Research Update:

Lithuanian Retail Property Owner Akropolis Group UAB Assigned 'BB+' Rating; Outlook Negative

May 19, 2021

Rating Action Overview

- Lithuania-based Akropolis Group UAB is a leading retail and entertainment real estate owner and operator in the Baltic region, with a modest €771 million portfolio at year-end 2020 that included mainly shopping centers, and a prudent financial policy targeting a reported net loan-to-value of up to 40%.
- The company is a core subsidiary of Vilniaus Prekyba UAB (VP) group, whose main core subsidiary is Maxima Grupe UAB (Maxima), and we view Akropolis as integral to VP's strategy, with the parent likely providing support in case of need.
- We therefore assigned our 'BB+' ratings to Akropolis and its senior unsecured debt, in line with those on VP and Maxima.
- The negative outlook mirrors that on Maxima and reflects our expectation that, over the next 12-18 months, Maxima's adjusted leverage and funds from operations (FFO) to debt could hover at 2.9x-3.1x and 27.0%-29.5%, respectively.

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Rating Action Rationale

Akropolis' business risk assessment is constrained by the company's concentration risk in a limited number of assets, almost solely in the retail property segment, and its overall small portfolio. The company owns four shopping and entertainment centers valued at €771 million at year-end 2020. Its growth strategy is clearly defined, with a large retail development project in Vilnius (Lithuania) that should be delivered in second-half 2024, and a potential sizable acquisition in 2021. By 2026, Akropolis' portfolio would likely almost double to include six shopping centers with a value close to €1.5 billion, although this remains small in comparison to most rated European retail property companies. The dependence on a few assets makes the company more vulnerable to any market volatility, in our view. We also generally consider retail property sector less resilient than other property segments like residential, since it largely depends on household consumption and changes in consumer habits. We further believe the retail segment has been facing structural challenges for years due to increasing e-commerce competition, although this has been limited so far in the Baltics. Long-lasting restrictions related to the COVID-19 pandemic and the resulting economic downturn will likely further affect retail tenants, which could harm retail property landlords' revenue. In that context, the density of shopping centers per inhabitant is also an important factor. Although it remains moderate in Lithuania and Latvia, close to Western European levels and lower than the Nordics, we also view competition as a risk because these markets do not have very strong legal barriers to entry.

Akropolis' shopping centers are prime and well positioned in the Baltics, attracting high footfall and demonstrating very low vacancy rates in the past couple of years. Each of the company's shopping centers is either the largest in its city (Vilnius, Klaipeda, and Siauliai) or the second-largest (Riga), with an average size of about 65,500 square meters (sqm)--almost twice that of large European company Klepierre. They are not located in city centers, but still within affluent and easily accessible areas of cities. Akropolis' tenants (both international and local) include a mix of a convenience offerings, featuring its anchor grocery store Maxima (about 11% of Akropolis' total income), pharmacies, services, and easily accessible parking areas; and entertainment offerings (10%-15% of gross lettable area), including cinemas, restaurants, bowling, and indoor skating rinks, in addition to the usual clothing (20%-30% of gross lettable area) and home interior/household tenants. As a result, its shopping centers attract particularly high footfall, with 41 million visitors overall in 2019, which represents about 10.2 million visitors per asset; the combined Lithuanian and Latvian population is only about 4.7 million. Furthermore, reflecting their attractiveness to customers and tenants, these assets have demonstrated a low 1% vacancy level for the past couple of years. We therefore believe that Akropolis' position in the retail real estate market is robust, and that its assets should continue attracting footfall and tenants, despite competition.

The company's leverage centers on a relatively prudent financial policy targetting a 40% maximum net-loan-to-value, while its S&P Global Ratings-adjusted debt to EBITDA should remain relatively low. Overall, Akropolis' leverage should increase over the next two years, due to its large Vingis development project and potential acquisition. But the company's financial policy targets a maximum net loan-to-value of 40%, which would translate into S&P Global Ratings-adjusted debt to debt plus equity of about 42.5%, as per our 2020 calculations. Although our forecasts show the ratio could slightly exceed this level in 2021 due to our assumption of exceptional pandemic effects and large development capital expenditure (capex), we believe it should stabilize below 42.5% because of the company's financial policy. In addition, thanks to its relatively high 7% yield, Akropolis' adjusted debt to EBITDA should remain relatively low at well below 7.5x, which compares well with that of rated retail property companies in Europe.

Due to its strong position in the Baltics and comparably low debt-to-EBITDA ratio, we view the company's stand-alone credit quality as comparable with that of 'BB+' peers. Although our business risk profile assessment remains constrained by the small portfolio size, concentration risk, and operations in a challenging retail market, we still believe Akropolis compares slightly positively with companies positioned in the same weak business risk profile category, which have less solid market positions. In addition, we believe the company is also well positioned within its financial risk profile assessment, with debt to EBITDA well below 7.5x, combined with our expectation of strong EBITDA interest coverage and moderate debt to debt plus equity of well below 45%.

We view Akropolis as a core subsidiary of the VP group and integral to its strategy. We believe it is highly unlikely that VP, which has owned 100% of Akropolis since 2016, will sell the company. This is because we understand VP views Akropolis as part of its group identity, as the real estate arm. About 50% of VP's real estate assets are Akropolis' shopping centers, and VP's subsidiaries represent about 25% of Akropolis' total gross leasable area and approximately 17% of its total income, as anchor tenants. We expect VP to support Akropolis under foreseeable circumstances, as demonstrated through the group's flexible dividend policy, under which the group envisages no dividend from Akropolis during the realization of its large Vingis development project (which includes €287 million of estimated capex). In addition, we understand Akropolis' decision-making process heavily involves VP, with all decisions above €1 million approved by VP management. Since Maxima is the main factor in VP's credit quality, we align our final rating on Akropolis with that on Maxima, at 'BB+' with a negative outlook.

Outlook

The negative outlook on Akropolis mirrors that on Maxima, as the main business driver of the VP group.

The negative outlook on Maxima reflects our expectation that, over the next 12-18 months, the company will take longer than we expected to deleverage. There is a risk that credit metrics remain weaker at the current rating level, including adjusted debt to EBITDA of 2.9x-3.1x and FFO to debt of 27%-29.5%, amid intensifying competition in Latvia and Estonia. In addition, the negative outlook reflects our view that the weaker performance of Maxima could weigh on VP's financial strength, since the food retailer represents more than 70% of group earnings. This would prevent deleveraging at the group level.

Downside scenario

We could lower the ratings on Akropolis following a downgrade of Maxima, which would affect VP's overall credit quality. This could happen if:

- Maxima significantly underperforms our base-case scenario, including a material decline in operating performance and lower profitability because of intensifying market competition, or if a weaker macroenvironment in the Baltics or Poland weighs on margins and cash flows;
- Maxima's or VP's financial policies are less prudent, either due to increased dividends or large-scale, debt-funded acquisitions that keep leverage about 3.0x or FFO to debt below 30% at Maxima or the wider group level; or
- Liquidity at both Maxima and VP deteriorates.
- We could lower the ratings on Akropolis if we perceive that VP's approach to the company has changed, leading us to no longer regard Akropolis as a core subsidiary of VP.

Although it would not result in a downgrade, due to expected group support, we could revise down our assessment of Akropolis' stand-alone credit profile if its liquidity cushion tightens, or leverage increases materially, such that S&P Global Ratings-adjusted debt to EBITDA increases well above 7.5x, or debt to debt plus equity does not stay well below 45%.

Upside scenario

We could revise the outlook on Akropolis to stable if we take a similar rating action on Maxima. This could happen if Maxima deleverages well below 3x on an adjusted basis while strengthening and sustaining FFO to debt above 30%, supported by the financial policy. These metrics could stem from Maxima's increasing profitability, with cost-control and efficiency measures more than offsetting competitive pressure on the group's profitability in Latvia and Estonia.

An outlook revision to stable would also hinge on VP's progressive deleveraging, such that its leverage falls well below 3x and its FFO comfortably and sustainably exceeds 30%, combined with low re-leveraging risk at both Maxima and VP.

Company Description

Akropolis is a Lithuanian retail property landlord, with four shopping centers valued at €771 million at year-end 2020 and an average 7% yield. Three-quarters of its portfolio is in large Lithuanian cities (Vilnius, Klaipeda, and Siauliai), and 25% in Latvia (Riga). It also owns offices within its shopping centers in Vilnius and Riga but they represent less than 5% of total gross rental income.

The company is 100% owned and fully consolidated by the wider VP group, whose main consolidated business is Maxima (73% of EBITDA at year-end 2019), a leading Lithuanian retail chain with a focus on food. VP also consolidates pharmacy business Euroapotheca (12% of EBITDA), and other retail businesses (4%), in addition to Akropolis (11%).

Our Base-Case Scenario

Assumptions

- We factor in S&P Global Ratings' macroeconomic assumptions for the markets in which the company operates. We consider consumer confidence, household consumption, and shopping centers' density among the most important factors for retail property investors. Uncertainty and constraints to economic activity mean some businesses will likely fail, which would lead to rising unemployment. This was seen in Lithuania and Latvia in 2020, reaching 8.5% and 8.1% respectively, and expected at 7.9% and 8.4% in 2021. We expect real GDP to rebound to 2.5% growth in Lithuania and 2.8% growth in Latvia, after moderate declines of 0.8% and 3.6% in 2020, respectively. Overall, this slump is causing a drop in household consumption, which could harm retail tenants' robustness and ability to pay rents. At the same time, we project lower inflation than in 2019 in Lithuania and Latvia, at 1.4% and 1.1% respectively.
- A like-for-like revenue decline of about 5% in 2021. Although Akropolis' rental income is indexed, with a minimum increase per year of 1.0%-3.0%, we believe heavy pandemic-related restrictions on nonessential stores in Lithuania and Latvia since November 2020 could harm rental income growth in 2021. Only 25%-30% of gross lettable area at Akropolis' stores was open to March 2021, with a gradual reopening thereafter. At April 30, 2021, about 78% of total gross lettable area was open, including restaurants and cafes, which can only provide food-to-go. These long-lasting restrictions will likely lead to discounts in rents, and potential greater tenant bankruptcies. We still believe Akropolis should maintain low vacancy rates, evidenced by the historically constant level of about 1%, which reflects the strong attractiveness of the company's Baltic assets. We expect flat or slightly positive annual growth from 2022.
- Potential portfolio devaluation of 2%-5% in 2021, reflecting weaker cash flow expectations from the pandemic. We think the European retail investment market has been relatively quiet since the pandemic began and the revenue impact of restrictions at the beginning of 2021

might not be fully captured by property appraisers yet. After 2021, we conservatively expect flat revaluations.

- Capex of less than €10 million in 2021 then rising to about €70 million in 2022, reflecting the large Vingis development project that should be delivered in second-half 2024. Akropolis' maintenance spending should be relatively limited as it fully refurbished its largest asset in Vilnius in 2019 and delivered its shopping center in Riga the same year. The Vingis investment totals about €300 million and includes another large shopping center in Vilnius (98,000 sqm) and an office (38,000 sqm). We understand that this asset is about 8 kilometers from the company's existing shopping center in the same city.
- Less than €200 million of potential acquisitions for 2021-2022. We assume the company would continue investing in its core markets.
- No cash dividends in 2021 and 2022. VP would likely not consider any dividend outflows from Akropolis to offset the cash outflows for Vingis.
- No disposals, since the company only has four assets that are all core to its strategy.

Key metrics

- S&P Global Ratings-adjusted debt to EBITDA of 7.0x-7.2x in 2021, and 6.2x-6.6x in 2022.
- S&P Global Ratings-adjusted EBITDA interest coverage of 5.0x-6.5x over the next two years.
- S&P Global Ratings-adjusted debt to debt plus equity increasing to 42%-44% in 2021 from 35.8% at year-end 2020, before improving to 41%-43% in 2022.

Liquidity

We assess Akropolis' liquidity as adequate. We anticipate that liquidity sources will likely cover uses by more than 1.2x in the 12 months started Jan. 1, 2021.

We estimate principal liquidity sources for the 12 months started Jan. 1, 2021, include:

- €56.7 million of available unrestricted cash; and
- Cash FFO of about €40 million.

We estimate principal liquidity uses for the same period include:

- €15.5 million of contractual debt amortization payments and the repayment of outstanding credit lines; and
- €8 million-€10 million of maintenance or committed capex.

Covenant Analysis

Compliance expectations

We understand that Akropolis has some covenants for its existing unsecured bond. We estimate that the headroom under these covenants should be adequate, at more than 10%.

Requirements

Akropolis has to comply with the following covenants:

- Consolidated leverage ratio, that is reported total debt to total assets, should not exceed 60%.
- Consolidated coverage ratio (reported EBITDA interest coverage) of at least 2.0x.
- Consolidated secured leverage ratio (total secured debt to total assets) to not exceed 30%.
- An unencumbered-asset test (unencumbered assets/unsecured debt) of at least 125%.

Issue Ratings - Subordination Risk Analysis

Capital structure

Akropolis' capital structure would comprise about €400 million of debt in 2021, the bulk represented by the €300 million proposed senior unsecured bond. We understand that more than 50% of the bond proceeds will be used to repay existing secured debt, and the other half to fund potential acquisitions and the Vingis development project.

Analytical conclusions

Total debt would mainly include unsecured debt following the proposed bond issuance. We do not see significant subordination risk in the capital structure since the ratio of secured debt to total assets is around 25%, well below our threshold of 50%. Hence, we align our issue rating on the senior unsecured bond with the 'BB+' long-term issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Negative/--

Business risk: Weak

- Country risk: Intermediate risk
- Industry risk: Low risk
- Competitive position: Weak

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)

- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bb+

Entity status within the group: Core

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Can European Retail Property Owners' Belt-Tightening Save Ratings From COVID And E-Commerce Headwinds?, March, 31, 2021

Ratings List

New Rating; Outlook Action	
Akropolis Group UAB	
Issuer Credit Rating	BB+/Negative/--
Senior Unsecured	BB+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.