29 August 2024

Corporates

JSC Nikora
Georgia, Retail and Consumer Products

BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2022	2023	2024E	2025E
Scope-adjusted EBITDA/interest cover	5.0x	6.0x	5.4x	4.0x
Scope-adjusted debt/EBITDA	2.0x	2.0x	2.5x	2.5x
Scope-adjusted funds from operations/debt	39%	42%	32%	29%
Scope-adjusted free operating cash flow /debt	8%	-7%	-10%	-17%

Rating rationale

The issuer rating of JSC Nikora (Nikora) benefits from comparatively high profitability, a vertically integrated business model and the group's ability to continue expanding in the local market. Negative free operating cash flow (FOCF) and inadequate liquidity, due to continued reliance on very high short-term credit lines, limited size and low geographical diversification are negative rating drivers.

Outlook and rating-change drivers

The Stable Outlook reflects Nikora's continued expansion strategy and related investments. Scope notes that the investments are dependent on available financing and will only be made if profitability is not negatively affected. Scope assumes that the company will draw adequately in advance its options to refinance the bond maturity in 2024 and the large capex planned for 2025. Credit metrics are expected to remain stable, with Scope-adjusted debt/EBITDA between 2.0x and 2.5x and Scope-adjusted fund from operations/debt above 30%. Foreign currency risk is reflected in the tighter debt thresholds than for other companies.

The upside scenario (deemed remote for the time being) for the rating and Outlook would require (collectively):

- Significant growth of operations outside of Georgia
- Sustainably improved liquidity (to adequate)
- Credit metrics remaining at least in line with rating guidelines

The downside scenario for the rating and Outlook would require (individually):

- Scope-adjusted debt/EBITDA* to exceed 2.5x on a sustained basis
- Scope-adjusted funds from operations/debt below 30%
- Unsuccessful refinancing of the upcoming bond maturing in 2024

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
29 Aug 2024	Affirmation	BB-/Stable
01 Sep 2023	Affirmation	BB-/Stable
01 Sep 2022	Outlook change	BB-/Stable
02 Sep 2021	Outlook change	BB-/Negative

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

Analyst

Zurab Zedelashvili
+49 69 6677389 47
z.zedelashvili@scoperatings.com

Related Methodologies and Related Research

General Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2024

Consumer Products Rating Methodology; November 2023

Sovereign and Public Sector rating report on Republic of Georgia; July 2024

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Subsidiary Nikora Trade's top position in Georgia's organised 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	• 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	Negative rating-change drivers
• Sustainable improvement in liquidity • Significant growth outside Georgia • Credit metrics remaining at least in line with rating guidelines	• Scope-adjusted debt/EBITDA sustained above 2.5x • Scope-adjusted funds from operations/debt sustained below 30% • Liquidity remaining 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 over 8,000 employees.

Financial overview

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	5.0x	6.0x	5.4x	4.0x
Scope-adjusted debt/EBITDA	2.0x	2.0x	2.5x	2.5x
Scope-adjusted funds from operations/debt	39%	42%	32%	29%
Scope-adjusted free operating cash flow/debt	8%	-7%	-10%	-17%
Scope-adjusted EBITDA in GEL m				
EBITDA	118,077	139,338	156,396	175,164
Other items	0	0	0	0
Scope-adjusted EBITDA	**118,077**	**139,338**	**156,396**	**175,164**
Funds from operations in GEL m				
Scope-adjusted EBITDA	118,077	139,338	156,396	175,164
less: (net) cash interest paid	-23,642	-23,121	-28,911	-43,913
less: cash tax paid per cash flow statement	-1,143	-1,911	-2,673	-2,673
Funds from operations	**93,292**	**114,306**	**124,812**	**128,578**
Free operating cash flow in GEL m				
Funds from operations	93,292	114,306	124,812	128,578
Change in working capital	9,945	-6,730	-19,811	-18,020
Non-operating cash flow[1]	-1,568	4,138	0	0
less: capital expenditure (net)	-58,905	-97,374	-110,000	-150,000
less: operating lease payments (amortization)	-23,095	-25,368	-22,945	-25,454
less: dividends (preferred shares)	-1,373	-7,059	-10,148	-10,148
Free operating cash flow	**18,296**	**-18,087**	**-38,093**	**-75,044**
Net cash interest paid in GEL m				
Net cash interest per cash flow statement	23,642	23,121	28,911	43,913
Change in other items	0	0	0	0
Net cash interest paid	**23,642**	**23,121**	**28,911**	**43,913**
Scope-adjusted debt in GEL m				
Reported gross financial debt	240,105	275,025	388,075	437,273
less: cash and cash equivalents	0	0	0	0
Other items	0	0	0	0
Scope-adjusted debt	**240,105**	**275,025**	**388,075**	**437,273**
Cash (for information purposes only)	39,804	20,814	79,681	36,638

[1] Provisions and other 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 should 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 has 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.

Efficiencies

Inventory shrinkage and obsolete inventory still equate to 2% of sales and decrease gross margins. The cost of managing 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+

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

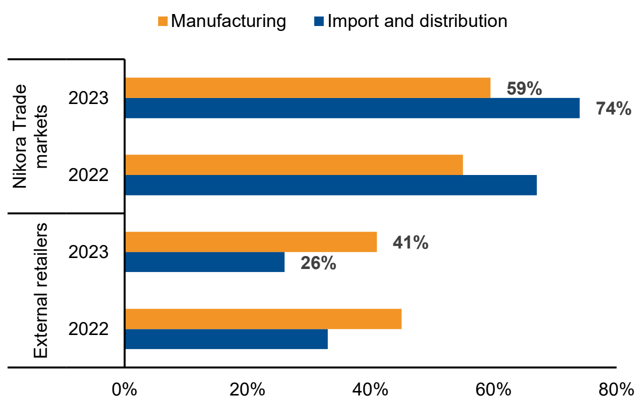
Dominant in Georgian retail (consumer products)

Nikora's competitive position continues to be supported by its ownership of subsidiaries which are key producers of consumer goods with high brand recognition in Georgia. The group's business had solid momentum throughout 2022-23, 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

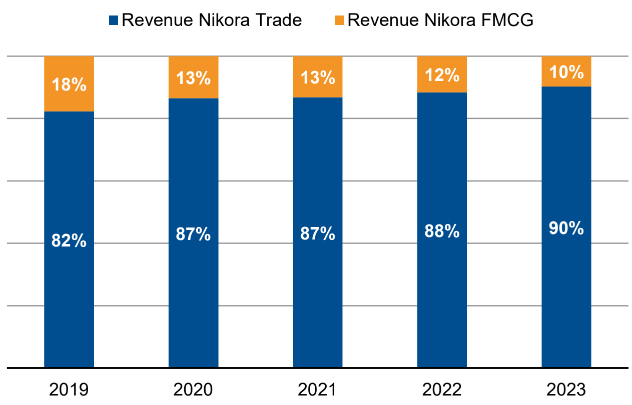
The group's market position is still constrained by its small size (GEL 1,295m in revenue for FY 2023) at a European level, which is the main negative driver of its business risk profile. However, its size is still significant compared to Georgian peers.

Figure 1: Nikora business unit sales



Sources: Nikora, Scope

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



Sources: Nikora, Scope

Regulatory environment

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

High concentration on Nikora Trade

Subsidiary Nikora Trade is implementing a massive investment plan to expand its store network, which will increase the group's consumer goods activities. Even so, the group is heavily dependent on Nikora Trade, as around 60% of Nikora's consumer goods sales are linked to intra-group sales.

Geographical diversification remains weak

Geographical diversification remains the other major weakness in the group's business risk profile. Nikora is only active in Georgia, increasing its exposure to geopolitical risk and currency exchange rate volatility for other currencies such as EUR and USD. However, diversification is improved by the vertically integrated group structure.

Country growth outlook

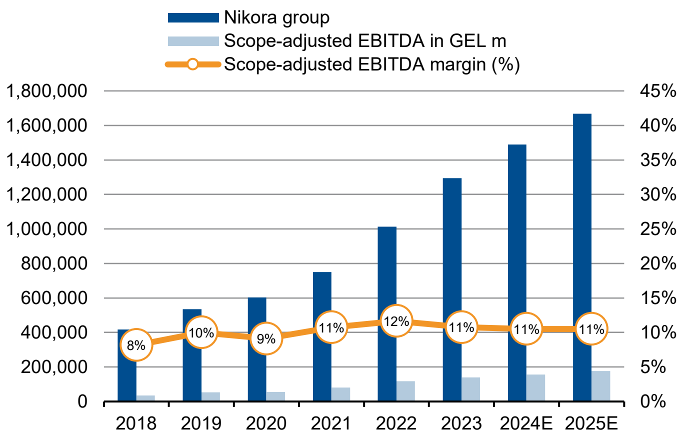
Following a robust post-pandemic recovery, with over 10% annual growth in both 2021 and 2022, the Georgian economy grew by 7.5% last year, benefitting from continued positive economic spillovers from the Russia-Ukraine war. Georgia is supported by strong medium-run economic-growth potential (estimated at 5%), driven by good dynamics in private consumption, tourism sector receipts and investment. Foreign direct investment inflows have recently weakened and remain below pre-Covid crisis levels as a share of GDP.

Heightened geopolitical risks relevant for Georgia

Despite the ongoing risk related to reliance on Ukrainian and Russian suppliers, Niikora remains confident in its ability to source alternative suppliers, who are on standby should the current Ukrainian suppliers become unable to fulfil orders. If this situation arises, there may be a short-term impact on input prices, but it would not constrain operations. This assumption is partly supported by the reduced bottlenecks in the supply of primary food products compared to the Covid years.

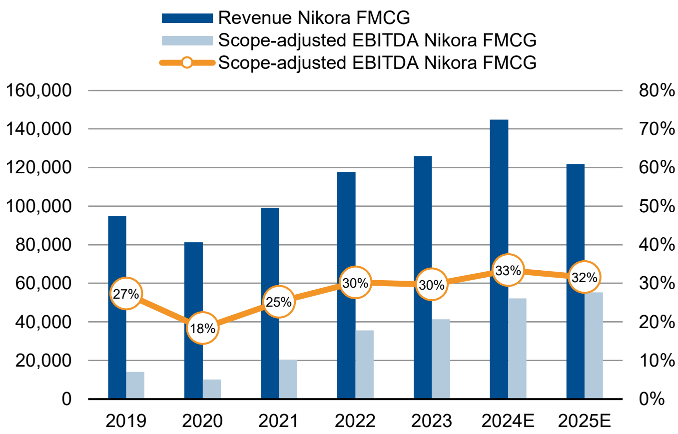
Our forecast includes stable gross margin development and no major supply chain disruptions. However, a sudden substitution within the supply chain could still significantly hamper the company's operating performance.

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



Sources: Nikora, Scope estimates

Figure 4: Nikora FMCG financial overview



Sources: Nikora, Scope estimates

Stable EBITDA margin at above 10%

We expect Nikora to keep a solid and rather stable profitability over the medium term. H1 2024 results support this view, with double-digit revenue growth and interim EBITDA reaching 11% of revenues.

Our base case sees a Scope-adjusted EBITDA margin of above 10% in the short to medium term. This view is supported by: i) historically good management of cost of goods sold, which has stabilised gross margins at 29% of revenues; ii) the issuer's significant investment in 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.

Nikora's heavy dependency on imported materials threatens the sustainability of its gross margin development. However, this is common for Georgian retailers and mitigated by the ability to pass the increased costs on to customers.

Inventory shrinkage and obsolete inventory costs remain at 2% of sales, which decreases gross margins by 200 bp (negative ESG rating factor).

Financial risk profile: BB-

Adjustments and assumptions

Our key adjustments are:

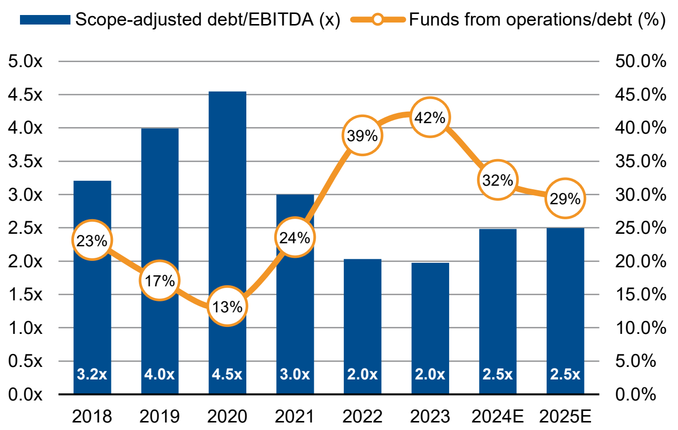
- Inclusion of short- and long-term lease obligations in gross debt
- Scope-adjusted EBITDA not adjusted for inventory shrinkage and inventory obstacles, as we consider these issues to be a consistent aspect of business operations
- Exclusion of available cash and cash equivalents from Scope-adjusted debt, as cash could still become restricted if supplier terms change or the supply chain is disrupted
- FOCF adjusted by lease repayments, capex and dividends on preference shares

Stable leverage metrics backed by Scope-adjusted EBITDA growth

Nikora's financial risk profile reflects sustained operating performance. This kept credit metrics stable in FY 2023, with solid Scope-adjusted EBITDA growth and the cash conversion cycle reflected in substantial cash flow.

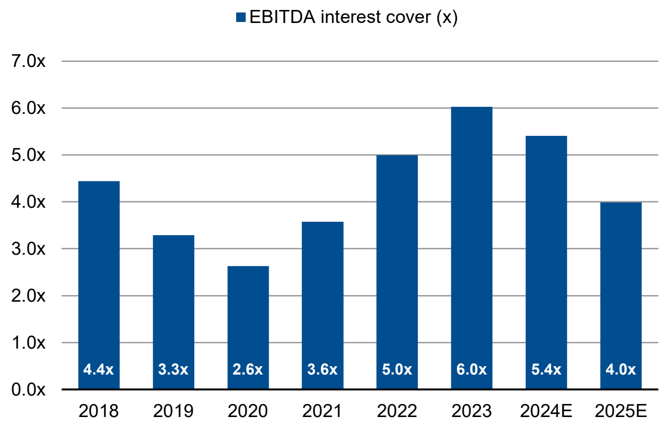
Leverage, in terms of Scope-adjusted debt/EBITDA, remained stable at 2.0x in 2023 for the second consecutive year (down from 3.0x in 2021) thanks to the solid performance of Nikora Trade and FMCG activities amid stable debt.

Figure 5: Leverage metrics



Sources: Nikora, Scope estimates

Figure 6: Debt protection



Sources: Nikora, Scope estimates

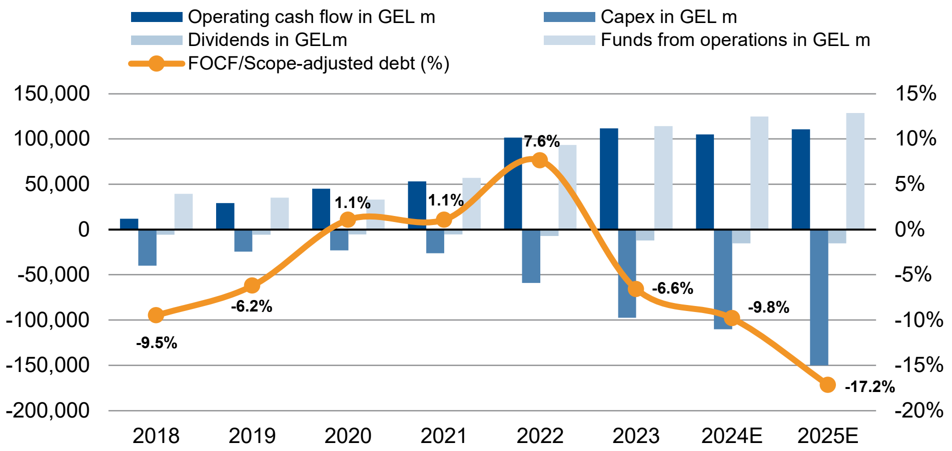
Debt-funded capex expected to elevate leverage

We foresee leverage of Scope-adjusted debt/EBITDA at around 2.5x and Scope-adjusted funds from operations/debt at around 30% in the medium term, mainly supported by the group's strategy to increase the organic growth of its FMCG and retail arms. This strategy will benefit performance, but the associated debt-funded capital expenditures will be a constraint.

Interest cover will weaken in 2025

In 2024, Georgia's central bank reduced the refinancing rate by 1 percentage point to 8.0%, which is expected to support Nikora's EBITDA interest cover ratio. However, we project that additional external funding requirements for the group's 2024 and 2025 capex programmes will lower EBITDA interest cover to 4.0x in 2025. We have also made conservative assumptions about future debt costs, considering that 2024 is an election year with ongoing political tensions. Our base case does not include severe impacts from the 'Transparency of Foreign Influence' law, which could lead to sanctions on Georgia and significantly restrict international capital inflows. We will closely monitor developments and adjust our base case if such material risks arise.

Figure 7: Cash flow cover



Sources: Nikora, Scope estimates

Higher capex than expected in 2023

In 2023, operating cash flow was positive thanks to strong EBITDA growth and favourable working capital changes. However, capex exceeded our base case and severely constrained free operating cash flow (FOCF), with GEL 90m spent on opening 110 Nikora Trade stores and on the construction of a meat production facility.

Negative FOCF amid heavy investments plans

In our forecasts, the investment plans will lead to negative FOCF. The group plans to expand its retail and FMCG activities significantly in 2024-2025. This will include: i) new manufacturing facilities for the meat and bakery subsidiaries; ii) new stores to be managed by Nikora Trade; and iii) a logistics centre to improve efficiencies in stock and meat production. The group expects total capex of around GEL 340m distributed over the next three years. Most of the capex will be devoted to Nikora Trade's shop openings.

The new meat processing facility is expected to be fully functional by the end of 2024, while the new logistics hub should be completed and operational after 2025.

Cash flow cover is the weakest element of 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 our financial risk profile assessment.

Inadequate liquidity

Liquidity is inadequate due to Nikora's debt structure and high amount of short-term debt. Cash could still be restricted if suppliers' commercial terms change, or supply chains are disrupted. The presence of undrawn committed lines has no effect on our liquidity assessment, as it remains 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.

Despite the inadequate liquidity, which is mainly due to the unique characteristics of the Georgian banking practices, with the majority of project investments being pre-financed, Scope does not anticipate significant refinancing risks associated with the bond maturity in 2024 and 2025. This is supported by the company's robust credit metrics, long-standing banking relationships and significant headroom to covenants.

Balance in GEL m	2024E	2025E
Unrestricted cash (t-1)	20,814	79,681
Open committed credit lines (t-1)	26,600	26,600
FOCF	-38,092	-75,043
Short-term debt (t-1)	53,040	63,000
Coverage	**52%**	**77%**

Supplementary rating drivers: +/- 0 notches

Credit-neutral supplementary rating drivers

We consider financial policy, governance and ESG supplementary drivers to be neutral. The group has a conservative financial policy on dividend distribution.

Long-term debt rating: BB-

Senior unsecured debt rating: BB-

We affirm senior unsecured debt at BB-. The rating 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 126m and credit lines of about GEL 15m ranked ahead of senior unsecured debt. As of 2023, close to 50% of loans consist of financial leases, which could be terminated within three months if necessary. Our debt waterfall does not include the recovery of operating leases.

Appendix: Peer comparison (as at last reporting date)

	Nikora JSC	Nikora Trade JSC	Tegeta Motors LLC	Cellfie Mobile LLC	VIAN JSC
	BB-/Stable	BB-/Stable	BB-/Stable	BB-/Stable	BB-/Negative
Last rating action date	29 Aug 2024	29 Aug 2024	04 Oct 2023	27 Dec 2023	31 May 2024
Business risk profile	**BB-**	**BB-**	BB-	BB	BB-
Market share	18%	18%	18%	~25%	10%
Scope-adjusted EBITDA	GEL 139.3m	GEL 98.0m	GEL 75.0m	GEL 70.0m	GEL 45.0m
Scope-adjusted EBITDA margin	11%	8%	12%	46%	17%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**BB-**	**BB-**	B+	BB	B+
Scope-adjusted EBITDA/interest cover	5.1x	5.8x	2.6x	16.4x	2.0x
Scope-adjusted debt/EBITDA	2.3x	2.3x	3.7x	4.4x	4.3x
Scope-adjusted funds from operations/debt	34%	35%	17%	0.5x	11%
Scope-adjusted free operating cash flow/debt	-11%	-5%	-6%	0.0x	1%
Liquidity	Inadequate	Inadequate	Adequate	Adequate	Adequate

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

Sources: Public information, Scope

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer