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Research Update:

Leading Baltic Retailer Maxima Grupe Assigned 'BB+' Ratings Following Refinancing; Outlook Stable

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Overview

- Maxima Grupe successfully placed €300 million of senior unsecured bonds in September 2018, and the final terms of the debt are largely in line with our expectations.
- We are assigning Maxima Grupe and its senior unsecured debt our 'BB+' ratings.
- The outlook is stable.

Rating Action

On Oct. 12, 2018, S&P Global Ratings assigned its 'BB+' long-term issuer credit rating to Baltic retailer Maxima Grupe UAB. The outlook is stable.

At the same time, we assigned our 'BB+' long-term issue credit rating to Maxima Grupe's €300 million senior unsecured bonds.

These ratings are in line with the preliminary issuer credit rating we assigned on July 17, 2018, and the preliminary issue credit rating on Aug. 29, 2018.

Rationale

Maxima Grupe successfully placed €300 million of senior unsecured bonds in September 2018. This was part of the group's refinancing plans to enable its acquisition of Polish retailer Emperia Holding SA, the owner of Polish retail chain Stokrotka. The bonds' final terms are largely in line with our expectations and the group's credit metrics remain within the thresholds for our 'BB+' rating.

Maxima Grupe is a leading Lithuanian retail chain with a focus on food retail (over 75% of revenues) operating in the Baltics since 1998. It owns retail chain Maxima (in the Baltic states), Stokrotka and Aldik (in Poland), T-Market (in Bulgaria), and food e-store Barbora, which operates in Lithuania and Latvia. In 2017, pro forma the recent acquisition of Emperia and the integration of Franchisee Franmax, it generated €3.4 billion of sales, with about €221 million of reported EBITDA. The company is fully owned by Vilniaus

Prekyba--a holding company with other stakes in retail and real estate--and is the group's most important asset, with Maxima expecting to represent about 75% of the group's overall EBITDA in 2018.

The 'BB+' rating reflects our assessment of Maxima Grupe's leading position in the Baltics region, a market we deem less competitive than other European retail markets because of its relatively limited size and demographics. It also incorporates our view that the group's debt to EBTIDA, in particular on a reported basis, is somewhat lower than that of some other retail peers of comparable size, and further supported by a clear financial policy aimed at gradual deleveraging from the 2018 high point, due to the Emperia Holding acquisition for €285 million, excluding transaction-related costs. This stems from our anticipation of an increasing EBITDA margin and positive discretionary cash flow, despite a material dividend distribution.

Maxima has maintained its leading position (28% market share) in the Baltics, despite the greater pressures due to the arrival in Lithuania of large international discount retailer Lidl in 2016. In our view, this is thanks to Maxima's competitive price positioning and high brand awareness. We do not expect competition in the Baltics to escalate further, given the market's overall modest size, already competitive nature, and what we perceive as limited remaining growth avenues for new entrants.

We see Maxima's Baltic operations as a strength, given our expectation that the group's like-for-like growth in the region will remain in excess of 1.5%, driven by real GDP growth of about 3%-4% per year. That said, we expect that the Baltics combined GDP for 2018 will be about 4x less than that of Poland, where the group aims to continue expanding following the Emperia Holding acquisition. We forecast that the supportive macroeconomics trends, alongside the group's expansion plan in Poland as well as the Baltics, will result in overall growth of about 7% per year. We also believe the resilience and relative predictability of the food retail industry, as well as the group's modest exposure to foreign exchange risk--in particular in comparison with other Eastern European peers' thanks to the Baltics' adoption of the euro--provides the group with some visibility on revenues and earnings.

The group also benefits from a resilient operating model. In particular, we note the meaningful sales contribution from private labels of about 17%, which is in line with that of Western European peers, as well as its diversified store formats. Proximity format as of end-2017, as per the company's definition and without taking into account Emperia Holding's store network, already represented 45% of sales and about 77% of formats, and we expect these shares will rise. Both factors, in our view, support margins and help maintain Maxima's strong competitive advantage over peers. We understand that the group has a local sourcing strategy that provides the group with fairly good bargaining power, despite its overall limited size. Additionally, we believe the group benefits from a partly owned real estate network, with a book value estimated by management at approximatively €500 million and a market value that is likely higher.

Lastly, while online sales still represent a very small part of the group's revenues (less than 1% of sales), we believe the group is well positioned in that space, since it faces little competition and already has an online-dedicated offering through the Barbora website.

Our view of Maxima's business profile is constrained by its relatively small size, scale, and EBITDA base compared with other rated food retailers, as well as its still-substantial, but declining, geographic concentration (the Baltics represent over 75% of revenues). These factors tend to limit the group's bargaining power with suppliers, and its relatively narrow EBITDA base means less flexibility to adapt to potential disruptions, either from competition or unforeseen operating events, without hurting credit ratios. Additionally, the group's concentration of revenues exposes it to potential macroeconomic headwinds in the Baltics, although this is not our base case. Furthermore, while the expansion into Poland will improve diversification, we see a degree of execution risk given the presence of several large competitors in that market.

We anticipate a moderate increase in margins, notably thanks to the integration of the highly EBITDA-accretive Franchisee Franmax, and to synergies from the Emperia Holding acquisition. Maxima's adjusted EBITDA margin was about 7.2% in 2017, and we forecast it will increase to about 8.0%-8.5% in 2018. While Maxima's adjusted EBITDA margin is somewhat higher than that of larger Western European peers, it remains modest, in our view, given that the group owns 45% of its store network (which should reduce fixed costs) and is of a much more moderate size, which we consider facilitates implementation of cost-control initiatives. Maxima's margins are below what we see for Russian retail peers, such as X5 and Magnit, who typically have adjusted EBITDA margins of about 11%-12%.

The group's debt increased in 2017 and 2018 owing to the Emperia acquisition. We understand the group plans to refinance part of the bank debt raised for that purpose, which could translate into €150 million of new funding from 2017 levels. We estimate that this will result in adjusted debt to EBITDA of about 2.7x-2.8x in 2018, and 2.4x-2.6x from 2019 as the group's EBITDA base increases. The S&P Global Ratings-adjusted metrics incorporate our operating lease adjustment, which in the case of Maxima Grupe is significant, pro forma the Emperia Holding acquisition, with about €496 million of operating lease adjustments for 2018 against €282 million based on 2017's audited figures. Mitigating this, we note the group's comfortable EBITDAR ratio of over 3x and solid free operating cash flow (FOCF), despite high capital expenditures (capex).

That said, we expect deleveraging will slow because of the group's expansion plans, which entail annual investments of about €90 million-€100 million in 2018 and 2019, as well as planed annual dividends of about €90 million-€100 million. That said, excluding the Emperia Holding deal, we expect discretionary cash flow generation will remain positive throughout the period, enabling the group to comply with its net leverage ratio threshold under the current financial policy. We also note that the business has working-capital-supportive characteristics.

In our base case, we assume:

- Real GDP growth in Lithuania of about 2.9%-3.1% from 2018 to 2020, buoyed by firming exports and strong investments, with inflation of 2.3%-2.6%, which is above the Eurpoean Central Bank's target range.
- Real GDP growth in Latvia of about 3%-4% over the next two years, supported by strong investments and favorable external environment. Wage growth will have inflationary implications, and we expect inflation of 2.6%-2.8% over this period.
- Real GDP growth in Estonia, Bulgaria, and Poland of about 3%-4% over the next two years, driven by favorable external environment and an uptick in exports.
- Revenue growth of about 5%-7% for 2018 and 2019, supported the abovementioned economic conditions, the group's store development plan, expansion in Poland, and our anticipation of like-for-like growth in excess of 1.5% in all of the group's geographies. That said, we expect price pressures in its main markets to remain, in particular as we perceive consumers as particularly price sensitive.
- Moderate gross margin improvement by about 30-50 basis points on a pro forma basis, driven by the group's centralization efforts, improved negotiating terms thanks to increased size, and development of private label offerings. Mitigating this, competitive conditions in the food retail market and potential for cost inflation could constrain any meaningful uplift.
- A reported EBITDA margin of about 6.0%-6.5% for 2018 and 2019, broadly stable from the 6.3% pro forma reported in 2017 and increasing from historical levels, thanks to contributions from Franchisee Franmax in particular. This should translate to an adjusted EBITDA margin of about 8%-9% in 2018 and 2019. While we expect some economies of scale from the Emperia acquisition, a rise in restructuring costs could weigh on the EBITDA margin, especially in 2018.
- Capex to remain around 2.5%-2.7% of sales through 2019 (excluding the Emperia acquisition), equating to about €90 million-€100 million of capex per year, which should translate into reported FOCF generation in excess of €120 million per year. We expect a material portion of this capex to be dedicated to the expansion in Poland.

Based on these assumptions, we arrive at the following credit measures:

- An adjusted debt to EBITDA of about 2.7x-2.8x in 2018, declining to 2.4x-2.6x in 2019, together with funds from operations (FFO) to debt of 28%-32% in 2018 and 30%-34% in 2019; corresponding to a net reported leverage of about 1.3x in 2018 and 1.0x-1.1x in 2019.
- An EBITDAR ratio exceeding 3x, and remaining stable over the next few years.
- Most of the reported FOCF to be absorbed by the group's dividend

distribution. That said, we expect discretionary cash flow generation to remain positive throughout the period at around €30 million in 2018, climbing to €40 million in 2019.

Importantly, Maxima Grupe is part of a wider group, Vilniaus Prekyba, whose main consolidated asset is Maxima. Vilniaus Prekyba also consolidates a pharmacy business Euroapotheca, which we expect will generate about €45 million of reported EBITDA in 2018, and consider has fairly good geographic diversification. Vilniaus Prekyba also owns a real estate business, Akropolis, which we assume will generate about €22 million of EBITDA. Vilniaus Prekyba is slightly more leveraged than Maxima alone on a net reported basis, by about 0.2x-0.3x as per our estimates. That higher level of leverage results from the acquisition of ApoteksGrupen in Sweden by Euroapotheca for a €334 million cash consideration. Offsetting this, we understand Vilniaus Prekyba is looking at various alternatives to deleverage the business and to reduce debt at the holding level. We expect the gross reported debt at the Vilniaus Prekyba level to stand at around €1 billion for 2018, with about €446 million of cash immediately available and a comparable operating leases adjustment. Thanks to incremental EBITDA provided by the group's other businesses, adjusted leverage stands around 2.5x-2.7x, slightly lower than that of Maxima Grupe.

Given that Maxima Grupe contributes the bulk of the overall group revenues and earnings, and because we consider Maxima Grupe the largest business of founder Mr. Nerijus Numavicius, we believe it is a core entity to the wider group. We also understand there is no plan for a partial listing of Maxima Grupe and that main shareholders intend to retain control of the company going forward.

Lastly, we note that Vilniaus Prekyba services a very modest dividend to entities above it in the group, which we understand are debt free on a stand-alone basis. We assess the wider group credit profile (GCP) at 'bb+', which is driven by and consistent with our assessment of Maxima's stand-alone credit profile (SACP) at 'bb+'. Hence, our final rating on Maxima Grupe is in line with its SACP and the GCP.

Liquidity

Following the recent refinancing, we assess Maxima Grupe's liquidity as adequate. This is based on our calculation that its sources of liquidity will exceed uses by about 2x over the next 12 months, and our expectations that the sources would cover liquidity uses even if EBITDA were to decline by 15%. Our liquidity assessment of the group is further underscored by management's strong commitment to maintain liquidity of at least €100 million, and by the group's committed bilateral lines available, not included in our sources given that we understand that they mature in less than 12 months, but which are still available in case of short-term needs.

Over the next 12 months, we expect principal liquidity sources to include:

- Cash and liquidity investments of about €174 million;
- €23 million of committed overdraft maturing beyond 21 months

- About €200 million of FFO; and
- Working capital inflows of about €15 million.

For the same period, we expect principal liquidity uses to include:

- Seasonal working capital requirements of €60 million;
- About €45 million-€50 million of maintenance capex outflows (as opposed to about €90 million of overall capex); and
- Dividends up streamed to Vilniaus Prekyba of €90 million-€100 million.

We forecast comfortable headroom under the proposed covenants and the covenants existing for the remaining senior secured debt.

With the recent refinancing, the group's main maturity is now more than four years.

Outlook

The stable outlook reflects our expectation that Maxima Grupe will defend or strengthen its already solid position in the Baltic food retail markets, and soundly execute on its Polish acquisition. This should allow the group to augment its revenues and earnings, underpinned by the recent strengthening in operating margins stemming from the Franchisee Franmax integration and cost-control efforts.

We think the group will gain some upside from acquisition-related synergies, partially offset by the impact of incremental restructuring costs and inflationary pressures.

In our base case, we forecast S&P Global Ratings-adjusted FFO to debt at about 30% and adjusted debt to EBITDA of about 2.7x-2.8x in 2018 and trending toward 2.5x by end-2019.

Our stable outlook also points to our anticipation of balanced financial policies, particularly related to capex and dividends, and comparable credit metrics at the Vilniaus Prekyba group level, namely FFO to debt of around 30% in 2018 and above 35% in 2019.

Downside scenario

We could consider a downgrade if there was a significant decline in operating performance, with profitability deteriorating substantially because of stiff market competition, or a weaker market environment in the Baltics or Poland, or because of a difficult integration of Emperia Holding weighing on margins.

Although not in our base case, we could also consider a negative rating action if Maxima Grupe's current financial policy became more aggressive in the form of increased dividend distribution or large-scale, debt-funded acquisitions.

Such a scenario would result in weakening credit metrics from what we currently anticipate at the group level, for example, the adjusted debt to EBITDA increased to above 2.8x in 2018, or if FFO to debt meaningfully lower than 30%.

Upside scenario

An upgrade is remote at this stage, since we see Maxima Grupe's overall size and narrow EBITDA base constraining our overall assessment of its credit quality.

Over the next 18-24 months, Maxima Grupe's SACP may benefit from a marked improvement in trading, resulting in an EBITDA margin in excess of 10%. This could translate into improved credit metrics stemming from stronger free cash flow generation, causing adjusted FFO to debt to move closer to 45%, with adjusted debt to EBITDA decreasing toward 2x on a consistent basis. Even if we were to revise upward our assessment of Maxima Grupe's SACP, an upgrade would still hinge on our view of the credit profile of the wider Vilniaus Prekyba group. For any rating upside, there needs to be a low risk of releveraging at both Maxima Grupe and the Vilniaus Prekyba group level, based on our assessment of the group's financial policy. Additionally, we would need to see similar improvement in the wider Vilniaus Prekyba group's credit metrics, to comparable levels as that of Maxima Grupe, and a track record of prudent financial policy across the whole group.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/--

Business risk: Fair
- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Fair

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 ratings analysis: Neutral (no impact)

Stand-alone credit profile: bb+

- Group credit profile: bb+
- Entity status within group: Core (no impact)

Issue Ratings--Subordination Risk Analysis

Capital structure

Following the bond issuance, Maxima Grupe's capital structure comprises about €585 million of debt, the bulk of it represented by the recently issued €300 million senior unsecured bond. In addition, the group will still have about €244 million of remaining portion of secured debt and or unsecured debt standing at the subsidiaries level.

Analytical conclusions

The proportion of secured debt and unsecured debt both at the group and subsidiaries level is about 40% in our calculation of overall financial debt, in line with our criteria. We also note the group will have about €50 million of secured debt amortizing over the upcoming 12 months. We have also reviewed the final credit documentation and terms are in line with our initial expectations.

As a result, the 'BB+' rating on the senior unsecured bond is in line with the issuer credit rating. This is because no significant elements of subordination risk are present in the capital structure.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Retail And Restaurants Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Leading Baltic Retailer Maxima Grupe UAB Assigned Prelim 'BB+' Rating On Planned Refinancing; Outlook Stable, July 17, 2018
- Leading Baltic Retailer Maxima Grupe Senior Unsecured Bonds Assigned Preliminary 'BB+' Rating, Aug. 29, 2018

Ratings List

New Rating

Maxima Grupe UAB	
Issuer Credit Rating	BB+/Stable/--
Senior Unsecured	BB+

Additional Contact:
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