FitchRatings

Fitch Affirms NEPI Rockcastle at 'BBB'; Outlook Stable

Fitch Ratings - London - 31 October 2018: Fitch Ratings has affirmed real-estate company NEPI Rockcastle plc's Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB' with a Stable Outlook. Fitch has also affirmed the senior unsecured rating of NE Property Cooperatief U.A., a 100% owned subsidiary of NEPI Rockcastle, at 'BBB'.

The ratings reflect the company's large portfolio of dominant shopping centres across central and eastern Europe (CEE), mainly located in Romania (37% by market value) and Poland (24% by market value). Despite rapid growth, the company has maintained a conservative financial profile with good liquidity and a high degree of financial flexibility. In addition, the expansion is steadily reducing asset concentration and continues to increase geographic diversification into higher-rated countries.

The Stable Outlook reflects our expectations that NEPI Rockcastle will continue its expansion, while maintaining its conservative financial profile by funding through a combination of debt and equity.

RATING ACTIONS

ENTITY	RATING		PRIOR
NE Property Cooperatief U.A.			
senior unsecured	LT BBB Affirmed		BBB
NEPI Rockcastle plc	LT IDR BBB Affirmed		BBB
senior unsecured	LT BBB Affirmed		BBB

KEY RATING DRIVERS

Strong Portfolio: NEPI Rockcastle's expanding retail portfolio predominately comprises dominant shopping centres in large and medium-sized urban conglomerations across CEE. The portfolio features large catchment areas with positive macro-dynamics and good transportation access. The total gross lettable area is around 2 million square metres (sq m) and the occupancy rate is 96%. 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.

Geographic Diversification Improving: Fitch views the continued growth into higher rated countries as a credit positive. The company now owns properties in nine countries across CEE, with 95% of the portfolio located in investment-grade countries. The large acquisitions of Arena Plaza (September 2017) and Mammut Shopping Centre (September 2018) in Hungary (BBB-/Positive), and Paradise Center (September 2017) in Bulgaria (BBB/Stable), have helped reduce concentration in Romania (BBB-/Stable) to 37% of asset value from 47% in August 2017. It has also improved geographic diversity, but Fitch would view positively further investment in 'BBB+' or higher rated countries.

Rapid Growth to Continue: We expect NEPI Rockcastle to continue to grow its portfolio through acquisitions and developments. From the end of 2017 to October 2018, the company grew by around EUR700 million to EUR5.4 billion. Fitch expects a similar level of expansion in 2019. The company has successfully integrated the shopping centres acquired in 2018 into the portfolio while maintaining operational efficiency metrics. Although future acquisitions will continue to bring execution risk, we expect the company to effectively integrate these and maintain its strong operational and financial profile.

Strong Financial Structure: The company has a conservative financial policy, targeting an LTV of 35%. In 2017, the Fitch-calculated LTV (adjusted net debt/investment properties) was 30% and net debt to EBITDA was 6.6x. We expect these metrics to slightly increase in 2018 and 2019, due to higher acquisitions and capex, but we expect this LTV and net debt to EBITDA to fall below 30% and 6x, respectively, by 2020.

Frequent and oversubscribed equity issuances have historically supported the company's ability to maintain low leverage despite rapid expansion. In 2018, the company has not issued any equity to finance its acquisitions and capex, instead selling down a portion of its listed securities portfolio, which comprises liquid real-estate and infrastructure holdings. We expect the company to retain its ability to raise equity in the future, but an inability to do so while remaining highly acquisitive would lead to a deterioration in the company's credit metrics and negatively impact the rating.

Some Asset Concentration: NEPI Rockcastle has some asset concentration, in part due to its ownership of large shopping mall assets. At 1H18, the top 10 assets accounted for about 47% of total standing investments and contributed 42% of the company's passing rent. Although this is a characteristic shared by some similarly sized peers, we view positively the company's continuing asset diversification.

Diversified Offering and Tenant Mix: The shopping centres have a wide variety of offerings, with nearly all having 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. Operational metrics are strong, with occupancies of around 96%, tenant revenue growth of 7.7% and a low occupancy cost ratio of 11.7% at 1H18. Tenant concentration is low, with the top 10 tenants representing 22% of rents. The weighted average remaining lease term is 4.1 years, which is comparable with peers. E-commerce penetration is still low across CEE at less than 5%. While this will certainly grow over the next few years, the company's portfolio of dominant, destination shopping centres will help manage the effects.

Element of Currency Risk: NEPI Rockcastle's leases and debt are euro-denominated, 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, substantial currency depreciation could weaken tenants' revenue as well as their ability to meet rent obligations. However, the various currencies in the portfolio have been stable against the euro for some time.

DERIVATION SUMMARY

NEPI Rockcastle's portfolio of EUR5.4 billion, spread across nine countries in CEE, is larger and more geographically diversified than Atrium European Real Estate Limited's (BBB-/Positive) EUR2.4 billion portfolio. However, it is smaller than Hammerson Plc's (BBB+/Stable) proportionally consolidated portfolio of around EUR10 billion, which is located in the more mature markets of Western Europe. Romania-based office real-estate company Globalworth (BBB-/Stable) is also smaller, with a portfolio of around EUR2.5 billion with higher exposure to Romania (57%) and higher assets concentration, with the top 10 assets accounting for 57% of the total.

NEPI Rockcastle's conservative financial profile is demonstrated by its low Fitch-calculated LTV of 30% and net debt to EBITDA of 6.6x. Atrium maintains a similarly conservative profile with LTV of around 33% and net debt/EBITDA of around 6.0x, while Globalworth's debt metrics are weaker with forecast LTV exceeding 40%. NEPI's financial profile is stronger than Hammerson's, but is similar to higher rated British Land plc (A-/Stable) and Derwent plc (A-/Stable). However, these companies have long operating histories through cycles in higher rated sovereign environments.

We do not apply a sector specific uplift to the senior unsecured rating, as NEPI Rockcastle operates in CEE where Fitch believes property investment markets are less liquid compared with other Western European markets. In addition, the company's secured debt is greater than 20% of total debt, which exceeds Fitch's criteria for a senior unsecured uplift.

KEY ASSUMPTIONS

- Similar vacancy levels over the forecast horizon
- Gross yield on capex and acquisitions consistent with the current portfolio
- Capex of around EUR900 million over the next four years
- Continued significant acquisitions over the next two years
- Listed securities portfolio to be sold down by the end of 2018
- Consistent ability to raise equity from shareholders

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Continued 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 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 AND DEBT STRUCTURE

Strong Liquidity, No Immediate Debt Repayments: NEPI's liquidity profile has further improved through 1H18, following the three year extension of two of its committed credit lines, the EUR100 million and EUR150 million revolving credit facilities (RCF) with ING and Societe Generale/Garanti Bank, respectively. As of 30 June 2018, the company had around EUR120 million of cash on balance sheet and access to an undrawn aggregate amount EUR300 million under its three RCFs. No significant maturities are expected in 2019, after which the first significant maturity is a EUR187 million loan on Bonarka City Center that falls due in 2020.

Securities Boost Liquidity: The company uses its 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. We expect the company to fully sell down the listed securities portfolio by the end of 2018.

Rapid Equity Issuance: 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, raising EUR325 million to fund acquisitions in 2017, 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. NEPI Rockcastle has not raised any equity in 2018.

DATE OF RELEVANT COMMITTEE

30 October 2018

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (/site/re/10023790)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 16 Apr 2018) (/site/re/10026835)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10050500)
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