NEPI Rockcastle plc (/gws/en/esp/issr/96565755)

FitchRatings

Fitch Assigns 'BBB' First-Time Ratings to NEPI Rockcastle

Fitch Ratings-London-01 November 2017: Fitch Ratings has assigned a Long-Term Issuer Default Rating (IDR) of 'BBB' with a Stable Outlook to real-estate company NEPI Rockcastle plc. Fitch has also assigned a senior unsecured rating of 'BBB'.

The rating reflects the company's portfolio of dominant shopping centres in eight central and eastern Europe (CEE) countries, mainly in Romania (39% by market value) and Poland (29% by market value). The average occupancy rate exceeds 95% with an average lease maturity of 4.2 years and high renewal rates. The tenant profile has good granularity and predominantly comprises large international and local companies. Despite rapid growth, the company has maintained conservative finances, in part owing to strong shareholder support.

At the same time, Fitch believes the company's significant acquisition plans could be a source of operational risk, although the company has a solid history of integrating new assets. In addition, although about 95% of the portfolio is located within investment-grade countries, about 60% is in jurisdictions that Fitch rates 'BBB-' or lower. We also believe there is an element of foreign-exchange risk as leases and debt are denominated in euros, while tenants generate revenue in local currency. A substantial devaluation could therefore stress tenants' revenue and ability to meet rental payments.

KEY RATING DRIVERS

Strong Portfolio
NEPI Rockcastle's retail portfolio mainly comprises dominant shopping centres in large and medium-sized urban conglomerations across CEE. The portfolio features large catchment areas with good macro-dynamics, with a total gross lettable area exceeding 1.5 million square metres (sq m) and an occupancy rate of over 95%. The portfolio also includes a small, but sound, portfolio of high-quality offices in Romania's three largest cities, as well as in Bulgaria and Slovakia.

Diversified Offering and Tenant Mix
The shopping centres have a wide variety of offerings: nearly all have a major food anchor, such as Carrefour or Auchan, a diversity of stores with a bias toward fashion, as well as food and entertainment outlets. Tenants are mainly large international and local companies with a good credit profile. Granularity is good with the 10 largest tenants accounting for less than 25% of total annual rent. The average lease length is 4.2 years with high renewal rates.

Good Economic Prospects
CEE countries have been benefiting from growing GDP and consumer spending, supported by sound macro fundamentals and healthy banking systems. Active real-estate markets have also been attracting good investment.

Some Asset Concentration
While geographic and tenant diversity is good, there is some asset concentration with the 10 largest assets generating about 46% of passing rent. Nevertheless, this will decrease as NEPI Rockcastle continues to expand through acquisitions and developments.

Rapid Growth to Continue
NEPI Rockcastle expects to continue the high levels of acquisitions that drove the rapid growth of NEPI and Rockcastle. While we expect the company to continue to acquire active, tenanted shopping centres and to maintain the current conservative financial position, we have some concerns that the volume of acquisitions may increase operational risks.

Element of Currency Risk
NEPI Rockcastle's leases and debt are denominated in euros, while tenants generate revenue in local currency. Rent is invoiced in the equivalent local currency with any material differences between the invoice and collection recoverable from the tenants, which largely mitigates this risk. Nevertheless, a substantial devaluation could weaken tenants' revenue as well as their ability to meet rent obligations. That said, the various currencies in the portfolio have been stable against the euro for some time.

Strong, Flexible Financial Position
The company has a conservative financial structure and policy, which centres on a loan/value (LTV) of 35% and a maximum limit of 40% in exceptional cases. The current LTV is a low 30%. Fitch forecasts net debt/EBITDA to be around 5.0x over the next two years, which is low for the sector and reflects the comparatively high yields of the assets. Frequent and oversubscribed equity issuances have supported rapid expansion while maintaining low leverage, recently demonstrated in October 2017, when the company raised EUR325 million - more than 70% above the initial target. NEPI Rockcastle holds an investment portfolio (gross exposure valued at EUR1.16 billion at June 2017), largely comprising liquid real-estate and

infrastructure holdings. The company can borrow against the holdings, replenishing the position through debt or divesting the shares, adding financial flexibility.

DERIVATION SUMMARY

Atrium European Real Estate Limited (BBB-/Stable), which largely focuses on retail investments in Poland, maintains a similarly conservative financial profile and good key performance indicators, such as high occupancy rates and reasonably long lease maturities. Atrium, however, has some riskier exposure to Russia, as well as to Turkey through its land bank. NEPI Rockcastle's scale and geographic diversity is also higher than Atrium. We expect the portfolio to surpass EUR5 billion within the upcoming year and to continue expanding, achieving similar scale to that of PSP Swiss Property AG (BBB+/Stable) and approaching that of UK-based Hammerson plc (BBB+/Stable). Nevertheless, these companies, as well as British Land Company PLC (BBB+/Positive), are in a more stable business position in mature markets with long operating histories.

KEY ASSUMPTIONS

- Similar vacancy levels over the forecast horizon
- Gross yield on capex and acquisitions consistent with the current portfolio
- Capex of about EUR1 billion over the next four years
- Continued significant acquisitions over the next four years
- Reduction of the listed securities portfolio
- Consistent ability to raise equity from shareholders

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Continuing the expansion and positive diversification of the portfolio, while maintaining similar occupancy rates, current conservative financial profile, and like-for-like growth.
- Proportional increase to higher-rated countries in the portfolio, either through expansion or through ratings upgrades.
- Establishing a longer operating history of stable operations.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Material expansion into new or existing non-investment-grade countries.
- Significant deterioration of operating metrics on a sustained basis, such as higher vacancies.
- Increase in leverage with such metrics as LTV (adjusted net debt/investment properties) consistently exceeding 35% or net debt to EBITDA surpassing 6.5x on a sustained basis.
- A liquidity score below 1.25x on a sustained basis.
- Inability to pass large foreign-exchange movements to tenants.

LIQUIDITY

NEPI Rockcastle has a comfortable liquidity position. The company had EUR70 million of cash (combined basis as of end-2016), as well as undrawn revolving facilities of EUR380 million (end-August 2017). The first maturity is not until 2018, when the revolving facilities mature, while the first outstanding debt facility repays in 2020.

The company uses their listed securities portfolio as a source of additional liquidity, borrowing against the shares to make acquisitions, subsequently replenishing the position through debt or divesting the shares. Fitch excludes the assets from liquidity calculations, but accounts for the net dividend income stream (net of the interest expense on equity derivatives) under recurring associate dividends. Therefore, it is included in coverage and leverage ratios, but excluded from operating EBITDA.

NEPI Rockcastle also has a demonstrated ability to quickly issue new equity through book builds as fast as six working days from announcement to receipt of funds, recently raising EUR325 million to fund acquisitions, a significant oversubscription. In case of adverse conditions, the company has a large unencumbered pool of assets and can reduce or eliminate dividends, as it is not a real-estate investment trust, or REIT.

FULL LIST OF RATING ACTIONS

NEPI Rockcastle plc
Long-Term IDR: Assigned at 'BBB', Stable Outlook
Long-Term senior unsecured rating: Assigned at 'BBB'

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Summary of Financial Statement Adjustments - Not applicable.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017) (https://www.fitchratings.com/site/re/901296)
Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 16 Jun 2017) (https://www.fitchratings.com/site/re/899659)

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