JSC Nikora Trade
Georgia, Retail

B+ STABLE

Corporate profile

JSC Nikora Trade (Nikora Trade) is one of the leading food retailers in Georgia. The company has developed a significant market share in organised retail, with a large range of shops (307) and more than 4,500 employees selling over 10,000 different products.

Nikora is affiliated to Nikora JSC, which developed Nikora Trade to sell the meat products generated by one of its entities. Entry into the retail sector led to the acquisition of retailer Masiv LTD, whose name was changed to JSC Nikora Trade in 2010. Nikora Trade has developed further shops over the years and acquired Nugeshi in 2015. Today, Nikora Trade is one of the leading domestic food retail operators in Georgia.

Key metrics

			Scope estimates	
Scope credit ratios	2018	2019	2020e	2021e
EBITDA/interest cover (x)	4.4x	2.8x	3.0x	3.3x
SaD/EBITDA	3.7x	3.8x	3.2x	2.3x
Scope-adjusted FFO/SaD	20%	16%	21%	29%
FOCF/SaD	-19%	-15%	-7%	2%

Rating rationale

Scope Ratings has today affirmed its issuer rating of B+/Stable on Nikora Trade JSC. The rating of senior unsecured debt is affirmed at BB-.

The rating is supported by Nikora Trade's reinforced market position, which has grown in terms of market shares and overall size in Georgia, mainly due to the decline of the unorganised retail market. It is highly likely that organised retail will continue to develop at the expense of bazaars over the next few years, leading to an automatic increase in the market shares and size of all the country's retailers. However, market competition has increased quickly in recent years, with new competitors and the development of new formats. While Nikora Trade's market position is not in jeopardy, we believe that its growth is likely to slow down in the coming years due to the increased competition, notably in Tbilisi. This could result in management deciding to trade profitability for market shares, putting pressure on the group's cash flow generation ability.

Diversification remains one of the weaker elements in the group's business risk profile. There are no sales outside of Georgia and distribution channels are not diversified. However, we do not place too much emphasis on this factor, due to the small size of the retailer in an international context and the fact that e-commerce is still in a nascent stage in Georgia.

While Nikora Trade's Scope-adjusted EBITDA margin for 2019 decreased slightly (9% versus 10% in 2018), this was mainly for exceptional rather than recurring reasons (a delay in the development of shops among others). The Scope-adjusted EBITDA margin remains extremely comfortable for a food retailer and is well above that of peers (both Scope-rated peers and local peers). Besides the impact on credit metrics of weakening profitability, ratios were also impacted by the transition to IFRS16.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	BB-

Analysts

Adrien Guerin
+49 69 6677389 16
a.guerin@scoperatings.com

Related methodology

Corporate Methodology 2020

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

The operating leases component of Scope-adjusted debt (SaD) (now under 'lease liabilities') was underestimated in previous years due to the complexity of the Georgian leasing system (under three months and therefore not recognised within the new accounting framework) and is 16% higher than initially anticipated. The transition especially took its toll on interest cover, with the interest component of operating leases close to 2.5 times higher than initially expected. This caused the ratio to decrease to 2.8x at YE 2019 versus 4.4x at YE 2018. Currently, leverage measured by SaD/EBITDA and funds from operations (FFO)/SaD stand at 3.8x and 16% respectively at YE 2019. This is forecasted to improve to 3.1x and 21% for the end of 2020, with further improvement in the following years.

Going forward, we expect leverage to improve slightly over time. However, we also expect the pace of development at Nikora Trade to be slightly hindered by the rapid growth of competition in Georgia.

Scope notes that the flow of information between management and the rating agency was often very slow. While this has not led to any rating impact so far, it may warrant a downgrade going forward (ESG rating driver).

Outlook and rating-change drivers

The Outlook is Stable and reflects our expectation that Nikora Trade's credit metrics will remain at the current level for indebtedness (SaD/EBITDA under 4.0x and FFO/SaD above 15%). It also incorporates our expectation that the retailer will continue to obtain waivers for any potential covenant breaches and that it will continue operating with very limited liquidity, due to a heavy investment phase limiting free operating cash flow generation. We do not expect any M&A activity in the short term.

A positive rating action could be the consequence of FFO/SaD and SaD/EBITDA above 30% and below 3x respectively on a sustained basis as well as a dramatic improvement in liquidity on a sustained basis. This could be achieved via deleveraging while maintaining relatively high EBITDA. A positive rating action could also be warranted if the group grows significantly in size.

A negative rating action could result from a deterioration in credit metrics as indicated by FFO/SaD falling below 15% and SaD/EBITDA increasing above 4.0x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Strong national market positioning, with a gradual crowding out of the unorganised retail market leading to potential for significant sales growth	• Absolute size still small with low market shares if we include the unorganised market
• Profitability higher than peers thanks to small shop formats and integrated vertical structure	• Exposure to Georgia only, enhancing vulnerability to macro-changes
• Active on the food retail scene, considered the retail industry subsector least prone to cyclicality	• Low liquidity • Weak transparency • Interest cover deterioration due to transition to IFRS16

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/Scope-adjusted EBITDA below 3x	• SaD/Scope-adjusted EBITDA above 4x
• Scope-adjusted FFO/SaD above 30%	• Scope-adjusted FFO/SaD below 15%

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
EBITDA/interest cover (x)	4.4x	2.8x	3.0x	3.3x
SaD/EBITDA	3.7x	3.8x	3.2x	2.3x
Scope-adjusted FFO/SaD	20%	16%	21%	29%
FOCF/SaD	-19%	-15%	-7%	2%
Scope-adjusted EBITDA (in GEL thousands)	**2018**	**2019**	**2020e**	**2021e**
EBITDA	15,155	39,715	46,355	54,772
Operating lease payment in respective year	19,861	-	-	-
Scope-adjusted EBITDA	35,016	39,715	46,355	54,772
Scope funds from operations (in GEL thousands)	**2018**	**2019**	**2020e**	**2021e**
EBITDA	15,155	39,715	46,355	54,772
less: (net) cash interest as per cash flow statement	-4,064	-14,234	-15,632	-16,619
less: cash tax paid as per cash flow statement	-964	-1,715	-348	-767
add: depreciation component operating leases	15,888			
Scope funds from operations	26,015	23,766	30,375	37,387
Scope-adjusted debt (in GEL thousands)	**2018**	**2019**	**2020e**	**2021e**
Reported gross financial debt	48,801	152,313	146,376	127,529
add: operating leases commitments	79,442	-	-	-
Scope-adjusted debt	128,243	152,313	146,376	127,529

Business risk profile (BB-)

Crowding out of unorganised retail is increasing competition among retailers

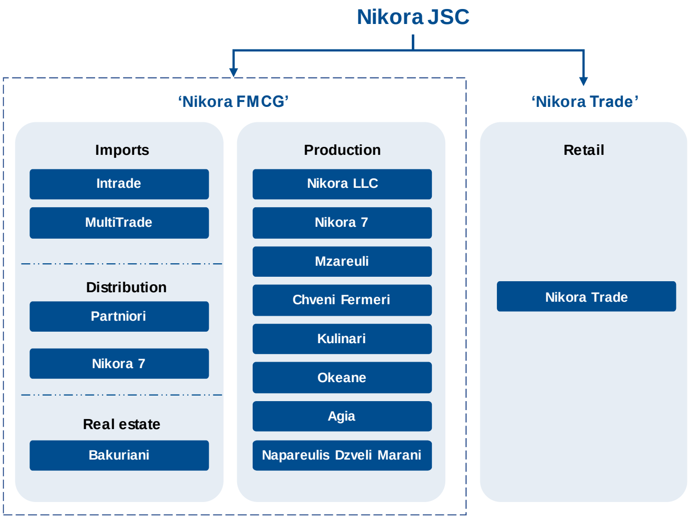
A significant share of overall retail in Georgia is still 'unorganised', taking the form of bazaars or unaffiliated shops. However, this share has fallen markedly in recent years, estimated by TBC Bank, Georgia, research to represent 72% at YE 2019 (versus 77% at YE 2018). This crowding out of unorganised retail has led to a considerable rise in the sales of most Georgian food retailers and a significant increase in competition among them. A study by TBC also notes the increased competition in the country, with the fast development of new retailers, such as Retail Group and the development of franchises. As some of this might have been achieved outside of Tbilisi (while Nikora is still focused on the capital) it needs to be seen whether these trends are sustainable. The country has reached an historical low point of concentration which is supported by the rapidly growing number of shops (+55% in Tbilisi in 2018-2019). The pace of Nikora Trade's market share development is therefore expected to decrease slightly over the coming years, due to rising competition.

Management reports having 288 shops (including 25 kiosks) in operation, with 25 new stores expected to be added by YE 2020. There are 35 more in the pipeline, for which the timing is currently unknown. This fast development of its shop network has allowed Nikora Trade to capture considerable market share over the last few years. When we first rated Nikora Trade back in 2017, the retailer only had 153 shops in operation.

Small size still constrains issuer rating

Although Nikora Trade's size (sales of GEL 440m corresponding to around EUR 123m) is significant in Georgia, it is one of the most negative rating drivers compared to international peers. Even if the retailer manages to successfully maintain its number one position in Georgia, it will remain a very small actor on the international food retail scene. This factor therefore limits the potential rating uplift.

Figure 1: Organigram of the group



Source: Scope

Figure 2: Market share of JSC Nikora Trade

Market shares	2016	2017	2018	2019
Carrefour	26%	24%	20%	17%
Nikora Trade	19%	20%	19%	18%
Ori Nabiji	2%	13%	15%	12%
Spar/Foodmart/Ioli	9%	10%	12%	8%
Goodwill	8%	7%	6%	5%
Retail Group	0%	0%	4%	7%
Others	36%	25%	24%	33%

Source: Scope, TBC Bank

Integrated company structure helps Nikora Trade to develop its barganing power

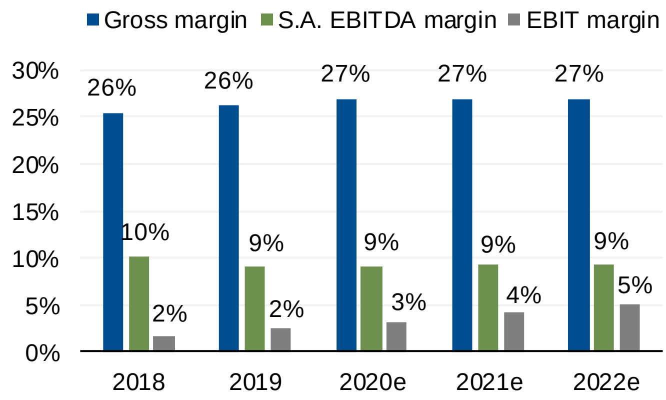
One of Nikora Trade's key features is its holding structure in which the parent company, Nikora JSC (rated BB- by Scope), not only owns Nikora Trade but also several other food suppliers which sell their products to the food retailer. These internal suppliers offer a huge range of products, from meat to dairy and frozen products.

We view this integration positively because it should allow Nikora Trade to benefit from more advantageous commercial terms than it would from negotiations with external entities. We believe that this approach has helped to improve both the cash conversion cycle and gross margins over the years. The company's organic growth strategy should also continue to enhance the two aforementioned ratios as the bargaining power of the company increases, potentially creating higher margins in future.

Lack of geographical diversification weighs negatively on the rating

Nikora Trade is solely active in Georgia and does not intend to develop its operations abroad in the short to medium term. This lack of geographical diversification is seen as a negative rating driver as it leads to vulnerability to macroeconomic risks. We consider the Georgian retail market to be relatively small (3.5m inhabitants) and dependent on imports for some of its key products. Despite this focus on Georgia, Nikora Trade is present in most format sizes (apart from the hypermarket format) and offers close to 10,000 types of product, ensuring high product and customer diversification. The absence of any e-commerce services would normally be seen as a shortcoming for a company involved in retail activity, but in light of the developmental level of Georgian retail, we have not over-emphasised this factor.

Figure 3: Development of profit margins



Source: Scope, Nikora Trade

Figure 4: Profitability margins versus local peers

2018	Sales (GELm)	YoY	Assets (GELm)	YoY	Gross margin	EBITDAR margin
Carrefour	430	22%	164	8%	19%	4%
Nikora Trade	345	29%	130	31%	26%	10%
Ori Nabiji	232	38%	51	37%	18%	8%
Spar/Foodmart/ Ioli	142	50%	52	22%	27%	13%
Average Georgian retailers					21%	7%

Source: Scope, TBC Bank

Profitability above that of peers

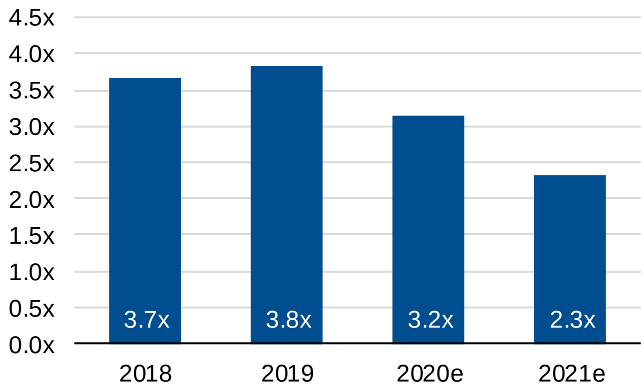
Profitability is one of the group's key rating drivers. Nikora Trade's Scope-adjusted EBITDA margin declined to about 9% in 2019 (from about 10% in 2017 and 2018) and is expected to stay stable for the next few years. Nonetheless, the group benefits from a relatively large share of private labels, sourced by its parent company (Nikora JSC). In a national comparison and based on TBC data, Nikora Trade appears to have higher gross margins, and therefore higher Scope-adjusted EBITDA margins, than peers. Going forward, we expect profitability to remain at a similar level but to come under increasing pressure.

Financial risk profile (B+)

Negative impact of IFRS16 on financial metrics

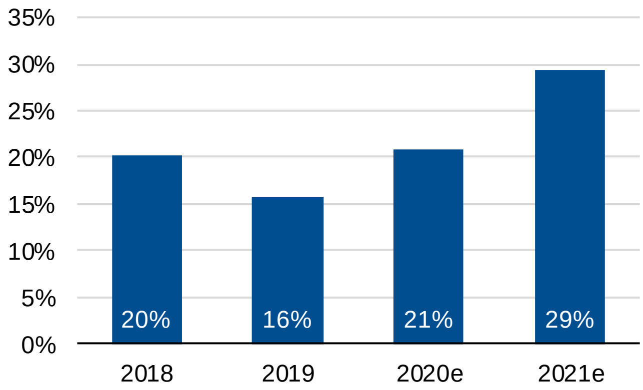
SaD was affected by IFRS 16 in 2019. In 2018, we estimated operating lease commitments at around GEL 80m, increasing to GEL 92m in 2019. While these figures are not comparable as the shop network evolved over the period, group debt still increased substantially. 2020E should see a similar level of gross debt as we do not expect any significant net variation in debt this year.

Figure 5: Development of SaD/EBITDA



Source: Scope, Nikora Trade

Figure 6: Development of FFO/SaD



Source: Scope, Nikora Trade

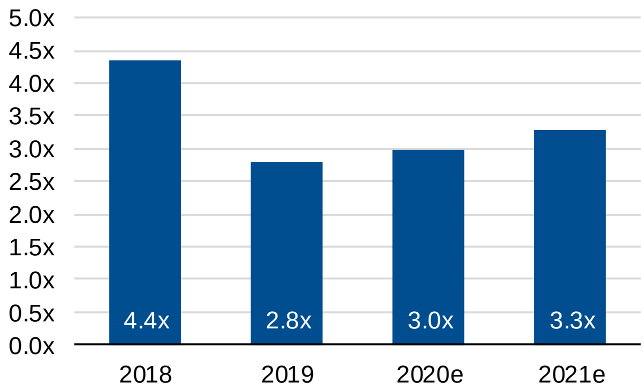
Leverage expected to improve

SaD/EBITDA is expected to decrease slightly, also supported by an improvement in EBITDA. Our gross margin forecast (27%) is fairly conservative, as it is likely that the retailer will manage to successfully improve its gross margin further. The SaD/EBITDA ratio is forecasted to remain at levels slightly above 3x in 2020E and could fall below 2.5x in 2021. FFO/SaD is expected to follow a similar trend, increasing to around 20% at YE 2020 and possibly increasing to levels close to 30% at YE 2021.

Interest cover hit hard by IFRS16 transition

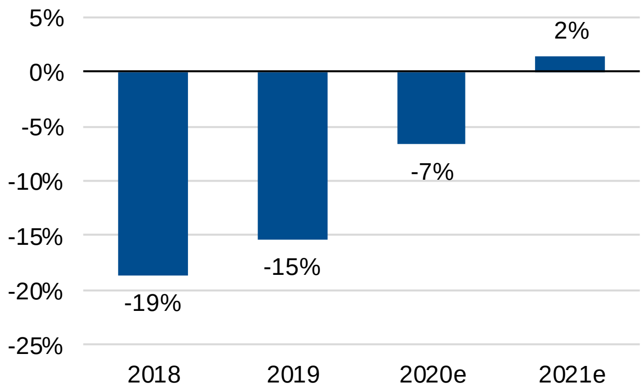
Interest cover was heavily impacted by the implementation of IFRS16, due to our underestimation of the effect the transition would have. The metric therefore dropped to 2.8x in 2019 from 4.4x in 2018. While it is likely that the group will manage to renegotiate interest payments on existing leases and improve expenses, we remain conservative for the time being. Going forward, we expect the ratio to increase steadily each year, but to remain below 4.0x.

Figure 5: Development of interest cover



Source: Scope, Nikora Trade

Figure 6: Development of FOCF/SaD



Source: Scope, Nikora Trade

FOCF continues to improve

The issuance of Nikora Trade's first bond has allowed it to start its expansion phase, bringing FOCF/SaD below 0% since 2018. Considering the consolidation of the market in Tbilisi, it is likely that the group will continue its expansion strategy but at a slower pace. We therefore expect FOCF/SaD to recover somewhat in the coming years and possibly even to increase to low, positive levels.

Inadequate liquidity

Liquidity is inadequate. As we forecast that FOCF will remain negative in the short to medium term, we expect short-term debt to remain high. This is based on the group's considerable reliance on short-term debt. Multiyear open committed credit lines (accounting for GEL 10.6m) nonetheless provide a liquidity buffer. Although they are on a one-year basis, they are provided and extended every year. Their amounts are, however, too low to effectively counterbalance short-term liabilities.

Instrument rating affirmed with one-notch uplift to BB-

For the recovery analysis, we calculate the enterprise value on a going concern basis for YE 2021, assessed at GEL 128m. The debt category rating reflects the ranking status of the debt, ranking below substantial senior secured bank debt but still warranting a one-notch uplift relative to the issuer rating.

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer

Scope Ratings GmbH, Lennéstraße 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Directors: Guillaume Jolivet