Nikora JSC
Georgia, Retail / Consumer Goods

SCOPE BB- STABLE

Corporate profile

Nikora JSC is the parent company of Nikora Trade. While the latter is only active in the retail sector, holding company Nikora JSC includes additional entities focused on importing, producing and distributing food. Around 23% of Nikora Trade's purchases are made from integrated suppliers belonging to Nikora JSC. The group currently has more than 6,000 employees and is solely focused on Georgia.

Key metrics

			Scope estimates	
Scope credit ratios	2018	2019	2020e	2021e
EBITDA/interest cover (x)	4.4	3.5	2.7	2.8
Scope-adjusted debt (SaD)/EBITDA (x)	3.2	3.4	2.9	2.3
Scope-adjusted FFO/SaD (%)	23	19	21	28
FOCF/SaD (%)	-17	-14	-8	1

Rating rationale

The issuer rating continues to reflect our perception of Nikora JSC as one of the key national players in Georgia's fast moving consumer goods (FMCG) and retail industries. We view comparatively current high profitability and the group's ability to grow as key supports to the rating. Negative free operating cash flow (FOCF) and inadequate liquidity, due to continued reliance on very high short-term credit lines, are negative rating drivers.

The rating benefits from Nikora JSC's dominant market share within Georgia's organised retail segment, bolstered by a considerable shop network (through its daughter company Nikora Trade, rated B+/Stable) and strong fast moving consumer goods producing entities with high national brand recognition. In detail, Nikora Trade has a share of nearly 20% of the modern retail market in the country, spearheaded by a high number of shops across all regions and all formats, ensuring a stable revenue stream. The shop network reinforces the market share of the group's fast moving consumer goods-producing companies, which sell to Nikora Trade among others. Our business risk profile analysis highlights the weight of the group's meat production arm, which is a clear market leader with more than 30% of the national market. Although the rest of the entities are smaller in terms of size, they manufacture a large range of edible products, thus contributing to overall product diversification.

While Nikora Trade remains Georgia's market leader in terms of retail market shares, we expect increasing competition to put pressure on the future profitability of the retailer. Currently high profitability is likely to be traded for the maintenance of large national market shares, leading to a lower cash flow generation ability once the market is more consolidated (in the medium term). We expect the sizes of both Nikora Trade and Nikora JSC to remain small in an international peer comparison, due to their diminished growth prospects in the coming years, despite the expected progressive disappearance of the unorganised retail scene in the country. That said, the growing importance of the retail arm in group sales and EBITDA has led us to underweight the impact of the FMCG segment on the final rating.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured debt	BB-

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Related methodology

Corporate Methodology 2020

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We expect the group's financial risk profile to remain largely unchanged going forward but acknowledge the stronger-than-expected impact of the adoption of accounting rule IFRS16 (operating leases) on credit metrics. Similar to Nikora Trade, interest cover was heavily impacted by the implementation, which caused it to fall to 3.5x in 2019 from 4.4x in YE 2018. We expect the metric to remain under pressure going forward, given the group's financing needs and the increase in the financing rate since our last monitoring review. The inclusion of operating lease obligation repayments and fixed preferred dividends (whose rate is determined by shareholders) in our FOCF calculation has put pressure on the cash flow cover ratio (FOCF to Scope-adjusted debt [SaD]). We anticipate that liquidity will remain inadequate in the coming years, constraining the rating.

Scope notes that the flow of information between management and the rating agency was often very slow. While this has not led to any rating impact so far, it may warrant a downgrade going forward (ESG rating driver).

Outlook and rating-change drivers

The Outlook is Stable and reflects our expectation that credit metrics will remain at the current level for indebtedness: SaD/EBITDA below 4x and funds from operations (FFO)/SaD of over 15%. It also incorporates the expectation that both companies (Nikora JSC and Nikora Trade) will continue to obtain waivers for any potential future covenant breaches and that they will continue operating with very limited liquidity due to a heavy investment phase limiting free operating cash flow generation.

A positive rating action could result from FFO/SaD and SaD/EBITDA above 30% and below 3x respectively on a sustainable basis, with liquidity improving dramatically on a sustained basis. 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 grows significantly in size.

A negative rating action could result from a deterioration in credit metrics as indicated by the FFO/SaD ratio falling below 15% and the SaD/ EBITDA ratio increasing above 4x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominating national market share in both retail and consumer goods sectors, via Nikora Trade and Nikora FMCG • Active on the food retail scene, considered the retail industry subsector least prone to cyclicality • Presence in the two sectors (retail and consumer goods) provides some diversification, despite the large contribution of the retail segment to both revenue and EBITDA	• Relative size for both retail and consumer goods is small if we include the unorganised market • Low liquidity due to the use of short-term funding • Low free operating cash flow (FOCF) due to expansion ambitions • Weak group transparency

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• FFO/SaD above 30%, on a sustainable basis • SaD/EBITDA below 3x, on a sustainable basis	• FFO/SaD below 15%, on a sustainable basis • SaD/EBITDA above 4x, on a sustainable basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
EBITDA/interest cover (x)	4.4x	3.5x	2.7x	2.8x
SaD/EBITDA	3.2x	3.4x	2.9x	2.3x
Scope-adjusted FFO/SaD	23%	19%	21%	28%
FOCF/SaD	-17%	-14%	-8%	1%
Scope-adjusted EBITDA in GEL k	**2018**	**2019**	**2020e**	**2021e**
EBITDA	34,137.0	59,899.0	69,744.3	80,195.2
Operating lease payment in respective year	19,035.0	-	-	-
Scope-adjusted EBITDA	53,172.0	59,899.0	69,744.3	80,195.2
Scope funds from operations in GEL k	**2018**	**2019**	**2020e**	**2021e**
EBITDA	34,137.0	59,899.0	69,744.3	80,195.2
less: (net) cash interest as per cash flow statement	-8,165.0	-17,090.0	-25,987.9	-28,343.8
less: cash tax paid as per cash flow statement	-1,750.0	-2,617.0	-882.4	-882.4
add: depreciation component operating leases	15,228.0			
Scope funds from operations	39,450.0	40,192.0	42,874.0	50,969.1
Scope-adjusted debt in GEL k	**2018**	**2019**	**2020e**	**2021e**
Reported gross financial debt	94,500.0	206,238.0	201,917.0	185,329.8
add: operating lease obligation	76,140.0			
Scope-adjusted debt	170,640.0	206,238.0	201,917.0	185,329.8

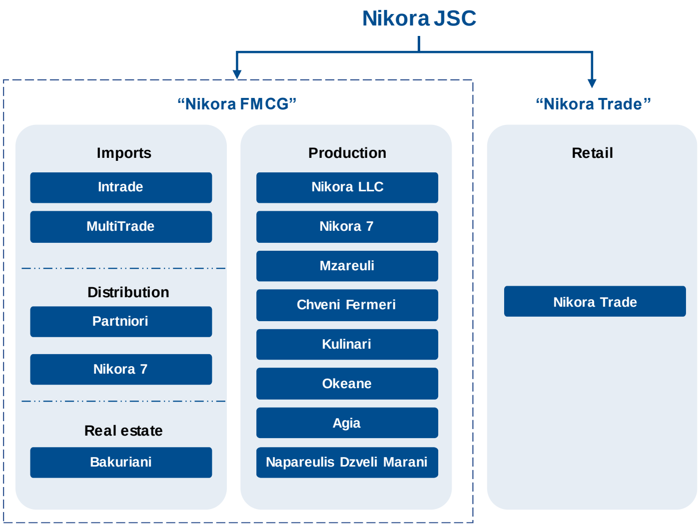
Business risk profile (BB-)

Composition of the holding company

Thanks to its specific structure, Nikora JSC is active into two different industry sectors: retail (Nikora Trade JSC, rated B+/Stable by Scope) and various entities in fast moving consumer goods ('Nikora FMCG') illustrated in Figure 1. In order to rate Nikora JSC's business risk profile, we aggregated all of the fast moving consumer goods producing entities under one name 'Nikora FMCG' and assigned a subrating to this fictive entity. Once each subrating for the business risk profile had been defined, we obtained the final rating by using a weighted average based on the EBITDA of Nikora Trade and Nikora FMCG.

The prevalence of the retail arm in the overall rating of Nikora JSC should be noted. Nikora Trade represented close to 80% of the group's sales and 66% of its Scope-adjusted EBITDA in 2019.

Figure 1: Organigram of the group



Source: Scope, Nikora Trade, Nikora JSC

Figure 2: Nikora Trade's market share

Market shares	2016	2017	2018	2019
Carrefour	26%	24%	20%	17%
Nikora Trade	19%	20%	19%	18%
Ori Nabiji	2%	13%	15%	12%
Spar/Food mart/Ioli	9%	10%	12%	8%
Goodwill	8%	7%	6%	5%
Retail Group	0%	0%	4%	7%
Others	36%	25%	24%	33%

Source: Scope, TBC Bank

Strong market positioning of the two segments

The two companies, Nikora Trade and Nikora FMCG, both benefit from high brand recognition in the country, leading to a relatively high market share in each of their sectors. Nikora FMCG, spearheaded by its meat production arm – Nikora LLC and Nikora 7 – benefits from close to 30% of national meat production. Although they are more minor players on the national scene, the other entities constituting Nikora FMCG make a large range of products, complementing Nikora FMCG's overall offer.

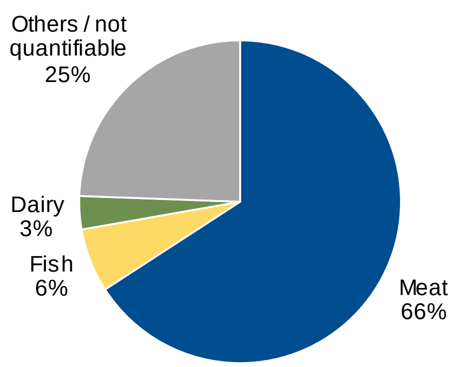
Nikora Trade is the largest retailer in the country in terms of size and market share, having taken first place from Carrefour in 2019. The rapid crowding out of the unorganised market (which represented 72% of the national market in 2019 versus 77% a year before, based on TBC research estimates) is not only spurring the development of retailers in the country but also the competition between them. We expect Nikora Trade to maintain its leadership but forecast slower growth in the coming years in terms of the number of new shops and sales development.

While the two entities appear to be nationally dominant, they remain relatively small in terms of the absolute market (under 5%, according to our estimates of Nikora Trade's market shares). This small size limits potential rating uplift.

Activities in two industries supports diversification

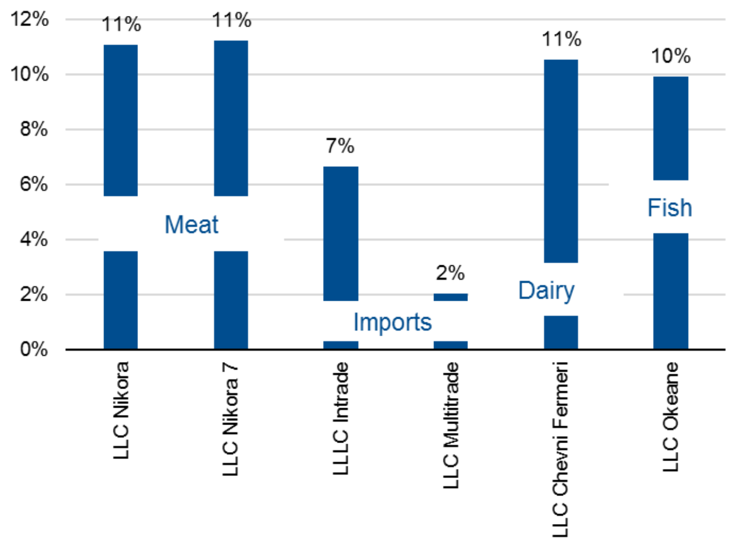
In terms of diversification, Nikora JSC benefits greatly from its footprint in the two sectors of retail and FMCG, decreasing the holding company's overall risk. The combination ensures a vast range of customers (B2C via Nikora Trade through its shops and B2B via the various entities of Nikora FMCG which sell to retailers). Nikora FMCG sells close to 23% of its total products to Nikora Trade. The two entities are 'semi-integrated' but also have commercial agreements with most of the country's retailers, ensuring high overall diversification. We understand that the poorest performing entities can also be transformed into purely private label sources (fully integrated) for Nikora Trade, affording the group increased flexibility to adapt products to customer demand. Diversification is nonetheless constrained by the group's small geographical footprint although it does import raw materials and finished products from abroad. While the sales generated by other distribution channels than the brick and mortar format are negligible, we do not overemphasise this factor due to the very early stage of development of e-commerce, click and collect, and driver delivery in Georgia.

Figure 3: Diversification of group sales by product



Source: Scope, Nikora JSC

Figure 4: Profitability of the different entities of Nikora JSC (based on unconsolidated figures)



Source: Scope, Nikora JSC

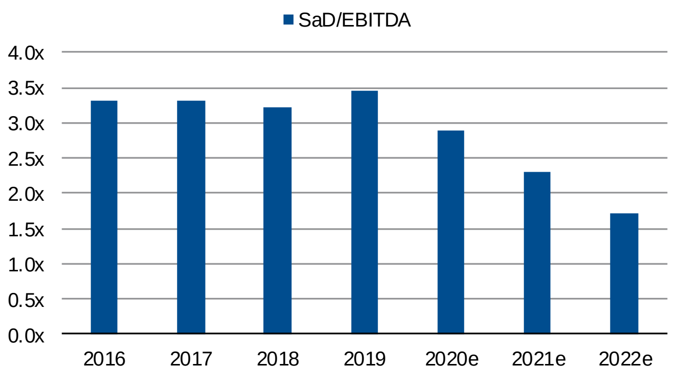
Profitability of Nikora Trade supports the group

2019 saw a significant drop in the Scope-adjusted EBITDA margin to 20%, linked to the group's foreign exchange rate exposure. Going forward, we expect profitability to remain below 20% for the consumer goods segment (versus a Scope-adjusted EBITDA margin estimated at close to 25% in recent years). Nikora FMCG has been supported by a consistently high gross margin since 2016, in the 40%-50% range.

As mentioned above, 66% of group profitability is generated by Nikora Trade (in 2019). While the retailer benefits from relatively high profitability compared to national and international peers, the recent rise of competition in the market coupled with the group's expansion plans is likely to put pressure on profitability. It is likely that the group will have to decrease its overall profitability in order to maintain its market leadership in the country. Going forward, we expect profitability to decrease slightly but to remain one of the group's strongest rating drivers.

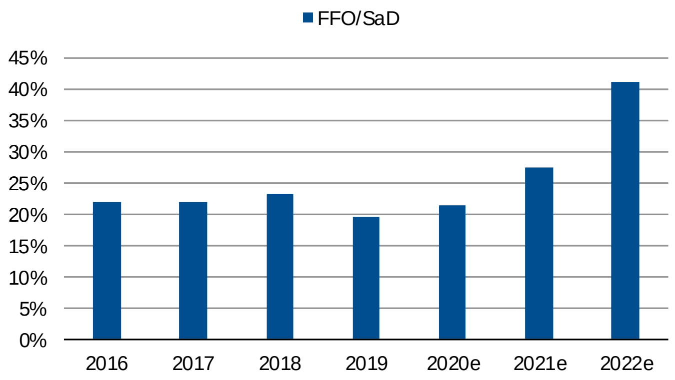
Financial risk profile (BB-)

Figure 5: Nikora JSC's evolution of SaD/EBITDA



Source: Scope, Nikora JSC

Figure 6: Nikora JSC's evolution of FFO/SaD

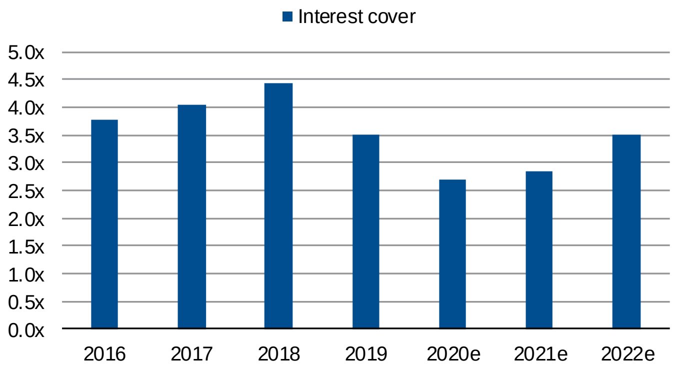


Source: Scope, Nikora JSC

Similar to Nikora Trade, the impact of IFRS16 was heavier than initially expected and led to an increase in gross debt (see rating report on Nikora Trade's as the retailer represents 75% of group debt). This led to a deterioration in both leverage metrics: Scope-adjusted debt (SaD)/EBITDA increased to 3.4x at YE 2019 versus 3.2x at YE 2018 and funds from operations (FFO)/SaD dropped to 19% versus 23% the year before. Going forward, we expect both ratios to recover slightly from 2020 on, based on deleveraging at both Nikora Trade (notably its bond) and Nikora JSC. This recovery could lead SaD/EBITDA to stabilise below 3x and FFO/SaD to increase above 20% from 2020 on.

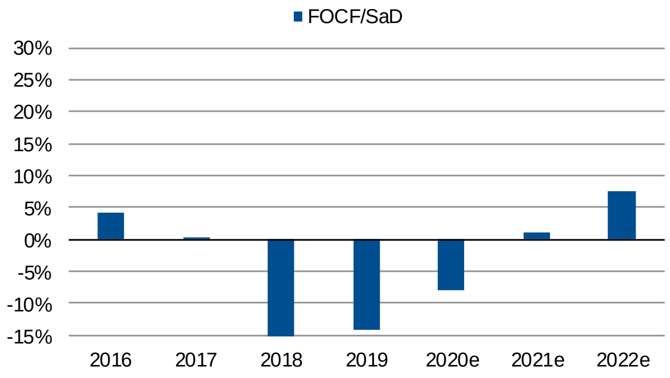
Interest cover dropped significantly over the course of 2019, to 3.5x from 4.4x in 2018. We consider it likely that the group will manage to renegotiate interest payments on existing leases and improve Scope-adjusted interest expenses going forward. However, we expect this metric to remain under pressure going forward because: i) the group will continue to expand and increase its amount of financial leases; ii) the markets are starting to become more concentrated, which will weaken negotiating power in the next few years; and iii) while the group is used to financing its annual activities via numerous credit lines, a deterioration in interest rates could have a negative effect. Going forward, we expect the ratio to remain under pressure due to our conservative expectations regarding interest rates for new debt. We forecast that the interest cover ratio will recover slightly from our expected 2020 low point but that it will remain below 4x.

Figure 5: Nikora JSC's evolution of interest cover



Source: Scope, Nikora JSC

Figure 6: Nikora JSC's evolution of FOCF/SaD



Source: Scope, Nikora JSC

In line with the holding company's development, FOCF has been under pressure from high capex in recent years. Considering the consolidation of the market in Tbilisi, it is likely that the group will continue its expansionist strategy but at a slower pace. The inclusion of dividends in the calculation puts pressure on FOCF but is motivated by the fact that the remuneration corresponds to preferred shares, whose payments are fixed (but the interest rate is determined by the shareholder). We therefore expect a certain recovery of FOCF/SaD in the coming years with the metric turning positive but remaining low in 2021.

Liquidity: weak

Liquidity remains weak. The group is suffering from the large investments made by Nikora Trade (89% of total capex at YE 2019 and 81% at YE 2018), while maintaining a financing approach based on short-term loans. Although this is common in Georgia, where long debt maturities remain the exception, it puts pressure on liquidity. We have included undrawn committed credit lines in our liquidity assessment. These are on a one-year basis but are provided and extended every year, thus providing a certain liquidity buffer. However, they are too low to effectively counterbalance short-term liabilities.

Senior unsecured debt: BB-

For our recovery analysis, we calculated a liquidation value on a going concern basis for YE 2021, assessed at GEL 255m. Although our recovery analysis indicates a relatively high recovery rate for senior unsecured debt, we do not grant an uplift for the instrument due to uncertainty surrounding the resolution of distress/default and small-scale emerging market risk.

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