Georgian Beer Company JSC
Georgia, Consumer Products

SCOPE **BB-** NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	2.8x	4.1x	3.2x	3.5x
Scope-adjusted debt/EBITDA	3.0x	2.9x	4.4x	3.8x
Scope-adjusted funds from operations (FFO)/debt	21%	26%	16%	19%
Scope-adjusted free operating cash flow (FOCF)/debt	12%	-14%	6%	9%

Rating rationale

The issuer rating of JSC Georgian Beer Company (GBC) benefits from the company's strong positioning and diversified product portfolio, particularly within the Georgian market. GBC exhibits high profitability and an ability to grow organically while maintaining moderate leverage. Limited geographical diversification constitutes a negative rating factor as the company remains exclusively exposed to the Georgian beer market, which is heavily dependent on the country's macroeconomic situation. The fluctuating nature of FOCF and insufficient liquidity due to the continued dependence on very high short-term credit lines also constrain the rating.

The Negative Outlook in 2020 and 2021 was primarily due to the company's weak operational performance, specifically low demand from the hotel, restaurant, and café segment. The company effectively managed challenges related to Covid-19 and its operational performance proved resilient in FY 2022, with strong results in 2023.

Outlook and rating-change drivers

The Negative Outlook reflects the expected deterioration in credit metrics in FY 2023 as indicated by a Scope-adjusted debt/EBITDA of above 4.0x following a shareholder buyout, which also reduces visibility over the ability to deleverage over the next 12-18 months. The Outlook accounts for the successful refinancing of senior unsecured debt due in December 2023.

A downgrade could occur if credit metrics deteriorated, and Scope-adjusted debt/EBITDA remained above 3.5x. Weak financial performance could be triggered by delays in executing minority share sales or from debt-financed investments in other expansion projects. It could also result from substantial and unexpected negative impact from changes in the retail market and heightened competition, which would place considerable pressure on operating profitability.

A positive rating action (i.e. a revision of the Outlook back to Stable) could result from Scope-adjusted debt/EBITDA at around 3.5x on a sustained basis and/or a sustained improvement in liquidity. This could be achieved via deleveraging through share disposals while maintaining high EBITDA. Further rating upside could evolve if we see a strong improvement in credit metrics as indicated by Scope-adjusted debt/EBITDA falling below 3.0x possibly driven by the release of the minority buyout guarantee as early as 2024.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
6 Oct 2022	Outlook change	BB-/Stable
5 Oct 2021	Affirmation	BB-/Negative
12 Oct 2020	Outlook change	BB-/Negative
12 Mar 2020	Affirmation	BB-/Stable
14 Mar 2019	Affirmation	BB-/Stable
30 Mar 2018	New	BB-/Stable

Ratings & Outlook

Issuer	BB-/Negative
Senior unsecured debt	BB-

Analyst

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Related Methodology and Related Research

General Corporate Rating Methodology; July 2022

Consumer Products Rating Methodology; November 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• One of the largest Georgian breweries by sales volume, maintaining organic growth • Well-balanced product portfolio in the beverage segment • High operating margins that enable free cash generation partially constrained by apparent margin pressure due to ongoing retail market consolidation • Low maintenance capex due to state-of-the-art production facilities • Robust business relationships with expanding retail chains enhancing the growth prospects of the company	• Smaller scale than international consumer goods peers • Limited diversification outside Georgia • Concentrated distribution channels (ESG Negative factor) • Inadequate liquidity • Overall moderate leverage, currently high due to debt-funded acquisitions and a buyout • Significant foreign exchange dependence

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA of below 3.5x • Adequate liquidity	• Scope-adjusted debt/EBITDA of above 3.5x • Liquidity remaining inadequate

Corporate profile

GBC was founded in 2011 by Czesar Chocheli, who built a western-style brewery from scratch, equipped with a state-of-the-art brewhouse as well as filling-line technology (KHS, Krones).

GBC mainly produces beer and non-alcoholic drinks (lemonades, cola and juices). Currently, GBC is ultimately owned by the Chocheli family through its indirect ownership via Mixori, a building technology company. In August 2023, GBC's shareholder structure changed substantially. All minority shareholdings were bought out, including the 24.1% held by Georgian Industrial Group Holding LLC and the 12.4% by PSP Pharma LLC, using bank guarantees with a maturity of one year.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	3.4x	2.8x	4.1x	3.2x	3.5x	3.9x
Scope-adjusted debt/EBITDA	3.2x	3.0x	2.9x	4.4x	3.8x	3.5x
Scope-adjusted FFO/debt	22%	21%	26%	16%	19%	21%
Scope-adjusted FOCF/debt	-1%	12%	-14%	6%	9%	10%
Scope-adjusted EBITDA in GEL m						
EBITDA	18.6	17.1	23.8	26.4	28.4	31.0
Disposal gains fixed assets	0.0	0.0	0.0	0.0	0.0	0.0
Capitalised software development costs	0.0	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**18.6**	**17.1**	**23.8**	**26.4**	**28.4**	**31.0**
Funds from operations in GEL m						
Scope-adjusted EBITDA	18.6	17.1	23.8	26.4	28.4	31.0
less: (net) cash interest paid	-5.5	-6.2	-5.8	-8.2	-8.0	-7.9
less: cash tax paid per cash flow statement	0.0	0.0	0.0	0.0	0.0	0.0
Funds from operations	**13.0**	**10.9**	**18.0**	**18.3**	**20.4**	**23.1**
Free operating cash flow in GEL m						
Funds from operations	13.0	10.9	18.0	18.3	20.4	23.1
Change in working capital	-8.1	0.4	-18.8	-3.2	-2.9	-2.3
Non-operating cash flow	1.4	0.9	0.8	0.0	0.0	0.0
less: capital expenditure (net)	-7.7	-7.0	-9.8	-8.0	-8.0	-10.0
Free operating cash flow	**-1.3**	**5.2**	**-9.8**	**7.1**	**9.6**	**10.8**
Net cash interest paid in GEL m						
Net cash interest per cash flow statement	5.5	6.2	5.8	8.2	8.0	7.9
add: interest component, operating leases	0.0	0.0	0.0	0.0	0.0	0.0
Net cash interest paid	**5.5**	**6.2**	**5.8**	**8.2**	**8.0**	**7.9**
Scope-adjusted debt in GEL m						
Reported gross financial debt	59.2	50.9	70.0	63.8	54.8	53.8
less: cash and cash equivalents	0.0	0.0	0.0	0.0	0.0	0.0
Guarantees	0.0	0.0	0.0	54	54	54
Scope-adjusted debt	**59.2**	**50.9**	**70.0**	**117.5**	**108.5**	**107.5**

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Environmental, social and governance (ESG) profile[1]

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)

Clarity and transparency

Previous rating actions (2019-2020) have flagged issues surrounding the group's ability to communicate and the timeliness of its financial disclosures. However, the flow of information between management and Scope has significantly improved over the last three years. Information based on internally developed templates strengthens our visibility of the company's short and medium-term strategic goals, giving us full confidence to analyse the company's operating performance based on KPIs.

Corporate structure

We highlight, the complexity of the corporate structure primarily due to intra company transactions and cross-ownerships.While this has not led to any supplementary rating driver adjustments so far, it is reflected in the conservative assessment of the company's financial risk profile. Corporate structure complexity is therefore a credit-negative ESG factor for the rating.

GBC's business collaboration with Zedazeni 2012, a distribution channel that has been incurring losses for the past four years, presents a challenge for the recovery of GBC's trade receivables partly due to the illiquid nature of Georgia's unorganised retail market. GBC's link to Zedazeni 2012 complicates GBC's organisational structure as it operates outside the company's consolidation perimeter.

At end-2022, the allowance for credit losses on trade receivables amounted to approximately 14% of the total trade receivables (up from 12% at end-2021), which has a marginal adverse effect on the company's profitability. It is important to note that although we do not incorporate the company's financial metrics into our financial risk profile analysis, our assumptions are very conservative when assessing the recovery potential of senior unsecured debt, particularly in regard to trade receivables.

[1] 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 industry risk

GBC's industry risk profile (assessed at A) benefits from the low cyclicality, medium entry barriers and low substitution risk of the non-durable consumer goods industry.

Competition remains high while market is stagnant

Despite fierce competition in the saturated Georgian beer market, the company outperformed direct competitors in FY 2022, especially in the above mainstream market where its Bavaria beer brand remains a bestseller. We expect this trend to continue in FY 2023, especially given H1 results. GBC's strong competitive position will be reinforced by the ramp-up of international brand Miller and expected add-ons in the premium segment.

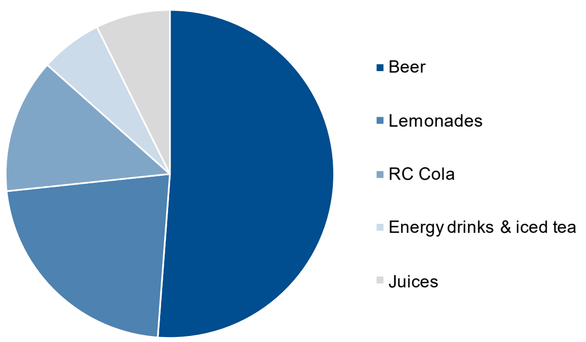
Carbonated soft drink sales growth

In 2022, nearly all of GBC's carbonated soft drink sales volumes increased. Hotel, restaurant, and café sales have fully recovered. Furthermore, we expect GBC's strong ties with fast-growing retail chains to support sales.

Growth potential from export

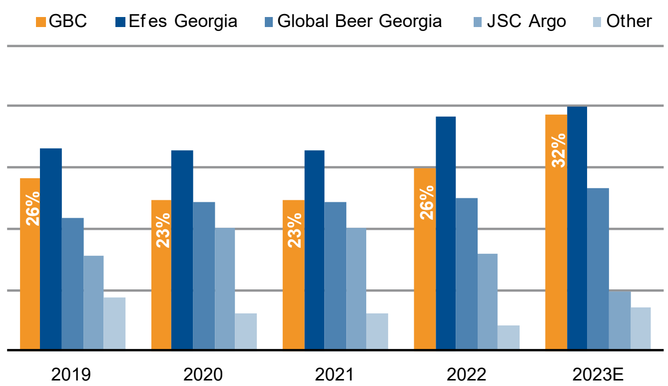
Despite intense competition, GBC retains great potential to achieve its medium-term goal of increasing export sales of carbonated soft drinks, mainly among the Commonwealth of Independent States. Although exports to neighbouring countries increased in 2022, they still constitute a negligible portion of the company's overall sales.

Figure 1: GBC product split based on revenues (2022)



Sources: GBC, Scope (estimates)

Figure 2: Beer market share in Georgia by volume



Sources: GBC, Scope

Limited size

In a European context, GBC is small in size and operational scale. Based on our Consumer Products Rating Methodology, we assessed GBC's market share and concluded that its size constrains its business risk profile (GEL 102m in revenue for FY 2022) despite its significant size within Georgia.

Diversification still the weakest component of the business risk profile

The geographical concentration on Georgia remains the weakest point of GBC's business risk profile, exposing the company to the country's macroeconomic risk. However, domestic sales are well diversified within Georgia, particularly outside Tbilisi.

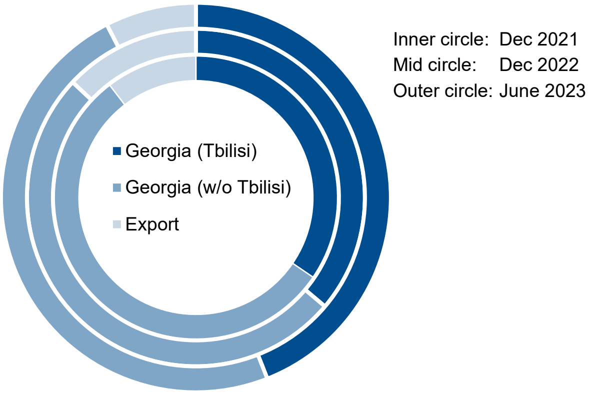
Overall diversification benefits from the broad product range in almost all beverage segments. However, the top two brands account for almost half of total portfolio sales. However, new products, including Miller, Ravi and Civ-Civi, showing sales growth, represent at least 10% of total sales.

Sales rely on distribution company Zedazeni 2012, expected to account for 75% of total sales by end-2023, up from 70% in 2022. Having a single distribution channel is typical for Georgian beverage companies but Zedazeni 2012's credit quality, although improved, remains low, which could hamper operational sustainability and value chain management and lead to an impairment of receivables (ESG factor: credit negative).

Profitability margins higher than local sector median

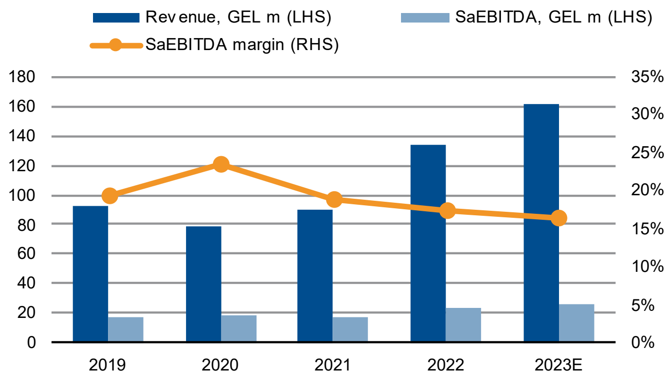
Profitability remains comfortable thanks to GBC's flexibility on selling prices. The heavy dependence on imported raw materials, typically without foreign exchange hedging, is expected to further pressure GBC's gross margins in the medium term. If GBC sells more to retail customers, sales costs will increase. We expect GBC's EBITDA margin will remain above 15% as retail market consolidation and competition coupled with the group's resumed marketing activities are likely to constrain profitability. Our base case includes a stable gross margin without major supply chain disruptions. A sudden disruption of the supply chain could have a significant negative impact on operating performance.

Figure 3: GBC sales by region



Source: GBC, Scope

Figure 4: GBC's operating performance



Sa: Scope-adjusted
Source: GBC, Scope (estimates)

The share of retail customers is also rising, reaching 49% of total sales in 2022 (25% in 2019), which increases selling costs and puts pressure on profitability. This share is expected to increase in the medium term towards 60%-65% following the significant growth anticipated for retail groups.

Scope-adjusted EBITDA margins remain above 15%

Profitability will likely decrease towards 20% based on the consolidation and competition in the retail market, coupled with the group's limited marketing activities.

Credit-positive brand

GBC's brand strength is credit positive. The company has been operating for almost 10 years, creating brand recognition and a loyal customer network. However, this strength is limited to the domestic market. Customer loyalty is driven by constantly strengthened product quality and the variety of products and offerings that are tailored to consumer needs.

Financial risk profile: B+

Adjustments and assumptions

Our financial projections are mainly based on the following assumptions:

- A moderate increase in revenue, in the range of 10%-12% in the medium term. We expect revenue growth to be driven by both organic expansion in the local market and improved export opportunities, even though H1 2023 did not exhibit YoY growth.
- GBC's capital spending staying at around GEL 10m over the next three years
- No further acquisitions/investments

Financial risk profile at B+

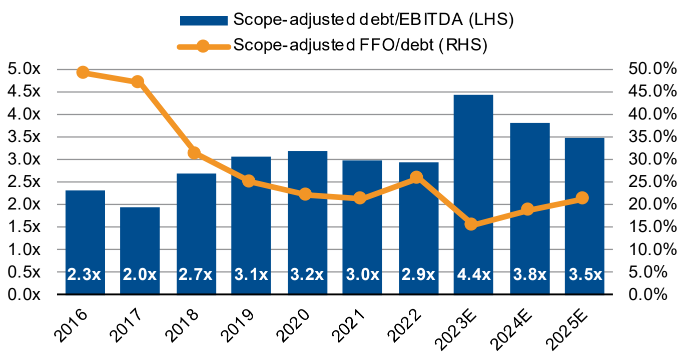
GBC's financial risk profile (assessed at B+) is constrained by its high leverage, including the financial guarantees issued for the share buyout. The sound leverage in 2022 with Scope-adjusted debt/EBITDA at 2.9x was the result of the higher-than-anticipated EBITDA due to the ramp-up phase of newly launched products; increased export sales; foreign exchange gains on non-lari liabilities; and the repayment of current debt.

GBC acquired 26.67% of shares in Retail Group for around GEL 20m in December 2022, bringing its equity stake to 46.71%, accounted for as an investment in an associate. Even though GBC's parent company, Mixori, owns 9.9% of Retail Group shares, we do not see the necessity of presenting consolidated accounts for Retail Group. This is due to GBC's minority stake in Retail Group and the ring-fenced decision-making structure within Retail Group.

Despite GBC's minority ownership in Retail Group, the company maintains strong commercial relationships with rapidly growing retail chains. These are bolstering GBC's sales, particularly outside the Georgian capital city of Tbilisi, and enhance negotiating leverage with other key clients .

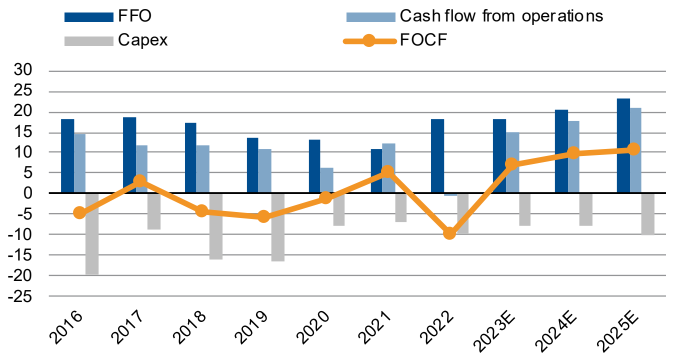
Financial guarantees related to the shareholders' buyout amount to GEL 60m and are included in the Scope-adjusted debt calculation under the category of guarantees for 2023-2025.

Figure 5: Leverage



Source: GBC, Scope (estimates)

Figure 6: Cash flow (GEL m)



Source: GBC, Scope (estimates)

Gradual deleveraging expected

We expect leverage as measured by Scope-adjusted debt/EBITDA to decrease to around a 3.5x in the medium term, driven by higher EBITDA through the expansion of the beer portfolio and increased exports. While the company believes that the financial guarantees may be resolved in the short term, the Scope-adjusted debt calculation conservatively includes these financial guarantees from 2023 to 2025. We expect that Scope-adjusted FFO/debt to exhibit a similar trend, improving toward 20% in the medium term.

Furthermore, some capex is developmental and will likely be funded through additional debt. Our liquidity calculation does not include potential cash inflows earmarked for funding development capex.

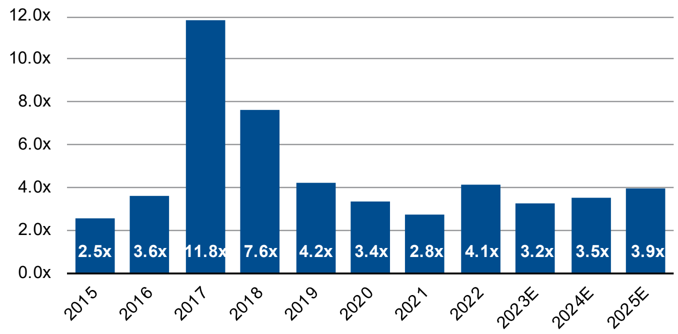
High cost of debt in Georgia

The relatively high cost of debt in Georgia puts pressure on EBITDA interest cover. While the company kept cost of debt at 9.2% in 2022 (9.5% in 2021). In 2023, Georgia's central bank lowered the refinance rate by 0.75pp to 10.25%, which will support GBC' EBITDA interest cover ratio in 2023. We expect the ratio to remain at a modest level of near 3.5x in 2024-25 supported by a proven track record of rising EBITDA.

Positive cash flow cover

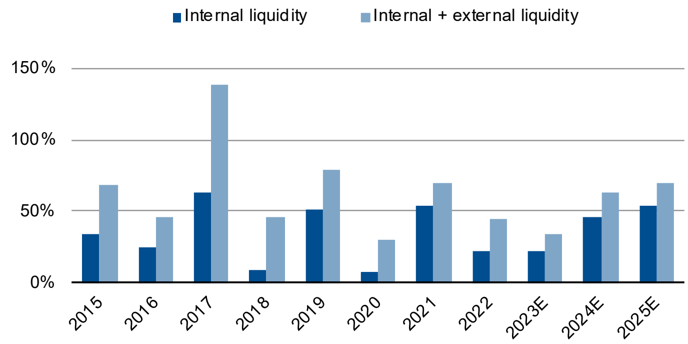
Due to expected modest annual capital expenditures of GEL 8m-10m in 2023-2025, along with conservative working capital investments, we expect operating cash flow to turn positive.

Figure 7: EBITDA cash coverage



Source: GBC, Scope (estimates)

Figure 8: Liquidity profile



Source: GBC, Scope (estimates)

Inadequate liquidity profile

The current debt structure, consisting of short-term financial leases and bank loans, significantly weakens liquidity. We estimate that low cash of around GEL 1.1m available at end-2022 will only partly cover financing and refinancing needs of the GEL 37.2m of current debt. The ratio is still inadequate when accounting for undrawn committed lines of GEL 4.6m and expected free operating cash flow of GEL 7.1m. GBC therefore remains exposed to refinancing risks and a strong dependency on its banks.

The GEL 25m bond will mature at end-2023. Operating profits are unlikely to cover the full repayment and refinancing will require new bonds or a term loan.

Balance in GEL m	2023E	2024E
Unrestricted cash (t-1)	1.1	2.0
Open committed credit lines (t-1)	4.2	10.8
Free operating cash flow (t)	7.1	9.6
Short-term debt (t-1)	37.2	25
Coverage	**33%**	**90%**

GBC's bond prospectus and bank loans include covenants on leverage (less than 4x) and debt service coverage (more than 1.1x).

In 2022, the company breached its covenant for debt service coverage ratio and leverage following investments in working capital and a debt-funded acquisition. Nevertheless, management secured letters from creditors before year-end to waive the right to accelerated repayment.

Supplementary rating drivers: +/- 0 notches

Credit-neutral financial policy

There is no explicit rating adjustment for supplementary rating drivers. GBC's financial policy has never been aggressive: it has not carried out significant dividend payments and it uses cash flow to strengthen equity, which reflects family ownership values.

Long-term debt rating

Senior unsecured debt rating: BB-

We have affirmed senior unsecured debt at BB- including the GEL 25m bond (ISIN GE2700603725). This reflects our expectation of an average recovery for senior unsecured debt positions in the hypothetical event of a company default. The recovery analysis is based on a hypothetical default scenario in 2025, which assumes outstanding senior secured debt, payables, and fully drawn credit lines of GEL 41m. Significant haircuts were applied to the account receivables as a consequence of Zedazeni 2012's low credit quality.

GBC will refinance its senior unsecured debt maturing in 2023 through the issuance of a new bond. The new issuance will be larger, at GEL 35m, have a three-year maturity, the same debt ranking level, and similar covenants as GBC's existing debt.

While the recovery analysis points to an above-average recovery, we constrain the debt category rating to the same level as the issuer rating given emerging market risks and the risk that GBC could raise higher-ranking debt, which would dilute the recovery for senior unsecured debtholders.

Appendix: Peer comparison

	Georgian Beer Company JSC	Tegeta Motors LLC	Nikora JSC	Evex Hospitals JSC	Nikora Trade JSC
	BB-/Negative	**BB-/Stable**	**BB-/Stable**	**BB/Stable**	**BB-/Stable**
Last rating action date	4 Oct 2023	4 Oct 2023	1 Sep 2023	5 Jun 2023	1 Sep 2023
Business risk profile	**BB-**	**BB-**	**BB-**	**BB**	**BB-**
Market share	~30%	~18%	~19%	~18%	~18%
Scope-adjusted EBITDA	GEL 23.8m	GEL 90.0m	GEL 80.5m	GEL 80.0m	GEL 60.2m
Operating profitability	16%	10%	11%	20%	9%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**B+**	**BB-**	**BB-**	**BB**	**BB-**
Scope-adjusted EBITDA interest cover	3.6x	2.8x	5.0x	2.6x	5.0x
Scope-adjusted debt/EBITDA	3.9x	3.2x	2.0x	3.2x	2.1x
Scope-adjusted FFO/debt	19%	19%	39%	19%	39%
Scope-adjusted FOCF/debt	8%	-4%	8%	1%	16%
Liquidity	Inadequate	Adequate	Inadequate	Adequate	Inadequate

* Financial risk profile metrics are presented as average of current year and next two projection years.

Sources: Public information, Scope

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