19 Jul 2019 | Affirmation

Fitch Affirms NEPI Rockcastle at 'BBB'; Outlook Stable

Fitch Ratings-Stockholm-19 July 2019:

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 'BBB' rating of bonds issued by NE Property B.V. which are guaranteed by NEPI Rockcastle plc.

The ratings reflect the group's large portfolio of regionally dominant shopping centres across central and eastern Europe (CEE) financed with low leverage. Assets are primarily located in Romania (36% by market value at end-2018) and Poland (24%). NEPI's core countries provide potential for higher retail sales (therefore rental) growth as countries converge towards Western Europe, but also exposure to higher country risk as they are lower rated. Geographical, asset concentration and tenant diversification help spread some of these risks.

The Stable Outlook reflects our expectations that NEPI will continue to conservatively finance its expansion through a combination of debt and equity.

Key Rating Drivers

Regionally Dominant Assets: With a EUR5.8 billion portfolio (including JV at share), NEPI has reached a size that benefits from efficient asset, property and leasing management. The majority of NEPI's assets are dominant shopping centres in large and medium-sized urban conurbations across CEE. Asset concentration is moderate, with the top 10 assets constituting 44% of the income-producing portfolio. NEPI aims to fully concentrate on retail assets and has put its small Romanian office portfolio up for sale.

Growth at Reduced Pace: We expect NEPI to continue to grow its portfolio through acquisitions and developments, in existing territories, although at a slower pace than in recent years. NEPI is pursuing a development pipeline of eight extension and refurbishment projects with estimated costs totaling EUR381 million. Additionally, EUR317million of greenfield developments are at different stages. Costs to complete the committed projects are around EUR200 million. To help reduce risk of the programme, management requires significant pre-lets as well as procurement of internal funding sources before committing to the spend.

Wide Geographical Footprint: NEPI's portfolio is spread across nine countries in CEE, which is a high number compared with most Fitch-rated property companies. However, the majority of assets are concentrated in Romania and Poland (totaling 60% of the portfolio) with a further 28% evenly spread across Hungary, Bulgaria and Slovakia. NEPI's growing portfolio is reducing its concentration to Romania (one of the lower rated countries in its portfolio). NEPI's exposure to low investment grade countries (or lower in the case of Serbia) highlights a higher risk profile than other Fitch-rated peers.

Strong Financial Profile: NEPI's financial policy is prudent with a target LTV of 35%. Management has adhered to its target despite the portfolio expansion and used equity issuance and scrip dividends to preserve the group's metrics. Net debt to EBITDA is expected to increase slightly in 2019 to 6.5x due to acquisition and capex. However, Fitch forecasts this leverage ratio will return to 6.2x in 2020. The average debt maturity is shorter than investment grade peers at around four years after its recent bond issuance. The Fitch-defined LTV was 35% at end-2018 (Fitch's calculation includes only investment property).

Maintained Access to Capital Markets: NEPI has maintained its capital market access despite earlier market turbulence around its share and bond pricing. South Africa's financial regulator FSCA completed its investigations in May 2019 and found the allegations made by Viceroy Research regarding NEPI's accounting to be without substance. NEPI subsequently issued EUR500 million of bonds with a four-year maturity.

Robust Operational Metrics: The rapid expansion in recent years has not impacted NEPI's operational performance. The shopping centre portfolio exhibits low vacancy (EPRA: 2.8%), increasing sales per sq. m (5.7% like-for-like growth in 2018) and low occupancy costs (11.9%). The tenant mix is granular with the top 10 tenants (22% of total rents) well-known global or regional brands skewed towards fashion retailers. The weighted average lease length is stable at around four years, which is comparable with other CEE peers, and affords both the landlord and tenant some flexibility, given the very dynamic retail environment.

Retail Transformation Underway: As a retail landlord the group is potentially exposed to negative trends already seen in some Western European retail markets, especially in the UK. CEE e-commerce penetration is increasing, albeit from a low base and significantly below the penetration in UK or other Western European countries. Robust retail sales growth helps limit the impact of an increasing proportion of online sales. These factors give CEE landlords time to learn from the experience of their western counterparts in how to deal with the new retail landscape. NEPI's strategy is to create dominant destination centres that embrace the customer experience in preparation for likely retail transformation.

Currency Risk: NEPI's leases and debt are euro-denominated, while in the majority of NEPI's jurisdictions tenants generate revenue in local currency. This type of setup is standard in CEE real estate markets. Nevertheless, a sharp substantial depreciation of the local currency can weaken tenants' profitability and their ability to meet euro-denominated rent obligations. The negative effect from NEPI's perspective could be amplified as currency markets in the region share some element of contagion risk. However, the various currencies in the portfolio have been stable against the euro for some time

Derivation Summary

NEPI's portfolio of EUR5.8 billion spread across nine countries in CEE is larger and more geographically diversified than fellow CEE peers such as Atrium European Real Estate Limited's (BBB/Stable) EUR2.8 billion portfolio and the EUR2.4 billion office-focused portfolio held by Globalworth (BBB-/Stable).

NEPI's conservative financial profile is demonstrated by its low (Fitch-calculated) LTV of 35%. Its end-2018 net debt to EBITDA at 6.3x is also a reflection of owning higher income-yielding assets. The resultant financial profile is stronger than Atrium's and Globalworth's. However, the majority of Atrium's assets are located in countries rated 'A-' and above, whereas the lower average country risk rating of NEPI's exposure more resembles that of Globalworth.

Western European peers like Hammerson (BBB/Stable) or British Land plc (A-/Stable) have assets located in the more mature Western European markets where income yields are tighter, thus their resultant financial metrics are not directly comparable with CEE entities.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- New rental income coming on-stream through developments and acquisitions is accounted on a 12-month basis in given year

- Aggregated acquisitions and capex of around EUR1.2 billion over the next four years

- Divestment of the Romanian office portfolio to be completed in 2019

- Listed securities portfolio sold down by the end of 2020

- No equity issuance during the forecast period

RATING SENSITIVITIES

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

- Continuing the expansion and positive geographical diversification of the portfolio, while maintaining similar occupancy rates, current conservative financial profile, and like-for-like rental growth

- Proportional increase to higher-rated countries in the portfolio, either through expansion or through upgrades

- Net debt to EBITDA below 7.0x on a sustained basis

- Average debt maturity no shorter than five years

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 45% or net debt to EBITDA surpassing 8.0x on a sustained basis

- A liquidity score below 1.25x on a sustained basis

Liquidity and Debt Structure

Adequate Liquidity, Active Debt Management: At end-2018 NEPI had EUR90 million readily available cash and EUR236 million of available revolving credit facilities (RCF) with three banks compared with EUR265 million maturities in 2019. During 1H19 NEPI refinanced short-term bank loans and issued a EUR500 million bond with a 2023 maturity. NEPI's resultant liquidity score is now comfortably above 1x pro forma for the refinancing (end-2018: 0.8x)

Sources of Information

Public Ratings with Credit Linkage to other ratings

NEPI Rockcastle plc; Long Term Issuer Default Rating; Affirmed; BBB; RO:Sta
----senior unsecured; Long Term Rating; Affirmed; BBB
NE Property B.V.
----senior unsecured; Long Term Rating; Affirmed; BBB

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)

Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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