4 October 2023 Corporates

Tegeta Motors LLC
Georgia, Retail

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	3.9x	2.6x	3.4x	3.1x
Scope-adjusted debt/EBITDA	3.1x	3.7x	3.2x	3.0x
Scope-adjusted funds from operations/debt	24%	17%	22%	22%
Scope-adjusted free operating cash flow/debt	4%	-6%	1%	2%

Rating rationale

The rating is supported by the strong positioning in the domestic market, underpinned by continuous growth and an agile business model, which has enabled Tegeta to preserve market share and profitability. It is also driven by the wide product offering, which despite belonging to the cyclical retail category, presents better granularity than its competitors, supported by the revenue backlog from bus and heavy vehicles tenders, which over years have ensured recurring revenues, compensating even for the declining consumer demand during the pandemic. The less cyclical nature of after-sale services, which constitute a substantial part of the revenue, provides an additional umbrella against macroeconomic headwinds. The rating is constrained by the small size compared to international peers, poor geographical diversification, focus on emerging markets, and weak free operating cash flow.

Outlook and rating-change drivers

The Outlook change to Stable from Negative reflects the expectation that Tegeta will continue growing its sales at a double-digit percentage, thus keeping credit metrics stable, despite potential risk arising from negative FOCF and refinancing needs. It also incorporates our view that the current Georgian political and economic environment will help the issuer to keep stable operating costs (low inflation) and cost of debt at current or lower levels, thus relieving pressure from leverage and interest cover.

A positive rating action could result from Scope-adjusted debt/EBITDA declining below 3x on a sustained basis combined with a sustained improvement in cash flow. This could be achieved via deleveraging while maintaining a high EBITDA. A positive rating action could also be warranted if the company were to increase export sales significantly, leading to higher diversification.

A negative rating action could result from a deterioration in credit metrics as indicated by Scope-adjusted debt/EBITDA increasing above 4.0x on a sustained basis. Weak financial performance could be triggered by an adverse change in the operating environment with muted sales growth pressuring operating profitability.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
04 Oct 2023	Outlook change	BB-/Stable
05 Oct 2022	Outlook change	BB-/Negative
04 Nov 2021	Affirmation	BB-/Stable

Ratings & Outlook

Issuer BB-/Stable

Senior unsecured debt BB-

Analyst

Claudia Aquino
+49 30 2789 1599
c.aquino@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2023

European retailers: persistent inflation, low consumer confidence threaten demand, squeeze margins; June 2023

Retailing bankruptcy risk grows in Europe: business failures to rise after slowdown in 2021-2022; April 2023

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Dominating market share in the domestic market • Profitability higher than peers thanks to complementary product portfolio • Credit metrics on relatively good level	• Low geographical diversification by being mainly present in Georgia and Caucasian region • Execution risks linked to the activity in emerging markets • Investment strategy restrains free cash flow generation

Positive rating-change drivers	Negative rating-change drivers
• Improved cash flow and Scope-adjusted debt/EBITDA below 3x on a sustained basis • Improved diversification	• Scope-adjusted debt/EBITDA above 4x on sustained basis

Corporate profile

Tegeta Motors is a holding company operating new car and spare parts retailing (auto tires, lubricants, accumulators and other spare parts), as well as providing vehicles maintenance and repair through servicing facilities located in different regions of Georgia. The Company owns twelve regional retail outlets and servicing facilities around Georgia and an administrative office in Tbilisi. Through its subsidiaries, Tegeta is the official retailer of Mazda, Toyota, Volvo and Porsche cars well as services ManTruck & Bus AG (sale and aftersales of bus, tracks and specialised equipment) and JCB and DRESSTA (road and construction equipment). Tegeta is the largest importer of more than 300 leading automotive brand in Georgia and the largest automotive company in the Caucasus and Central Asia.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022P**	**LTM 2023**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	3.9x	2.6x	3.7x	3.4x	3.1x	3.2x
Scope-adjusted debt/EBITDA	3.1x	3.7x	3.0x	3.2x	3.0x	2.8x
Scope-adjusted funds from operations/debt	24%	17%	26%	22%	22%	24%
Scope-adjusted free operating cash flow/debt	4%	-6%	16%	1%	2%	4%
Scope-adjusted EBITDA in GEL m						
EBITDA	89	96	148	140	152	173
Operating lease payments	0	0	0	0	0	0
Other items[1]	-1	-1	-1	0	0	0
Scope-adjusted EBITDA	**88**	**95**	**147**	**140**	**152**	**173**
Funds from operations in GEL m						
Scope-adjusted EBITDA	88	95	147	140	152	173
less: (net) cash interest paid	-23	-37	-39	-41	-50	-54
less: cash tax paid per cash flow statement	-1	1	3	-2	-1	-2
Funds from operations (FFO)	**64**	**59**	**111**	**97**	**101**	**117**
Free operating cash flow in GEL m						
Funds from operations	64	59	111	97	101	117
Change in working capital	-24	21	20	-40	-27	-21
Non-operating cash flow	0	-46	-13	0	0	0
less: capital expenditure (net)	-23	-44	-43	-46	-59	-73
less: lease amortisation	-5	-12	-7	-5	-5	-5
Free operating cash flow (FOCF)	**12**	**-22**	**68**	**6**	**10**	**18**
Net cash interest paid in GEL m						
Net cash interest per cash flow statement	23	37	39	41	50	54
Net cash interest paid	**23**	**37**	**39**	**41**	**50**	**54**
Scope-adjusted debt in GEL m						
Reported gross financial debt	201	305	405	393	436	470
less: cash and cash equivalents	-30	-20	-28	-25	-54	-66
add: non-accessible cash	0	0	0	0	0	0
less: guarantees	71	37	31	37	37	37
Other items[2]	28	28	28	47	41	41
Scope-adjusted debt	**270**	**350**	**436**	**452**	**460**	**482**

[1] Loss/gain on fixed assets
[2] Off balance sheet guarantees

Table of Content

Environmental, social and governance (ESG) profile[3]

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)

ESG considerations

During 2020, the group went through an agile transformation to increase the effectiveness of its management and operations. As a result, the operations of the group have been partially reallocated from the company to its subsidiaries. The agile transformation had no effect on the consolidated financial statements of the group.

As a retailer and wholesaler of automotive vehicles and parts, Tegeta is exposed to environmental risk due to the regulatory pressure for carbon-neutral vehicles. Although the pursuit of zero emissions is directly driven by the manufacturers, dealerships' strategy should directly depend on and align with the OEMs; car dealerships must therefore constantly re-assess the sustainability of their products and supply chain. Tegeta's strategy towards carbon emission reduction includes: i) the establishment of the first hub for electric car services in the Porsche Center Tbilisi, offering sales of electric vehicles and charging stations; ii) electric trucks usage to transfer vehicle parts within the territory; iii) being engaged in the global project Eco Challenge 2050 to promote the sale of hybrid cars.

We note that the flow of information between management and the rating agency was often very slow. In addition, the audited statements for 2022 were received after the rating assessment, as those were being audited after a change of auditor. (Nonetheless audited figures were in line with preliminary figures on which the rating case is based). Although this has not led to any rating impact yet, we highlight this as a governance concern, which will be watched closely going forward.

---

[3] 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-

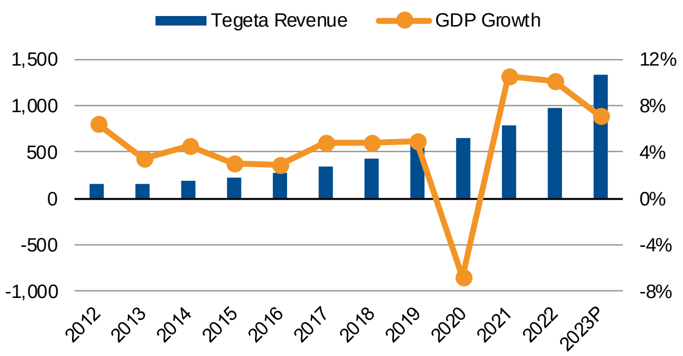
Industry risk profile: BB

We assess the industry risk profile of automotive retailers as BB, based on medium cyclicality, low entry barriers and low substitution risk.

Strong positioning in the domestic market

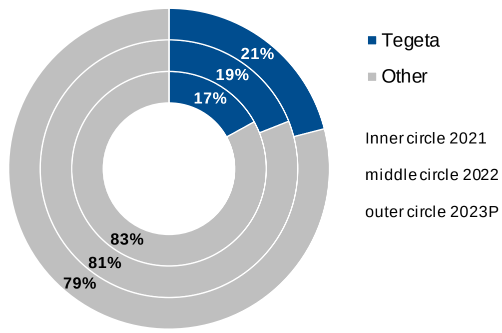
Tegeta's business risk profile, assessed at BB-, benefits from a strong position in its domestic market. The issuer has established itself as the largest automotive retailer in Georgia, holding a solid market share in each subsector of operations. While the Georgian auto market is small and highly fragmented, with Tegeta being ca. 23x times larger than the second market player, we deem competition risk to be rather low, as thanks to its size Tegeta is advantaged in winning exclusive brand contracts and large tenders. The issuer's ability to keep a large stock, while negatively weighting on the working capital, represents an additional competitive strength, when it comes to making discretionary B2B sales to neighbouring countries.

Figure 1: Tegeta Motors top-line vs. real GDP growth development



Sources: Tegeta Motors, Scope estimates

Figure 2: Evolution of Tegeta Motors' market share



Sources: Tegeta Motors

… small size compared with international peers

The size of Tegeta Motors (GEL 950m revenue in 2022, corresponding to about EUR 340m) while significant in Georgia, is limited in the international retail contest. Tegeta's small scale makes it vulnerable to external factors and the economic cycle and might limit the access to external financing and economies of scale, compared to large international players, in the issuer's expansion outside of Georgia.

… focus on Caucasian regions entails diversification risk

The geographical diversification is limited as Tegeta generates most of its revenue in Georgia and the Caucasian region, exposing the business to the highly volatile economic conditions of the emerging markets. Nonetheless the issuer has a major project to expand its presence outside of the Caucasian region through joint ventures, thus limiting investment risk.

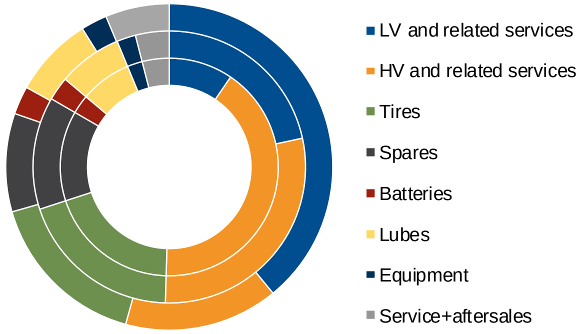
… however, offering of less cyclical products ensures stability

Likewise, product diversification is weak as all products belong to the auto segment, which is considered cyclical. However, the mix of products within this segment is competitive compared to other national retailers, which mostly focus on car sales. Tegeta offers part and accessories as well as repair and maintenance services, which in 2022 were 46% of total revenue. We deem these products to be less sensitive to the economic cycle and able to generate higher margins. Moreover, the presence in all the consumer segments: the premium with Volvo and Porsche, the volume brands (e.g. Toyota) and the low price (e.g. Mazda) ensures a full market coverage.

Figure 3: Tegeta's Geographical presence

Sources: Tegeta Motors

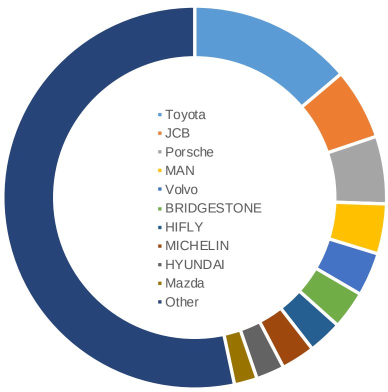
Figure 4: Sale split by product category (inner circle - FY 2020, middle circle - FY2021, outer circle - FY 2022)



Sources: Tegeta Motors

Tegeta's customer portfolio is highly granular. As for most car retailers, the main demand comes from private buyers, on the other side Tegeta benefits from a good percentage of deals (fleet sales and lease sales) with corporate and government institutions which reduce the risk of cash flow volatility and over time has ensured recurring revenues. In terms of suppliers, Toyota represents 14% of sales, with the second top suppliers (JCB and Porsche) representing 6% of sales; while we recognise there is still a dominance of Toyota, we believe there is no dependency on the manufacturer; should Toyota decide to cancel the franchise agreement (unlikely) or change its business model in the future, we believe the issuer would be quickly able to compensate the loss of revenue.

Figure 5: Tegeta's top ten suppliers (% revenue 2022 FY)



Sources: Tegeta Motors, Scope

High profitability margin compared to sector peers

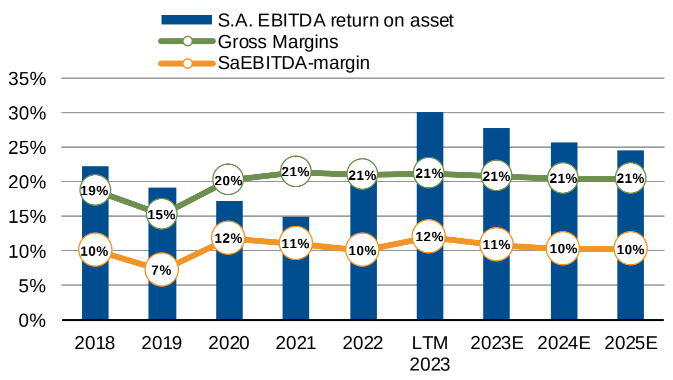
Tegeta's profitability is the major driver of the business risk profile. With Scope-adjusted EBITDA margins averaging 10% over 2015-2021, the issuer performs above the automotive sector average, typically a low margin sector. While 2020 and 2021 were exceptional, with profit margins of 12% and 11% respectively, driven by a euro-denominated heavy vehicle tender, in 2022 the margin decreased to 10%, affected by the increase in general expenses. In 2023 we expect higher growth from the main business line, driven by export sales to neighbouring countries, especially Armenia, Kazakhstan and Kyrgyzstan, which cannot currently import from Russia. In H1 2023 the sales grew by 73% compared to H1 2022; the growth was the effect of the stable political and economic environment, the continuation of the war and the backlog of orders from the prior year (in 2022, due to logistics constraints, many orders could not be delivered in Europe), driving EBITDA to increase by 50% in LTM 2023 compared to FY 2022. In H2 2023 we expect

Tegeta to continue growing, however at a slower pace than H1 2023, as backlog orders stabilise. We anticipate margins to remain at around 10% in the medium term. The assumption is driven by the expectation that revenue will grow in line with the market trend, at around 15%, and inflation will stabilise.

We believe the high profitability is the result of: i) the company benefiting from significant demand for premium products, which have relatively high margins and stock availability; ii) the significant involvement in after-sale services, with typically higher margins compared to vehicle sales; iii) in general, Georgian dealerships have higher margins compared to their European peers; explained by the small market size, with companies enjoying a low level of competition and lower labour and other costs.

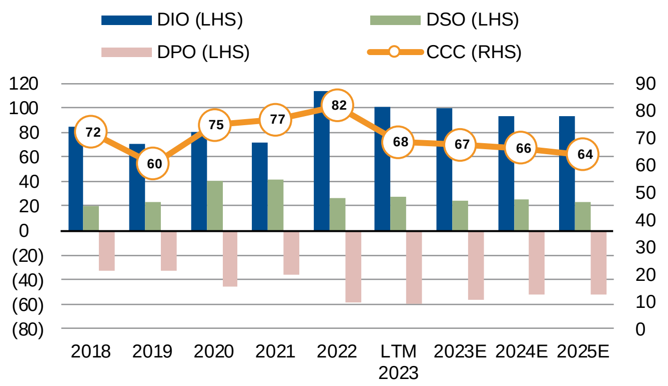
In addition, the profitability benefits from the good macroeconomic environment, reflected in the political stability and the government investments in infrastructure, which favours the automotive business. The Russia-Ukraine war has further boosted domestic sales, as Georgia could take over a large part of the two countries' business in Georgia.

Figure 6: Tegeta Motors operating profitability overview



Sources: Tegeta Motors, Scope estimates

Figure 7: Cash conversion cycle overview



Sources: Tegeta Motors, Scope estimates

Financial risk profile: BB-

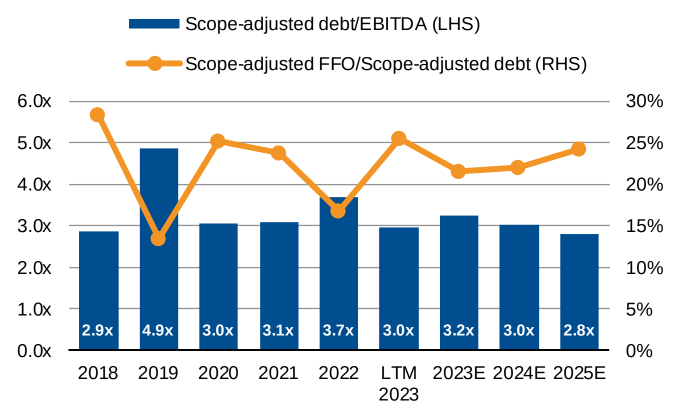
The financial risk profile is assessed at BB-, compared to previous assessment at B+.

Leverage increased driven by company expansion strategy

Trend to revert driven by EBITDA growth

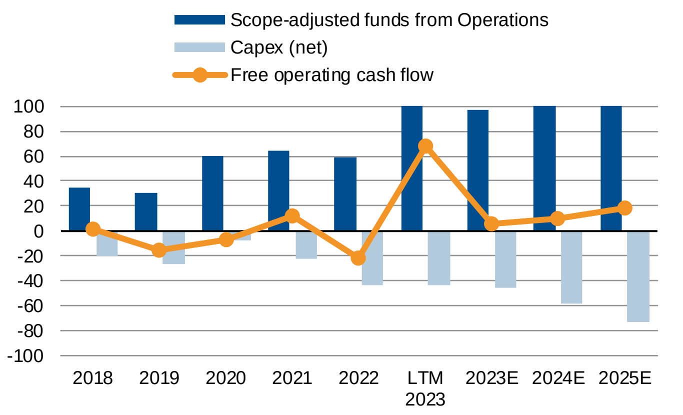
The leverage, measured by the Scope-adjusted debt/EBITDA, suffered from the company's debt-financed growth strategy and profitability growth slowing down in 2022. However, compared to our previous expectation, the issuer was able to maintain the EBITDA at the prior year level, and keep the leverage below 4x. Going forward, we expect the ratio, driven by the sustained profitability, to decrease and remain at around 3x; nonetheless we hint at the execution risk of the company strategy strongly oriented to expansion and the small scale of operations, where a lower-than-expected demand for the second half of 2023 could quickly bring pressure on the EBITDA. Scope-adjusted debt includes the financial liabilities to the subsidiaries 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; it also includes off balance sheet guarantees (ca. GEL 40m), mostly letter of credits issued to support working capital financing.

Figure 8: Leverage



Sources: Tegeta Motors, Scope estimates

Figure 9: Cash flow generation (GEL m)



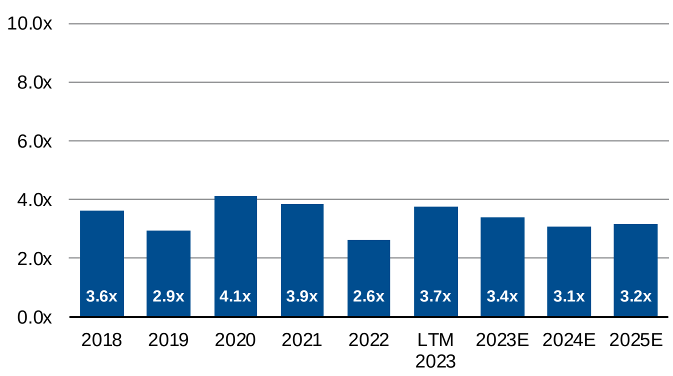
Sources: Tegeta Motors, Scope estimates

Interest cover to remain stable

Following the decrease in debt protection, measured by the Scope-adjusted EBITDA interest cover, and the effect of rising interest rates and new debt issuance, we anticipate the metric to improve and range between 3x and 3.5x, thanks to the EBITDA growth and the stable interest rate environment going forward.

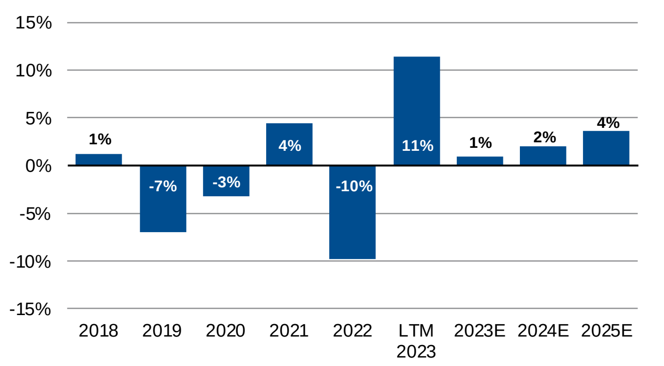
The historically negative free operating cash flow is the weakest point of the financial risk profile. Considering the company's ambition to continue to expand, we anticipate that FOCF will remain around 0. Annual expected capex in the high double-digit million GEL range limits the room for deleveraging. Nonetheless, we highlight that capex programmes mainly relate to the opening of new point of service and/or showrooms and the company has the necessary flexibility to adjust.

Figure 10: Evolution of interest cover



Sources: Tegeta Motors, Scope estimates

Figure 11: Scope-adjusted free operating cash flow/debt



Sources: Tegeta Motors, Scope estimates

Improving but volatile liquidity

While the historical debt structure, heavily relying on short-term debt, combined with the negative FOCF, has weakened Tegeta's liquidity profile, the issuer recently changed its debt composition with the issuance of long-term bonds, and a slight decrease of the short-term debt, which combined with better cash generation, should reduce immediate pressure on the company's liquidity. Furthermore, the substantial amount of light vehicle inventory (20% of inventory value at YE 2022, as confirmed by the management) support the company's liquidity. However, we maintain our view that the liquidity remains volatile, and issues could quickly escalate should the company not generate the expected profits or excessive investments could put further weight on the cash flow.

Balance in GEL m	2022	2023E	2024E
Unrestricted cash (t-1)	37	80	100
20% inventory adjustment	83	56	64
Free operating cash flow	-22	6	10
Short-term debt (t-1)	92	85	79
Coverage	**106%**	**166%**	**220%**

Long-term debt rating

Senior unsecured debt rating: BB-

We affirmed the BB- rating of the senior unsecured debt of Tegeta Motors, consisting of a GEL 150m bond; a GEL 20m green bond (fully subscribed by the Asian Development bank), a USD 20m bond and a EUR 5m bond, all maturing in 2025. Our recovery expectations are based on an estimated enterprise value, assuming operation as a going concern, in a hypothetical default scenario in 2024, which assumes outstanding senior secured loans, payables, contract liabilities and guarantees ranked prior to the senior unsecured debt category. Out calculation results in above average recovery rate; however, given high sensitivity to advance rates, Scope refrained from upgrading the rating.

Appendix: Peer comparison (as at last reporting date)

	Tegeta Motors LLC	Axial Kft	JSC Nikora Trade	Marso Kft.	Autowallis Nyrt
	BB-/Stable	BB/Stable	BB-/Stable	BB-/Stable	B+/Positive
Last reporting date	31 December 2022	31 December 2022	31 December 2022	31 December 2021	31 December 2022
Business risk profile					
Country retail strength	Low	Medium-high	Low	Medium-high	Medium-high
Market position	Strong	Strong	Strong	Strong	Medium
Revenue (in EUR m)	340	381	350	96	700
Consumer good category	Discretionary	Discretionary	Non-discretionary	Discretionary	Discretionary
Geographical exposure	Immediate neighbours	Immediate neighbours	One country	Immediate neighbours	No countries > 70% sales
Product diversification	1 cyclical	1 cyclical	Grocer	1 cyclical	1 cyclical
Profitability assessment	Strong	Strong	Strong	Moderate	Weak
Financial risk profile					
Scope-adjusted EBITDA/interest cover	2.6x	33x	5.2x	15.8x	22.5x
SaD/Scope-adjusted EBITDA	3.7x	0.6x	2.1x	3.7x	3.5x
Funds from operations/SaD	17%	221%	40%	24%	25%
Free operating cash flow/SaD	-6%	78%	16%	-41%	-18%

Sources: Public information, Scope

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

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

Disclaimer

© 2023 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Ratings UK Limited, Scope Fund Analysis GmbH and Scope ESG Analysis GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.