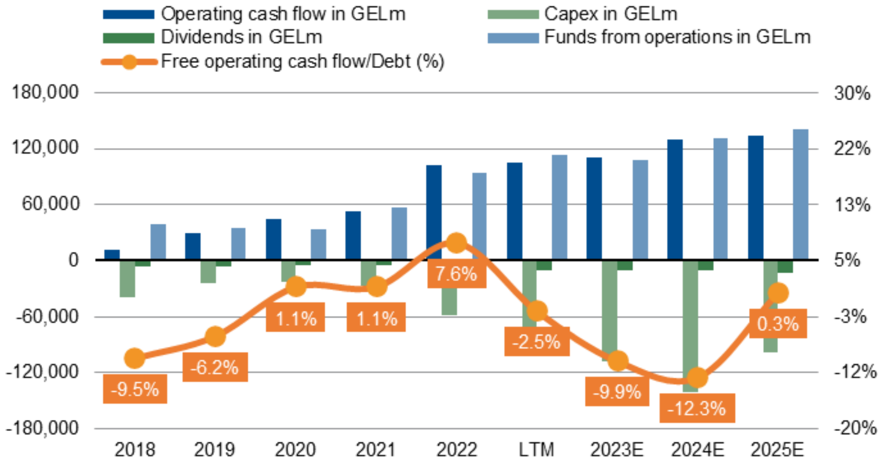
This will be supported by the group's organic growth strategy, which we expect will strengthen the group's general performance, keeping credit metrics at current levels into the medium term. Our base case also sees no significant increase in indebtedness, including in operating leases.

Interest cover to improve due to easing inflation and looser monetary policy

Interest cover represented by Scope-adjusted EBITDA/interest also continued to improve, reaching 5.0x in 2022 despite the bond issue in October (GEL 35m nominal value; three-month TIBR + 3.5%).

We expect the metric to remain comfortable at around 5.0x, based on an expected decrease in interest rates in the short to medium term that will follow an easing of inflation and an interest rate cut by the central bank as part of a looser monetary policy.

Figure 7: Cash flow cover



Sources: Nikora, Scope estimates

Higher capex in 2022 than expected

In 2022, free operating cash flow (FOCF) was positive thanks to strong EBITDA growth and favourable working capital changes. However, capex exceeded our base case and severely constrained FOCF, with GEL 50m spent for opening 95 Nikora Trade stores and GEL 10m to acquire a freeze warehouse.

Negative FOCF amid heavy investments plans

In our base case, the investment plans will lead to negative FOCF. The group plans to expand its retail and FMCG activities significantly in 2023-2025. This will include: i) three new manufacturing facilities for the meat and bakery subsidiaries; ii) new stores, to be managed by Nikora Trade; and iii) a logistics centre that improves efficiencies in stock and meat production. The group expects a capex of around GEL 340m that will be split over the next three years. Most of the capex will be devoted to the Nikora Trade's shop openings.

In our view, the FOCF will improve slightly from 2025 and it can only break even once the store openings, the new meat and bakery processing facilities and new logistic hub are completed and operational at the end of 2025.

All in all, Cash flow cover is the weakest element of JSC Nikora's financial risk profile. Nevertheless, the group still has financial flexibility as capex can be adapted to operating performance. Therefore, we have not overweighted this metric in the financial risk profile assessment.

Inadequate liquidity

Liquidity is inadequate, a consequence of the debt structure and high amount of short-term debt. We estimate a lower accessible cash level on the balance sheet, around GEL 4.0m, to the group's historical cash levels. In our view, cash could still be restricted if commercial terms of suppliers change, or supply chain are disrupted. The presence of undrawn committed lines has no effect on the liquidity assessment, as the remain insufficient to cover short-term debt. The current level of liquidity exposes the group to refinancing risks and increases its dependency on banks for funds.

Balance in GEL m	2023E	2024E	2025E
Unrestricted cash (t-1)	4,000	4,000	4,000
Open committed credit lines (t-1)	15,500	26,600	26,600
FOCF	-28,593	-43,128	1,111
Short-term debt (t-1)	31,023	40,000	40,000
Coverage	**negative**	**negative**	**79%**

Supplementary rating drivers: +/- 0 notches

Credit-neutral supplementary rating drivers

Financial policy, governance and ESG supplementary drivers are treated as neutral. The group has a conservative financial policy towards dividend distribution.

Long-term debt rating: BB-

Senior unsecured debt rating: BB

We have affirmed the senior unsecured debt to BB-. This expectation is based on an estimated liquidation value in a hypothetical default scenario in 2025, which assumes tough market conditions and the full drawdown of the outstanding bank facility.

Operating leases excluded from debt waterfall

The debt waterfall includes senior secured loans of GEL 70m and credit lines of about GEL 15m ranked ahead of senior unsecured debt. Senior unsecured debt of GEL 70m includes a potential GEL 35m issuance and ranks pari passu. As of 2022, close to 50% of loans consists of financial leases, which could be ceased within three months if needed. Our debt waterfall does not consider the recovery of operating leases.

Appendix: Peer comparison (as at last reporting date)

	JSC Nikora	Tegeta Motors LLC	Nikora Trade JSC	Georgian Beer Company JSC	Evex hospitals JSC
	BB-/Stable	BB-/Negative	BB-/Stable	BB-/Stable	BB/Stable
Last reporting date	1 September 2023	5 Oct 2022	1 Sep 2023	6 Oct 2022	5 Jun 2023
Business risk profile	**BB-**	**BB-**	**BB-**	**BB-**	**BB**
Market share	19%	18%	18%	23%	18%
Scope-adjusted EBITDA	GEL 118.0m	GEL 88.0m	GEL 82.4m	GEL 17.1m	GEL 52.0m
Operating profitability	11.7%	11%	9%	22%	20%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**BB**	**BB-**	**BB-**	**BB-**	**BB**
Scope-adjusted EBITDA/interest cover	5.0x	3.9x	5.0x	2.8x	2.1x
Scope-adjusted debt/EBITDA	2.0x	3.1x	2.1x	3.0x	3.7x
Scope-adjusted funds from operations/debt	39%	24%	39%	21%	14%
Scope-adjusted free operating cash flow/debt	8%	4%	16%	12%	-4%
Liquidity	Inadequate	Adequate	Inadequate	Inadequate	Adequate

* Financial risk profile metrics are presented as average of projections

Sources: Public information, Scope

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