

RATING ACTION COMMENTARY

Fitch Affirms Akropolis at 'BB+'; Outlook Stable

Thu 20 Jul, 2023 - 10:56 AM ET

Fitch Ratings - Warsaw - 20 Jul 2023: Fitch Ratings has affirmed 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 of 'BB+' with a Recovery Rating of 'RR4'.

Akropolis's concentration on five shopping centres in Lithuania and Latvia, which limits asset, tenant and geographical diversification, constrains the ratings. The largest asset comprises more than 30% of the group's portfolio value.

The ratings also reflect Akropolis's dominant position in its local retail markets and its strong operating performance. Fitch-calculated net debt/EBITDA of Akropolis is low at under 4.5x, while EBITDA interest coverage remains healthy at around 4.0x, stemming from a high income-yielding profile of Baltic-located assets and a moderate Fitch-calculated loan-to-value (LTV) of below 35%. This financial profile is strong for the rating, despite the substantial capex to be incurred on its Vingis mixed-use development.

KEY RATING DRIVERS

Strong Operating Performance: Akropolis's rental income in 2022 increased over 25% compared with pandemic-affected 2021 on a like-for-like basis. Despite the rental increase, the tenants' occupancy cost ratio (OCR) decreased to 10% (2021: 11%) as tenant sales exceeded 2019 levels, aided by high inflation in 2022 that averaged 19% and 17% in Lithuania and Latvia, respectively.

Akropolis did not pass on all higher property operating expenses, which included increased energy costs, to its tenants, resulting in a lower EBITDA margin of 93% (2021: 96%). Occupancy remained stable at 98% at end-2022, but the GLA weighted average lease expiry (to break) decreased to 5.1 years (end-2021: 6.1 years) as a substantial portion of leases expires in 2024. However, the metric would be lower if weighted by income.

Rental Indexation Limited: Akropolis decided to forfeit part of its annual rent indexation, which is included in most of its tenancy agreements and is based on the previous year's CPI. The average indexation applied in January 2023 for the portfolio was around 8%, which tried to balance sustainable rents in a high inflation environment that is affecting household consumption and tenant sales. Fitch forecasts inflation in 2023 of 11% and 10% for Lithuania and Latvia, respectively. We expect Akropolis to again forfeit part of inflation-linked rent increases in 2024.

Concentrated Portfolio: Akropolis's EUR1 billion portfolio includes five assets located in Lithuania (around 60% by market value, (MV)) and Latvia (around 40%), countries with populations of 2.86 million and 1.9 million, respectively. The limited number of assets and the small size of the retail markets, where some well-known brands are present via franchisees, mean tenant and asset concentration is high. The top 10 tenant groups generate 39% of rent, including 11% from tenants owned by Akropolis's parent company, Vilniaus Prekyba Group (VP Group).

Strong Market Position: Akropolis's shopping centres, with an average retail gross lettable area (GLA) of 64,000 square metres (sqm), have dominant positions in the key cities of Lithuania and Latvia. They provide comprehensive retail offerings, including food retailers Rimi and VP-Group owned Maxima, a wide range of fashion brands, including Zara, H&M, Reserved, and entertainment. This, combined with good locations and the strong Akropolis brand, attracted 41 million visitors in 2022.

Low Leverage: Fitch expects Akropolis's net debt/EBITDA to decrease to 3.6x in 2023 (2022: 4.3x), aided by rent indexation, limited capex and the absence of dividends. We forecast leverage to rise moderately to 4.2x in 2026, due to higher capex on the Vingis project. Its EBITDA interest coverage in 2022 decreased to 6.4x (2021: 16.8x) as Akropolis upsized its bank loan that is secured on the Akropolis Vilnius shopping centre. The loan (34% of total debt) is not hedged against interest rates. We expected interest coverage to remain between 4.0x and 5.0x during the next four years.

Vingis Rent Postponed: In the beginning of 2023, Vilnius local authorities approved plans to improve the transportation infrastructure around Akropolis's Vingis project, a mixed-use development including retail, office and residential space. Akropolis expects to submit the documents necessary to receive building permits by end-2023. Once the permit is received, construction is expected to start. The first rental income receipts are now expected in 2026, a year later than scheduled. Total capex for the project will be around EUR300 million to be spent until end-2027, but this is largely uncommitted at this stage.

Akropolis is also refurbishing the common space in its Klaipeda asset for an expected total cost of around EUR8 million.

No Independent Oversight: Akropolis's concentrated ownership by the privately-held VP Group means financial disclosure and corporate governance are not comparable with listed companies'. This, together with the lack of independent directors on Akropolis's board, means that the arm's length nature of related-party transactions (including the Maxima Group and sister tenants) does not have the independent oversight of listed peers. The related-party links are also underlined by the rotation of management within the VP Group when in June 2023, Nerijus Maknevičius, who worked in the VP Group, replaced Manfredas Darguzis as CEO of Akropolis, while Darguzis was appointed CEO of the Maxima Group.

PSL Assessment: Fitch rates Akropolis on a consolidated plus one-notch basis under its Parent and Subsidiary Linkage (PSL) Criteria. We view the legal ringfencing as 'porous' based on self-imposed restrictions in its bond documentation 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's EUR1 billion retail portfolio is similar in size and concentration to Balkans Real Estate B.V.'s (BRE; BB(EXP)/Stable) EUR0.7 billion (fully consolidated) portfolio of retail (73% of market value) and office (27%) assets. However, country risk exposure is materially higher as all its assets are in Serbia (BB+/Stable). MAS plc's (BB/Positive) core EUR0.9 billion CEE portfolio is predominantly in Romania (BBB-/Stable), but has slightly lower asset concentration.

The portfolio of NEPI Rockcastle N.V. (BBB+/Stable), valued at EUR5.7 billion; Globalworth Real Estate Investments Limited (BBB-/Negative) at EUR2.8 billion; and Globe Trade Centre S.A. (BBB-/Negative) at EUR2 billion; are bigger and more diversified. However, only GTC and BRE are diversified between retail and offices.

Akropolis has the most conservative financial profile with net debt/EBITDA expected at below 4.5x until 2026 and an LTV below 35%. BRE's net debt/EBITDA is expected at 6.0x-7.0x until 2025 and NEPI's at around 6.0x. NEPI's assets are lower-yielding at a net initial yield of 6.8%. The financial profiles of Globalworth and GTC are weaker.

KEY ASSUMPTIONS

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

- Rent increase of 7% in 2023 including CPI indexation effect. Average rent increases in 2024-2026 of 4%, reflecting CPI indexation effect and Vingis's first rent in 2026
- Stable occupancy of above 97%
- Around EUR270 million capex until 2026, mostly related to the Vingis project
- No dividends paid for the next four years
- Akropolis's bond to be refinanced at 6.5% in 2026

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Expansion of the 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
- Improvements in the consolidated profile of VP Group and Akropolis

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 and/or materially outside the assumed budget

- Liquidity score below 1.0x
- Transactions with related-parties that are detrimental to Akropolis's interests
- A deterioration in the consolidated profile of VP Group and Akropolis

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: Cash reported by Akropolis at end-2022 amounted to EUR176 million, including EUR42 million from the Akropolis Vilnius refinancing in September 2022. At end-2022 this EUR42 million, although available for Akropolis, was held in accounts pledged to banks as collateral. Out of a total of EUR62 million cash held in these accounts, Fitch treats EUR20 million as restricted, leaving Fitch-deemed readily available cash at EUR156 million.

The readily available cash, together with Fitch-forecast free cash flow (FCF) of EUR33 million, comfortably covers EUR8 million of loan amortisations in 2023. The next meaningful debt repayment is in 2026 when Akropolis's EUR300 million unsecured Eurobond matures. Akropolis does not use committed revolving credit facilities as a contingent source of liquidity.

Four out of Akropolis's five assets are unencumbered, resulting in an unencumbered assets/unsecured debt of 2.3x.

ESG CONSIDERATIONS

Akropolis has an ESG Relevance Score of '4' for Governance Structure, reflecting the lack of corporate governance attributes 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 ↕	RECOVERY ↕	PRIOR ↕
AKROPOLIS GROUP, UAB	LT IDR BB+ Rating Outlook Stable Affirmed		BB+ Rating Outlook Stable
senior unsecured	LT BB+ Affirmed	RR4	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 \(pub. 28 Oct 2022\)](#) (including rating assumption sensitivity)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub. 12 May 2023\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 16 Jun 2023\)](#)

APPLICABLE MODELS

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

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