Tegeta Motors LLC
Georgia, Retail

SCOPE BB- STABLE

Corporate Profile

Tegeta Motors LLC (Tegeta) is a Georgian retailer specialising in the sale of cars, car parts and special vehicles. The company has a large footprint in Georgia with 20 service centres and five retail outlets spread across every region. Thanks to numerous commercial agreements with international leaders in the automotive sector, Tegeta has developed swiftly in most of its retail segments.

Key metrics

			Scope estimates		
Scope credit ratios	2019	2020	2021E	2022E	2023E
EBITDA/interest cover	2.9x	4.1x	3.8x	2.3x	2.7x
Scope-adjusted debt (SaD)/EBITDA	4.8x	3.0x	3.0x	3.9x	3.9x
Scope-adjusted funds from operations/SaD	14%	25%	24%	12%	16%
Free operating cash flow/SaD	-6%	-1%	-6%	13%	0%

Rating rationale

Scope Ratings GmbH has today affirmed its BB-/Stable issuer rating on Tegeta Motors LLC. Scope has also affirmed its BB- rating on the senior unsecured debt category.

The affirmation is driven by the company's solid development despite constrained operations during lockdowns. As anticipated, Tegeta's overall top line remained in the positive growth area in 2020, benefitting from revenue backlogs from bus and heavy vehicle tenders, while other business line revenues dropped by 10% YoY in 2020. The company is currently in the process of issuing a new bond in the amount of GEL 50-60m, which we expect to improve its liquidity profile.

Outlook and rating-change drivers

The Outlook is Stable and reflects our expectation of the successful placement of the additional GEL 50-60m senior unsecured bond. A successful bond placement would remove Tegeta's dependence on short-term funding and dispense with potential liquidity concerns that would otherwise exist. The Outlook also incorporates our expectation that sales will continue to grow at a low double-digit percentage with modest working capital and capital investments. We do not expect any M&A activity in the short term.

A positive rating action could be the consequence of funds from operations (FFO)/Scope-adjusted debt (SaD) above 30% on a sustained basis. This could be achieved if Tegeta deleverages while maintaining relatively high EBITDA. A positive rating action could also be warranted if the company grows significantly in size.

A negative rating action could result from a deterioration in credit metrics as indicated by negative free operating cash flow on a sustained basis or SaD/Scope-adjusted EBITDA increasing above 4.0x on a sustained basis. Weak financial performance could be triggered by the delayed collection of scaled project-related funds or higher-than-expected capital expenditure. A negative rating action could also be indicated by inadequate liquidity, which could result from the unsuccessful placement of an additional bond.

Ratings & Outlook

Corporate rating	BB-/Stable
Senior unsecured rating	BB-

Analyst

Zurab Zedelashvili
+49 69 667738 947
z.zedelashvili@scoperatings.com

Related Methodology

Corporate Rating Methodology: July 2021

Rating Methodology: Retail and Wholesale Corporates March 2021

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Tel. + 49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant national market positioning, with leading market shares in business lines leading to potential for significant sales growth • Profitability higher than peers thanks to complementary, well-diversified product portfolio • Modest leverage despite forex risk and guarantees	• Absolute size still small compared to international peers • Weak diversification with operations mainly in Georgia, enhancing vulnerability to macro-changes in the region • Working capital management and investment programme restraining free cash generation • High indebtedness at parent level (TGM Group)

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted FFO/SaD above 30% on a sustained basis • Increase in the company's critical size	• SaD/Scope-adjusted EBITDA above 4x on sustained basis • Negative free operating cash flow • Inadequate liquidity

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	2.9x	4.1x	3.8x	2.3x	2.7x
SaD/EBITDA	4.8x	3.0x	3.0x	3.9x	3.9x
Scope-adjusted FFO/SaD	14%	25%	24%	12%	16%
FOCF/SaD	-6%	-1%	-6%	13%	0%
Scope-adjusted EBITDA in GEL m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	46	75	94	62	69
Operating lease payments in respective year	0	0	0	0	0
Other	0	3	0	0	0
Scope-adjusted EBITDA	46	78	94	62	69
Scope-adjusted funds from operations in GEL m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	46	78	94	62	69
(Net) cash interest as per cash flow statement	-15	-18	-25	-27	-26
Cash tax paid as per cash flow statement	-1	0	-1	-6	-2
Other	0	0	0	0	0
Scope-adjusted FFO	30	60	67	29	42
Scope-adjusted debt in GEL m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	131	162	207	202	197
Cash, cash equivalents	0	-23	-31	-19	0
Other adjustments[1]	86	98	102	57	74
SaD	217	237	278	240	269

[1] Adjustments have been made to historical debt numbers (YE2019 in the table) based on analytical judgment, due to the guarantees and debt at parent (TGM group) level.

Tegeta Motors LLC

Georgia, Retail

Business risk profile: BB-

Credit-neutral industry risk

We see retailers of car parts and automotive vehicles as part of the cyclical retail industry, with medium cyclicality, low entry barriers and low substitution.

Limited size

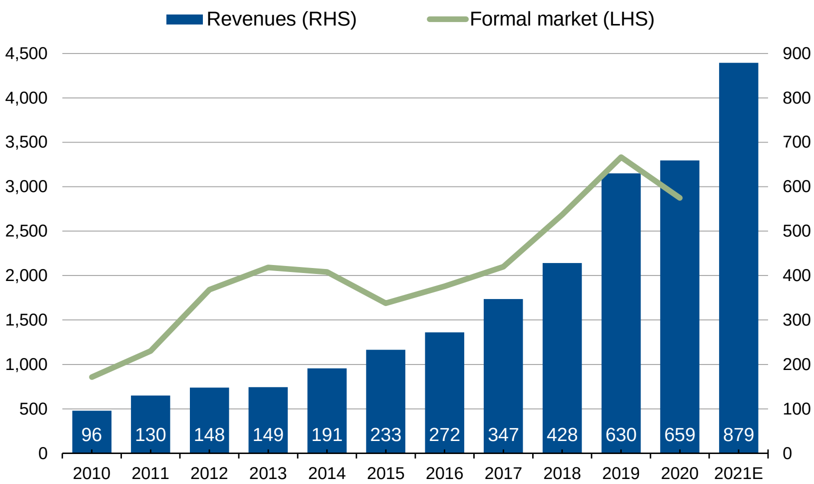
Tegeta is a small player in a European context in terms of its size and scale of operations. Following the introduction of our dedicated sectorial methodology, we assess the company's market shares as constrained by its size (GEL 659m in revenues for FY 2020). Although Tegeta's size is significant in Georgia, this factor restrains its business risk profile. Even if the retailer manages to successfully maintain its number one position in Georgia, it will remain a very small actor on the international auto retail market.

Dominant player on Georgian retail market

Tegeta's business risk profile benefits from a leading position in the Georgian auto retail market in terms of sales with a robust growth track record. This relatively high local market positioning allows the company to benefit from exclusive contracts with world leading brands in the automotive industry. According to management, the other direct competitors (Iberia & GT group) do not represent a serious threat due to: i) their size (revenues of GEL 270m and GEL 67m versus GEL 659m for Tegeta); ii) their regional focus (Tbilisi for both versus the whole country for Tegeta); and iii) the range of products they offer (both focussing on new cars versus the full range offered by Tegeta). The importance of large-scale operations with prudent supply chain management has been confirmed by the post Covid-19 business environment: some domestic competitors have been bankrupted, while Tegeta has managed to keep all business units functional.

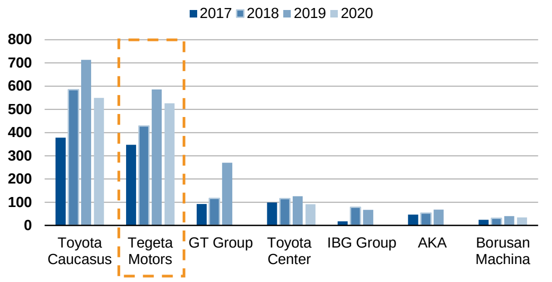
Figure 1: Snapshot of top-line development (GEL m)

	2016	2017	2018	2019	2020
Share in formal market	14%	16%	16%	18%	18%
Share in total market	10%	11%	11%	12%	14%



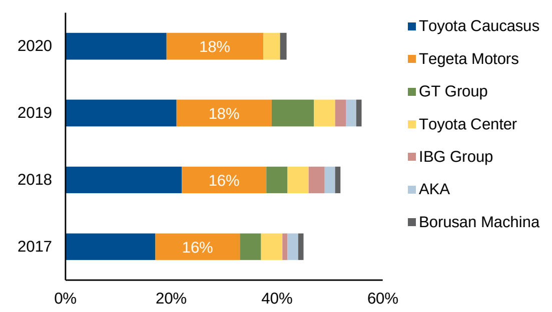
Source: Galt&Tagart, Tegeta Motors, Scope

Figure 2: Development of market peers (GEL m)



Source: Reportal, Tegeta Motors, Scope

Figure 3: Formal auto market shares in Georgia



Source: Galt&Tagart, Reportal, Tegeta Motors, Scope

Sustained business operations during pandemic despite supply bottlenecks

During the lockdown, when regulations were at their strictest and imports were suspended, Tegeta suffered from supply bottlenecks. Now Tegeta is able to serve clients without any major interruptions and a sufficient inventory of stock. In addition, Georgia's fragmented automotive sector means that most of Tegeta's competitors have limited financial flexibility. The company's favourable inventory delivery times thus provide a competitive advantage, which has been confirmed by increased demand for spare parts at FY 2021.

Additional potential for consolidation on underpenetrated market

In FY 2020 the top line decreased by 7% due to cautious spending patterns for new cars. In contrast, H1 2021 results promise top line growth of light vehicle sales by 68% in FY 2021, supported by the ramping up of the newly opened Toyota Batumi Center together with the Volvo center in Tbilisi. Heavy vehicle sales were hit hard by the Covid-19 pandemic, resulting in a drop in total revenue by 16% YoY in 2020. However, we expect the same recovery trend in this business line in 2021 and anticipate an increase in heavy vehicle sales of around 50% YoY in 2021.

Constrained export sales seen asshould be temporary

Tegeta's sales expansion strategy through exports was constrained in 2020 by conflict between neighbouring countries and lockdowns. However, we see this event as temporary and expect export shares to Armenia and Azerbaijan to return to normal in the short term, at around 30% of total export sales.

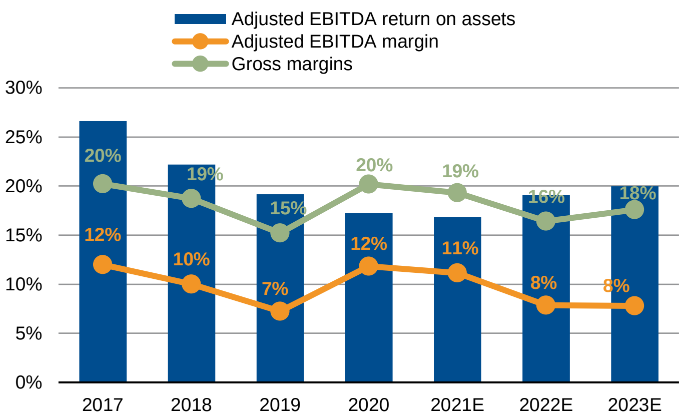
Diversification remains weakest component of business risk profile

Diversification remains one of the weaker elements in Tegeta Motors's business risk profile. There are still limited sales outside of Georgia and distribution channels are not diversified. Despite the recent creation of an e-portal and showroom for online sales, e-commerce related sales remain low. However, we have not placed too much emphasis on weak distribution channels as e-commerce is still in a nascent stage in Georgia.

Broad mix of product portfolio with different cyclicality patterns

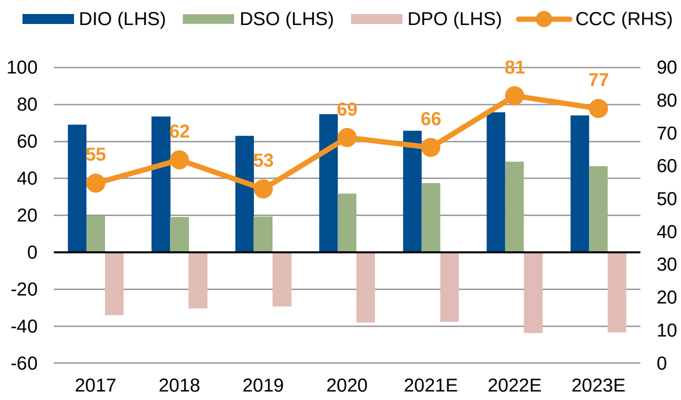
Product diversification is an important factor for Tegeta due to the defence it affords against the economic cycle. Although all of Tegeta's products belong solely to one class of consumer goods (automotive related products), the broad product portfolio is positive as it covers discretionary purchases (cars or similar) and regular purchases (maintenance). The different cyclicality patterns for the goods Tegeta sells are also beneficial, as was confirmed by luxury car sales in FY 2020 when customer spending was minimal. Supplier diversification is weaker than customer diversification, with Toyota remaining the largest supplier for the company.

Figure 4: Operating performance



Source: Tegeta Motors, Scope estimates

Figure 5: Evolution of cash conversion cycle[2]



Source: Tegeta Motors, Scope estimates

Profitability margins are high compared to local sector median

High overall profitability, with a Scope-adjusted EBITDA margin of around 8%-10% in the last five years, supports Tegeta's business risk profile. Increased EBITDA margins for FY 2020-2021 benefitted from euro-denominated heavy vehicle's tenders. These have relatively high margins and a high stock balance, which was purchased at a lower exchange rate and the last batch delivered in H1 2021. According to Tegeta's management, there were additional minor effects such as an increased margin on some products (tyres) due to reduced supply on the market as smaller competitors were unable to cope with

[2] CCC: cash conversion cycle; DIO: days inventory outstanding; DSO: days sales outstanding; DPO: days payable outstanding

challenges posed by the pandemic. Temporary cost containment events, like limited marketing expenses, also positively affected EBITDA. While the intercompany transformation will result in restructuring costs, in line with management projections, we expect operating expenses to remain at the pre-Covid level in medium term (around 8% of sales).

Scope-adjusted EBITDA return on assets is low

We now measure operating efficiency with a newly introduced metric, the Scope-adjusted EBITDA return on assets. This allows us to evaluate how well assets are used to generate a certain EBITDA level. Tegeta's adjusted EBITDA return on assets is gradually increasing and we expect it to remain above 20% going forward, thanks to rapid EBITDA growth.

We believe that Tegeta will be able to keep EBITDA margins at 7%-8% in the medium term. These will be supported by historically stable gross margins of around 25% benefitting from a complementary product portfolio with advantageous commercial terms. The company's growth strategy should also continue to enhance its bargaining power, potentially creating higher margins in different markets.

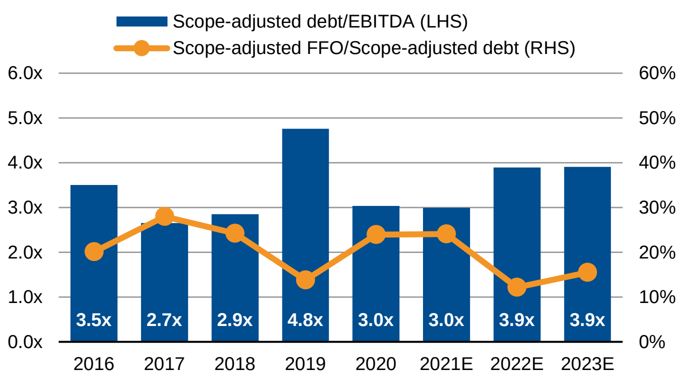
Financial risk profile: BB-

Our assumptions and adjustments

Tegeta's financial risk profile is supported by the high margins of its scaled project business in 2020-2021, reflected in substantial cash flow generation. Higher-than-expected leverage is the result of our SaD calculation, which additionally includes guarantees and financial obligations at parent level (TGM Group). Foreign exchange losses on foreign currency-denominated debt have also increased the company's indebtedness.

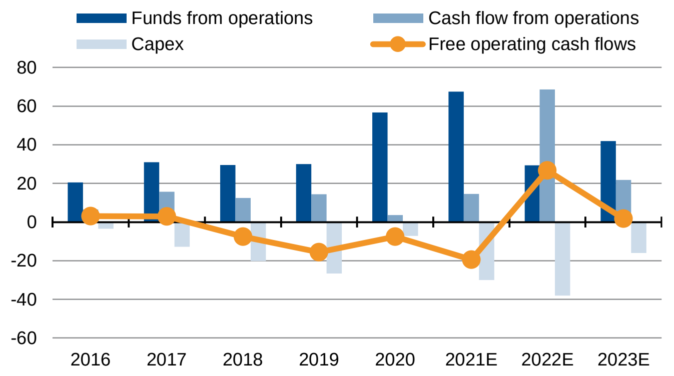
SaD includes the financial liabilities of parent TGM Group as the holding company does not have any regular operations besides investments in sole subsidiary Tegeta Motors LLC and debt is recourse. We expect indebtedness at the parent level to increase at YE 2021 as a result of the additional purchase of shares in Tegeta Motors LLC, made in June 2021. SaD also includes financial guarantees from TBC bank in the amount of around GEL 80m in YE 2020. Guarantees are mainly comprised of letters of credit (payment-related guarantees) and are expected to decrease to GEL 30m going forward as around 60% of guarantees were linked to the heavy vehicles tender delivery which was fulfilled in H1 2021. We expect EBITDA to drop by around 30% at YE 2022 (to GEL 62.0m from GEL 94m) due to the completion of the heavy vehicles tenders delivery in FY 2021. Together with still elevated SaD, this should lead to a deterioration in both leverage metrics in medium term. We expect SaD/EBITDA to peak at 3.9x at YE 2022 versus 3.0x at YE 2021 and FFO/SaD to drop to 12% versus 24% the year before.

Figure 6: Leverage



Source: Tegeta Motors, Scope estimates

Figure 7: Cash flow cover (GEL '000)



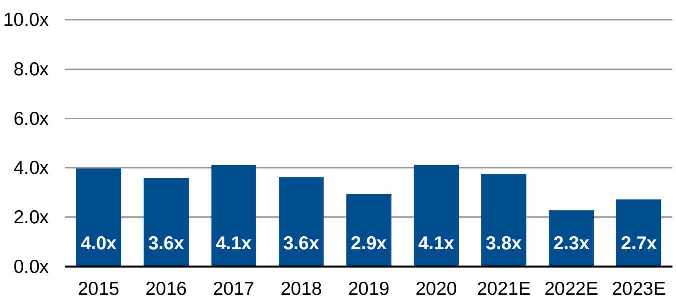
Source: Tegeta Motors, Scope estimates

As the cost of debt is relatively high in Georgia, we expect the new debt issuance to increase pressure on EBITDA interest coverage. We expect the ratio to remain at a modest level, above 2.0x in 2021-2023, supported by a proven track record of increased EBITDA.

In light of Tegeta's expansion strategy, it is likely that the company will continue to invest in new projects while increasing inventory levels. However, operating cash flow will benefit from cash inflows from heavy vehicle tenders in Q1 2022. We expect free operating cash flow/SaD to recover somewhat in the medium term and our rating case incorporates positive free operating cash flows in 2022-2023.

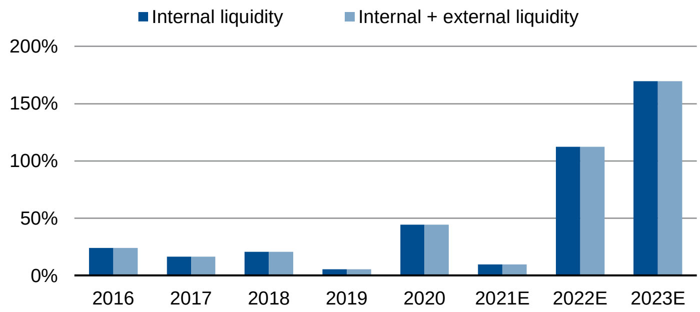
While cash flow cover is the weakest element of Tegeta's financial risk profile, we note the company's financial flexibility in terms of capex spending. The maintenance level is around GEL 8m and expansionary investments are at the sole discretion of the company's management without any obligations to invest. Consequently, we have not overweighted this metric.

Figure 8: EBITDA interest cover



Source: Tegeta Motors, Scope estimates

Figure 9: Liquidity



Source: Tegeta Motors, Scope estimates

Improved liquidity profile

Liquidity is adequate. Although liquidity has historically always been inadequate (internal plus external cover below 100%), we expect the issuance of the new bond with a bullet repayment structure to significantly decrease the amount of short-term debt going forward. The anticipated cash buffer of over GEL 30.0m together with positive free operating cash flows appears sufficient to fully cover (re)-financing needs of around GEL 30-40m in short-term debt even without undrawn committed credit lines.

- We expect free operating cash flow to benefit from the collection cash from the heavy vehicle's tender delivery in Q1 2022, which will move the metric into positive territory.
- Liquidity should benefit from the expected new bond issuance in 2021 in the amount of GEL 50-60m as we do not anticipate any refinancing difficulties thanks to Tegeta's well-established relationships with local banks. Cash proceeds will be used to refinance short-term debt.

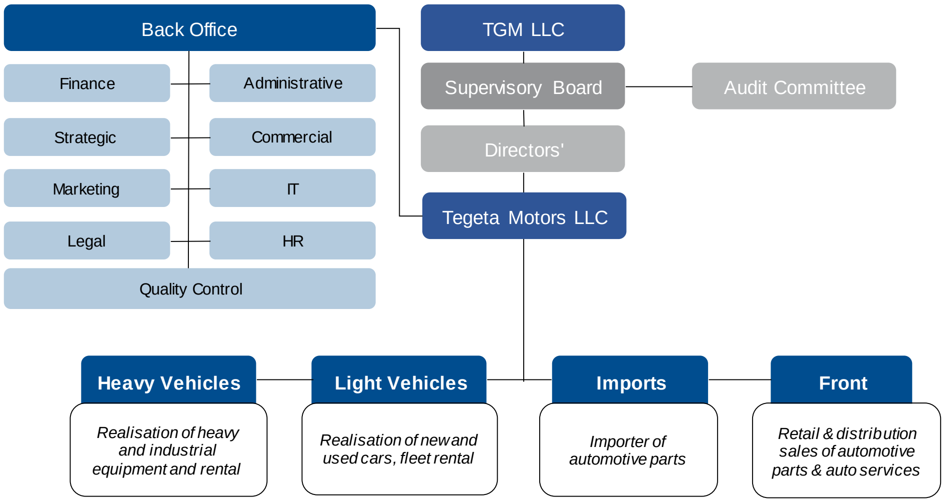
Position	2021E		2022E		2023E	
Unrestricted cash (t-1)	GEL	22m	GEL	38m	GEL	38m
Open committed credit lines (t-1)	GEL	0m	GEL	0m	GEL	0m
Free operating cash flow	GEL	-19m	GEL	27m	GEL	2m
Short-term debt (t-1)	GEL	71m	GEL	31m	GEL	6m
Coverage		**0.1x**		**1.1x**		**1.7x**

Supplementary rating drivers

Supplementary rating drivers are credit-neutral

While no explicit adjustment for supplementary rating drivers has been made, we note that the transformation of Tegeta's organisational structure not only increases transparency but also enhances reporting consistency and operating performance visibility for each company business line. Higher dividend payments are mainly to repay financial liabilities on parent level. We therefore do not consider this to be an aggressive financial policy. A similar transaction already took place in 2021, when dividends were used to repay TGM's loans.

Figure 10: Organisational structure



Source: Tegeta Motors, Scope estimates

Long-term debt rating

Senior unsecured debt affirmed at 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 enterprise value, assuming operation as a going concern, in a hypothetical default scenario in 2023, which assumes outstanding senior secured loans, payables, contract liabilities and guarantees ranked prior to the senior unsecured debt category.

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

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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