29 August 2024

Corporates

JSC Nikora Trade Georgia, Retail

STABLE

BB-

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	5.2x	7.1x	5.9x	4.4x
Scope-adjusted debt/EBITDA	2.1x	2.0x	2.6x	2.5x
Scope-adjusted funds from operations/debt	40%	42%	32%	31%
Scope-adjusted free operating cash flow/debt	16%	4.1%	-7%	-11%

Rating rationale

The issuer rating of JSC Nikora Trade benefits from comparatively high profitability, the ability to pass cost increases on to customers and the company's capacity to grow. Negative free operating cash flow and inadequate liquidity, heavy dependence on foreign exchange rates and limited size are negative rating drivers. Significant capex has stretched Nikora Trade's liquidity. However, capex is related to the opening of new points of sale and the company has the necessary flexibility to adjust expenditure.

Outlook and rating-change drivers

The Stable Outlook reflects Nikora Trade'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	Upgrade	BB-/Stable
01 Sep 2022	Affirmation	B+/Stable
02 Sep 2021	Affirmation	B+/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies and Related Research

General Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2024

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

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong national market position within the organised retail market, with the gradual crowding-out of unorganised retail players likely leading to significant sales growth potential (neutral ESG rating driver) • Profitability higher than international peer levels thanks to issuer's small shop format and integrated vertical structure, though constrained by inventory shrinkage and obsolete inventory costs (negative ESG rating driver) • Operations in the least cyclical retail subsector (food) • Comfortable leverage despite high forex risk from USD-denominated leases	• Absolute size still small, with moderate market share when considering also the unorganised retail market • Weak diversification with operations only in Georgia, increasing vulnerability to macroeconomic changes • Vulnerable free operating cash flow due to high capex • Inadequate liquidity due to high short-term debt, although this is a common strategy in Georgia

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% • Unsuccessful refinancing of the upcoming bond maturing in 2024

Corporate profile

Nikora Trade is the leading food retailer in Georgia. It is a 97%-owned subsidiary of Nikora JSC and was developed to sell the meat products generated by one of its entities. The company has developed a significant market share in organised retail, with a large range of shops (616) and more than 8,200 employees selling over 10,000 different products. It is now implementing a major expansion strategy, opening hundreds of new shops.

Financial overview

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	5.2x	7.1x	5.9x	4.4x
Scope-adjusted debt/EBITDA	2.1x	2.0x	2.6x	2.5x
Scope-adjusted funds from operations/debt	40%	42%	32%	31%
Scope-adjusted free operating cash flow/debt	16%	4.1%	-7%	-11%
Scope-adjusted EBITDA in GEL '000s				
EBITDA	82,426	98,001	104,217	119,849
Other items	96	29	0	0
Scope-adjusted EBITDA	**82,525**	**98,030**	**104,217**	**119,849**
Funds from operations in GEL '000s				
Scope-adjusted EBITDA	82,525	98,030	104,217	119,849
less: (net) cash interest paid	-14,001	-13,718	-17,786	-27,491
less: cash tax paid per cash flow statement	0	0	0	0
Change in provisions	0	0	0	0
Funds from operations	**68,521**	**84,297**	**86,431**	**92,359**
Free operating cash flow in GEL '000s				
Funds from operations	68,521	84,297	86,431	92,359
Change in working capital	16,373	2,538	-11,826	6,455
Non-operating cash flow	3,525	1,485	0	0
less: capital expenditure (net)	-36,083	-53,614	-60,000	-95,000
less: operating lease payments	-24,461	-26,409	-33,950	-36,666
Free operating cash flow	**27,875**	**8,297**	**-19,345**	**-32,852**
Net cash interest paid in GEL '000s				
Net cash interest per cash flow statement	14,001	13,718	17,786	27,491
Change in other items	0	0	0	0
Net cash interest paid	**14,001**	**13,718**	**17,786**	**27,491**
Scope-adjusted debt in GEL '000s				
Reported gross financial debt	162,249	189,580	288,269	302,002
Less: available cash and cash equivalents	0	0	-29,003	-15,847
Other items[1]	10,000	10,000	10,000	10,000
Scope-adjusted debt	**172,249**	**199,580**	**269,265**	**296,155**
Cash for information purposes only	35,474	17,633	96,677	52,824

[1] **Bond guarantee:** The part of the monetary obligations arising from the suretyship between JSC TBC Bank and JSC Nikora Trade, namely the part that exceeds 10,000,000 (ten million) GEL, is subordinated to the obligations based on the bonds of JSC Nikora Trade.

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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 is likely to exert 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

In order to reduce pollution and harm to the environment, Nikora Trade uses energy-efficient and environmentally friendly equipment for its shopping facilities. These include 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. Nikora Trade is seeking to address this by integrating SAP enterprise resource planning systems (expected to become functional in the second half of 2024) 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 Industry risk profile: BBB

Nikora Trade's business risk profile benefits from the underlying non-discretionary retail industry's low cyclicality, low entry barriers and low substitution risk.

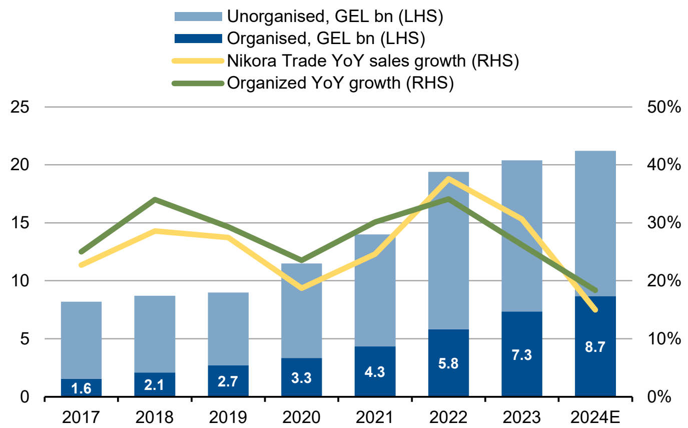
Significant size in Georgia but very limited size on a European scale

Although it dominates its home market of Georgia, Nikora Trade is small in a European context in terms of size and operational scale (GEL 1.2bn in revenues in 2023 or around EUR 420m). This aspect remains a negative driver for the company's business risk profile, despite the opening of new stores helping to consolidate its top position in Georgia.

Dominant player on Georgian retail market

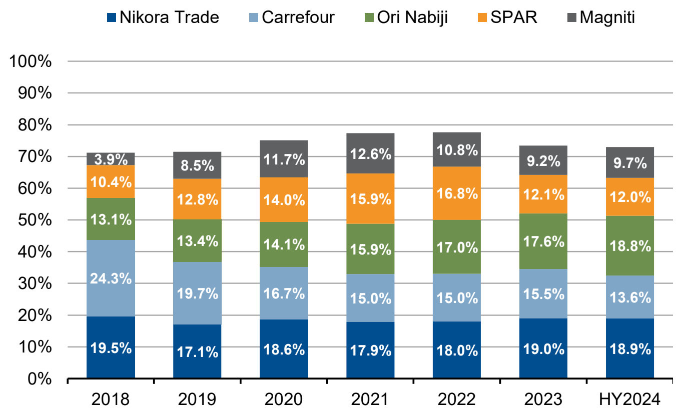
Nikora Trade is the largest player on the Georgian retail market, with a market share of about 18% in terms of sales. Carrefour used to lead the market with 20% in 2019, but this fell to only 15% as at YE 2023; it now ranks after Nikora and Ori Nabiji. Local competition remains intense, and Nikora Trade could still gain market share in the unorganised market, especially outside the Georgian capital. This will be core to the issuer's medium-term strategy.

Figure 1: Retail market evolution in Georgia and Nikora top line growth dynamics



Sources: TBC Capital, Nikora Trade, Scope

Figure 2: Retail market shares in Georgia by sales



Sources: TBC Capital, Nikora Trade, Scope

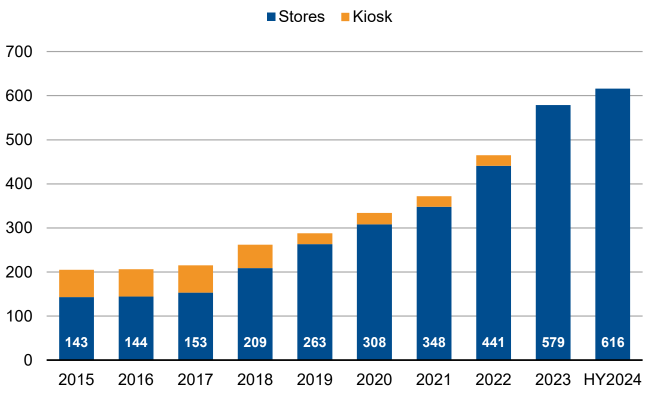
Regulatory environment

Local food safety standards and stricter regulations might put some pressure on the issuer. However, we do not expect food retail regulation to change quickly. Furthermore, we believe that any regulatory action will likely weaken the unorganised market (neutral ESG rating driver), thus consolidating Nikora Trade's market share.

Stable top line performance

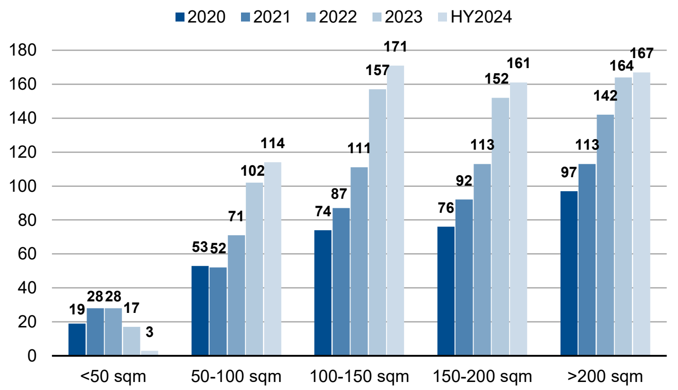
Nikora Trade's strategy to direct resources towards opening new stores continued to strengthen revenues in 2023, with 31% YoY growth. This was further supported by increased local purchasing power, thanks to wage growth outpacing inflation and migration from neighbouring countries, whose residents have higher purchasing power. We anticipate that this positive impact on operating performance will diminish as some migrants are returning to their home countries, a trend partially reflected in weaker performance in the first quarter of 2024. At the same time, the overall effect will be counterbalanced by a significant rise in tourism during the summer months.

Figure 3: Nikora Trade stores development



Sources: Nikora Trade, Scope

Figure 4: Nikora Trade stores based on trading area



Sources: Nikora Trade, Scope

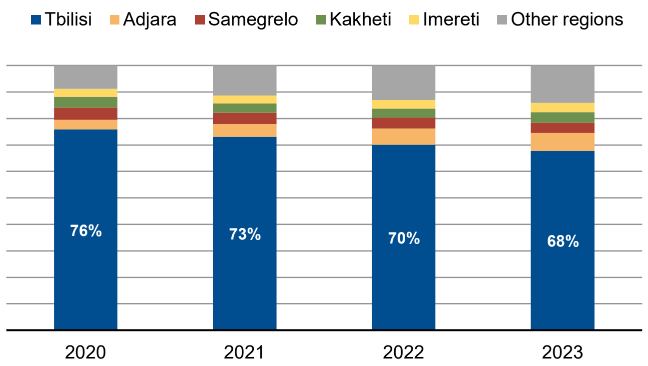
Low country retail strength

The country retail strength of Georgia, in which Nikora Trade operates, is 'low'. The Georgian market is fairly mature but still has room for development, underpinned by the largely underpenetrated market outside of the country's capital city.

Weak diversification

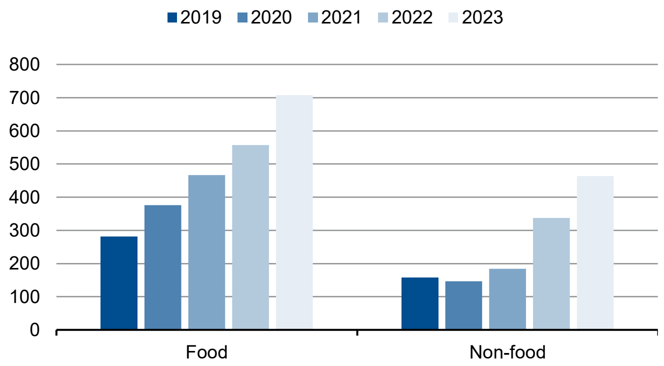
Diversification remains one of the weakest elements in Nikora Trade's business risk profile and is a negative rating driver. The sole exposure to the Georgian market makes the company more vulnerable to domestic macroeconomic risks.

Figure 5: Nikora Trade's sales split by Georgian region (%)



Sources: Nikora Trade, Scope

Figure 6: Sales distribution based on product category



Sources: Nikora Trade, Scope

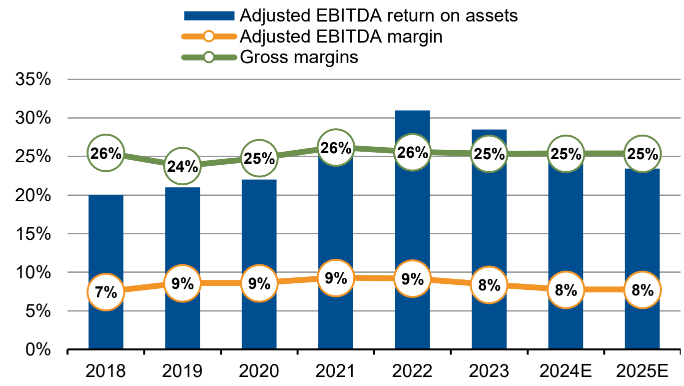
Strong growth outlook

After 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 weakened recently and remain below pre-Covid crisis levels as a share of GDP.

Heightened geopolitical risks relevant for Georgia

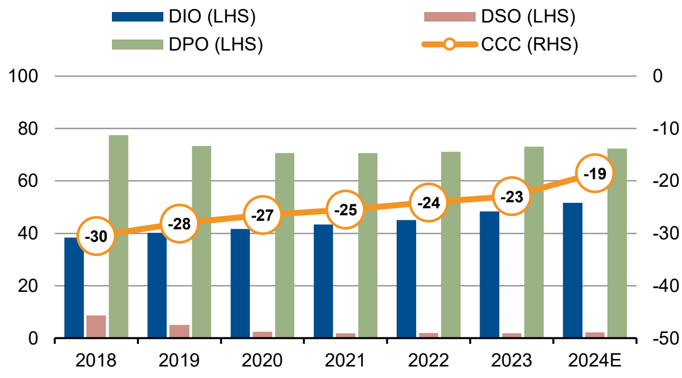
Despite the ongoing risk related to reliance on Ukrainian and Russian suppliers, the company remains confident in its ability to source alternative suppliers, who are on standby should the current Ukrainian suppliers become unable to fulfil orders. If this situation arises, there may be a short-term 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.

Figure 7: Operating performance



Sources: Nikora Trade, Scope estimates

Figure 8: Evolution of cash conversion cycle



Sources: Nikora Trade, Scope estimates

Comfortable operating profitability

We expect Nikora Trade's profitability margins to remain comfortable. This view is supported by: i) historically stable gross margins at about 25%, thanks to a vertical group structure with advantageous commercial terms; ii) the ability to pass on input costs to customers; and iii) a strong organic growth strategy, confirmed by store openings in 2022 and H1 2024, which should enhance bargaining power and potentially lead to synergies and higher margins.

Ability to pass cost increases on to customers

Nikora Trade'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 company's 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). Our rating scenario sees Scope-adjusted EBITDA maintained at around 8% and the Scope-adjusted EBITDA return on assets gradually reaching and being maintained at around 25%.

Financial risk profile: BB-

Adjustments and assumptions

Our adjustments include the following key elements:

- Scope-adjusted EBITDA has not been adjusted for inventory shrinkage and inventory obstacles, as we consider these issues to be a consistent aspect of business operations.
- Available cash and cash equivalents are excluded from Scope-adjusted debt because these funds could become restricted if there are changes in commercial terms with suppliers or disruptions in supply chains. For 2024 and 2025, we applied a 30% haircut to the significantly elevated cash balance resulting from the anticipated debt issuance at the end of 2024. The proceeds from this issuance will be gradually used for the development of a centralized warehouse.

Credit metrics remain strong in FY 2023

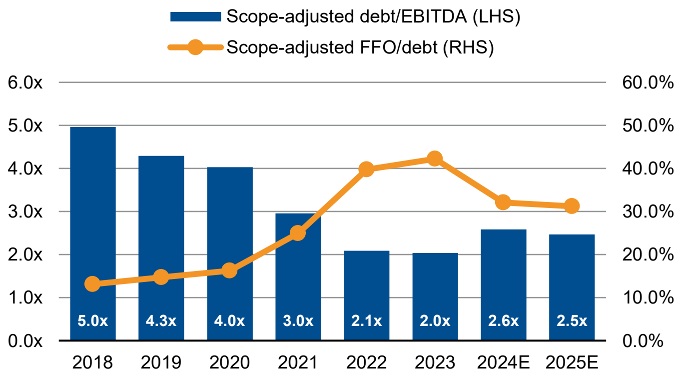
The company's strong growth helped keep credit metrics robust in FY 2023. Leverage as measured by debt/EBITDA remained broadly stable at 2.0x. Funds from operations/debt exceeded 30% due to solid EBITDA growth in absolute terms, partially offset by increased operating leases after new store openings.

Heavy foreign exchange dependence

Nikora Trade's indebtedness has remained largely stable, mostly consisting of bonds and leases. Leases still make up much of reported gross debt, about 78% at YE 2023. The company has also entered into more leases, mainly for the store openings. Our rating scenario sees increasing leases, based on more stores opening in the short to medium term. In addition, 70% of the leases are denominated in US dollars, creating foreign exchange exposure. In 2023, the foreign exchange effect was negligible, while of the effect from modified lease payments and terms has increased overall lease liabilities by GEL 3.7m.

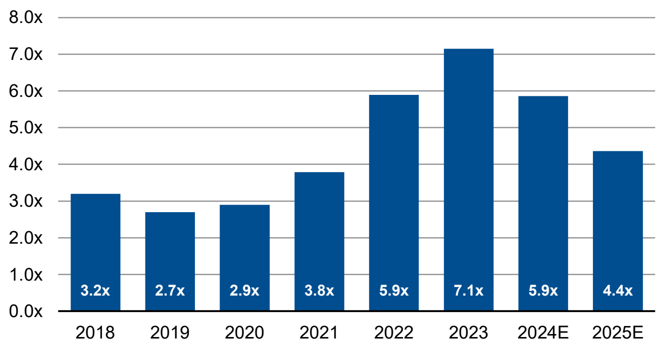
Management balances lease agreements with fixed and variable payment terms. In 2023, 75% of payments were fixed, 16% were related to turnover and 9% were hybrid. In addition, the US dollar leases have currency hedging requirements. Even so, many of the leases are heavily influenced by foreign exchange movements, which could affect cash flow and thereby constrain Nikora Trade's financial risk profile assessment.

Figure 9: Leverage



Sources: Nikora Trade, Scope estimates

Figure 10: Interest cover



Sources: Nikora Trade, Scope estimates

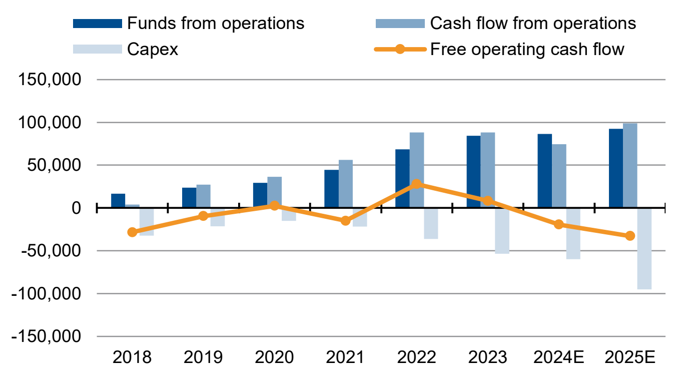
Debt-funded capex elevates leverage

We foresee elevated leverage at around 2.5x, driven by the anticipated debt-funded capex programme. We expect Scope-adjusted funds from operations/debt to follow a similar trend and to remain above 30% in 2024-25.

Interest cover to decrease slightly

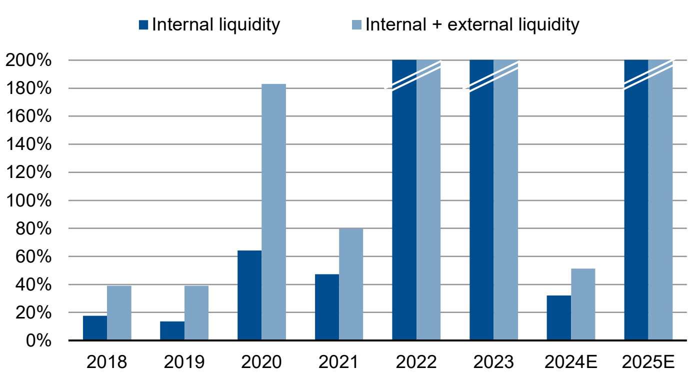
In 2024, Georgia's central bank reduced the refinancing rate by 1 percentage point to 8.0%, which we expect will support Nikora Trade's EBITDA interest cover ratio. However, we project that an additional debt issuance by the end of 2024 (to fund a greenfield warehouse project) will lower EBITDA interest cover to below 5.0x in 2025. We have also made conservative assumptions regarding 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 11: Cash flow cover GEL'000



Sources: Nikora Trade, Scope estimates

Figure 12: Liquidity ratios



Sources: Nikora Trade, Scope estimates

Negative free operating cash flow while company remains in heavy capex phase

Cash flow cover remains the weakest element of Nikora Trade's financial risk profile despite the strong cash flow conversion cycle in 2023. Capex for the expansion of the store network will continue to hamper this metric. However, the company's scale and flexibility in terms of capital spending is beneficial. Therefore, we have not overweighted this metric in our analysis.

We expect capex of around GEL 150m in 2024-2025 allocated to opening new stores and partially funding construction of a centralized warehouse in Tbilisi .

Inadequate liquidity

Liquidity is inadequate, despite being well above expectations in 2023 due to the strong results. From 2024, we expect negative free operating cash flow and short-term debt to continue to strain liquidity. The GEL 10.6m committed credit line remains undrawn as of 2023.

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, we do not anticipate significant refinancing risks associated with the bond maturity by the end of 2024. This is supported by the company's robust credit metrics, long-standing banking relationships and significant headroom to covenants

We estimate that accessible balance sheet cash will increase significantly compared to historical levels. However, we do not see cash as permanent in today's market environment as suppliers' commercial terms can change quickly or supply chains can become disrupted.

Balance in GEL '000s	2024E	2025E
Unrestricted cash (t-1)	17,633	96,677
Open committed credit lines (t-1)	10,600	10,600
Free operating cash flow	-19,345	-32,852
Short-term debt (t-1)	35,664	2,000
Coverage	**51%**	**308%**

Supplementary rating drivers: +/- 0 notches

Credit-neutral supplementary rating drivers

Previous rating actions flagged issues about the company's transparency. The flow of information between management and Scope has improved, and concerns related to corporate governance had been resolved.

Long-term debt rating

Senior unsecured debt rating: BB-

We have affirmed senior unsecured debt at BB- including a GEL 35m bond (ISIN GE2700604061), reflecting the 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 loans and intercompany guarantees ranked prior to senior unsecured debt.

Emerging market risk and access to higher-ranking debt

The recovery analysis indicates an above-average recovery. However, we have constrained the debt category rating to the same level as the issuer rating given the emerging market risks and the risk that Nikora Trade could raise higher-ranking debt, which would dilute the recovery for senior unsecured debtholders.

Appendix: Peer comparison

	Nikora Trade JSC	Nikora JSC	Tegeta Motors LLC	Cellfie Mobile LLC	VIAN JSC
	BB-/Stable	BB-/Stable	BB-/Stable	BB-/Stable	BB-/Negative
Last rating action date	28 Aug 2024	28 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 98.0m	GEL 139.3m	GEL 75.0m	GEL 70.0m	GEL 45.0m
Scope-adjusted EBITDA margin	8%	10%	12%	46%	17%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**BB-**	**BB-**	B+	BB	B+
Scope-adjusted EBITDA/interest cover	5.8x	5.1x	2.6x	16.4x	2.0x
Scope-adjusted debt/EBITDA	2.4x	2.3x	3.7x	4.4x	4.3x
Scope-adjusted funds from operations/debt	35%	34%	17%	0.5x	11%
Scope-adjusted free operating cash flow/debt	-5%	-11%	-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

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