Georgian Beer Company JSC
Georgia, Consumer Products

SCOPE BB- Negative

Corporate Profile

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

GBC mainly produces beer and non-alcoholic drinks (lemonades, cola and juices). The Chocheli family owns 63.5% of GBC indirectly via building technology company Mixori. The other shareholders, GIG (active; supervisory board representation) and PSP (passive), are independent owners.

Key metrics

			Scope estimates		
Scope credit ratios	2019	2020	2021E	2022E	2023E
EBITDA/interest cover	4.2x	3.4x	2.6x	2.8x	3.0x
Scope-adjusted debt (SaD)/EBITDA	3.1x	3.2x	3.4x	3.2x	3.0x
Scope-adjusted funds from operations/SaD	25%	22%	18%	20%	23%
Free operating cash flow/SaD	-11%	-1%	12%	8%	8%

Rating rationale

Scope Ratings GmbH (Scope) has today affirmed the BB-/Negative issuer rating of Georgian Beer Company JSC along with its BB- rating for senior unsecured debt.

The rating affirmation is based on the expected improvement in GBC's financial situation in medium term despite sales within HoReCa (hotel, restaurant and café) foreseen to recover slower than anticipated. While we expect GBC's growth to be further slowed by fierce competition in the Georgian beverages market, the ongoing consolidation of the retail sector and a slow recovery for the HoReCa business, elevated export sales, a successful implementation of the newly launched product portfolio, development of draft beer segment sales and a full recovery in HoReCa sales are expected to fuel EBITDA growth in medium term.

Outlook and rating-change drivers

The Negative Outlook on GBC's rating reflects the continued risk of deterioration in operating performance, due to fierce competition on Georgian beverages market, ongoing consolidation of retail sector and delayed recovery of Horeca business. This is expected to put further pressure on liquidity and selected credit metrics this year.

A positive rating action (i.e. an Outlook change to Stable from Negative) could be the consequence of the SaD/SaEBITDA remain below 3.5x and the SaFFO/SaD goes back towards 30%. This could be achieved through stronger top line growth due to a recovery in HoReCa sales and an increase in exports that outpace the forecasted surge in raw materials prices.

A negative rating action could result from weaker credit metrics with a SaFFO/SaD remain significantly below 30% and SaD/SaEBITDA above 3.5x. This could be triggered by i) operating profitability pressures from worse-than-anticipated effects from the retail market transition and increased competition; ii) higher-than-expected capital expenditure; iii) debt-financed investment in new projects.

Ratings & Outlook

Corporate rating BB-/Negative

Senior unsecured rating BB-

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Related Methodologies

Corporate Rating Methodology

Rating Methodology: Consumer Products

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Bloomberg: RESP SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Second largest Georgian beer brewer by sales volume • Low maintenance capex due to state-of-the-art production facilities • High operating margins that enable free cash generation • Moderate leverage	• Smaller scale than international consumer goods peers • Limited diversification outside of Georgia • Concentrated distribution channels • Inadequate liquidity • Apparent margin pressure due to ongoing retail market consolidation • Significant foreign exchange dependence

Rating-change drivers

Positive rating drivers	Negative rating drivers
• SaD/SaEBITDA remaining below 3.5x and SaFFO/SaD towards 30% • Increased scale and diversification	• Debt-funded acquisitions • SaFFO/SaD of below 30% and SaD/SaEBITDA of above 3.5x

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	4.2x	3.4x	2.6x	2.8x	3.0x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	3.1x	3.2x	3.4x	3.2x	3.0x
Scope-adjusted finds from operations/SaD	25%	22%	18%	20%	23%
Free operating cash flow/SaD	-11%	-1%	12%	8%	8%
Scope-adjusted EBITDA in GEL m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	17.9	18.6	16.2	16.8	17.1
Operating lease payments in respective year	0	0	0	0	0
Other	0	0	0	0	0
Scope-adjusted EBITDA	**17.9**	**18.6**	**16.2**	**16.8**	**17.1**
Scope-adjusted funds from operations in GEL m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	17.9	18.6	16.2	16.8	17.1
(Net) cash interest as per cash flow statement	-4.1	-5.5	-6.1	-5.9	-5.6
Cash tax paid as per cash flow statement	0	0	0	0	0
Other	0	0	0	0	0
Scope-adjusted FFO	**13.8**	**13.0**	**10.1**	**10.9**	**11.5**
Scope-adjusted debt in GEL m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	54.9	59.2	55.9	53.9	50.9
Cash, cash equivalents	0	0	0	0	0
Guarantees	0	0	0	0	0
Provisions	0	0	0	0	0
SaD	**54.9**	**59.2**	**55.9**	**53.9**	**50.9**

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 its industry of non-durable consumer goods.

Lower beer market shares as the result of fierce competition

GBC's competitive position is supported by its second-ranked position on the saturated Georgian beverages market. However, in 2020, GBC's beer volume sales decreased by 12.4% YoY. This was due to fierce competition from local players, some of which outperformed the market's modest growth (1.0% YoY) such as Global Beer Georgia with 11.3% annual growth and JSC Argo with 30.3%. Despite the decreased overall market share to 23% in 2020 (26% in 2019), GBC remained strong in the upper mainstream market, where sales of its best-selling product were resilient to the pandemic's impacts.

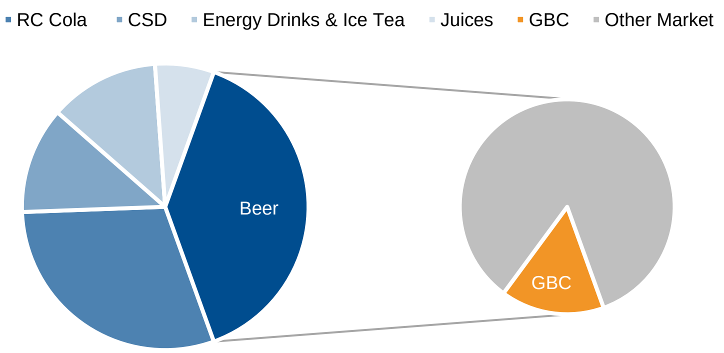
Carbonated soft drink sales growth in Georgia constrained by HoReCa exposure

In 2020, sales volumes on nearly all GBC's carbonated soft drinks were either constant or lower due to the impact of Covid restrictions on its HoReCa exposure. Furthermore, HoReCa sales are recovering slower than we expected, negatively affecting our assessment of top-line performance. However, GBC's strong ties with fast-growing retail chains are expected to support sales growth and we expect the business to recover fully in 2022.

Growth potential from export

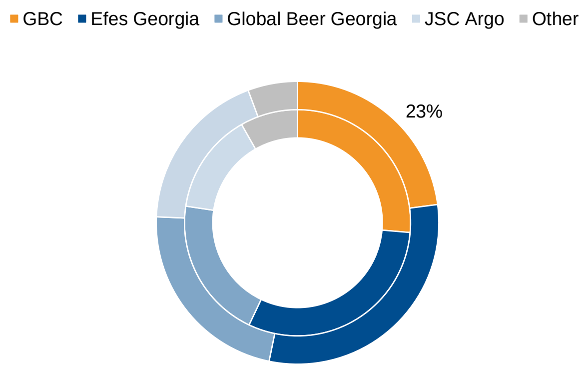
Despite intense competition, GBC retains great potential to increase export sales of carbonated soft drinks (CSD), mainly among the Commonwealth of Independent States. This is GBC's main medium-term objective.

Figure 1: GBC addressable market (2020)



Source: GBC, Scope

Figure 2: Beer market share in Georgia by volume
(inner circle Dec 2019, outer circle Dec 2020)



Source: GBC, Scope

Limited size

In a European context, GBC is small in size and operational scale. After the introduction of our methodology for consumer goods corporates, we assessed GBC's market share and concluded that its size constrains its business risk profile (GEL 70m in revenues for FY 2020) despite its significant size in Georgia.

Diversification still the weakest component of 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 macro-economic risk. However, domestic sales are well diversified within Georgia, particularly outside of Tbilisi (around 60% of total sales).

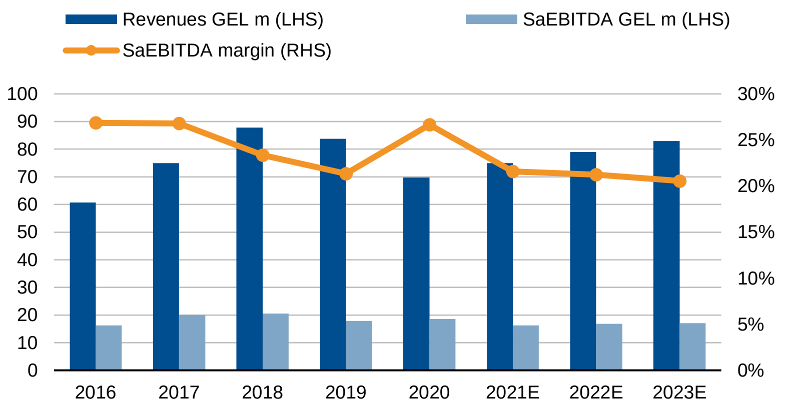
Overall diversification benefits from the broad product range in almost all beverage segments. However, the top two brands account for almost half of total portfolio sales. New products, including Harp, Ravi, AIA and Civ-Civi, comprise at least 10% of total sales.

Customer concentration increased further following the termination in 2019 of the Diplomat Georgia contract and the 2021 merger between GBC's distributor/customer, Zedazeni Kutaisi LLC, and distributor, Zedazeni 2012 LLC. GBC is heavily dependent on Zedazeni 2012, with the exposure expected to represent 80% of total sales in FY 2021 (35% in FY 2019). While the 'single distribution channel' is inherent to Georgian beverage companies (EFES Georgia has Natakhtari 2015 and Global Beer Group has GDL), Zedazeni 2012's low credit quality raises concerns on its operational sustainability and value chain management, which could translate into an impairment of receivables. We expect this risk to remain into the medium term.

Profitability margins higher than local sector median

Profitability has remained comfortable thanks to the company's flexibility on selling-price changes. The Scope-adjusted EBITDA margin increased slightly to 26% in 2020. The heavy dependence on imported raw materials – also without the use of foreign currency hedging, though common among Georgian producers – is expected to put further pressure on GBC's gross margins.

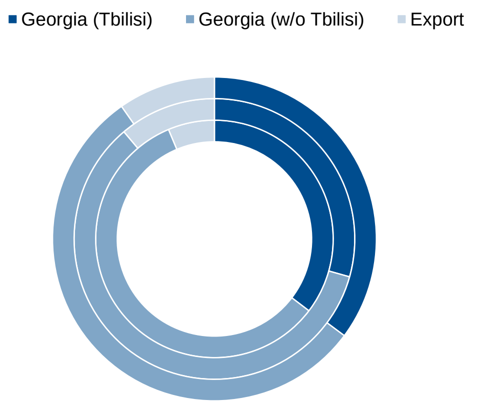
Figure 3: GBC operating performance



Source: GBC, Scope estimates

Figure 4: GBC sales by region

(Inner circle Dec 2019, mid circle Dec 2020, outer circle June 2021)



Source: GBC, Scope

The share of retail customers is also rising, reaching 30% of total sales in 2020 (25% in 2019), which increases selling costs and puts pressure on profitability. The share is expected to increase in the medium term towards 40%-45% following the significant growth anticipated for retail groups.

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

Credit-supportive brand

We view positively GBC's brand strength. The company's almost 10 years of operations have created brand recognition and a loyal customer network. However, this strength is limited to the region in which it operates. Customer loyalty is driven by constantly strengthened product quality and the variety of products and offerings that are also tailored to consumer needs.

Financial risk profile: BB-

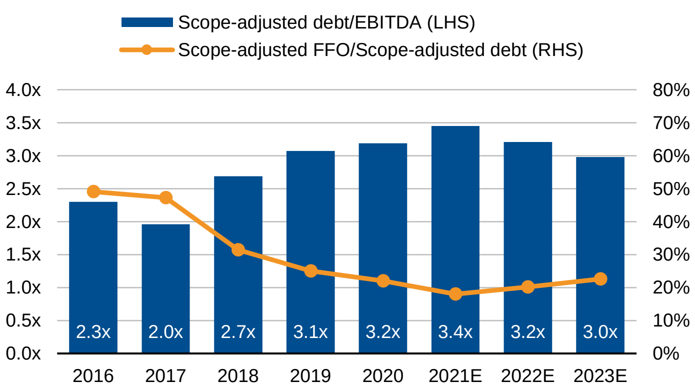
Pandemic weakened operating performance in 2020

GBC's financial risk profile is constrained by the weaker operating performance in 2020, as anticipated in the wake of the pandemic. This also led to deterioration in leverage: SaD/SaEBITDA increased to 3.1x at YE 2020 from 3.0x at YE 2019 and SaFFO/SaD dropped to 22% from 25% over the same period. This was due to i) fluctuating foreign exchange rates, which increased the debt balance by GEL 5.0m; ii) the increased cost of debt; and iii) the limited growth anticipated for EBITDA (absolute terms). Our key adjustment for the financial risk profile is the exclusion of available cash and cash equivalents from the SaD calculation.

Our base case for 2021 incorporates even weaker operating performance. We expect the slow recovery of HoReCa sales, increased selling costs and fierce market competition to result in lower EBITDA compared to 2020 in absolute terms. In the medium term, elevated export sales, a successful implementation of the newly launched product portfolio, development of draft beer segment sales and a full recovery in HoReCa sales are expected to fuel EBITDA growth.

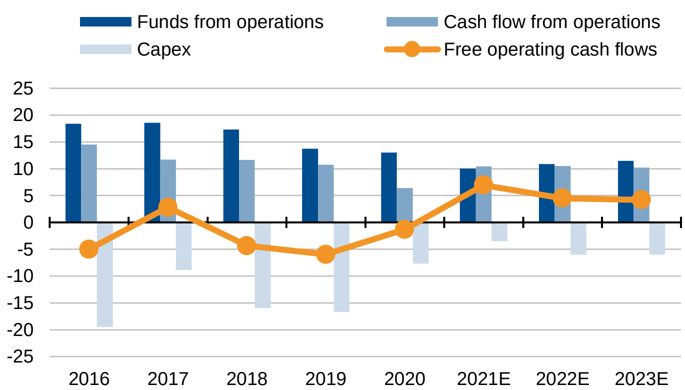
While the partial refinancing of existing lari-denominated term loans with euro-denominated loans has decreased the cost of debt and aligned principal payments with the seasonality of the business, it has also increased the debt exposure to the euro. Foreign currency debt now represents more than 50% of total debt including leases, mostly in euro. This makes the debt balance volatile given the fluctuating exchange rate.

Figure 5: Leverage



Source: GBC, Scope estimates

Figure 6: Cash flow cover (GEL m)

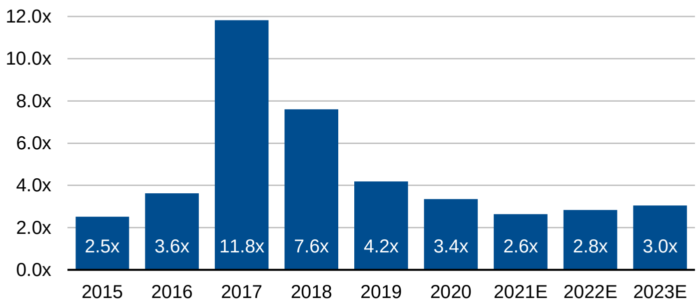


Source: GBC, Scope estimates

GBC's high cost of debt in the Georgian context puts pressure on its EBITDA interest coverage. We expect the ratio to remain modest at above 2.5x in 2021-23, supported by the expected increase in absolute EBITDA from FY 2022 while the cost of debt remains at the current level.

We foresee the operating cash balance to turn positive, based on expected annual capex in the mid-single-digit millions of lari in 2021-23, in line with the management forecast, and the limited working capital investments. Our rating case incorporates free operating cash flows and discretionary cash flows of more than GEL 5m in 2021-23, which would result in a free operating cash flow/SaD ratio of around 10% (2021E: 12%; 2022E: 8%; 2023E: 8%).

Figure 7: EBITDA interest cover



Source: GBC, Scope estimates

Figure 8: Liquidity

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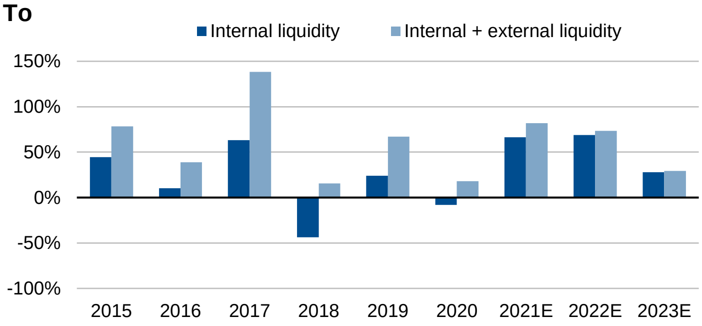

Source: GBC, Scope estimates

Inadequate liquidity profile

The current debt structure, consisting of short-term financial leases and bank loans, significantly weakens liquidity. We estimate available cash at around a low GEL 2.0m at YE 2020 and free operating cash flow at around GEL 5.0m, which together is unable to fully cover (re-)financing needs of currently GEL 11.0m-13.0m in debt. Even including undrawn committed lines of GEL 2.1m, the ratio is inadequate, exposing GBC to continued refinancing risks and a dependency on bank credit.

While the conversion in H2 2021 of lari-denominated term loans to euro with a restructured payment schedule (debt amortisation starts in 2022) could help mitigate the weak liquidity, we do not expect a fundamental change in the debt structure.

Position	2021E	2022E	2023E
Unrestricted cash (t-1)	GEL 1.9m	GEL 3.1m	GEL 5.6m
Open committed credit lines (t-1)	GEL 2.1m	GEL 0.5m	GEL 0.5m
Free operating cash flow	GEL 6.9m	GEL 4.5m	GEL 4.2m
Short-term debt (t-1)	GEL 13.4m	GEL 11.0m	GEL 35.0m
Coverage	**0.8x**	**0.8x**	**0.4x**

Short-term debt is expected to peak in 2022 with GEL 25m of senior unsecured bonds and GEL 10.0m of bank debt. Such high debt positions can hardly be redeemed through the operating business alone but we believe GBC can refinance this debt either by issuing new bonds or through a term loan. This is because expect deleveraging is likely to create headroom of financial flexibility.

GBC's bond prospectus and bank loans include covenants on leverage (less than 4x) and debt service coverage (more than 1.1x). The leverage covenant was revised up in 2021 from 3.0x in 2020. However, GBC management has confirmed it will implement no significant changes in its capital investment programme, shareholder remuneration or debt-financed acquisitions.

Supplementary rating drivers

Credit-neutral supplementary rating drivers

There is no explicit rating adjustment for supplementary rating drivers. GBC's financial policy has never been aggressive, with no significant acquisitions or dividend payments, and cash flows used to strengthen equity. This shows true family ownership values, in our view. We do not expect this to change for the time being.

Long-term debt rating

Senior unsecured debt affirmed at BB-

We affirm senior unsecured debt at BB-. This reflects our 'average' recovery expectation for senior unsecured debt based on an estimated liquidation value in a hypothetical default scenario in 2023, which assumes outstanding senior secured debt of GEL 25m, payables and fully drawn credit lines.

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