JSC Nikora
Georgia, Retail and Consumer products

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	2.6x	3.6x	3.4x	3.2x
Scope-adjusted debt/EBITDA	4.5x	3.0x	2.8x	2.7x
Scope-adjusted funds from operations (FFO)/debt	13%	24%	25%	25%
Scope-adjusted free operating cash flow (FOCF)/debt	1%	1%	-5%	0%

Rating rationale

The issuer rating of Nikora JSC (Nikora) benefits from comparatively high profitability, vertically integrated business model and the group's ability to grow. Negative free operating cash flow and inadequate liquidity, due to continued reliance on very high short-term credit lines, limited size and low geographical diversification are negative rating drivers. The Outlook change back to Stable from Negative is driven by Nikora's resilient operating performance, stable growth and improved credit metrics.

Nikora's financial risk profile is one notch higher than that of Nikora Trade (subsidiary representing 75% of EBITDA and a leading food retailer in Georgia). While they show similar credit metrics, the group benefits from a larger size, a higher level of vertical integration and an exposure to perishable consumer goods, which support cash flow stability.

Outlook and rating-change drivers

The Outlook change back to Stable from Negative reflects our expectation that indebtedness will remain at its current level with Scope-adjusted debt/EBITDA at around 3x and Scope-adjusted FFO/debt of over 20%. We also expect that the group will be able to tackle inflation, retain its margins and continue to operate with very limited liquidity due to a heavy investment phase, dividend payments on preferred shares and lease repayments limiting FOCF. The Outlook also incorporates a successful refinancing of senior unsecured debt maturing in October 2022 from proceeds of a new bond (GEL 30m-35m) with similar terms and conditions.

A positive rating action could result from Scope-adjusted FFO/debt and Scope-adjusted debt/EBITDA above 30% and below 3x respectively on a sustained basis, with liquidity dramatically and sustainably improving. This could be achieved via deleveraging while maintaining a relatively high level of EBITDA. A positive rating action could also be warranted if the group were to grow significantly, leading to higher market shares and diversification.

A negative rating action could result from a deterioration in credit metrics as indicated by Scope-adjusted FFO/debt falling below 15% and Scope-adjusted debt/EBITDA increasing to above 4x on a sustained basis. Such weak financial performance could be triggered by a significant increase of the cost base and/or a supply chain disruption, putting operating profitability and cash flow under pressure. A negative rating action could also occur if liquidity remained inadequate.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
01 Sep 2022	Outlook change	BB-/Stable
02 Sep 2021	Outlook change	BB-/Negative
11 Sep 2020	Affirmation	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies and Related Research

General Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2022

Consumer Products Rating Methodology; September 2021

Sovereign and Public Sector rating report on Republic of Georgia; August 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• The owner of Nikora Trade holds a high share of Georgia's retail market and has high profitability for a retailer which is constrained by 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 (fast moving consumer goods) is one of the largest organised food producers in the country. • High EBITDA cash conversion benefiting from bargaining power on local market • Modest leverage constrained by USD foreign exchange risk	• Cash flow cover remains under pressure due to significant capex spending and lease repayments • Limited diversification of the group outside Georgia • Inadequate liquidity • Highly concentrated supply chain mainly exposed to Ukraine and Russia • Significant foreign exchange risk as almost all raw materials are imported while revenue is generated in Georgian Lari

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA below 3x and Scope-adjusted FFO/debt above 30% on a sustained basis paired with dramatically and sustainably improved liquidity • Increase in the group's critical size	• Scope-adjusted debt/EBITDA above 4x on a sustained basis • Scope-adjusted FFO/debt below 15% on sustained basis • Liquidity to remain inadequate

Corporate profile

JSC Nikora (Nikora) is the parent company of Nikora Trade. While the latter is only active in the retail sector, the holding company Nikora includes additional entities focused on importing, producing and distributing food. Around 40% of Nikora Trade's purchases are made from integrated suppliers belonging to Nikora. The overarching group JSC Nikora currently has more than 7,000 employees and is active solely in Georgia.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	3.3x	2.6x	3.6x	3.4x	3.2x	3.5x
Scope-adjusted debt/EBITDA	4.0x	4.5x	3.0x	2.8x	2.7x	2.5x
Scope-adjusted FFO/debt	17%	13%	24%	25%	25%	28%
Scope-adjusted FOCF/debt	-6%	1%	1%	-5%	0%	4%
Scope-adjusted EBITDA in GEL '000s						
EBITDA	51,814	54,918	80,477	89,601	102,501	106,714
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**51,814**	**54,918**	**80,477**	**89,601**	**102,501**	**106,714**
FFO in GEL '000s						
Scope-adjusted EBITDA	51,814	54,918	80,477	89,601	102,501	106,714
less: (net) cash interest paid	-15,750	-20,888	-22,521	-26,044	-31,797	-30,221
less: cash tax paid per cash flow statement	-725	-993	-1,062	-1,250	-1,250	-1,250
FFO	**35,339**	**33,037**	**56,894**	**62,308**	**69,454**	**75,243**
FOCF in GEL '000s						
Funds from operations	35,339	33,037	56,894	62,308	69,454	75,243
Change in working capital	-7,163	8,341	-2,016	-4,884	-2,064	-629
Non-operating cash flow	1,013	3,766	-1,764	0	0	0
less: capital expenditure (net)	-24,479	-22,931	-26,362	-43,000	-40,000	-35,000
less: operating lease payments	-14,251	-17,948	-23,152	-24,122	-24,592	-25,763
less: dividends (preferred shares)	-3,320	-2,477	-988	-2,083	-2,083	-2,083
FOCF	**-12,861**	**1,788**	**2,612**	**-11,781**	**714**	**11,768**
Net cash interest paid in GEL '000s						
Net cash interest per cash flow statement	15,750	20,888	22,521	26,044	31,797	30,221
Change in other items	0	0	0	0	0	0
Net cash interest paid	**15,750**	**20,888**	**22,521**	**26,044**	**31,797**	**30,221**
Scope-adjusted debt in GEL '000s						
Reported gross financial debt	206,881	249,826	241,519	254,036	279,727	266,554
less: cash and cash equivalents	0	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted debt	**206,881**	**249,826**	**241,519**	**254,036**	**279,727**	**266,554**

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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)

Regulatory and reputational risk

The government of Georgia will likely put increasing pressure on unregulated retailers. While food safety standards and stricter regulations might put the operating environment under pressure, we do not expect quick changes in the regulatory environment for food retailers and we believe the effect of regulatory action will likely consolidate Nikora Trades' market share as it will weaken the unorganised market.

Clarity and transparency

Some issues about the group's transparency had been flagged regarding its ability to communicate and the timeliness of its financial disclosures in previous rating actions. We highlight that the flow of information between management and Scope has improved.

Efficiencies

The inventory shrinkage and obsolete inventory costs remain at 2% of sales, which decreases gross margins. While the group suffers from costly food supply chain management, it plans to integrate SAP's enterprise resource planning (ERP) management systems in the current year, to track and organise stock and improve working capital management. With better access to available stocks, the group will be able to increase operating efficiency.

[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 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-durable consumer products (assessed at A), which has low cyclicality, low-to-medium barriers to entry and low substitution risk.

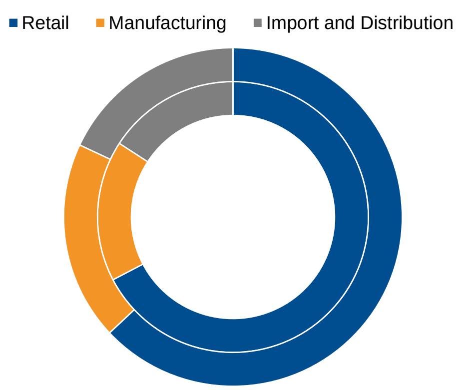
Dominant player in Georgian consumer product and retail landscape

Nikora's competitive positioning continues to benefit from its standing as a key national player in the consumer goods and retail industries, including producing entities with high national brand recognition. While the retail sector remained resilient to the Covid-19 pandemic, Nikora's FMCG arm was negatively affected but started to recover in H1 2022 when restaurants resumed work with normal hours and had lighter Covid-19-related restrictions.

Limited size

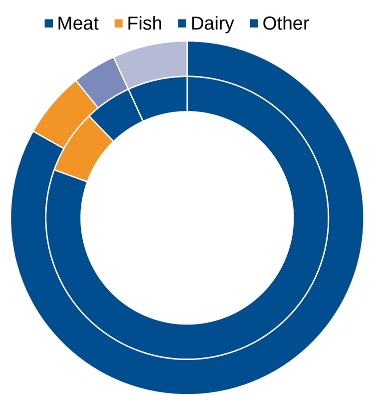
The group's market share is constrained by its small size (GEL 750m in revenue for FY 2021). Although Nikora Trade's size is significant within Georgia, size remains one of the most negative rating drivers of the group's business risk profile.

Figure 1: JSC Nikora unconsolidated operations (2021)



Sources: Nikora, Scope

Figure 2: Nikora FMCG – product split by category (inner circle Dec 2020, outer circle Dec 2021)



Sources: Nikora, Scope

Regulatory environment

We do not expect quick changes in the regulatory environment for food retailers and we believe the effect of regulatory action will likely consolidate Nikora's market share as it will weaken the unorganised market (neutral ESG rating driver).

High concentration in Nikora Trade

We expect the expansion of Nikora Trade to have a positive effect on the growth Nikora FMCG. However, the dependency on Nikora Trade is high as around 60% of Nikora FMCG's sales are linked to intra-group sales.

Geographical diversification remains weak

While diversification benefits from a vertically integrated group structure, geographical diversification remains the weak element of the group's business risk profile as it remains heavily dependent on exchange rates (macroeconomic vulnerability, see below) in determining input costs.

Country growth outlook and inflation

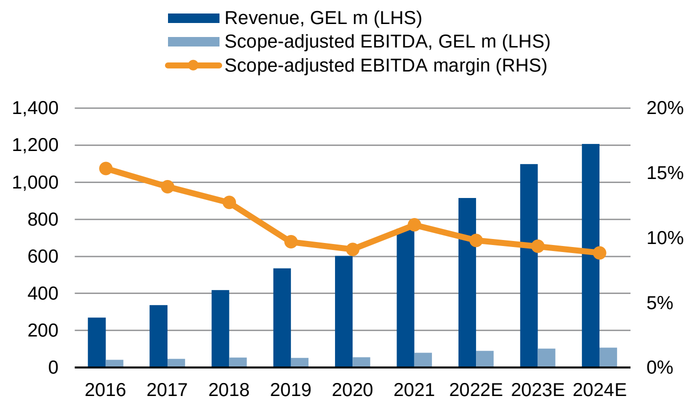
Nikora Trade is active solely in Georgia and its lack of geographical diversification is seen as a negative rating driver since it leads to vulnerability to macroeconomic risks. The Russian invasion of Ukraine poses economic uncertainties for the Georgian economy given its strong economic links with Russia and Ukraine: the two countries accounted for 22% of Georgian exports, 21% of remittances (mostly from Russia) and 25% of tourism inflows in 2021. Headline inflation peaked at 13.9% YoY in January 2022. Inflation has eased slightly since, to 12.8% YoY in June 2022, still well above the National Bank of Georgia target of 3%. The National Bank of Georgia expects inflation to average 9.6% over 2022, with this inflation rate starting to move towards its target rate as sharp rises in food and energy prices gradually dissipate.

Limited visibility on supply chain sustainability

We highlight the risk of depending on the Russian, Ukrainian and Belarusian markets for primary consumption food import. Coverage of the full value chain from the import of raw materials is exposed to a supply chain disruption risk. As of August 2022, the group's management confirms no significant disruption or challenges in supply chain management as main suppliers continue to deliver. The reliability of such supply over the medium term raises concerns.

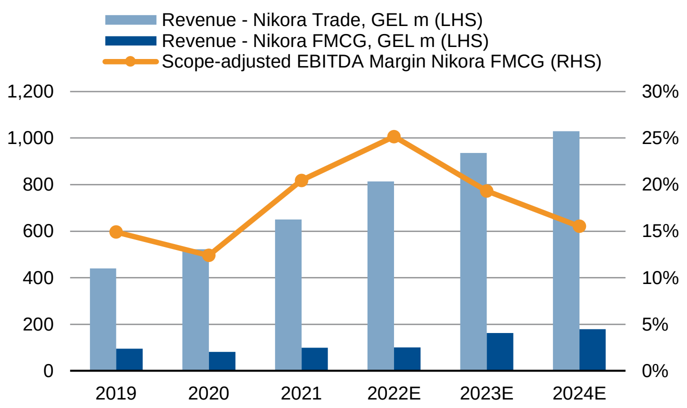
Alternatively, Nikora could turn to markets like Poland, Türkiye and/or Brazil to substitute or diversify suppliers. Our base case includes stable gross margin development without major supply chain disruptions. However, a sudden substitution of supply chain could have a significant negative impact on the company's operating performance.

Figure 3: JSC Nikora's consolidated operating performance



Sources: Nikora, Scope estimates

Figure 4: Revenue Split by sales and EBITDA margin



Sources: Nikora, Scope estimates

Comfortable operating profitability margins

We expect that Nikora will be able to keep comfortable profitability margins. These will be supported by i) historically stable gross margins of about 29%, 400 bp higher than Nikora Trade's gross margins that benefit from the group structure and its advantageous commercial terms; ii) the company's growth strategy that should continue to enhance the bargaining power of the group, potentially creating synergies and higher margins; and iii) the fully recovered HoReCa sales after Covid-19 ravaged 2020 and 2021.

Financial risk profile: BB-

Adjustments and assumptions

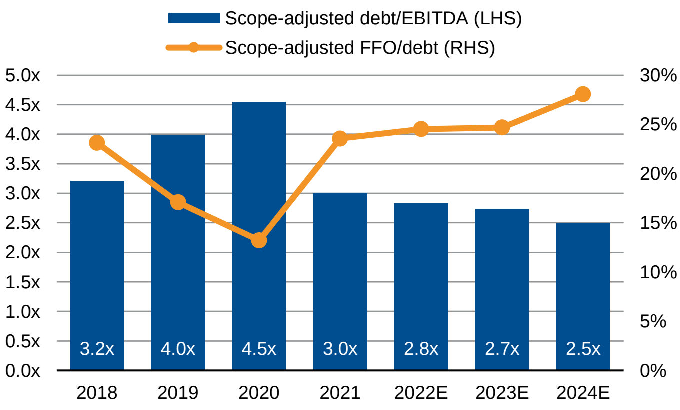
Our adjustments include the following key elements:

- Available cash and cash equivalents are excluded from our Scope-adjusted debt calculation. The cash is not seen permanent in today's market environment as commercial terms of suppliers could quickly change or due to supply chain disruptions
- FOCF has been adjusted by the amount of the repayment of leases and dividends on preference shares
- Scope-adjusted EBITDA does not include adjustments for the received government subsidy on personal income tax

Improved leverage

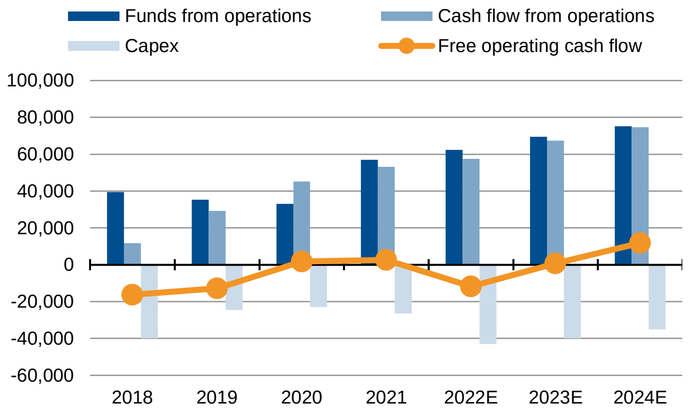
Nikora Trade's financial risk profile is supported by its sound cash conversion cycle, reflected in substantial cash flow. The lower-than-expected leverage in 2021 with Scope-adjusted debt/EBITDA of 3.0x (decreased by 1.5x YoY) is the result of solid EBITDA development coupled with foreign exchange gains on USD-denominated lease liabilities, which decreased overall reported debt by GEL 6m.

Figure 5: Leverage



Sources: Nikora, Scope estimates

Figure 6: Cash flow (GEL '000s)



Sources: Nikora, Scope estimates

Expected lower leverage

While expected negative FOCF will limit room to decrease financial debt, leverage is anticipated to remain below 3.0x. The forecasted deleveraging should be driven by increasing EBITDA following Nikora Trade's expansion and the increased production capacity of meat at Nikora LTD. Indebtedness is not expected to increase significantly. For the same reasons, we expect Scope-adjusted FFO/debt to follow a similar trend, improving towards 25% in medium term.

New meat processing facility

In line with the holding company's development through Nikora Trade's expansion strategy, it is likely that the group will continue to invest and will add production facility during next two to three years. In December 2021, the group has received land free of charge from the Georgian government under committed investment conditions. The committed investment volume is determined in the amount of GEL 14.5m during 2022-2023 while the full project size is around GEL 20m-25m including inventory for the additional production facility of processed meat.

Negative FOCF while group remains in heavy capex spending phase

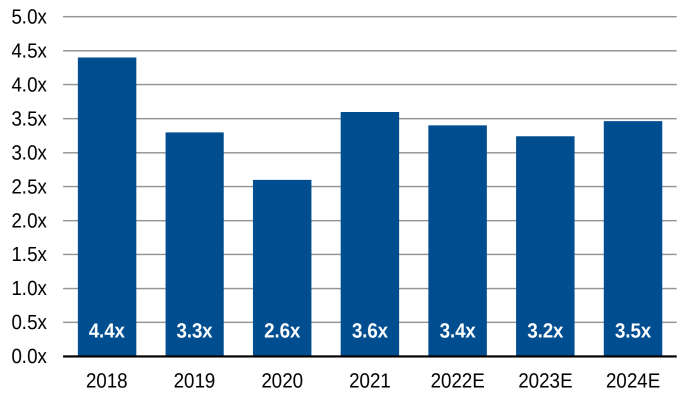
Annual capex is expected to stand at around GEL 40m-45m, higher than management guidance. FOCF is negatively affected by increased fixed interest payments on preference shares (6.5%) after 78 preferred shares owned by JSC Nikora were exchanged for 402,667 JSC Nikora Trade ordinary shares with an individual, Mr. Taradin. Our rating case incorporates moderate FOCF from 2024. The main drivers for FOCF to break even are fully ramped up newly opened stores and fully functional new meat processing facility, which will further increase scale and EBITDA.

While cash flow cover is the weakest element of Nikora's financial risk profile, we positively regard the group's financial flexibility in terms of capital spending and do not overweight this metric in our overall financial risk profile assessment.

Relatively high cost of debt in Georgia

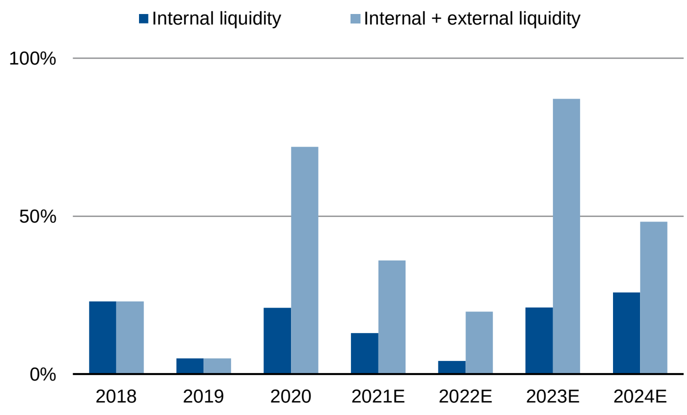
Interest cover had improved in FY 2021 thanks the recovery of EBITDA with the lifting of Covid-19-related restrictions over the course of the year while interest expenses remained stable. To deal with inflationary pressures, the National Bank of Georgia continues to tighten monetary policy. The refinancing rate has risen by 2.0pp over the last 12 months to end-August 2022, to 11% from 9%, which will cause higher cost of debt, reflected in slightly deteriorating cash cover in FY 2022 compared to FY 2021. We expect the ratio to remain slightly above 3.0x in 2022-2024, supported by further growth of EBITDA driven by ability to pass on a large share of inflationary pressure to customers.

Figure 7: Interest Cover



Sources: Nikora, Scope estimates

Figure 8: Liquidity



Sources: Nikora, Scope estimates

Inadequate liquidity

Liquidity is seen as inadequate. The current debt structure and the amount of short-term debt significantly weakens Nikora's liquidity profile. We estimate lower cash levels on the balance sheet, around GEL 3.5m equivalent to the group's historical cash levels. Cash might be restricted if the commercial terms of suppliers change or due to supply chain disruptions and could increase (re)-financing risks of the company. Even accounting for the group's undrawn committed lines of GEL 13.2m, the liquidity remains inadequate, exposing Nikora to continued refinancing risks and a strong dependency on banks.

Liquidity should benefit from the expected GEL 35m of new bond issuance in 2022 as we do not anticipate any refinancing difficulties thanks to Nikora's well established relationships with local banks, a resilient business model and improved leverage. Cash proceeds will be used to refinance the existing GEL 28m bond in October 2022.

Balance in GEL '000s	2022 E	2023 E	2024 E
Unrestricted cash (t-1)	3,500	3,500	3,500
Open committed credit lines (t-1)	13,222	13,222	13,222
FOCF	-11,781	714	11,768
Short-term debt (t-1)	72,572	20,000	59,000
Coverage	**20%**	**87%**	**48%**

Better financial profile than Nikora Trade

JSC Nikora's financial risk profile is assessed one notch above that of Nikora Trade (rated B+ by Scope), a subsidiary representing 75% of EBITDA and showing the same credit metrics. The group benefits from its larger size, higher level of vertical integration and exposure to perishable consumer goods, all supporting stability of cash flow. However, given the strong interdependencies between Nikora JSC and its main subsidiary Nikora Trade (which represented 75% of the group's EBITDA in 2021), we note that Nikora Trade's heightened refinancing risk could negatively impact the group's financial risk profile.

Supplementary rating drivers: +/- 0 notches

Credit-neutral supplementary rating drivers

We highlight that the flow of information between management and the rating agency has improved. (neutral ESG rating driver)

Long-term debt rating

Senior unsecured debt rating: BB-

We have affirmed senior unsecured debt at BB-, reflecting our expectation of an average recovery for senior unsecured debt positions. Our recovery expectations are based on an estimated liquidation value in a hypothetical default scenario in 2024. In this scenario we assume that market conditions are tough and that the outstanding bank facility at the time is fully drawn.

Operating leases are excluded from debt waterfall

The debt waterfall includes senior secured loans of GEL 70m and credit lines of about GEL 13m ranked prior to senior unsecured debt category. The senior unsecured debt of GEL 70m (a potential issuance of new senior unsecured debt of GEL 35m is incorporated in our analyses) and payables ranked pari passu. As of YE 2021, the loans are constituted of close to 50% of financial leases, which might stop within three months should the situation require it. Our debt waterfall does not take into consideration the recovery of operating leases.

Appendix: Peer comparison

	Nikora JSC	Tegeta Motors LLC	Nikora Trade JSC	Georgian Beer Company JSC	Evex hospitals JSC
	BB-/Stable	BB-/Stable	B+/Stable	BB-/Negative	BB/Stable
Last reporting date	01 Sep 2022	04 Nov 2021	01 Sep 2022	05 Oct 2021	9 Jun 2022
Business risk profile	**BB-**	**BB-**	**BB-**	**BB-**	**BB**
Market share	19%	18%	18%	23%	18%
Scope-adjusted EBITDA	GEL 80.5m	GEL 75.0m	GEL 60.2m	GEL 18.6m	GEL 80.0m
Operating profitability	11%	12%	9%	26%	23%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**BB-**	**BB-**	**B+**	**BB-**	**BB**
Scope-adjusted EBITDA/interest cover	3.4x	2.9x	3.6x	2.8x	2.9x
Scope-adjusted debt/EBITDA	2.9x	3.6x	2.8x	3.2x	2.8x
Scope-adjusted FFO/debt	24%	14%	25%	20%	25%
Scope-adjusted FFO/debt	-3%	7%	0%	8%	7%
Liquidity	Inadequate	Adequate	Inadequate	Inadequate	Adequate

* Financial risk profile metrics are presented as average of projections

Sources: Public information, Scope

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