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Research Update:

Food Retailer Maxima Grupe Outlook Revised To Stable From Negative On Stronger Operating Results; 'BB+' Rating Affirmed

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Rating Action Overview

- Maxima Grupe UAB's (Maxima's) operating performance in 2020 and first-half 2021 was stronger than we expected, lowering S&P Global Ratings-adjusted leverage to about 2.6x-2.9x for 2021 despite COVID-19 pandemic headwinds and intensifying competition in the Baltics.
- Although earnings growth will be supported by expansion in Poland, we believe that related investments and substantial dividends paid to shareholder Vilnius Prekyba (VP) will constrain further deleveraging on a stand-alone basis.
- However, VP's stronger credit metrics and a supportive financial policy commitment from VP and Maxima's management support our rating.
- We therefore revised our outlook on Maxima to stable from negative and affirmed our 'BB+' long-term issuer credit and issue ratings on the group and its senior unsecured debt.
- The stable outlook reflects Maxima's earnings growth, resulting in debt to EBITDA of about 2.6x-2.9x for Maxima and 2.0x-2.5x for the wider VP group in 2021 and 2022, with timely bond refinancing expected early next year and dividends not exceeding free operating cash (FOCF) after lease payments.

Rating Action Rationale

Maxima's operating performance in 2020 and 2021 exceeded our expectations and we now forecast stronger credit metrics. Maxima's trading performance was mainly supported by its store expansion, with 101 new stores in 2020, and stronger food demand in its developed e-commerce channel Barbora, which represented about 3.4% of revenue in the Baltics. However, like-for-like sales were modest due to intensifying competition in the Baltics. Cost efficiencies and optimized promotional activities realized during the pandemic resulted in adjusted EBITDA margins improving 90 basis points (bps) in 2020. We expect this trend to hold in 2021, underpinned by about 100 new stores, moderate positive like-for-like growth across geographies, and a robust EBITDA margin, which remains somewhat above prepandemic levels despite moderating from second-half 2021. Consequently, Maxima achieved lower adjusted leverage of 2.8x in 2020, compared with the 2.9x-3.1x that we expected previously. In light of resilient trading and cash generation, we expect these stronger credit metrics to persist in 2021.

Maxima's switch in focus to Poland from more saturated Baltic markets supports diversification and reduces the impact of competition from large food retailers. Maxima has a market leading position in the Baltic region and superior profitability in Lithuania. However, we see the risk that this could deteriorate following the entry and expansion of Lidl, a leading international player focused on competitive pricing, in the Baltic region. We also forecast slower growth in increasingly saturated Baltic markets. That said, we acknowledge Lidl is a discount retailer, which leaves room for the premium, quality, and fresh assortments that Maxima is more associated with in the Baltics. The group's well diversified store formats also enable it to capture a large customer base and strengthen its competitive advantage. Maxima is focusing on expansion outside the Baltics in Poland, following the acquisition of local food retail chain Emperia in 2018, and ramping up its small business in Bulgaria. Given Poland's overall market size and Maxima's brand awareness there, we see high growth potential, with most of the about 100 store openings planned in the country. In 2020, the Polish business saw revenue growth of about 10% and company adjusted EBITDA growth of about 30%, which indicates much better growth prospects despite Maxima's limited market share, and it has demonstrated solid execution of the expansion so far.

Deleveraging remains constrained by higher-than-usual capital expenditure (capex) and continued dividend distributions. We expect Maxima to add about 100 new stores annually in the next two years, leading to higher capex. It also pays sizeable dividends to parent company VP. In 2021, it paid €106 million and we expect about €80 million-€90 million annually in 2022 and 2023. This financial policy will consume most of the strong operating cash flows expected for the next two years from growth and Maxima's high profit levels. Following exceptionally high discretionary cash flow (DCF) after lease payments, capex, and dividends of about €50 million in 2021, we also expect only neutral DCF. This limits cash accumulation and any material debt reduction in absolute terms.

Maxima's financial policy supports the current rating but limits upside. Due to sizable discretionary spending on dividends and planned investments, we see Maxima's credit metrics at the weaker end for the current rating level over the next two years. We take comfort from its resilient adjusted FOCF to debt of 15%-20% in 2022 and 2023, which demonstrates high cash generation and a robust ability to withstand potentially stronger than expected operating setbacks. This is coupled with our view of a supportive financial policy framework and the management and shareholder commitment to maintain leverage broadly within our expectation for the rating. At the same time, we understand that management intends to maintain an efficient balance sheet at Maxima, with no real deleveraging below currently anticipated levels on a sustainable basis.

The VP group continues to support our rating on Maxima. Maxima is part of VP, a wider group that includes geographically diversified pharmacy business Euroapotheca UAB, real estate business Akropolis Group UAB, as well as ERMI Group UAB, which has retail operations in construction, finishing materials, and household products in Lithuania and Estonia. These entities were positive contributors to the group's overall profitability and cash flow in 2020 and provide diversity in industries beyond food retail. Since Maxima still represents nearly 75% of VP group, its stronger than expected performance has positively affected overall results. In addition, we highlight that shareholder distributions at the VP level are lower compared to Maxima and cash generation is stronger. We therefore expect stronger deleveraging at the VP level following the current acquisition and related investments executed at Akropolis. We anticipate S&P Global Ratings-adjusted leverage of 2.4x-2.6x in 2021 and 2.0x-2.5x in 2022. These metrics place the wider group more soundly at the current rating level in comparison to Maxima. We believe this further supports our rating on Maxima.

Maxima's above-industry-average management turnover does not substantially influence our view of its governance. We note that Maxima has seen more senior management level changes than the wider industry average. Although we generally associate frequent changes with the risk of strategic and operational missteps, we note that Maxima's operating performance has improved since current CEO Mantas Kuncaitis took office in October 2020. Moreover, the majority of the leaving personnel remained part of the group in different positions. In addition, we note that Maxima's notes are maturing in September 2023. Although they represent nearly half of the interest-bearing debt, we currently envisage a smooth refinancing in first-half 2022, which will support our current rating. This is supported by the group's now-stronger operating performance and the bond's current pricing, which is well-above par in capital markets.

Outlook

The stable outlook reflects our expectations that Maxima will maintain its leading market position in the Baltics despite intensifying competition, soundly execute planned store expansion in Poland and Bulgaria, and see normalizing demand for food following the end of lockdowns, resulting in 4%-8% sales growth and S&P Global Ratings-adjusted EBITDA margins falling toward, but not below, 2019 levels. It also takes into account Maxima's prudent dividend distributions, funded through FOCF, and our expectation of 30%-35% S&P Global Ratings-adjusted funds from operations (FFO) to debt and about 2.6x-3.0x adjusted debt to EBITDA in 2021 and 2022. In addition, we expect stronger credit metrics and deleveraging at the VP group level, with debt to EBITDA of 2.4x-2.6x-x in 2021 and 2.0x-2.5x in 2022, supported by a continued more conservative financial policy.

Downside scenario

We could lower the ratings on Maxima if:

- The company significantly underperforms our base case, including a material decline in operating performance, with dropping profitability because of intensifying market competition, or a weaker macroeconomic environment in the Baltics or Poland, weighing on margins and cash flows;
- Maxima's or VP's current financial policies become less prudent, either due to increased dividends or large-scale, debt-funded acquisitions that kept leverage at about 3.0x or above and FFO to debt below 30% at either Maxima or the wider group; or
- Maxima's or VP's liquidity deteriorates or the senior notes refinancing is not addressed in a timely manner.

Upside scenario

Albeit unlikely over the next 12 months given our understanding of management's financial policy, we could raise the ratings following stronger than expected operating performance at Maxima and the overall VP group. This would include:

- Adjusted debt to EBITDA falling below 2.0x for Maxima and VP;
- Maxima's FOCF substantially exceeding actual dividend payments resulting in debt reduction; and
- Solid liquidity levels that are maintained.

We would also need to see a financial policy commitment from Maxima and its parent to sustain these credit metrics.

Company Description

Maxima is the leading food retailer in the Baltic countries, with a market share of about 27%. Operating since 1998, the group has experienced rapid growth in its home market and started to expand internationally, entering Bulgaria in 2011 and subsequently Poland. In 2020, Maxima generated more than €4.2 billion of sales, with about €385 million of reported EBITDA. The company is fully owned by VP--a holding company with other stakes in retail and real estate. Maxima is the group's most important asset, generating about 75% of its overall EBITDA in 2020.

Our Base-Case Scenario

Assumptions

- Real GDP in Lithuania and Latvia to expand 2.5%-3.0% in 2021 after a contraction of 0.8% in Lithuania and 3.6% in Latvia in 2020.
- Real GDP in Poland to expand 3.2%-3.6% in 2021 and 4.2%-4.6% in 2022 after a contraction of 2.7% in 2020.
- Revenue to increase about 6%-8% in 2021 and 5%-7% in 2022, reflecting the strong store expansion in Poland and Bulgaria, along with about 1%-2% sales growth on a like-for-like store basis.
- S&P Global Ratings-adjusted EBITDA margins to contract somewhat to 8.5%-8.9% in 2021 versus 9.1% in 2020 due to continued pandemic-related costs and increasing input costs that may not be fully transitioned to customers. For 2022, we expect margins to moderate to 8.2%-8.6% but remain somewhat above prepandemic levels, reflecting price competition from Lidl in the Baltics and an increasing share of relatively weaker margins in Poland.
- Annual working capital inflows of about €20 million in 2021 and neutral working capital from 2022.
- Capex of €100 million-€120 million in 2021 and €160 million-€180 million in 2022 given accelerating store expansion in Poland. This incorporates about €50 million-€80 million of maintenance capex a year and substantial expansion capex.

- Annual dividends of €80 million-€110 million in 2021-2023, in line with the company's policy to pay out 50%-70% of last year's net income.
- No material acquisitions.
- Ongoing annual repayments on amortizing debt of €50 million-€100 million in 2021-2022.

Key metrics

Table 1

Maxima Grupe UAB--Key Metrics*

	--Fiscal year ended dec. 31--				
	2019a	2020a	2021f	2022f	2023f
(Mil. €)					
Revenue	3,993.1	4,225.6	4,400-4,600	4,700-4,900	4,900-5,100
Revenue growth (%)	15.7	5.8	6-7	5-6	5-6
EBITDA	328.2	385.5	370-310	380-420	410-450
EBITDA margin (%)	8.2	9.1	8.6-8.8	8.3-8.5	8.3-8.5
Funds from operations (FFO)	274	327.1	320-340	330-350	350-370
Capital expenditure	126.6	99.8	100-120	160-180	160-180
Free operating cash flow (FOCF)	176	177.5	235-255	160-180	180-210
Dividends	82	86.6	106	80-90	80-90
Debt	1,050.4	1,094.7	1,000-1,100	1,000-1,100	1,000-1,100
Debt to EBITDA (x)	3.2	2.8	2.6-2.9	2.6-2.9	2.4-2.6
FFO to debt (%)	26.1	29.9	30-32	30.5-32.5	33-35
FOCF to debt (%)	16.8	16.2	20-24	14-18	16-20

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Maxima's liquidity as adequate. This is based on our calculation that its sources of liquidity will exceed uses by just above 1.2x over the next 12 months and our expectation that sources would cover uses even if EBITDA declines 15%. Our assessment is further underscored by management's strong commitment to maintain sound liquidity of at least €100 million and the group's available committed bilateral lines. These are not included in our sources given our understanding that they mature in less than 12 months but are still available in case of short-term needs. In addition, we expect that the group will refinance its €300 million unsecured bond, maturing in September 2023, in a timely manner.

We estimate Maxima's liquidity sources for the next 12 months started Oct. 1, 2021, include:

- Cash and liquid investments of about €170 million; and
- Forecast FFO of €225 million-€250 million.

We estimate liquidity uses for next 12 months started Oct. 1, 2021, include:

- Debt repayments of about €135 million.
- Seasonal working capital requirements of about €50 million;
- €70 million-€90 million in confirmed maintenance capex out of total budgeted capex; and
- Dividends to VP of €80 million-€90 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

Maxima's capital structure comprises about €520 million of financial debt, of which €300 million is a senior unsecured bond issued in October 2018 and maturing in September 2023. In addition, the group still has about €175 million of secured debt and/or unsecured debt at subsidiaries.

Analytical conclusions

The 'BB+' issue rating on the senior unsecured €300 million bond is in line with the long-term issuer credit rating. The issue rating is supported by the moderate amount of priority-ranking liabilities in the capital structure, comprising secured debt and unsecured debt, both at the group and subsidiary levels. We estimate the priority debt ratio at about 34%, which is below our 50% threshold, supporting our view that there are no significant elements of subordination risk in the capital structure.

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)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb+

- Group credit profile: bb+
- Entity status within group: Core

Related Criteria

- 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 | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Maxima Grupe UAB		
Issuer Credit Rating	BB+/Stable/--	BB+/Negative/--
Senior Unsecured	BB+	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.