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Summary:

NEPI Rockcastle PLC

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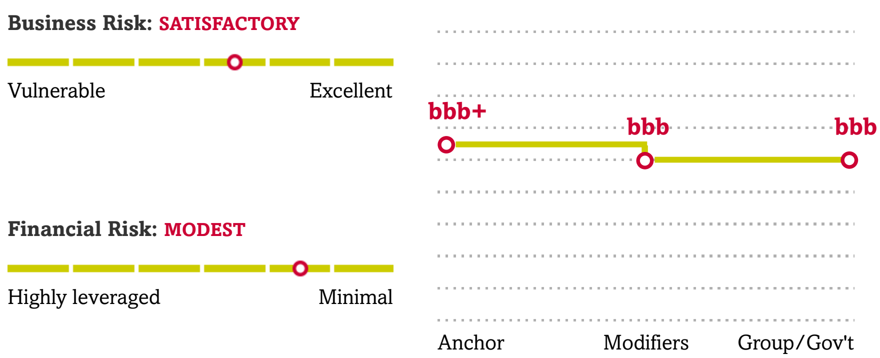

CORPORATE CREDIT RATING

BBB/Stable/--

Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• A €4.8 billion income-producing property portfolio, consisting of retail assets in eight countries of Central and Eastern Europe (CEE) with a large share in Romania and Poland. • Sound operating performance, with high occupancy, positive like-for-like rental income growth, and a well-spread lease maturity profile. • Good asset quality with well-located modern shopping centers. • Relatively high country risk in developing CEE markets and lower barriers to entry than in developed markets. • Concentration on the retail property sector, which is currently exposed to negative global trends. • Foreign currency exposure through euro-denominated tenant agreements with customers whose retail turnover is in local currencies.	• Modest leverage, with the financial policy centered on a loan-to-value (LTV) ratio of less than 35%. • Good access to equity capital markets. • A well-spread debt structure with no large maturities in the next two years and an unencumbered asset ratio of more than 75%.

Outlook: Stable

The stable outlook on retail property owner, NEPI Rockcastle PLC reflects S&P Global Ratings' view that the company should continue to benefit from healthy economic trends in CEE, particularly in Romania and Poland, thanks to its quality assets. We also believe its debt to debt and equity will be less than 35% and EBITDA interest coverage higher than 3.8x over the next two years, supported by the company's resilient cash flows and conservative financial policy. We expect NEPI Rockcastle will maintain a large liquidity buffer.

Downside scenario

We could consider taking a negative rating action if, in particular, NEPI Rockcastle's debt to debt plus equity increased above 35% as a result of unexpected asset devaluations, or if its EBITDA interest coverage fell below 3.8x. Downward rating pressure might also materialize if we see negative dynamics in its operating performance. We could also take a negative rating action on NEPI Rockcastle if Romania experienced economic, monetary, or political turbulence, leading to a sovereign downgrade.

Upside scenario

An upgrade would hinge on NEPI Rockcastle materially improving its portfolio in terms of size, as well as geographic and sector diversification, making it more comparable with that of peers with stronger business risk profiles. Necessary conditions for an upgrade are the ability to continue generating positive like-for-like rental income growth and showing positive portfolio revaluations. In addition, a positive rating action on NEPI Rockcastle would be contingent on an improvement of Romania's credit quality or a significant dilution of the company's exposure to Romania to less than 25% of its assets.

Our Base-Case Scenario

Assumptions

- Positive like-for-like rental income growth in 2018-2019. We assume occupancy will remain high at about 96%-97%, supported by solid demand from tenants and the shortage of modern properties in CEE.
- Overall net rental income and EBITDA growth of more than 50% in 2018, thanks to acquisitions and new developments.
- Marginally positive portfolio revaluations of 1%-2%.
- Large acquisitions financed with debt and equity issuance.

Key Metrics

	2017A	2018E	2019E
EBITDA interest coverage (x)	7.3	6.3-6.7	6.4-7.0
Debt/EBITDA	6.9	6.1-6.4	5.0-5.5
Debt to debt + equity (%)	27.8	31-34	30-34

A--Actual. E--Estimate.

Business Risk: Satisfactory

NEPI Rockcastle's business risk profile is underpinned by its position as a large retail property owner in CEE. It is the largest retail property owner in Romania, the fourth-largest in Poland, and the second-largest in Slovakia. It manages a portfolio of prime retail and office income-producing assets worth €4.8 billion as of Dec. 31, 2017. The company enjoys a high occupancy ratio of 96.5%. Most of the company's tenants are strong, multinational companies or regional leaders with triple net lease contracts fixed in euro. NEPI Rockcastle's portfolio consists of 56 core assets, including large shopping centers with over 35,000 square meters of gross rentable area on average. About 45% of NEPI Rockcastle's rental income is generated by assets in Romania, 23% in Poland, 10% in Bulgaria, 8% in Slovakia, 5% in Hungary, 5% in Croatia, 3% in Czech Republic, and 1% in Serbia.

We see limited development risk in the portfolio because a large share of development activities consist of the extension of existing projects, which are mostly pre-let. Moreover, the share of assets under development was less than 5% of the total portfolio as of Dec. 31, 2017. NEPI Rockcastle has a successful growth track record through acquisitions and development, with the size of its income-producing portfolio increasing to the current €4.8 billion from about €3.9 billion in July 2017.

We believe that NEPI Rockcastle's rent stability should be supported by the good asset quality of its portfolio, with prime positions in most of its locations, and a sound lease maturity profile with an average weighted lease maturity of about five years.

The business risk profile is mainly constrained by the company's exposure to developing economies, such as Romania or Bulgaria, which pose relatively high country risk. We understand that demand for retail and office space is increasing quickly across CEE, and current economic prospects are favorable. At the same time, barriers to entry in most CEE countries where NEPI is present are relatively low compared with those in developed markets such as France, creating a risk of oversupply.

Another risk is NEPI Rockcastle's concentration on the retail sector, which we believe to be exposed to negative global trends, such as the increasing penetration of e-commerce. At the same time, we note that the use of e-commerce is relatively low in CEE.

Furthermore, we see a risk from an increasing rent burden for tenants, due to currency movements (rents are contracted in euros, while tenants' revenues are in local currencies). We understand that NEPI Rockcastle's tenants have relatively modest occupancy costs (rent-to-sales ratio) of less than 15%, which somewhat mitigates this risk.

Peer comparison

Table 1

NEPI Rockcastle PLC--Peer Comparison

Industry Sector: Real Estate Investment Trust or Company

	NEPI Rockcastle PLC	Mercialys	Atrium European Real Estate Ltd.	Klepierre S.A.	CPI Property Group SA
Rating as of June 13, 2018	BBB/Stable/--	BBB/Stable/A-2	BBB-/Stable/A-3	A-/Stable/A-2	BBB/Stable/--

Table 1

NEPI Rockcastle PLC--Peer Comparison (cont.)

(Mil. €)	--Fiscal year ended Dec. 31, 2017--				
Revenues	234	176	189	1,332	484
EBITDA	217	149	166	1,025	235
Funds from operations (FFO)	188	118	116	825	132
Net income from cont. oper.	(580)	87	89	1,229	694
Cash flow from operations	209	139	101	812	121
Capital expenditures	153	103	62	287	116
Free operating cash flow	56	37	39	525	5
Discretionary cash flow	17	(70)	(115)	(84)	5
Cash and short-term investments	196	197	72	565	177
Debt	1,506	1,462	950	9,087	3,089
Equity	3,915	2,135	1,894	12,961	3,315
Valuation of investment property	4,928	3,604	2,582	21,617	6,519
Adjusted ratios					
EBITDA margin (%)	92.8	84.3	88.1	76.9	48.5
Return on capital (%)	5.6	3.1	5.5	4.6	3.6
EBITDA interest coverage (x)	7.3	4.9	4.6	5.5	2.4
FFO cash int. cov. (X)	17.4	2.7	3.9	4.6	2.4
Debt/EBITDA (x)	6.9	9.8	5.7	8.9	13.2
FFO/debt (%)	12.5	8.1	12.2	9.1	4.3
Cash flow from operations/debt (%)	13.9	9.5	10.7	8.9	3.9
Free operating cash flow/debt (%)	3.7	2.5	4.1	5.8	0.2
Discretionary cash flow/debt (%)	1.1	(4.8)	(12.1)	(0.9)	0.2
Total debt/debt plus equity (%)	27.8	40.6	33.4	41.2	48.2

Financial Risk: Modest

Our assessment of NEPI Rockcastle's financial risk profile is underpinned by the company's prudent financial policy, centered on an LTV ratio of less than 35%, which is low for the industry.

NEPI Rockcastle also holds a significant portfolio of listed securities (valuation of about €600 million as of Dec. 31, 2017), mostly of large real estate companies operating in the U.S., U.K., and Continental Europe. NEPI Rockcastle is gradually recycling this portfolio into higher yielding new direct property acquisitions.

Under our base-case scenario, we continue to anticipate a debt-to-debt-plus-equity ratio of 30%-34% in 2018-2019. We also forecast that the EBITDA interest coverage ratio will be strong, at more than 6x, over that period. We expect the total dividend distribution to shareholders to remain stable, although NEPI Rockcastle is not legally required to distribute dividends.

To test NEPI Rockcastle's resilience to a Romanian sovereign default, we stressed our forecast of the company's liquidity position. Even under this hypothetical scenario, we estimate the company would have sufficient cash flow to cover its needs, and liquidity sources covering more than 1x uses for one year. For this reason, we believe NEPI Rockcastle can be rated higher than Romania, but by no more than one notch.

Although the current trend for the Romanian and Polish retail property markets is positive, we see them as more volatile and cyclical than those of peers in the same business risk category, such as French retail for Mercialys and German residential for Around Town Properties. Moreover, we believe NEPI Rockcastle's credit ratios are weaker than those of peers that we assess in the same financial risk category, such as Global Switch. We apply a one-notch negative adjustment to take into account this comparable ratings analysis.

We understand that the company has good access to equity capital markets, as shown by its track record of issuing equity in recent years to fund its retail-assets acquisition pipeline. The company benefits from the support of its shareholders, two large South African property funds and one pension fund, that own 45.8% of the company's shares, with the rest owned by a large number of investors. At the same time, we note recent volatility in NEPI Rockcastle's share prices, due to unfavorable broker reports on its large shareholders.

We expect that NEPI Rockcastle's secured debt will remain less than 40% of its total assets. This results in a capital structure in which unsecured debt issuance is not structurally subordinated to other debt obligations to the extent that it would affect the rating on this debt.

Financial summary

Table 2

NEPI Rockcastle PLC--Financial Summary		
Industry Sector: Real Estate Investment Trust or Company		
	--Fiscal year ended Dec. 31--	
(Mil. €)	**2017**	**2016**
Revenues	233.8	147.5
EBITDA	216.9	132.9
Funds from operations (FFO)	188.0	112.4
Net income	(579.7)	235.0
Cash flow from operations	208.7	138.7
Capital expenditures	152.8	163.8
Free operating cash flow	55.9	(25.1)
Discretionary cash flow	16.9	(73.4)
Cash and short-term investments	195.5	48.0
Debt	1,506.3	704.1
Equity	3,914.7	1,814.6
Adjusted ratios		
EBITDA margin (%)	92.8	90.1

Table 2

NEPI Rockcastle PLC--Financial Summary (cont.)

Industry Sector: Real Estate Investment Trust or Company

	--Fiscal year ended Dec. 31--	
(Mil. €)	**2017**	**2016**
Return on capital (%)	5.6	5.4
EBITDA interest coverage (x)	7.3	5.6
FFO cash int. cov. (x)	17.4	11.0
Debt/EBITDA (x)	6.9	5.3
FFO/debt (%)	12.5	16.0
Cash flow from operations/debt (%)	13.9	19.7
Free operating cash flow/debt (%)	3.7	(3.6)
Discretionary cash flow/debt (%)	1.1	(10.4)

Liquidity: Adequate

We anticipate that liquidity sources will likely cover liquidity uses for 2018-2019 by 1.8x. We assess debt covenant headroom as adequate. NEPI Rockcastle has sound relationships with a diverse group of banks, and a generally satisfactory standing in capital markets. At the same time, we believe that the company's financial flexibility and access to capital markets are somewhat weaker than its larger peers' in Western Europe, and it would be challenging for NEPI Rockcastle to absorb high-impact, low-probability shocks. Consequently, we continue to view NEPI Rockcastle's liquidity as adequate.

Principal Liquidity Sources	Principal Liquidity Uses
• As of March 31, 2018, unrestricted cash balances and listed securities of about €603 million; • Undrawn long-term bank lines of €330 million; and • Funds from operations of about €300 million for the next 12 months.	• About €11 million of contractual debt repayments for the next 12 months; • Capital expenditure needs of approximately €360 million in the next 12 months for the development pipeline; and • Dividends estimated at around €300 million.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/--

Business risk: Satisfactory

- **Country risk:** Moderately high

- **Industry risk:** Low
- **Competitive position:** Satisfactory

Financial risk: Modest

- **Cash flow/Leverage:** Modest

Anchor: bbb+

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Stand-alone credit profile : bbb

Related Criteria

- 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, 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

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	**Modest**	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	**bbb+**	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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