Research Update:

Shopping Center Owner NEPI Rockcastle Outlook Revised To Stable On Anticipated Operational Recovery; 'BBB' Rtg Affirmed

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Rating Action Overview

- NEPI Rockcastle's (NEPI) results for first-half 2021 indicate stable occupancy levels of 95.6%, improved rent collection (94% as of mid-August), and slightly increasing footfall (+2.2% versus first-half 2020).
- We understand that NEPI's property portfolio has been fully operational since June 2021, and anticipate that occupancy levels and rent collection rates will remain high (well above 90%) in the next 12-18 months.
- In addition, NEPI's S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio of 33.7% and debt to EBITDA of 6.3x (rolling 12 months as of June 30, 2021) remained below our rating downside thresholds of 35% and 7.5x, respectively.
- Therefore, we revised our outlook on NEPI to stable from negative, and affirmed our 'BBB' long-term issuer credit rating and senior unsecured debt ratings on the company.
- The stable outlook reflects our view that operating performance will continue to stabilize, thanks to improving footfall and tenants' sales as economic activity recovers in Central and Eastern Europe (CEE), with a debt-to-debt-plus-equity ratio below 35%, debt to EBITDA at about 6.0x-6.5x, and EBITDA interest coverage above 4.0x over the next two years.

Rating Action Rationale

Despite a continuously challenging operational environment, NEPI reported a stable occupancy level and slightly increasing footfall in the first half of 2021. NEPI continued to face operating pressures in the first six month of 2021, due to closure of nonessential stores and adoption of social-distancing measures. The company reported a decline in net rental operating income of 3.0% versus first-half 2020 (and -22.5% versus first-half 2019), mainly due to the impact of government regulated concessions in Poland and Slovakia and the full periodic rental impact from the disposal of its office assets, completed in August 2020. That said, we recognize the company's stable and high occupancy levels at 95.6% and slightly increasing footfall (+2.2% versus first-half of 2020, but -34.3% versus first-half 2019). We understand that only 2.1% of leases expire in 2021, whereas 81% are already agreed and 72% are already signed. We believe the likelihood of further rent renegotiations or unpaid rents is limited for this year, assuming no further lockdown in the company's operating regions. We also view positively the company's high number of fixed-rent contracts (above 94% as of June 30, 2021), which should limit losses linked to variable rent contracts. In our revised base-case forecast, we now assume like-for-like rental income growth of just about 1%-2% for 2021, following its first-half 2021 results. This encompasses some expected rent discounts/loss or some negative renegotiation, even after the lockdown measures end. In our base-case scenario for 2022, we now forecast about 10%-12% growth in rental income compared with 2021 figures.

Given that NEPI's property portfolio by gross leasable area is now 100% operational, we anticipate continued high and stable occupancy levels and high rent collection rates in the next 12-18 months. As a result of decreasing COVID-19 infection rates, trading restrictions were eased in all CEE countries at the end of first-quarter 2021. Since June, NEPI's shopping centers (which represent 99% of its overall portfolio) became fully operational, including all stores, cinemas, and indoor food services. In 2020, NEPI collected about 99% of reported revenue (adjusted for rent concessions granted to tenants). We understand that collection rates declined to 88% in the first six month of the year, but recovered back to 94% as of mid-August 2021. We believe acceleration of vaccinations could lead to further reopening of CEE economies, leading to higher footfalls and retailers' sales. We anticipate that NEPI will be able to sustain high occupancy rates and rent collections in next 12-18 months (well above 90%). We expect that its stores will remain open, supported by a lower number of new COVID-19 cases and increasing vaccination rates, however, we remain cautious as different virus variants could disrupt the market in the short term.

NEPI's credit metrics remained below our downside thresholds in the past 12 months, and we now believe that improving macroeconomic fundamentals should help the company maintain stable leverage in the next 12-24 months. NEPI's adjusted ratio of debt to debt plus equity stood at 33.7% as of June 30, 2021 (versus 37.9% as of June 2020) with debt to EBITDA (rolling 12 months) at 6.3x (versus 6.8x as of June 2020). We forecast that the company will be able to maintain a ratio of debt to debt plus equity at 34%-35% and debt to EBITDA below 7x over the next 12-24 months. Our new base case incorporates a flat valuation in 2021 versus our previous assumptions of a 5% decline, given that we note some signs of value stabilization for NEPI's assets. The company reported a revaluation increase of €25.5 million (+0.4% of total portfolio value) during the first half of 2021. NEPI's good-quality assets should also be supportive for an anticipated improving operational performance. NEPI has also taken measures to support its conservative capital structure with the sale of the Romanian office portfolio (net cash proceeds of €294 million) in August 2020 and a capitalization issue in 2020.

We believe NEPI's liquidity and funding profiles should remain solid over the next 12-24 months. The company enjoys a solid liquidity buffer with the ratio of uses over sources well above 1.2x as of June 30, 2021. The company's debt repayments for the next 12 months total only about €7.7 million. NEPI had about €380 million of cash and cash equivalents and €570 million available under its committed undrawn backup facility as of second-quarter 2021. We understand covenant headroom is also adequate (more than 15%).

Outlook

The stable outlook on NEPI reflects our view that the company's operating performance will continue to stabilize with improving footfall numbers and tenants' sales as economic activity recovers in the CEE, particularly in Romania and Poland, thanks to the quality of their assets and limited new competition. We also believe that its debt to debt plus equity will be about 34%-35% and EBITDA interest coverage will remain higher than 4.0x over the next two years, supported by the company's resilient cash flows and conservative financial policy. We expect NEPI will maintain a large liquidity buffer.

Downside scenario

We could consider taking a negative rating action if :

- Debt to debt plus equity increased significantly above 35% on a prolonged basis, for instance as a result of unexpected asset devaluations;
- Debt to EBITDA moved above 7.5x; or
- EBITDA interest coverage falls below 3.8x on a prolonged basis due to weaker operating performance.

We could also take a negative rating action on NEPI if Romania experienced an economic slowdown and monetary policy flexibility weakened, leading to a sovereign downgrade.

Upside scenario

An upgrade would hinge on NEPI materially improving its portfolio in terms of size, as well as geographic and segment 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 would be contingent on an improvement in Romania's credit quality or a significant dilution of the company's exposure to Romania to less than 25% of its assets and maintaining its debt to debt plus equity below 35%.

Company Description

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 and Rockcastle Global Real Estate Co. Ltd. The company has a portfolio valued at €5.8 billion, and a strong focus on retail, with some additional activities in offices and industrial. It operates in nine countries in CEE, particularly the Romanian and Polish markets.

Issue Ratings – Subordination Risk Analysis

Capital structure

As of June 30, 2021, NEPI's capital structure comprised 11% secured debt and 89% unsecured debt, spread across bond and bank debt.

Analytical conclusions

We expect that NEPI's secured debt will remain lower than 40% of total assets (less than 10% as of June 30, 2021). 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. We align our issue ratings on its senior unsecured debt with the 'BBB' issuer credit rating.

Ratings Score Snapshot

Issuer 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)

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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
NEPI Rockcastle PLC		
Issuer Credit Rating	BBB/Stable/--	BBB/Negative/--
NEPI Rockcastle PLC		
NE Property B.V.		
Senior Unsecured	BBB	BBB