JSC Nikora Trade Georgia, Retail

STABLE
BB-

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	3.8x	5.2x	5.1x	5.2x
Scope-adjusted debt/EBITDA	3.0x	2.1x	2.1x	2.0x
Scope-adjusted funds from operations/debt	25%	40%	38%	40%
Scope-adjusted free operating cash flow/debt	6.5%	16.1%	3%	-2%

Rating rationale

The issuer rating upgrade reflects Nikora Trade's strong operating performance while keeping indebtedness stable. Credit metrics also improved faster than expected, with leverage decreasing to 2.1x and funds from operations/debt reaching above 35%. The rating action also reflects the issuer's strong expansion strategy targeting unorganised regions, which will help to maintain EBITDA growth in absolute terms, along with its top position in the Georgian retail market.

The financial risk profile (revised to BB- from B+) reflects the issuer's strong operating performance thanks to higher local consumer expenditure, ongoing migration from neighbouring countries, and solid organic growth backed by new store openings. Nevertheless, the issuer's free operating cash flow, though positive in 2022, and inadequate liquidity remain the main constraints of the financial risk assessment, a consequence of the high capex.

The issuer's business risk profile (assessed at BB-) continues to benefit from its top local market share, solid non-discretionary product portfolio, comparatively high profitability, and ability to pass on cost inputs to customers. However, the business profile continues to be limited by the issuer's size and exposure to only one market.

Outlook and rating-change drivers

The Stable Outlook reflects our view that Nikora Trade JSC will continue its expansion strategy with related investments. We note that the investments are dependent on available financing and will only be carried out if profitability is not affected. Credit metrics are expected to remain stable, with Scope-adjusted debt/EBITDA between 2.0x - 2.5x and Scope-adjusted fund from operations/debt above 30%. The foreign currency risk is reflected in the tighter debt thresholds compared to other companies. We expect that high interest rates are likely to decline in the medium to long term as local inflation rapidly eases, helping to keep interest cover close to 5.0x.

A positive rating is considered unlikely but could be justified if the company grows significantly outside Georgia, while credit metrics remain at least in line with rating guidelines and liquidity improves sustainably.

A negative rating action could result from a deterioration in credit metrics indicated by Scope-adjusted funds from operations/debt falling below 30% or Scope-adjusted debt/EBITDA rising above 2.5x on a sustained basis. Such weak financial performance could be triggered by a slowdown in sales momentum, putting operating profitability under pressure.

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 2023

Sovereign and Public Sector rating report on Republic of Georgia; July 2023

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JSC Nikora Trade

Georgia, Retail

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
01 Sep 2023	Upgrade	BB-/Stable
01 Sep 2022	Affirmation	B+/Stable
02 Sep 2021	Affirmation	B+/Stable

Rating and rating-change drivers

Positive rating drivers

- Strong national market position, with the gradual crowding-out of unorganised retail players potentially 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 least cyclical retail subsector (food)
- Comfortable leverage despite high forex risk from USD-denominated leases

Negative rating drivers

- Absolute size still small, with moderate market share when including unorganised 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, though a common strategy in Georgia

Positive rating-change drivers

- Liquidity improves sustainably
- Significant growth outside Georgia
- Credit metrics remain at least in line with rating guidelines

Negative rating-change drivers

- Scope-adjusted debt/EBITDA sustained above 2.5x
- Scope-adjusted funds from operations/debt sustained below 30%

Corporate profile

Nikora Trade is the leading food retailer in Georgia. The company has developed a significant market share in organised retail, with a large range of shops (465) and more than 4,500 employees selling over 10,000 different products.

Nikora Trade (95%-owned subsidiary of Nikora JSC) was developed to sell the meat products generated by one of its entities. Entry into the retail sector has led to the acquisition of smaller retailers in recent years. Nikora Trade is undertaking a major expansion strategy, opening hundreds of new shops.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**LTM 2023**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	3.8x	5.2x	5.9x	5.1x	5.2x	5.2x
Scope-adjusted debt/EBITDA	3.0x	2.1x	2.0x	2.1x	2.0x	2.2x
Scope-adjusted funds from operations/debt	25%	40%	42%	38%	40%	37%
Scope-adjusted free operating cash flow/debt	6%	16%	5%	3%	-2%	-5%
Scope-adjusted EBITDA in GEL '000s						
EBITDA	60,213	82,426	94,271	100,690	117,081	130,204
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**60,213**	**82,426**	**94,271**	**100,690**	**117,081**	**130,204**
Funds from operations in GEL '000s						
Scope-adjusted EBITDA	60,213	82,426	94,271	100,690	117,081	130,204
less: (net) cash interest paid	-15,697	-14,001	-16,064	-19,607	-22,593	-25,206
less: cash tax paid per cash flow statement	0	0	0	0	0	0
Change in provisions	0	0	0	0	0	0
Funds from operations	**44,516**	**68,425**	**78,207**	**81,083**	**94,488**	**104,997**
Free operating cash flow in GEL '000s						
Funds from operations	44,516	68,425	78,207	81,083	94,488	104,997
Change in working capital	6,894	16,373	-2,177	12,973	9,077	7,159
Non-operating cash flow	4,964	3,525	4,101	0	0	0
less: capital expenditure (net)	-21,714	-36,083	-46,137	-60,000	-80,000	-95,000
less: operating lease payments	-23,095	-24,461	-25,260	-27,633	-29,015	-30,465
Free operating cash flow	**11,565**	**27,779**	**8,734**	**6,423**	**-5,450**	**-13,309**
Net cash interest paid in GEL '000s						
Net cash interest per cash flow statement	15,697	14,001	16,064	19,607	22,593	25,206
Change in other items	0	0	0	0	0	0
Net cash interest paid	**15,697**	**14,001**	**16,064**	**19,607**	**22,593**	**25,206**
Scope-adjusted debt in GEL '000s						
Reported gross financial debt	168,392	162,249	176,737	200,884	223,562	271,205
Other items[1]	10,000	10,000	10,000	10,000	10,000	10,000
Scope-adjusted debt	**178,392**	**172,249**	**186,737**	**210,884**	**233,562**	**281,205**
Cash for information purposes only	18,651	35,474	17,632	47,670	30,231	23,381

[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.

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 will likely 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 uses 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.

Clarity and transparency

Our previous rating actions flagged transparency issues including the ability to communicate and the timeliness of financial disclosures. We note that information flows between management and us has since improved. Further, our concerns over governance and transparency have faded.

Efficiencies

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

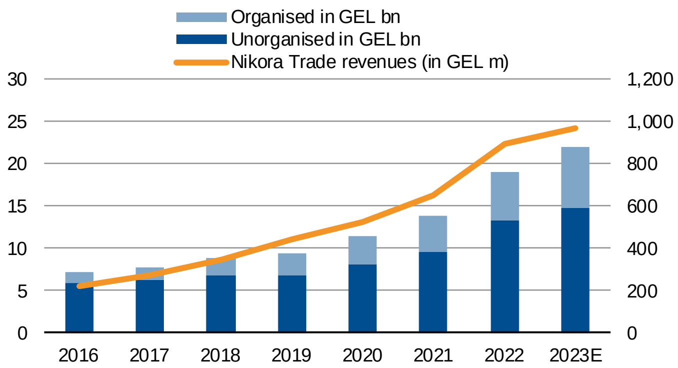
Significant size in Georgia but very limited size at a European scale

Nikora Trade, while dominating its home market of Georgia, is small in a European context in terms of size and operational scale (GEL 895m in revenues in 2022 or around EUR 310m). This aspect remains a negative driver of the business risk profile, despite the opening of new stores helping to consolidate the issuer's top position in Georgia.

Dominant player on Georgian retail market

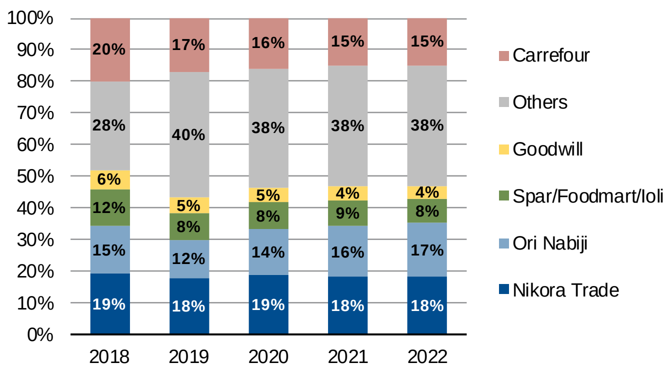
In the Georgian retail market, the issuer is the largest with about a 18% market share in terms of sales. Carrefour used to lead the market with 20% in 2019, but this reduced to only 15% as at YE 2022; it now ranks after Nikora, Ori Nabiji and Spar. Nevertheless, local competition remains intense, but Nikora Trade could still gain market share in unorganised regions, especially outside the Georgian capital. This will be core to the issuer's medium-term strategy.

Figure 1: Retail market structure in Georgia and Nikora Market revenues evolution



Sources: TBC Capital, Nikora Trade, Scope

Figure 2: Retail market shares in Georgia by sales



Sources: TBC Capital, Nikora Trade, Scope

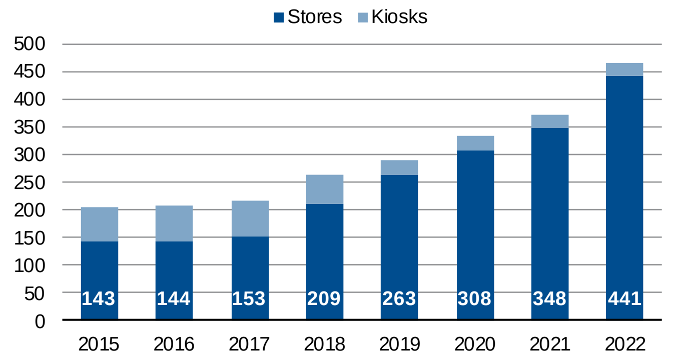
Regulatory environment

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, and we believe any regulatory action will likely weaken the unorganised market (neutral ESG rating driver) and consolidate Nikora Trades' market share.

Stable top line performance

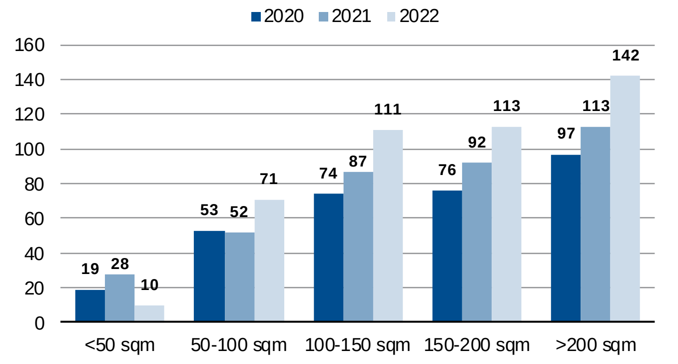
The group's strategy to direct resources towards opening new stores continued to strengthen revenues in 2022, with 38% YoY growth. This was further supported by: i) the pass-through of input costs to customers; ii) solid purchasing power after average wage growth surpassed core inflation; iii) ongoing migration from bordering countries, mainly Ukraine, Russia and Belarus; and iv) the gradual substitution of unorganised fast-moving consumer goods retailers. Operating results strengthened between H1 2023 and H1 2022, with higher absolute Scope-adjusted EBITDA and a 40% YoY increase in revenues.

Figure 3: Nikora Trade stores chain development



Sources: Nikora Trade, Scope

Figure 4: Nikora Trade stores based on trading area



Sources: Nikora Trade, Scope

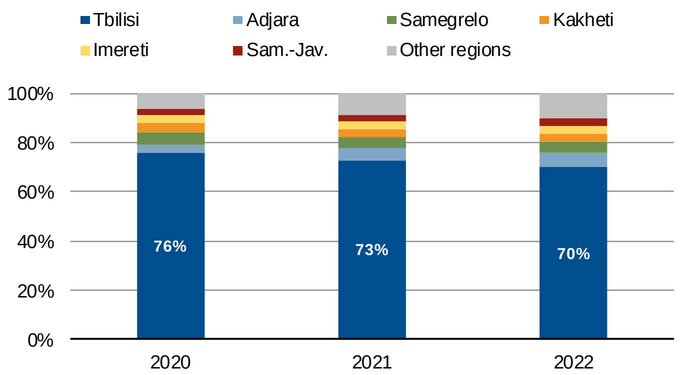
Low country retail strength

The country retail strength of the company's operations 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

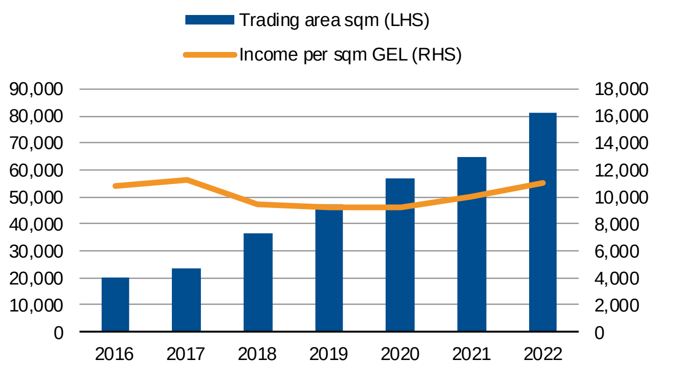
Diversification remains one of the weakest elements in Nikora Trade's business risk profile, and a negative rating driver, explained by the sole exposure to the Georgian market, which makes it more vulnerable to domestic macroeconomic risks.

Figure 5: Nikora Trade's sales split by regions in Georgia (%)



Sources: Nikora Trade, Scope

Figure 6: Nikora Trade total trading area vs income per sqm



Sources: Nikora Trade, Scope

Georgian economy to mark positive growth in 2023 and 2024 with headline inflation below target

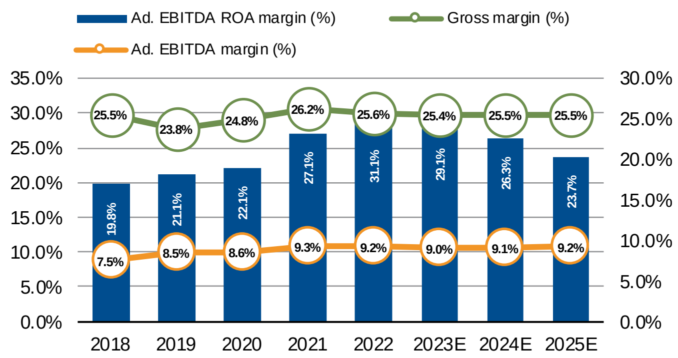
Russia's full-scale invasion of Ukraine in 2022 has increased economic uncertainties for the Georgia given its strong economic links with both Russia and Ukraine. Nevertheless, we expect Georgian's economic growth to remain solid in 2023 and 2024 at 7.5% and 6.1% respectively. Headline inflation in 2023 has rapidly eased to 0.6% YoY in June 2023, below the 3% target. The National Bank of Georgia expects inflation to average 2.5% over 2023.

Heightened geopolitical risks relevant for Georgia

We also highlight the country's latent geopolitical risk after Russia's military escalation in Ukraine, mainly for raw materials and food imports. Nevertheless, Nikora Trade's management has confirmed that main suppliers continue to be reliable and supply chains have not seen significant disruptions.

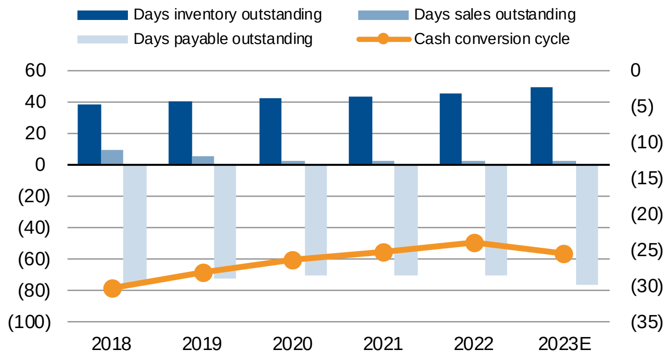
Nikora has also turned to Poland, Türkiye and Brazil to diversify its supplier base, but this has come at an increased cost. However, we highlight that the issuer has shown a capacity to maintain gross margins, even in difficult environments.

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. Our view is supported by i) the historically stable gross margins at about 25%, thanks to a vertical group structure with advantageous commercial terms; ii) its ability to pass on input costs to customers; and iii) the strong organic growth strategy, confirmed by store openings in 2022 and H1 2023, which should enhance its bargaining power and potentially lead to synergies and higher margins.

Ability to pass on cost increases to customers

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

We expect no 'sticker shock' for Nikora Trade products as its main products are non-discretionary with low cyclicality. The inventory shrinkage and obsolete inventory costs remain at 2% of sales, which decrease gross margins by 200 bp (negative ESG rating factor).

Our rating scenario sees Scope-adjusted EBITDA maintained at around 9% and the Scope-adjusted EBITDA return on assets to gradually reach and be maintained at around 25%.

Financial risk profile: BB-

Adjustments and assumptions

Our adjustments include the following key elements:

- Gross debt includes short- and long-term lease obligations.
- Available cash and cash equivalents are excluded from Scope-adjusted debt. This is because cash could still be restricted if the commercial terms of suppliers changed, or supply chains were disrupted.
- Free operating cash flow has been adjusted for lease repayments, capex, and dividends on preference shares.

Faster-than-expected deleveraging

Nikora Trade's financial risk profile has been revised to BB- from B+, reflecting the issuer's strong operating performance, thanks to a sound cash conversion cycle reflected in substantial cash generation. The company's strong growth helped credit metrics to strengthen. Leverage in 2022 decreased towards 2.0x (from 3.0x in 2021) and funds from operations above 30%, the result of solid EBITDA growth in absolute terms coupled with foreign exchange gains on USD-denominated lease liabilities.

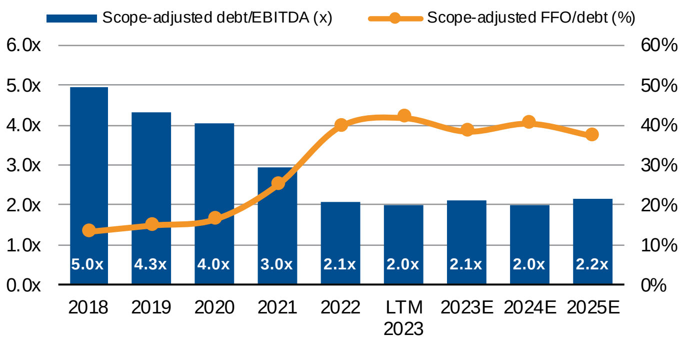
Heavy foreign exchange dependence

Nikora Trade's indebtedness has remained largely stable, consisting of bank credit, bonds and leases. Leases still make up much of reported gross debt, about 70% at YE 2022. The company also entered into more leases, mainly for the store openings.

Our rating scenario sees leases remaining in the 70%-73% range, based on more stores opening in the short to medium term. In addition, 70% of the leases are denominated in US dollars, creating a foreign exchange exposure. In 2022, the foreign exchange effect was positive, leading to a GEL 13m gain that was partially offset by an increase of GEL 11m due to the effects of lease terms negotiations in 2021 being reflected in 2022.

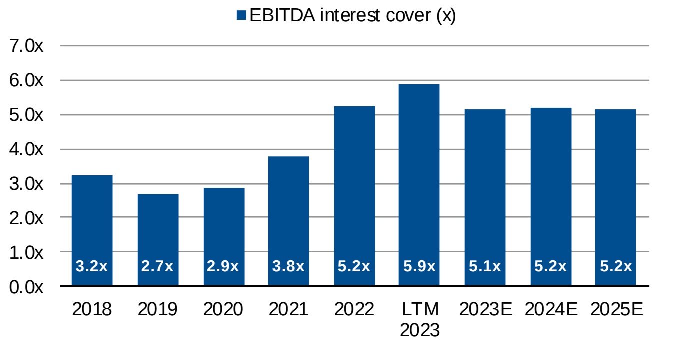
Management intends to balance lease agreements with fixed and variable payment terms. In 2022, 75% of payments were fixed, 16% related to turnover and 9% hybrid. In addition, the US dollar leases have currency hedging requirements. Even so, many of the leases are heavy influenced by foreign exchange movements, which could affect cash flow and thereby constrain the financial risk profile assessment.

Figure 9: Leverage



Sources: Nikora Trade, Scope estimates

Figure 10: Interest cover



Sources: Nikora Trade, Scope estimates

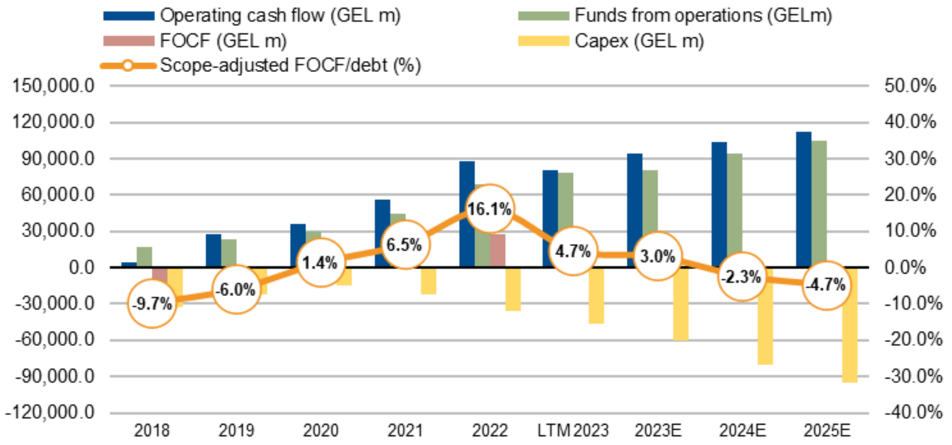
Fast deleveraging due to strong EBITDA growth in absolute terms

The issuer's fast deleveraging has been a key positive driver of the financial risk assessment. Leverage, exemplified by Scope-adjusted debt/EBITDA, decreased to 2.1x thanks to strong EBITDA growth. We expect leverage to stay at around 2.0x, driven by solid operating performance, already evident in the growth momentum during H1 2023. We do not expect indebtedness to significantly increase, including through new leases. Additionally, we expect Scope-adjusted funds from operations/debt to follow a similar trend to stay above 30% in 2023.

Interest rates to slightly decrease

EBITDA interest cover also improved in FY 2022 thanks to EBITDA growth and stable interest expenses, increasing to 5.0x. We expect the ratio to remain at these levels into 2025. This will be supported by an expected easing of inflation, a looser domestic monetary policy, and our expectation that the bond maturing in 2024 will be refinanced at a similar or lower rate.

Figure 11: Cash flow cover



Sources: Nikora Trade, Scope estimates

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

Cash flow cover remains the weakest element of the financial risk profile despite the strong cash flow conversion cycle in 2022. Capex towards expanding the store network will continue to hamper the metric. However, the company's scale and flexibility in terms of capital spending is beneficial. Therefore, we have not overweighted this metric in the analysis.

We expect capex of around GEL 220m during 2023-2025. This is higher than management guidance and based on the planned store openings. This amount of capex would cause cash flow cover to rapidly decrease below 5%, already observed in H1 2023 with free operating cash flow at around 4%.

Inadequate liquidity

Liquidity is inadequate, despite being well above expectations in 2022 due to the strong results. From 2023, we expect negative free operating cash flow and the high short-term debt to continue to strain liquidity. The GEL 10.6m committed credit line remains undrawn as of 2022.

We estimate accessible balance sheet cash to remain at around GEL 3.5m, similar to historical levels. However, we do not see cash as permanent in today's market environment as the commercial terms of suppliers could quickly change or supply chain disrupted.

The refinancing of the bond in 2024 is expected as the company benefits from durable relationships with banks and a better-than-expected credit profile.

Balance in GEL '000s	2023E	2024E	2025E
Unrestricted cash (t-1)	3,500	3,500	3,500
Open committed credit lines (t-1)	10,600	10,600	10,600
Free operating cash flow	6,423	-5,450	-13,309
Short-term debt (t-1)	1,227	38,455	3,500
Coverage	**>200%**	**22%**	**23%**

Supplementary rating drivers: +/- 0 notches

Credit-neutral supplementary rating drivers

Previous rating actions flagged issues about the company's transparency. We highlight that the flow of information between management and us has improved, and concerns related to corporate governance are fading (neutral ESG rating driver).

Long-term debt rating

Senior unsecured debt rating: BB-

We have affirmed senior unsecured debt at BB-, 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.

Appendix: Peer comparison

	Nikora Trade JSC	Tegeta Motors LLC	Nikora JSC	Georgian Beer Company JSC	Evex Hospitals JSC
	BB-/Stable	BB-/Negative	BB-/Stable	BB-/Stable	BB/Stable
Last reporting date	1 Sep 2023	5 Oct 2022	1 Sep 2023	6 Oct 2022	5 Jun 2023
Business risk profile	**BB-**	**BB-**	**BB-**	**BB-**	**BB**
Market share	18%	18%	19%	23%	18%
Scope-adjusted EBITDA	GEL 82.4m	GEL 88.0m	GEL 118.0m	GEL 17.1m	GEL 52.0m
Scope-adjusted EBITDA margin	9%	11%	12%	22.05%	20%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**BB-**	**BB-**	**BB-**	**BB-**	**BB**
Scope-adjusted EBITDA/interest cover	5.0x	3.9x	5.0x	2.8x	2.1x
Scope-adjusted debt/EBITDA	2.1x	3.1x	2.0x	3.0x	3.7x
Scope-adjusted funds from operations/debt	39%	24%	39%	21%	14%
Scope-adjusted free operating cash flow/debt	16%	4%	8%	12%	-4%
Liquidity	Inadequate	Adequate	Inadequate	Inadequate	Adequate

* Financial risk profile metrics are presented as average of projections

Sources: Public information, Scope

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