

Research Update:

Akropolis Group UAB 'BB+' Ratings Affirmed On Robust Performance Despite Shorter-Term Debt Maturity; Outlook Stable

May 24, 2024

Rating Action Overview

- Lithuania-based real estate company Akropolis Group UAB (Akropolis) reported a robust operating performance in 2023, with positive like-for-like rental growth of 11.8% and a revaluation in portfolio value of 4%. As a result, leverage metrics strengthened and we anticipate that S&P Global Ratings-adjusted debt to debt plus equity will remain at about 38.0%-40.0% and debt to EBITDA at 5.0x-5.5x over the next 12-24 months.
- However, Akropolis weighted-average debt maturity fell below three years as of Dec. 31, 2023. This was mainly because of an upcoming material debt maturity of the €300 million senior unsecured bond that is due in June 2026 and accounts for close to 67% of the company's total outstanding debt.
- Yet we anticipate that Akropolis will address the maturity well in advance, ensuring that debt maturities increase beyond three years again while maintaining a modest debt load. Additionally, we expect the company will have access to alternative funding sources, including potential support from its parent Vilniaus Prekyba UAB (VP group), which reduces refinancing risk significantly.
- We therefore affirmed the stand-alone credit profile (SACP) of Akropolis at 'bb+'. At the same time, we affirmed our 'BB+' issuer credit and issue ratings on Akropolis and the company's senior unsecured debt. The rating on Akropolis is in line with our rating on Maxima Grupe UAB (Maxima), VP group's main subsidiary.
- The stable outlook on the rating on Akropolis reflects our expectations that Maxima will maintain its leading market position in the Baltics, despite intensifying competition, and soundly execute its planned store expansions in Poland and Bulgaria.

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Rating Action Rationale

We anticipate that operating fundamentals for Akropolis' properties will remain robust over the next 12 months, underpinned by inflation-linked rental contracts and a high occupancy rates.

In 2023, Akropolis reported 11.0% like-for-like growth in net rental income, mostly due to the high degree of indexation of leases (about 60%-80% for its commercial contracts) for its five prime and well-located income-producing shopping malls. The average occupancy rate of the company's combined commercial portfolio was high and remained at 97.4% and we expect it will remain at the same level in 2024. We expect the company will continue benefiting from positive like-for-like growth in rental income, while maintaining the current low vacancy rate. Akropolis has a moderately diversified customer base, with its top 10 tenants accounting for 29% of customers, as of Dec. 31, 2023. Its leasing profile is well spread, with an average lease maturity of 3.8 years. 23% of annual rental income expires in 2024 and another 15% in 2025. Akropolis has one development project, Akropolis Vingis, which is located in Vilnius and which we expect will generate cash flows in 2028. Yet we expect development capital expenditure (capex) will not exceed 10% of total portfolio value in any given year, ensuring no major development risk for the company.

Akropolis has medium-term debt maturities that pose some refinancing risk amid improving, but still volatile, capital market conditions. As of Dec. 31, 2023, Akropolis' weighted-average debt maturity was 2.85 years. This is relatively short, compared with rated real estate peers in Europe, the Middle East, and Africa, and below our three-year requirement for the real estate sector. Akropolis' relatively short weighted-average debt maturity mainly reflects significant debt maturities related to the €300 million senior unsecured bond (coupon: 2.875%) that is due in June 2026 and represents close to 67% of the company's total outstanding debt of €450 million. Additionally, the company's senior secured loan of €150 million (variable interest rate of 5.606%) will mature in September 2027. We understand the company plans to address the debt maturities in a timely manner. Given the still challenging refinancing markets, rising interest rates, and limited access to debt capital markets for real estate companies, we will closely monitor Akropolis' capital structure and the potential effects on its liquidity profile over the coming quarters, should the weighted-average debt maturity fall below two years.

We expect Akropolis will take sufficient steps to ensure a weighted average maturity of well above three years. We understand the company may consider a capital markets issuance. If conditions are challenging, we believe Akropolis will have access to alternative funding sources. This is evident in the fact that the company refinanced a loan, which was due in March 2024, in September 2022 and increased the size of the loan to €160 million, despite unfavorable market conditions. While we believe lending conditions have tightened for the real estate sector, banks are generally willing to support clients with sound business models and sustainable financial capital structures. Additionally, we view the debt level at Akropolis as relatively moderate, compared with the average in the European real estate sector. Potential group support by VP group is another mitigating factor that limits refinancing risks.

We believe Akropolis' debt level will remain modest, with the adjusted ratio of debt to debt plus equity remaining well below 45%. In our assessment of Akropolis' financial risk profile, we consider its moderate leverage, both on an absolute and a relatively basis, and its conservative financial policy to maintain a long-term target of a net loan-to-value (LTV) below 40%. As of Dec. 31, 2023, the company's adjusted ratio of debt to debt plus equity was 38.6%, compared with

42.1% in 2022. The improvement in leverage metrics over the past year mainly reflected positive fair value adjustments of 4.0% in 2023. Leverage metrics also benefited from double-digit rental growth, which resulted from high inflation in the region--for instance, Lithuania's consumer price index (CPI) was 9.1% in 2023--and offset the negative effect from higher interest rates, with the average portfolio yield from the retail sector in Vilnius increasing by 50 basis points to about 7.5% at year-end 2023. We anticipate that adjusted debt to debt plus equity will remain at 38.0%-40.0% in 2024. This includes our base case assumption of a limited value impact over the next two years. Nonetheless, we anticipate Akropolis' debt-to-debt-plus-equity ratio will remain well below our 45% downside trigger. We expect Akropolis' adjusted debt to EBITDA will be 5.3x in 2024 and 5.0x in 2025, from 5.5x in 2023. This is well below our 7.5x downside threshold for maintaining the current SACP.

We consider VP group's holding in Akropolis is crucial, results in a high likelihood of group support, and markedly reduces refinancing risks. VP group owns 100% of Akropolis and we view Akropolis as core to VP group and integral to the group's identity and strategy. For instance, Akropolis' shopping centers account for about 49% of VP group's real estate assets, while VP group's subsidiaries represent about 22% of Akropolis' total gross leasable area and approximately 11% of its total income. As such, consider it unlikely that VP group will sell Akropolis.

We expect VP group will support Akropolis under any foreseeable circumstances. Among others, VP group's support is demonstrated by its flexible dividend policy, which helps align the capital structure with Akropolis' financial policy. Additionally, VP group could issue debt if Akropolis cannot access the debt capital market. In our view, this support from the owner reduces refinancing risk considerably over the coming 24-36 months and partly offsets the risk associated with the average-weighted debt maturity being below three years.

Outlook

The stable outlook on the rating on Akropolis reflects our expectations that Maxima will maintain its leading market position in the Baltics, despite intensifying competition, soundly execute its planned store expansion in Poland and Bulgaria, and pass on inflation-related costs to end-customers, leading to continued revenue growth and a recovery in EBITDA margins toward 7.9% in 2024. The stable outlook also takes into account Maxima's dividend distributions, funded with free operating cash flow (FOCF), and our expectation of adjusted funds from operations (FFO) to debt of more than 30% and adjusted debt to EBITDA of about 2.0x-2.5x over the next 12-18 months. Additionally, we expect VP group will deleverage, with debt to EBITDA of 2.0x-2.5x.

Downside scenario

We could lower the rating on Akropolis if we took a similar rating action on Maxima, which could happen if:

- Maxima significantly underperformed our base case, including a material decline in operating performance and profitability because of intensifying market competition or a weaker macro environment in the Baltics or Poland weighing on margins and cash flows;
- Maxima's or VP group's financial policies became less prudent, either due to increased dividends or large-scale, debt-funded acquisitions that keep leverage at about 3.0x or above and FFO to debt below 30% at either Maxima or the wider group level;

- The liquidity of Maxima and VP group deteriorated; or
- The refinancing of the senior notes was not addressed timely.

Although it would not result in a downgrade, due to expected group support, we could revise downward our assessment of Akropolis' SACP if:

- Its liquidity cushion reduces or if its weighted-average debt maturity falls below two years without tangible and advanced refinancing plans; or
- Leverage increases materially, such that adjusted debt to EBITDA increases well above 7.5x or debt to debt plus equity does not remain well below 45%.

Upside scenario

Albeit unlikely over the next 12 months, given our understanding of the management's financial policy, we could raise the rating if a stronger-than-expected operating performance of Maxima and VP group resulting in:

- Adjusted debt to EBITDA falling below 2.0x for Maxima and VP group;
- Maxima's FOCF generation substantially exceeding actual dividend payments and resulting in a debt reduction.

We would also have to see a financial policy commitment from Maxima and VP group to sustainably maintain these credit metrics solid liquidity.

Company Description

Akropolis is a real estate development and management company. It develops, manages, and leases shopping and entertainment centers and office buildings in Lithuania and Latvia. The company was incorporated in 2010 and is based in Vilnius, Lithuania. Akropolis is a subsidiary of VP group. As of Dec. 31, 2023, Akropolis' portfolio consisted of five shopping centers that were worth €1.1 billion and spread across a gross leasable area of 335,574 square meters.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Lithuania of 1.6% in 2024 and 2.6% in 2025, from a decline of 0.3% in 2023. Real GDP growth in Latvia of about 1.5% in 2024 and 2.8% in 2025, after a decline of 0.3% in 2023. We expect a CPI growth of about 2.0% in 2024 and 2.5% in 2025 in Lithuania, after 8.7% in 2023, and 2.0% in 2024 and 2.8% in 2025 in Latvia, after 9.1% in 2023.
- Like-for-like net rental income growth of 5%-7% in 2024 slowing down to 2%-3% in 2025.
- Occupancy rates to remain broadly stable at 97% over the forecast horizon, given the company's track record of stable occupancy rates and the fact that Akropolis is a dominant player in Baltics with high demand for its assets.
- Adjusted EBITDA margins to remain broadly stable at about 80% over the next few years, in line with average historical levels.

- We anticipate limited fair value adjustments, given already high yields (7.5% in Vilnius and 7.8% in Riga) and decreasing inflation.
- Limited development capex of about €13 million related to some delays of the Vingis development project in 2024. Development capex for this project will increase to €65 million from 2025, with an estimated capex of €300 million for Vingis, which we expect will generate rental income by 2028.
- Limited maintenance capex of about €2 million per year over the forecast horizon since renovations in Klaipeda will be completed in the second half of 2024 and renovations in Siauliai is planned to be completed by 2028.
- No acquisitions over 2024-2025 as we expect the company will focus on the refinancing of its upcoming maturities.
- No disposals since the company only has five assets that are all core to its strategy.
- Dividends of €70 million in 2024, in line with the management's guidance.
- Refinancing of the €300 million note, assumed at a fixed rate of about 6.5% and refinancing of the bank facility at a fixed rate of about 5.0%.
- Average cost of debt to gradually rise to 6.0% over 2025-2026, from 3.8% in 2023.

Key metrics

- Adjusted debt to EBITDA of 5.0x-5.5x over the next two years.
- Adjusted EBITDA interest coverage of about 5.0x in 2024, further declining to 3.0x-4.0x over 2025-2026.
- Adjusted debt to debt plus equity increasing to 38%-40% in 2024, from 38.6% at year-end 2023, before improving to 36%-38% over 2025-2026.

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 from April 1, 2024.

We estimate principal liquidity sources for the 12 months from April 1, 2024, include:

- Available unrestricted cash and cash equivalents of €235.8 million; and
- Expected cash FFO of about €57 million.

We estimate principal liquidity uses over the same period include:

- Contractual debt amortization payments of €8 million and the repayment of outstanding credit lines;
- Expected maintenance and committed capex of €25 million-€30 million; and
- Dividend payouts of €70.0 million.

Covenants

We understand that Akropolis has some covenants for its existing unsecured bond. We estimate that the headroom under these covenants is adequate, at about 15%-30% until end-December 2024. The main bond covenants include:

- Loan-to-value ratio to not exceed 60%;
- Consolidated coverage ratio (reported EBITDA interest coverage) of at least 2.0x; and
- Consolidated secured leverage ratio (total secured debt to total assets) to not exceed 30%.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2023, Akropolis' capital structure comprised of €149.5 million in secured bank loans and a €300 million senior unsecured bond.

Analytical conclusions

We rate the company's senior unsecured bond at 'BB+', in line with the issuer credit rating. This is because we do not see significant subordination risk in the company's capital structure. Secured debt represents about 14% of the fair-market portfolio value, well below our 40% threshold, for which we would typically lower the issue rating to one notch below the issuer credit rating.

Ratings Score Snapshot

Issuer credit rating	BB+/Stable/--
Business risk:	Weak
Country risk	Intermediate
Industry risk	Low
Competitive position	Weak
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
Anchor	bb
Modifiers:	
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Moderately negative (no impact)
Comparable rating analysis	Positive (+1 notch)

Issuer credit rating	BB+/Stable/--
Stand-alone credit profile:	bb+
Group credit profile	BB+
Entity status within group	Core
Related government rating	Not applicable

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed

Akropolis Group UAB

Issuer Credit Rating	BB+/Stable/--
Senior Unsecured	BB+

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