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NEPI Rockcastle PLC

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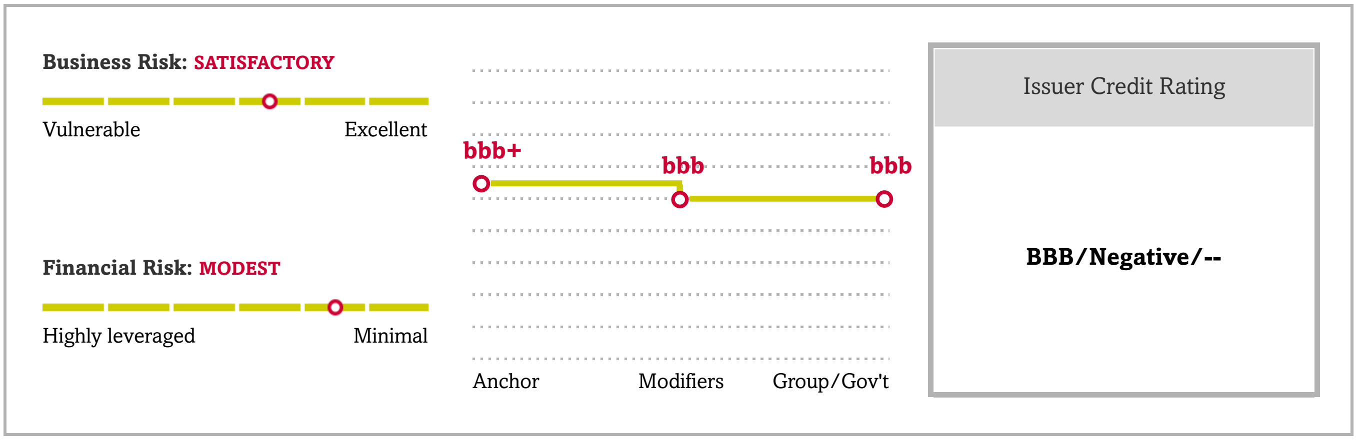
NEPI Rockcastle PLC



Credit Highlights

Overview

Key strengths	Key risks
Largest retail property owner in Central Easter Europe (CEE) with a property portfolio of about €5.8 billion (excluding recently disposed office assets), as of August 2020.	Weak operating performance in first-half (H1) 2020 as like-for-like net rental income declined by about 20% due to the closure of non-essential stores for several weeks, where rent forgiveness granted to selected tenants, and vacancies deteriorated by 2.1 percentage points to 4.2%.
Good asset quality underpinned by large and modern shopping centers, which are well-located in catchment areas and close to public transport.	High concentration (98%, excluding recently disposed office assets) to the retail segment, which has been materially impaired by the COVID-19 outbreak; further increasing penetration of e-commerce and uncertainty around the pandemic could significantly disrupt the sector fundamentals and long-term growth.
Well-diversified tenant base and less than 5% of total rental income linked to tenants' turnover.	Relatively high concentration in Romania, Poland, Hungary, and Bulgaria (80% of total portfolio value), which we view as more volatile and less mature real estate markets than those in Western European countries.
A well-diversified capital structure with limited upcoming debt maturities, supporting solid liquidity.	Drop in net rental income and negative fair-value appraisals on real estate properties weaken the credit metrics as debt to EBITDA reached close to 6.8x and debt to debt plus equity (D/D+E) ratio to 37.9% as of June 2020 (versus 5.6x and 34% respectively as of December 2019).

NEPI Rockcastle's operating performance weakened in H1 2020 due to the closure of its non-essential stores and the rent forgiveness/deferrals granted to its tenants. In response to challenges faced by retailers in the wake of COVID-19, NEPI Rockcastle adopted some measures to support its tenants: rent deferral for 60 days for closed units, rent discounts/forgiveness to non-essential store tenants, monthly rent invoicing instead of quarterly, marketing contribution relief for April and May for closed units, and reduction of non-critical operating expenses included in service charges. NEPI Rockcastle's implementation measures --such as partial forgiveness of receivables, rent discounts (imposed by the Polish government), and rent relief--resulted in a net operating income (NOI) decline of 19.8% (€39.5 million) versus H1 2019. Like-for-like portfolio valuation also declined by 3.4%, mainly driven by lower cash flow expectations in future periods as a result of the COVID-19 outbreak. In addition, vacancies increased by 2.1% (4.2% in June 20 compared with 2.1% in December 2019) mainly due to lower new leasing activities--on recent development completion and to some extent from retailer bankruptcies--than in the past. The revenue decline looks higher than immediate industry peers' in Europe as NEPI Rockcastle reflected most of the rental concessions in the H1 2020 profit and loss accounts rather than straight-lining them over the years. However, we note a wide divergence in peers' adoption of accounting standards on pandemic discounts and rent straight-lining, which distorts the comparison.

NEPI Rockcastle has so far collected 50% of second-quarter (Q2) 2020 invoiced rents and 72% of rents for H1 2020 (before concessions or deferrals). We understand that 17% were granted forgiveness of receivables and the remaining 11% were due and deferred. By mid-August, NEPI Rockcastle had negotiated deferral of payments and rent concessions for tenants representing 66% (30% signed lease addendums) of the gross rental income. This figure has improved materially on 5% signed lease addendums as of June 30, 2020, and the company is still negotiating the remaining 34% of the tenants.

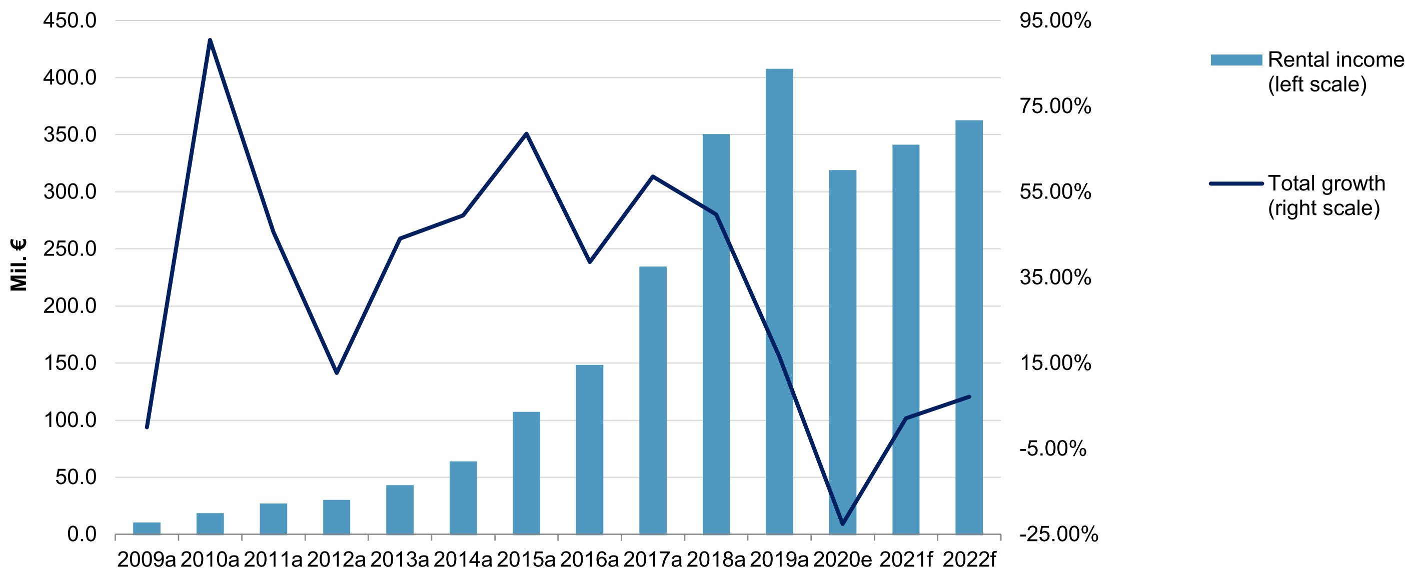
We revised our base case and now anticipate a drop in 2020 rental income of 20%-25%, as opposed to 15%-20% in our previous analysis at the beginning of April 2020, with a gradual recovery from 2021.

As of June 30, 2020, 96% of the total gross leasable area (GLA) was functional, with all stores trading except for 4% corresponding to indoor food services and cinemas in a few countries. Despite the recent easing of lockdown measures and tenants' improving sales figures (88% in June 2020), we still believe the social distancing restrictions and measures to fight the spread of COVID-19 will have a harsher effect on large shopping centers and we may see more negative rent renegotiations or a drop in occupancy rates, versus traditional local convenience centers. We also expect unemployment to rise, with less disposable income weakening consumers' purchasing power.

In light of the prevailing uncertainty and the relatively weak operating performance achieved in H1 2020, we have revised our base case for NEPI Rockcastle and anticipate an overall 20%-25% drop in rental income in 2020 compared with our previous expectations of 15%-20% with only a slow recovery in 2021. In our base-case scenario for 2021, we now forecast about 10%-12% growth in rental income compared with 2020 figures. We also anticipate that the overall occupancy will remain around 96%, mostly in line with June 30, 2020 results.

Chart 1

NEPI Rockcastle Rental Income And Rental Growth

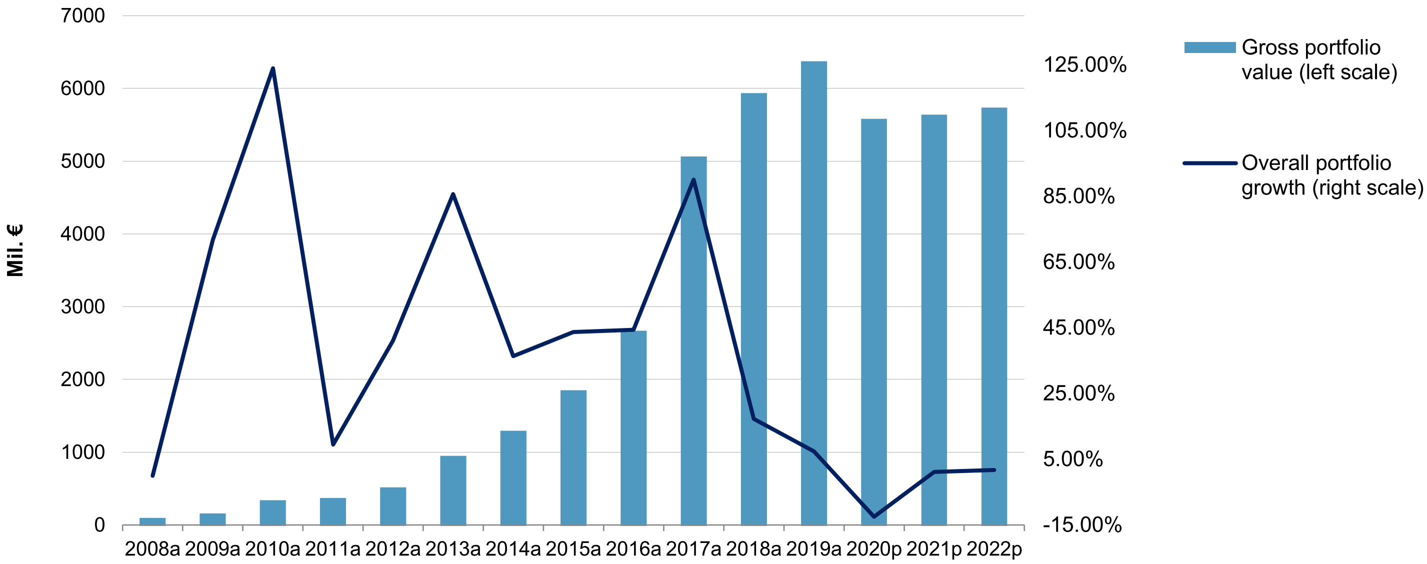


a--Actual. e--Estimate. f--Forecast. Source: S&P Global Ratings.

Credit metrics deteriorated during H1 2020 and we anticipate lower headroom over our ratings thresholds in H2 2020. NEPI Rockcastle reported an increase in its reported loan-to-value ratio (LTV) at 36.1%, which translates into S&P Global Ratings-adjusted D/D+E of 37.9% as of June 30, 2020 (versus 34.0% as of December 2019), above the 35% strategic target and threshold for the current rating. Debt to EBITDA also deteriorated to 6.8x (from 5.6x as of December 2019), but still remains below our downside threshold of 7.5x. The increase in D/D+E is largely due to the devaluation of the property portfolio of 3.4% on a like-for-like basis compared with December 2019. We believe NEPI Rockcastle will likely experience further declines in portfolio valuation, since the retail market dynamics were already under pressure due to e-commerce, and the pandemic will most likely continue to drive weaker operating performance across 2020. As a result, we believe appraisers are likely to take another hit at the company's asset valuations by year-end, given our expectations of a further drop in future cash flows in the current environment. Subsequently, we expect a 10% decline in portfolio valuations for full-year 2020.

Chart 2

NEPI Rockcastle Gross Portfolio Value And Total Portfolio Growth



a--Actual. p--Projected. Source: S&P Global Ratings.

We note, however, that NEPI Rockcastle intends to adhere to its financial policy target of net LTV below 35%. It sold its Romanian office portfolio to AFI Europe for a transaction value of €307 million (net cash proceeds of €294 million) in August 2020 and announced Half yearly 2020 dividend distributions in shares, which somewhat limit the credit metrics' deterioration. Taking this into account, we anticipate S&P Global Ratings-adjusted debt to EBITDA of about 6.5x-7.0x in 2020 and D/D+E to improve back to about 35.0%, within the rating level, though with very limited headroom to our downside threshold. That said, we believe there is a one-in-three probability that NEPI Rockcastle's credit metrics will deteriorate further if market conditions worsen more than expected.

Outlook: Negative

The negative outlook on NEPI Rockcastle reflects our view that due to the COVID-19-related disruption, its operating performance may be more adversely affected than we anticipated, leading to a more material deterioration of credit ratios over the next 12-18 months.

The outlook also captures the company's large operations in Romania, where the sovereign outlook remains negative. We expect emerging markets to be harder hit if the epidemic accelerates, and that it could last for several months, which could depress economic activity and weigh on health systems.

Downside scenario

We could consider taking a negative rating action if NEPI Rockcastle's:

- D/D+E increased sustainably above 35% as a result of unexpected asset devaluations,
- Debt to EBITDA moved above 7.5x, or
- EBITDA interest coverage fell below 3.8x on a sustained basis due to weaker operating performance.

A negative rating action would become increasingly likely if we saw negative dynamics in the company's operating performance due to a prolonged pandemic effect, or a sluggish recovery once the pandemic is over, affecting retailers in the medium term. We could also take a negative rating action on NEPI Rockcastle if Romania experienced an economic slowdown and monetary policy flexibility weakened, leading to a sovereign downgrade.

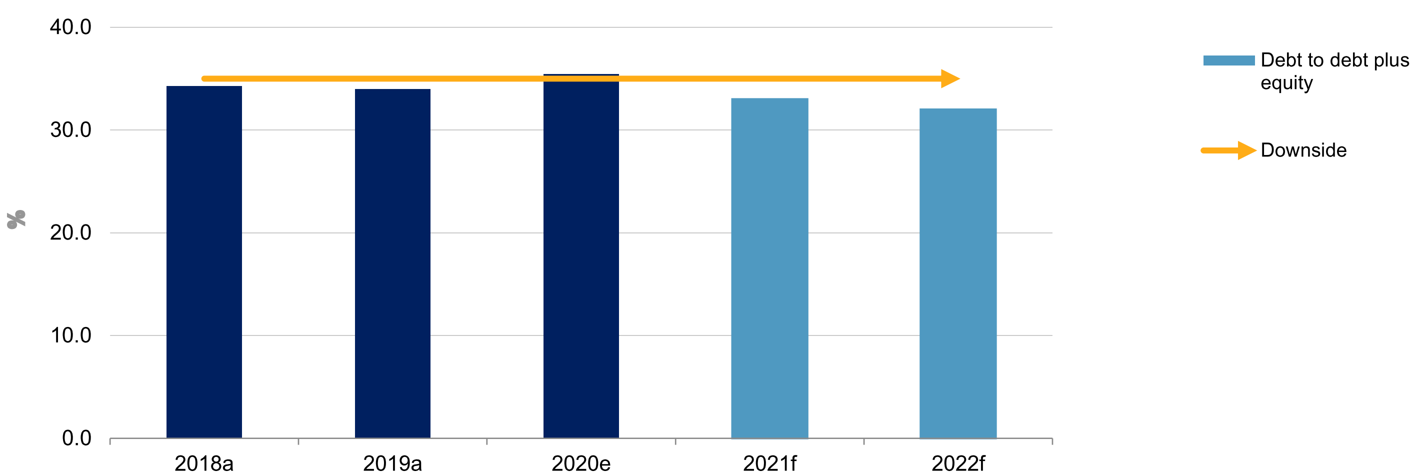
Upside scenario

We could revise the outlook to stable if NEPI Rockcastle is resilient against the tough retail conditions and macro environment in CEE caused by the COVID-19 pandemic. In addition, we could revise the outlook to stable if NEPI Rockcastle's:

- Adjusted D/D+E remains comfortably below 35%, and
- Debt to EBITDA stays below 7.5x.

Chart 3

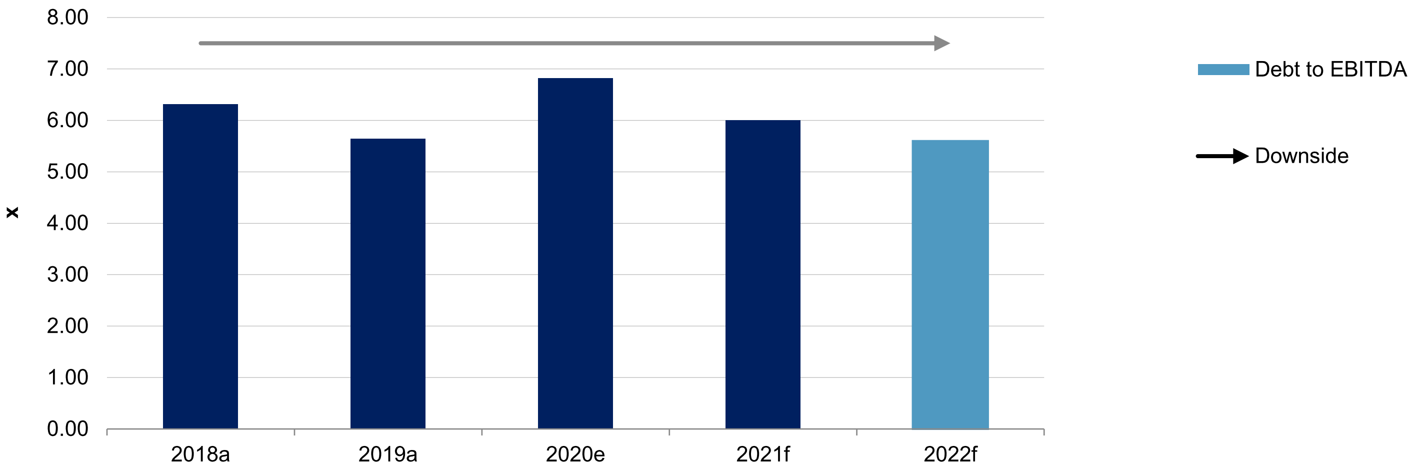
NEPI Rockcastle Debt To Debt Plus Equity



a--Actual. e--Estimate. f--Forecast. Source: S&P Global Ratings.

Chart 4

NEPI Rockcastle Debt To EBITDA



a--Actual. e--Estimate. f--Forecast. Source: S&P Global Ratings.

Our Base-Case Scenario

We consider consumer confidence, retail sales, and shopping centers' density among the most important rent factors for retail property investors. We expect GDP growth in the CEE to shrink by 5.9% due to the COVID-19 pandemic before rebounding by 4.9% in 2021. The economic impact is mainly due to a drop in household consumption, which has been severely restricted by government measures, in particular government's efforts to contain the spread of the virus. Uncertainty and constraints to economic activity could lead unemployment to increase to above 8.0% in 2020 and reduce inflation, as we expect lower consumer price index inflation of about 2.1% in 2020, and 2.4% in 2021.

Assumptions

- Like-for-like rental income decline of 20%-25% in 2020 due to expected rent discounts or potential effects from negative rent renegotiations and further drops in occupancy. We estimate a limited rebound of 10%-12%% in 2021 as we expect social distancing measures and increasing e-commerce penetration to have a medium-term effect on retailer sales performance. We assume occupancy to remain about 96% in 2020.
- We assume a 10% decline in asset valuation in 2020 since appraisers are likely to take another hit at the company's assets at year-end, given the further drop in future cash flow. Moving ahead, we expect like for like valuations to remain flat in light of the ongoing challenges facing the retail segment, including anticipated growing e-commerce penetrations.
- No major asset acquisitions expected in 2020 and we included the disposal of non-core Romanian office assets (about €294 million), which closed in August 2020.
- Lower development capital expenditure (capex) of €140 million-€160 million for 2020 and about €60 million-€80 million in 2021, in line with the company's current development plans.

- We assume dividend payments to be paid in shares for H1 2020, in line with company's current announcements.

Key Metrics

Table 1

NEPI Rockcastle PLC--Key Metrics

	--Fiscal year end Dec. 31--				
	2018a	**2019a**	**2020e**	**2021f**	**2022f**
EBITDA Interest Coverage (x)	6.6	6.5	4.0-4.5	4.5-5.0	5.0-6.0
Debt/EBITDA (x)	6.3	5.6	6.0-7.0	6.0-6.5	5.5-6.0
Debt to Debt plus Equity (%)	34.3	34.0	34.5-35.5	33-34	32-34

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

We expect a structural change in the retail segment, which may slow retail sector growth prospects for the medium-to-long term. We anticipate higher e-commerce penetration in the next couple of years especially as figures of ecommerce are still low (below 10%) in CEE countries, combined with a slow economic growth as a result of the COVID-19 outbreak. We believe the weakening consumer confidence, changing consumer habits, and increasing unemployment will most likely have a structural effect on the overall retail sector and consequently the retail property sector. We believe NEPI Rockcastle is likely to offer some further rent discounts and deferrals to support occupancy ratios, as retailer sales would suffer significantly due to the expected structural shifts and may affect credit metrics over medium term.

Company Description

Table 2

NEPI Rockcastle PLC--Portfolio Summary

Segment Focus	**Retail, Office & Industrial**
Total portfolio value	€6.1 billion (includes €187 million under development)
Total units	54 shopping centers, 6 offices, and 2 industrial
Average occupancy	95.80%
Occupancy cost ratio (Dec 2019)	11.90%
Average lease maturity	4.0 years
Average portfolio yield	6.80%
Overall portfolio quality*	Good quality retail assets
Market capitalization (€)§	~2.96 billion

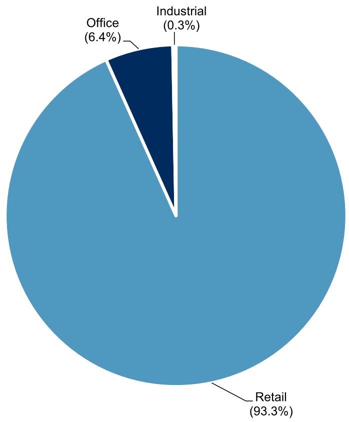
*S&P Global Ratings' view, based on June 2020 results. §As of August2020.

NEPI Rockcastle is a property and development company operating in the CEE region. It was established in 2017 by the merger of New Europe Property Investments PLC (NEPI) and Rockcastle

Global Real Estate Co. Ltd. (Rockcastle). The company has a portfolio of €6.1 billion as of June 30, 2020, and a strong focus on retail (93%), with some additional activities in office and industrial real estate (7%). It operates in nine countries in CEE, particularly the Romanian and Polish markets.

Chart 5

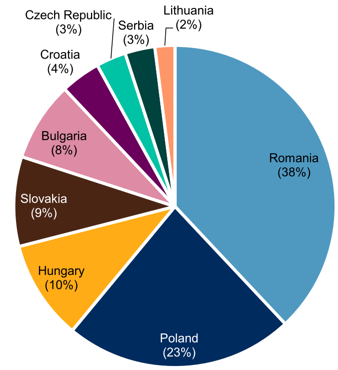
NEPI Rockcastle Segment Diversity
(% of portfolio value as of June 2020)



Source: S&P Global Ratings.

Chart 6

NEPI Rockcastle Geographic Diversity
(% of portfolio value as of June 2020)



Source: S&P Global Ratings.

The company's strategy is to focus on the retail segment as it recently sold its office assets and remains invested in the CEE region.

The company's major shareholders are Fortress Income Fund Limited (21.7%), Resilient Property Income Fund Limited (12.7%), and Government Employees Pension Fund (8.5%). It is listed on the Main Board of the Johannesburg Stock Exchange Limited (JSE), Euronext Amsterdam, and A2X.

Peer Comparison

Table 3

NEPIRockcastle Operating Peer Comparison as of June 2020

Companies	NEPI Rockcastle PLC	CPI Property Group	Carmila S.A.	Mercialys	Citycon Oyj
Ratings as of Sept. 7, 2020	BBB/Negative/--	BBB/Negative/--	BBB/Negative/A-2	BBB/Negative/A-2	BBB-/Negative/A-3
Business risk profile	Satisfactory	Satisfactory	Strong	Satisfactory	Satisfactory
Portfolio Value (bil. €)	EUR 6.1	EUR 9.8	EUR 6.2	EUR 3.5	EUR 4.4
% of Development	3.50%	<5%	<10%	<5%	<10%
Weighted-average unexpired lease term (years)	4.00	3.30	4.4	NA	3.1
Occupancy (%)	95.8%	94.8%	95.8%	97.5%	93.5%
Top 10 tenants as % of GRI	22%	12%	14.5%*	Top 1: 27.5%	26.7%*
Geography Diversity	Romania 38%, Poland 23%, Hungary 10%, Slovakia 9%, Bulgaria 8%, Croatia 4%, Czech Republic 3%, Serbia 3%, and Lithuania 2%	Czech Republic 41%, Germany 25%, Poland 16%, Hungary 7%, Western Europe 4% and Other CEE countries 7%	France 72%, Spain 22%, Italy 6%	France 100%	Finland & Estonia 46%, Norway 33%, Sweden & Denmark 21%

Table 3

NEPIRockcastle Operating Peer Comparison as of June 2020 (cont.)					
Companies	**NEPI Rockcastle PLC**	**CPI Property Group**	**Carmila S.A.**	**Mercialys**	**Citycon Oyj**
Assets Diversity	Retail 93%, Office 6% and Industrial 1%	Office 52%, Retail 22%, Hotels & Resorts 7%, Residential 7% and Landbank, development & Others 12%	Retail 100%	Retail 100%	Retail 100%

*Data as of December 2019. CEE--Central Eastern Europe & GRI--Gross rental income

The company's portfolio (€6.1 billion on June 30, 2020) is similar to most rated peers in the same business category.

The portfolio is well diversified geographically in the developing CEE. However, we factor in the company's continued focus on the retail segment (which increased further with the disposal of Romanian office portfolio in August 2020), which is subject to challenging market dynamics. The retail market was already under pressure due to expanding e-commerce penetration, and the pandemic renders the company's portfolio more volatile and cyclical than those of peers in the same business risk category, such as CPI Property Group or Germany-based Around Town Properties.

Table 4

NEPI Rockcastle PLC -- Financial Peer Comparison (RTM June 2020)					
Rolling 12 months as of June 30, 2020	**NEPI Rockcastle PLC**	**CPI Property Group SA**	**Carmila S.A.**	**Mercialys**	**Citycon Oyj**
Ratings as of Sept. 7, 2020	BBB/Negative/--	BBB/Negative/--	BBB/Negative/A-2	BBB/Negative/A-2	BBB-/Negative/A-3
Financial risk profile	Modest	Intermediate	Intermediate	Intermediate	Significant
(Mil. €)					
Revenue	362.4	466.8	344.1	179.0	210.3
EBITDA	336.5	292.0	262.7	157.8	185.1
Funds from operations (FFO)	276.8	198.3	202.9	122.9	118.2
Interest expense	58.1	93.8	58.1	17.4	59.4
Cash flow from operations	231.4	215.1	103.6	113.5	160.6
Capital expenditure	220.1	330.8	57.9	21.1	142.0
Free operating cash flow (FOCF)	11.3	(115.7)	45.7	92.4	18.6
Dividends paid	216.9	18.8	0.2	96.7	103.9
Cash and short-term investments	138.1	310.5	482.7	180.5	156.0
Debt	2,280.6	4,801.5	2,292.5	1,396.0	2,195.2
Equity	3,736.4	4,785.7	3,274.1	1,990.6	1,989.4
Debt and equity	4,132.3	6,611.9	3,850.3	2,377.4	3,349.1
Valuation of investment property	6,171.4	9,656.8	5,808.9	3,314.6	4,170.8
Adjusted ratios					
Annual revenue growth (%)	(6.2)	(0.1)	(2.3)	(1.5)	(3.1)
EBITDA margin (%)	92.8	62.6	76.3	88.1	88.0
Return on capital (%)	5.5	2.7	4.6	3.4	3.9
EBITDA interest coverage (x)	6.3	3.7	4.8	5.0	2.8
Debt/EBITDA (x)	6.8	16.4	8.7	8.8	11.9

Table 4

NEPI Rockcastle PLC -- Financial Peer Comparison (RTM June 2020) (cont.)					
FFO/debt (%)	12.1	4.1	8.8	8.8	5.4
Debt/debt and equity (%)	37.9	50.1	41.2	41.2	52.5

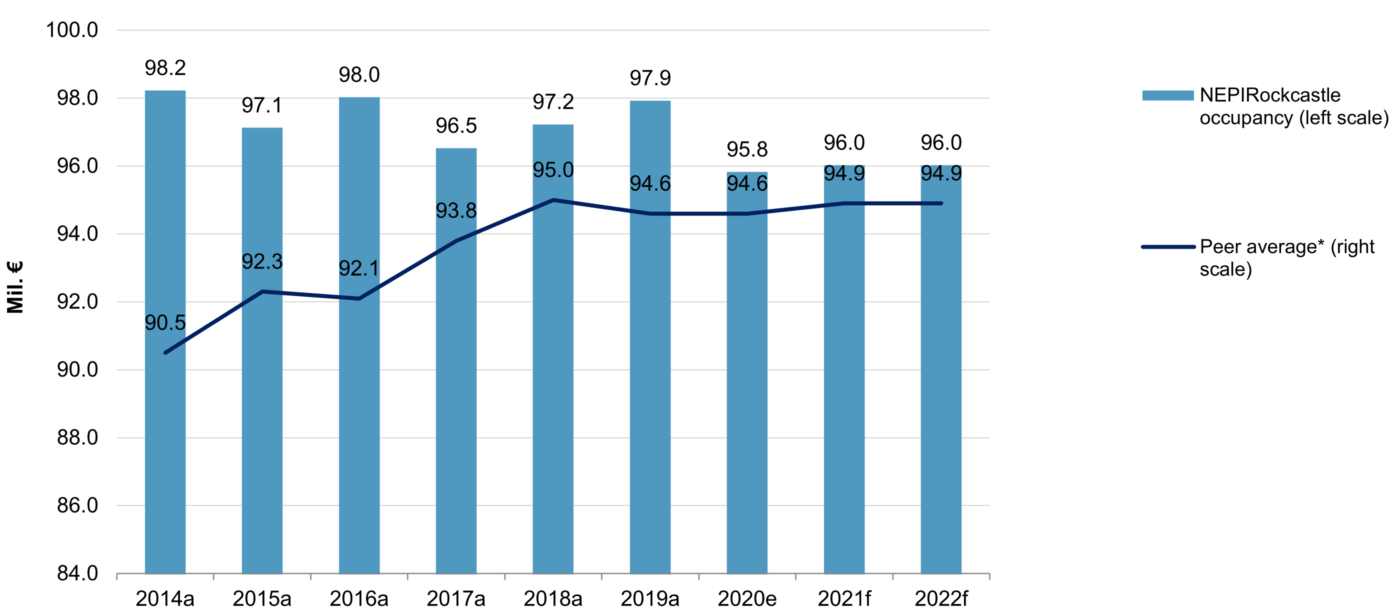
We view NEPI Rockcastle's credit ratios as weaker than those of peers that we assess in the modest financial risk category. This remains a key factor in our assessment of the company's business and financial risk at the lower end of its category compared with its close peers. We reflect this in our negative comparable rating analysis, which brings the rating down by one notch to 'BBB'.

Business Risk: Satisfactory

NEPI Rockcastle's satisfactory business risk profile is underpinned by its position as the largest retail property owner in CEE. It is the largest retail property owner in Romania and manages a portfolio of prime retail and office assets worth €6.1 billion as of June 30, 2020.

Chart 7

NEPI Rockcastle: Occupancy Versus Peer Average



a--Actual. e--Estimate. f--Forecast. *Average for NEPI Rockcastle,CPI Property Group, Merlin Properties, Aroundtown, and Globalworth. Source: S&P Global Ratings.

The company enjoys a high occupancy ratio of 95.8% (including the drop of 2.1% in H1 2020), staying well above 95%

over the past few years. We anticipate occupancy to remain around96%, mainly due to the slow leasing environment and expectation of further bankruptcies at the smaller tenants' level. Most of the company's tenants are strong, multinational companies or regional leaders with triple net lease contracts fixed in euros. NEPI Rockcastle's portfolio consists of 58 core assets (as of Aug. 30, 2020), including large shopping centers with over 36,300 square meters of gross rentable area on average. Overall, the portfolio comprises 30% of super-regional malls, 61% regional malls, 5% community centers, 3% lifestyle centers, and 1% strip centers. About 41% of NEPI Rockcastle's rental income is generated by assets in Romania, 21% in Poland, 8% in Bulgaria, 8% in Slovakia, 9% in Hungary, 4% in Croatia, 3% in Czech Republic, 4% in Serbia, and 2% in Lithuania.

We see limited development risk in the portfolio because a large share of such activities is 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 June 30, 2020. The company recently opened a new shopping center in Targu Mures, Romania (GLA: 40,200 square meters), which was already 95.2% leased with 85% tenants trading at completion. In addition, NEPI Rockcastle completed the extension and refurbishment works in Shopping City Buzau (Romania) and Forum Liberec Shopping Centre (Czech Republic).

We believe that NEPI Rockcastle's rent generation ability will be supported by its good asset quality and sound lease maturity profile with an average weighted maturity of about four years. That said, the business risk profile is mainly constrained by the company's exposure to developing economies--such as Romania, Hungary, or Bulgaria--which pose relatively high country risk. In addition, barriers to entry in most CEE countries where NEPI Rockcastle is present are relatively low compared with those in developed markets such as Germany or France, creating a risk of oversupply. Also, the top 10 assets represent 41% of total market value, with the largest asset accounting for 6.2%, which is higher than most of the rated peers in the same business risk category.

Table 5

NEPI Rockcastle Top 10 Assets

Asset Name	Asset Value (€)	Location	Size (m2)	% Total
Bonarka city center	393.6	Poland	74,400	6.20%
Mega mall	320.4	Romania	75,800	5.00%
Arena mall	316.2	Hungary	65,800	5.00%
Mammut shopping centre	283.6	Hungary	56,400	4.50%
Paradise centre	267.2	Bulgaria	81,300	4.20%
Arena centre	266.2	Croatia	75,200	4.20%
Promenada mall	209.3	Romania	39,400	3.10%
City park	196.3	Romania	52,200	3.10%
Aupark kosice mall	172.1	Slovakia	33,000	2.70%
Serdika centre	167.4	Bulgaria	51,500	2.60%

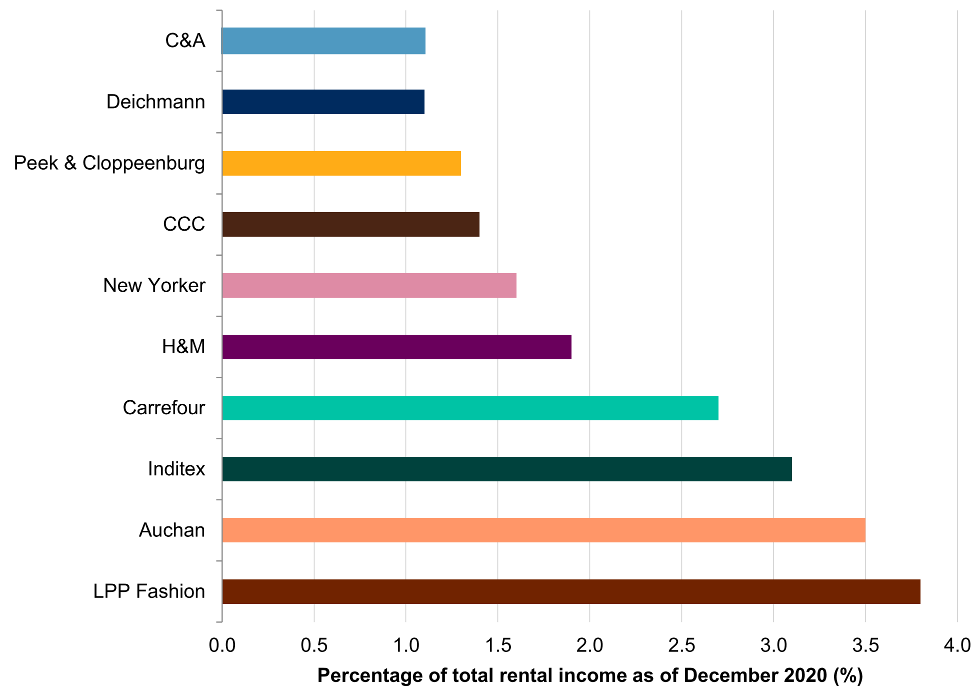
Note: Data is as of Dec. 31, 2019

NEPI Rockcastle's concentration to the retail sector is an increasing risk. We see this sector as exposed to negative global trends, such as the increasing penetration of e-commerce and changing customer habits, which are further exacerbated due to current economic crisis and social distancing norms due to the pandemic. Subsequently, we expect the use of e-commerce to pick up in regions like CEE, which had limited penetration so far, at less than 5% and expected to reach to 8% by 2023.

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 about 12% (as of December 2019), which somewhat mitigates this risk. We also note some tenant concentration, given the top 10 tenants account for 22% of total rents.

Chart 8

NEPIRockcastle Top 10 Tenants



Source: S&P Global Ratings.

Financial Risk: Modest

Our assessment of NEPI Rockcastle's modest financial risk profile is underpinned by the company's prudent financial policy, centered on an LTV ratio of less than 35% (corresponding to a 34%-35% D/D+E ratio), which is relatively low for the industry. 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, together holding 42.9% of the company's shares--with the remainder owned by a large number of investors.

That said, we expect the current challenging retail market dynamics to take a toll on NEPI Rockcastle's operating performance. Subsequently, we anticipate a D/D+E ratio of 35% and debt to EBITDA to increase to 6.0x-7.0x at year-end 2020 (versus 34% and 5.6x in 2019). The nominal increase in leverage is due to the company's adoption of current measures to sustain the effect of the pandemic. Though the metrics stands well at the current rating level thanks to recent office asset disposals, we still note weak headroom in our thresholds, which could be breached if market conditions worsen. We also note that the D/D+E ratio was 37.9% as of June 2020, above our threshold, although we anticipate this spike to be temporary with a return to about 35% as a result of recently disposed office assets. We believe, however, that our current negative outlook captures well the current uncertainty prevailing in retail property markets and the one-in-three risks that the credit metrics may deviate from our base case.

We also forecast EBITDA interest coverage ratio sustainably above 4.0x over next 12-24 months though declining from a solid 6.5x as of 2019. This is supported by low average cost of debt of 2.1% as of June 30, 2020, which declined from 2.4% as of 2019. We expect the dividend distribution to remain low and NEPI Rockcastle to resort to a partial scrip dividend payment to sustain cash flow flexibility along with investor confidence, although NEPI Rockcastle is not legally required to distribute dividends as it does not have REIT status.

In July 2020, NEPI Rockcastle issued a €500 million green unsecured bond, with a seven-year maturity and carrying a 3.375% fixed coupon, with an issue price of 98.172%. The green bond issue improved the group's liquidity position, which had a total liquidity sources of approximately €862 million in cash balances and undrawn credit lines as of July 31, 2020. In addition, the bond issue increased the weighted-average debt maturity to 4.5 years as of July 31, 2020 from 3.6 years on June 30, 2020.

NEPI Rockcastle also holds a portfolio of listed securities (valued at about €60.3 million as of June 30, 2020), mostly of Unibail Rodamco Westfield shares (A-/Negative/A-2)..

Financial summary

Table 6

NEPI Rockcastle PLC -- Financial Summary

(Mil. €)	June 2020	December 2019	June 2019	December 2018	June 2018
Revenue	156.3	206.2	201.0	185.3	164.6
EBITDA	150.8	185.7	188.3	164.4	153.6
Funds from operations (FFO)	121.0	155.8	153.2	135.9	129.3
Interest expense	27.4	30.7	27.0	25.6	22.5
Cash interest paid	27.9	25.7	27.6	22.4	24.3
Cash flow from operations	62.2	169.2	147.2	164.6	111.5
Capital expenditure	72.6	147.5	131.0	(32.3)	286.8
Free operating cash flow (FOCF)	(10.4)	21.8	16.2	196.9	(175.2)
Discretionary cash flow (DCF)	(164.8)	(48.3)	(79.3)	43.9	(318.5)
Cash and short-term investments	138.1	204.0	366.2	89.7	120.6
Gross available cash	183.6	204.0	366.2	89.7	120.6
Debt	2,280.6	2,109.2	2,091.4	2,008.4	1,598.3
Equity	3,736.4	4,096.9	3,975.1	3,845.9	3,920.5
Adjusted ratios					
EBITDA margin (%)	92.8	91.9	91.3	90.9	90.3
Return on capital (%)	5.5	6.2	6.1	5.8	5.3

Table 6

NEPI Rockcastle PLC -- Financial Summary (cont.)					
(Mil. €)	**June 2020**	**December 2019**	**June 2019**	**December 2018**	**June 2018**
EBITDA interest coverage (x)	5.8	6.5	6.7	6.6	7.0
FFO cash interest coverage (x)	6.2	6.8	6.8	6.7	8.7
Debt/EBITDA (x)	6.8	5.6	5.9	6.3	5.8
FFO/debt (%)	12.1	14.6	13.8	13.2	15.2
Debt/debt and equity (%)	37.9	34.0	34.5	34.3	29.0

Reconciliation

Table 7

NEPI Rockcastle PLC--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts										
	--Rolling 12 months ended June 30, 2020--									
NEPI Rockcastle PLC reported amounts (mil. €)	**Debt**	**Shareholders' equity**	**Revenue**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
	2,432.5	3,730.6	362.4	248.7	56.5	53.5	336.5	236.0	216.9	224.7
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(6.2)	--	--	--
Cash interest paid	--	--	--	--	--	--	(48.9)	--	--	--
Reported lease liabilities	31.8	--	--	--	--	--	--	--	--	--
Accessible cash and liquid investments	(183.6)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	4.6	(4.6)	(4.6)	--	(4.6)
Share-based compensation expense	--	--	--	1.1	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	--	2.6	--	--	--	--	--
Noncontrolling interest/minority interest	--	5.7	--	--	--	--	--	--	--	--
EBITDA: Foreign exchange gain/(loss)	--	--	--	1.9	1.9	--	--	--	--	--
EBITDA: Business divestments	--	--	--	(0.4)	(0.4)	--	--	--	--	--
EBITDA: Other	--	--	--	85.2	85.2	--	--	--	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	--	--	192.0	--	--	--	--	--

Table 7

NEPI Rockcastle PLC--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (cont.)

Total adjustments	**(151.8)**	**5.7**	**0.0**	**87.8**	**281.2**	**4.6**	**(59.7)**	**(4.6)**	**0.0**	**(4.6)**

S&P Global Ratings' adjusted amounts

	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends	Capital expenditure
	2,280.6	3,736.4	362.4	336.5	337.7	58.1	276.8	231.4	216.9	220.1

Liquidity: Adequate

We anticipate that liquidity sources will likely cover liquidity uses by over 1.2x for the next 12 months. Debt covenant headroom is adequate, in our view. NEPI Rockcastle has sound relationships with a diverse group of banks and a generally satisfactory standing in capital markets. We view the company's financial flexibility and access to capital markets as somewhat weaker than its larger peers' in Western Europe. As such, NEPI Rockcastle would find it challenging to absorb high-impact, low-probability shocks. Consequently, we continue to view NEPI Rockcastle's liquidity as adequate.

Principal liquidity sources

- As of June 30, 2020, unrestricted cash balances of about €138 million;
- Undrawn revolving credit facility of €45 million maturing in more than 12 months; and
- Funds from operations of about €220 million-€250 million for the next 12 months.

Principal liquidity uses

- About €25 million-€30 million of contractual debt repayments for the next 12 months; and
- Capex needs of approximately €80 million in the next 12 months for the development pipeline.

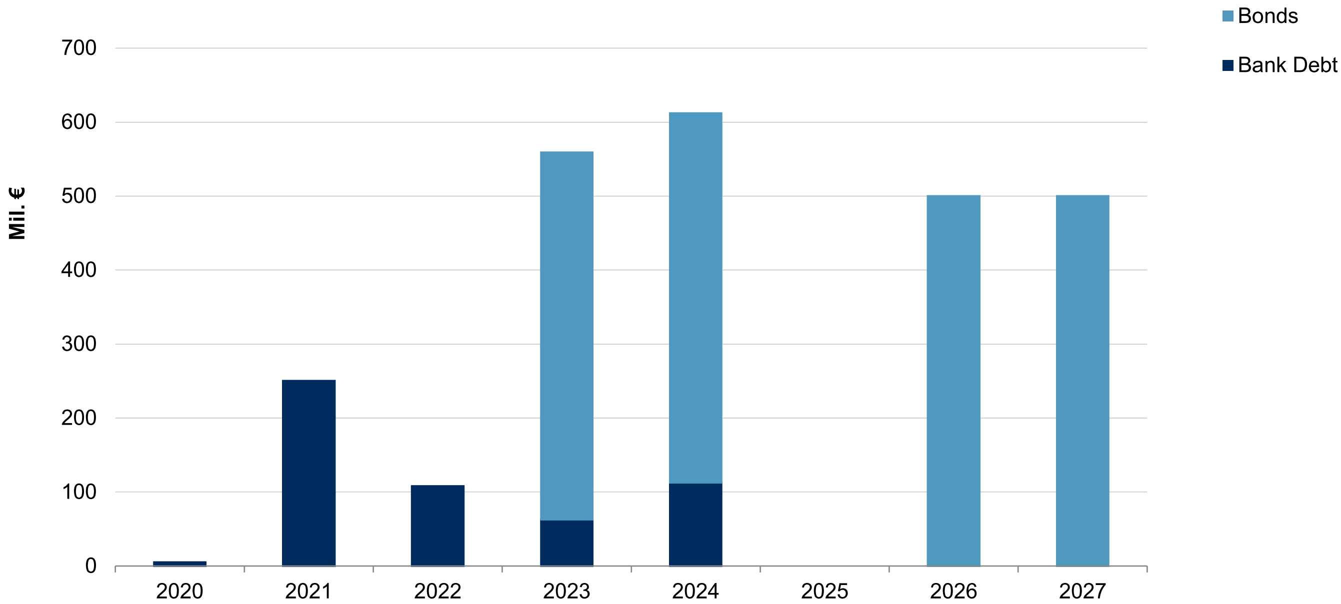
We note that liquidity improved further in the past two months with the successful issuance of €500 million unsecured green bonds in July 2020 and €294 million net cash proceeds received from disposal of the Romanian office portfolio in August. NEPI Rockcastle's cash balance increased to close to €1.2 billion as of August 2020.

Debt maturities

The average remaining debt maturity is 4.5 years as of July 2020.

Chart 9

NEPIRockcastle Debt Maturities As Of July 2020



Source: Company report.

Covenant Analysis

Compliance expectations

We understand that NEPI Rockcastle has financial covenants for its existing debt. We estimate that the headroom for these covenants is strong (more than 15%).

Requirements

NEPI Rockcastle has to comply with the following covenants for unsecured loans and bonds:

- Solvency ratio of maximum 60%. As of June 30, 2020, the ratio stands at 40%.
- Consolidated coverage ratio of minimum 2.0x. As of June 30, 2020 the ratio stands at 5.8x.
- Unsecured consolidated total assets/unsecured consolidated total debt of minimum 180%. As of June 30, 2020 the ratio stands at 268%

Environmental, Social, And Governance

We view NEPI Rockcastle's exposure to environmental, social, and governance (ESG) factors as in line with other CEE peers. The company has improved its overall portfolio certifications, which now stands at 51% of its buildings being BREEAM certified as "very good" or "excellent" as of Dec. 31, 2019. It aims to have 100% of the portfolio green certified by end of 2022. Over 95% of properties are accessible by public transport and some of the company's shopping centers offer facilities for bikes and electric car charging points. The company, as a part of continuous improvement on its ESG approach, launched different initiatives to reduce its carbon footprint, improve energy intensity, and increase community engagements to keep becoming more sustainable in its day-to-day business. In our view, this would help the company improve transparency and support its long-term strategy. In December 2019, NEPI Rockcastle signed an ESG-linked unsecured revolving credit facility of €175 million and issued €500 million unsecured green bonds in July 2020, showing its dedication to increase its sustainability framework.

Rating Above The Sovereign

Given NEPI Rockcastle's high share of revenues coming from Romania (35% of gross portfolio value, excluding office assets sold), which is currently rated one notch lower than NEPI (BBB-/Negative), we perform an analysis to test NEPI Rockcastle's resilience to a Romanian sovereign default. In order to do that, we stressed our forecast of the company's liquidity position by 25%. Even under this hypothetical stress scenario, we estimate the company would have sufficient cash flow to cover its needs, and liquidity sources would cover more than 1.0x its uses for one year. In addition, as per our criteria requirement LTV would remain below 80%. For these reasons, we believe NEPI Rockcastle can be rated higher than Romania by one notch.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of July 31, 2020, the group's capital structure comprises around 21% secured debt and approximately 79% unsecured debt, spread across bond and bank debt.

Table 8

NEPI Rockcastle PLC--Capital Structure And Liquidity, July 2020	
Average Interest Cost (%)	2.1
Weighted Average Debt Maturity (years)	4.5
Average Fixed Debt (including hedge, %)	100.0
Composition of Debt (Secured, %)	21.0
Liquidity (Sources/Uses)	Adequate

Analytical conclusions

We expect NEPI Rockcastle's secured debt to remain lower than 40% of total assets (less than 10% as of June 30, 2020). As a result, although unsecured debt issuance is structurally subordinated to other debt obligations, the subordination does not affect the rating on the unsecured debt.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Negative/--

Business risk: Satisfactory

- **Country risk:** Intermediate
- **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

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And

Assumptions, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, 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-

Ratings Detail (As Of September 9, 2020)*

NEPI Rockcastle PLC	
Issuer Credit Rating	BBB/Negative/--
Issuer Credit Ratings History	
01-Apr-2020	BBB/Negative/--
13-Jul-2017	BBB/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.