FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Akropolis at 'BB+'; Outlook Stable

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Fitch Ratings - Warsaw - 26 Aug 2022: Fitch Ratings has affirmed Baltics-focused retail property company Akropolis Group, UAB's Long-Term Issuer Default Rating (IDR) at 'BB+' with a Stable Outlook. Fitch has also affirmed Akropolis's senior unsecured rating at 'BB+'.

Akropolis's ratings are constrained by its concentration on a limited number (five) of retail assets, restricting asset and geographical diversification. The largest asset comprises more than 30% of the group's portfolio. This asset concentration is expected to improve once its Vilnius mixed-use development project is completed in 2025 as scheduled.

The ratings also reflect low cash-flow leverage and a high interest coverage ratio resulting from a high income-yielding profile of Baltic-located assets with moderate Fitch-calculated loan-to-value (LTV) of below 40%. Akropolis's shopping centres are anchored by grocers, predominantly of Maxima Group, a Baltic leading grocery chain owned by Akropolis's parent company UAB Vilniaus prekyba (VP Group). Other tenants include a range of fashion and entertainment retail offers.

KEY RATING DRIVERS

Concentrated Portfolio: Akropolis has one of the most concentrated property portfolios among EMEA Fitch-rated peers. Its EUR1 billion portfolio comprises five regional shopping centres with average size of 64,000 sqm of retail gross lettable area (GLA), located in Lithuania (60% by market value, (MV)) and Latvia (40%). The three largest assets are located in the capital cities of both countries, Vilnius (32% of portfolio MV) and Riga (40%).

The remaining two are in Klaipeda (20%) and Siaulai (8%), which are the third- and fourth-most populous cities in Lithuania. Akropolis's conveniently-located shopping centres dominate their respective catchment areas, providing a wide retail offering.

Riga Acquisition: In November 2021 Akropolis acquired Afla, a 71,000 sqm shopping centre, by GLA the biggest retail scheme in Riga. The asset, renamed Akropole Alfa, benefits from the high recognition of the group's brand, was valued EUR198 million at end-2021. The acquisition consolidated Akropolis's position in Riga's market where it now owns the two biggest shopping centres. Akropole Alfa is the only asset not anchored by Maxima. This acquisition helps to reduce the group's tenant concentration, which however remains high (top 10 tenant groups generate 41% of rent and related income including 16% by VP Group-owned tenants) compared with other Fitch-rated CEE peers whose top 10 tenant concentration is around 20%.

Rental Income Growth: Akropolis's average rent per sqm in 1H22 increased around 20% compared with 2021 on a like-for-like basis, after expiration of rent discounts granted to tenants due to the pandemic (EUR8.5 million in 2021) and reflecting the effect of inflation-linked rent indexation (2021 CPI: 4.6% and 3.2% for Lithuania and Latvia, respectively). Other portfolio metrics remained stable with occupancy of 98% and a weighted average lease length of around 4.5 years.

Inflation-Driven Rents Increases: A substantial part (around 90% of rental income) of Akropolis's tenancy contracts have an annual inflation-linked rent indexation (often with a 1%-3% floor). Fitch expects inflation in Lithuania and Latvia to average 15.9% and 16.8%, respectively, in 2022. Despite the assets' moderate occupancy costs (including an affordable rent/sales of 10%-12% in 2021) raising rents in line with inflation, combined with an increase in utility expenses, may be unsustainable, especially if inflation erodes households' disposable income, weakening consumption and tenants' sales.

We expect that to maintain an affordable rent profile for its assets and high occupancy levels Akropolis, like other landlords, may choose to forfeit part of inflation-linked rent increases.

Vingnis First Rental in 2025: Akropolis's mixed-use development Vingis is at the consultation phase with Vilnius's local authorities. After receiving the building permit, construction works are expected to start in 2023 with the first rental income receipt in 2025. Capex totals around EUR300 million, but at this stage it remains largely uncommitted.

Moderate Leverage: Akropolis's 2021 net debt/EBITDA of 7.1x was hit by the acquisition of Alfa shopping centre in November and some rent concessions provided to tenants. Using annualised rents from this acquisition, 2021 leverage would be around 5.5x. In 2022 cash flow leverage is expected to decrease to below 5x, helped by rent indexation. We forecast this metric to rise in 2024 to 5.4x before the Vingis development project is completed and starts yielding rent. Interest cover remains over 5x, due to strong cash flows and low fixed interest rates on the group's bond, which constitutes around 70% of total debt.

Governance Structure Limitations: As part of the VP Group, Akropolis has benefitted from cooperation with VP Group-owned retailers in creating comprehensive and coordinated retail offerings in its shopping centres. However, concentrated ownership by this privately-held group means financial disclosure and corporate governance are not comparable to listed companies'. Indirect 87% ownership by dominant shareholder Nerijus Numa, together with the lack of independent directors on Akropolis's board, means that the arm's length nature of related-party transactions (with Maxima Group and sister tenants) does not have independent oversight that is comparable to listed peers.

PSL Assessment: Fitch rates Akropolis on a consolidated plus one notch approach under its Parent and Subsidiary Linkage (PSL) Criteria. We view Akropolis' legal ringfencing as 'porous' based on self-imposed restrictions included in its bond documents that limit potential value transfers to the VP Group. The restrictions include a maximum 60% total indebtedness/total assets ratio (quasi-LTV) and less onerous limits on transactions with affiliates and dividends. The criteria's access and control factors are assessed as 'open' due to full ownership by the VP Group and despite Akropolis being separately funded with its own treasury functions and independent cash management.

DERIVATION SUMMARY

Akropolis' EUR1 billion portfolio, comprising five shopping centres located in Lithuania (A/Stable) and Latvia (A-/Stable), is smaller and materially more concentrated than the EUR5.6 billion CEE retail portfolio owned by NEPI Rockcastle S.A. (BBB/Positive). Office-focused Globalworth Real Estate Limited (BBB-/Stable) has a portfolio of EUR2.8 billion, which is similar in size to the EUR2.1 billion office (65% of MV) and retail (35%) portfolio of Globe Trade Centre S.A. (GTC; BBB-/Stable).

Akropolis' country risk exposure is the lowest among all Fitch-rated CEE peers'. NEPI has the highest diversification with a presence in nine CEE countries but the average country risk is lower and similar to that exhibited by Globalworth, whose office assets are almost equally split between Poland (A-/Stable) and Romania (BBB-/Negative), and to GTC's. GTC's assets are located in Poland with the reminder in five countries rated in the 'BBB' category or below.

Akropolis has the most conservative financial profile with forecast net debt/EBITDA at 4.9x for 2022, before a planned construction project increases its leverage over time. This is partly because Akropolis's assets yield high income with a net initial yield estimated at around 7% and a low LTV below 40%. This net debt/EBITDA is most comparable to NEPI's around 6x. NEPI's financial profile is stronger than Globalworth's and GTC's.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Like-for-like rent increases of 10% in 2023, reflecting partial forfeiture of inflation-linked rent indexation. Rent increases of 4% and 3%, respectively, in 2024 and 2025

- Vacancy rate to increase to 4% in 2025

- Around EUR275 million of capex (mainly related to Vingis's development) until 2025

- No dividends paid for the next four years

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Expansion of portfolio in less correlated markets while maintaining portfolio quality

- Unencumbered assets/unsecured debt cover above 2.0x

- Net debt/EBITDA below 8.5x

- Consistent interest-rate hedging policy

- Improved corporate governance

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Net debt/EBITDA above 9.0x and LTV trending above 55%

- Unencumbered assets/unsecured debt cover below 1.75x

- Failure to complete the Vingis development as per schedule or material cost overruns on the project

- Liquidity score below 1.0x

- Transactions with related-parties that are detrimental to Akropolis's interests

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Akropolis held EUR59 million of readily available cash (excluding EUR23 million pledged to a bank financing as collateral) at end-2021, which is sufficient to cover around an EUR7 million loan amortisation in 2022. Akropolis does not use committed revolving credit facilities as a contingent source of liquidity.

Four out of Akropolis's five assets are unencumbered. This results in an unencumbered assets/unsecured debt of 2.2x.

Akropolis is not a REIT so it is not constrained by dividend distribution requirements. Fitch interprets its internal dividend policy to mean that no dividends will be paid when material outlays related to the development programme or acquisitions are expected or would cause the company's reported LTV to be above 45%. No dividends are expected to be paid until 2025, which will allow Akropolis to retain free cash flow to finance the development of Vingis shopping centre.

ESG CONSIDERATIONS

Akropolis has an ESG Relevance Score of '4' for governance structure, reflecting the lack of corporate governance that would both mitigate key person risk from the dominant shareholder Nerijus Numa and ensure independent oversight of related-party transactions. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless stated otherwise above the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the company. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
AKROPOLIS GROUP, UAB	LT IDR	BB+ Rating Outlook Stable	Affirmed	BB+ Rating Outlook Stable
senior unsecured	LT	BB+	Affirmed	BB+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 15 Jul 2022)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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