09 NOV 2021

Fitch Revises NEPI Rockcastle Outlook to Positive; Affirms at 'BBB'

Fitch Ratings - Stockholm - 09 Nov 2021: Fitch Ratings has revised the Outlook on NEPI Rockcastle plc to Positive from Stable and affirmed the company's Long-Term Issuer Default Rating (IDR) at 'BBB'. Fitch also affirmed NEPI's unsecured debt rating at 'BBB', and the 'BBB' senior unsecured ratings on NE Property B.V.'s bonds, which are guaranteed by NEPI.

The Positive Outlook reflects NEPI's long record of a conservative financial profile and Fitch's expectation that new management will commit to maintain this. NEPI's net debt/EBITDA has remained below our 7.0x upgrade rating sensitivity at 6.1x (end-2020) and interest cover has remained strong at 6.0x.

The Outlook revision also reflects NEPI's EUR5.6 billion income-producing portfolio of regionally dominant shopping centres, which is well positioned to benefit from dynamic, post-pandemic retail sales growth in central and eastern European (CEE) countries. The portfolio benefits from diversification across countries, assets and tenants.

The potential for disruption from rising pandemic cases in NEPI's countries restricts a revision of the Outlook to Positive at present. The current wave of Covid-19 cases may force governments to tighten social distancing measures in order to curb transmission.

Key Rating Drivers

Stable Cash Flow Leverage: NEPI's end-2020 net debt/EBITDA remained low at 6.1x despite the challenging environment (end-2019: 5.6x). Fitch expects net leverage to increase moderately to 6.5x in pandemic-affected FY21 but improve to around 6x during 2022-2024 as net rental income returns to pre-pandemic levels. Our forecast includes an increase in capex and restored cash dividends, reflecting the improved operational performance. We expect interest cover to remain comfortable (2022: 6.3x; 2023 5.6x) due to strong cash flows, low leverage and low interest rates.

Vaccination Progress: Vaccination rates vary among CEE countries but are generally below the EU average of 65% of the population being fully vaccinated. Romania (36% of NEPI's portfolio by market value) and Bulgaria (8%) have among the lowest vaccination rates (33% and 23%, respectively) in the EU. They are now recording high numbers of new Covid-19 cases and deaths.

Cases are also growing in other countries where NEPI operates. This may force governments to introduce renewed restrictions, stunting recovery in the retail sector. Nevertheless, as of mid-October, almost 100% of NEPI's gross lettable area remained open.

Tenants' Sales Recovery: In June 2021 all NEPI's shopping centres were open. Tenants' sales in July had fully recovered and reached 103% of 2019's levels despite continued social distancing measures. Footfall, although also increasing, was only 87% of 2019's equivalent levels. This pattern of lower footfall but higher sales is visible across European markets. Increasing tenants' turnover will reduce the burden of rent on tenants and improve the occupancy cost ratio back towards healthy levels of around 12% (excluding hypermarkets).

High Occupancy: During 9M21 NEPI's shopping centres were closed (only essential stores could operate) on average for 60 days (9M20: 58 days). NEPI has maintained occupancy at above 95% (1H21: 95.6%). This was aided by granting short-term rent concessions to most-affected tenants (especially entertainment, and food and beverage), which helped limit the number of tenant insolvencies. We do not expect vacancy to change materially as NEPI has already agreed the bulk of 2021's lease expiries, and renewed rents remained largely stable. In 2022 leases generating 13.5% of rental income expire.

Rent Collection: NEPI reported 76% rent collection at end-1H21 (83% for 1H21 but at end-3Q21) unadjusted for concessions granted, including government-mandated rent reliefs in Poland (1H20: 72% on an unadjusted basis). The collection rate remains slightly higher than Continental European peers and higher than for UK peers, but below rates reported by Nordic retail landlords.

Unencumbered Asset Base: In June 2021 NEPI repaid secured debt, adding EUR455 million of assets to the unencumbered pool (1H21: total EUR5.0 billion, 91% of total income-producing assets, by value). The group's pro forma unencumbered asset cover was 2.4x.

Limited Development Risk: As at 1H21, NEPI had three projects under construction with total capex to complete at EUR86 million. Two of the projects are refurbishments (and extensions) of shopping centres in Poland. The third is a residential complex adjacent to an existing shopping centre in Bucharest. Projects under permitting and pre-leasing include construction of two shopping centres (around 60,000 sqm of space each) in Romania and Bulgaria, the mixed-use extension of Promenada Mall and another residential project in Bucharest.

CEE Retail Exposure: NEPI's property portfolio is diversified across nine CEE countries. Retailers present in CEE largely entered the pandemic period financially stronger than their western European peers, which have already had to deal with flat retail sales growth, higher and increasing e-commerce share and higher supply of retail space. CEE has consequently experienced fewer tenant bankruptcies and less downward pressure on prime shopping centre rents as we expect local consumption growth, contingent on new lockdowns, to return to pre-pandemic growth path levels.

Pending Management Change: The CEO and CFO of NEPI have decided to leave the company after over 10 years in their posts. Management continuity will be ensured by the implementation of the succession plan. It assumes suitable candidates will be found for both positions and the hand-over of responsibilities by the time of publication of NEPI's FY21 annual results. Until this time, the current management team remains in place.

Derivation Summary

NEPI's closest peer is Atrium European Real Estate Limited (BBB/Rating Watch Negative), with its EUR2.5 billion all-retail portfolio. Atrium has almost all its assets in Poland (A-/Stable) and the Czech Republic (AA-/Stable) with only 10% (by market value) of the portfolio located in non-core Russia (BBB/Stable). NEPI's retail-focused portfolio is in countries predominantly rated 'BBB' or below (61% of NEPI's market value). The smaller (EUR0.8 billion), all-retail portfolio of AKROPOLIS GROUP, UAB (BB+/Stable) is concentrated (75%) in Lithuania (A/Stable).

Globe Trade Centre S.A.'s (GTC, BBB-/Stable) EUR2.1 billion portfolio benefits from diversification across asset classes with offices (65% of market value) and retail (35%). Its country risk exposure is similar to NEPI's, with presence in six countries. Globalworth Real Estate Investments Limited's (BBB-/Stable) office-focused portfolio is almost equally split between Poland and Romania (BBB-/Negative).

Most of NEPI's assets are shopping centres with a comprehensive retail, leisure and entertainment offer. They are located in large cities in the region and in smaller secondary cities with dominance. This differs from Atrium's aim, which is to concentrate on Warsaw and Prague, and their large catchment area and above-average disposable income.

NEPI's end-2020 net debt/EBITDA, at 6.1x, is lower than Atrium's leverage of above 9x (which we forecast to normalise closer to 8x in 2022), while GTC's leverage is about 9x and Globalworth's is 8x.

NEPI and Atrium have comparable net initial yields (these measure annualised net rents to investment property asset values) of 6.0% to 6.8%, depending on each portfolio's asset and country mix. The remaining CEE peers do not disclose directly comparable net initial yield data. Fitch believes the quality of Globalworth and GTC's portfolios is broadly similar to that of NEPI and Atrium.

The Lithuanian all-retail Akropolis has the most conservative financial profile, with end-2020 net debt/EBITDA at 4.4x ahead of a planned construction project, which will increase its leverage over time. However, its rating is constrained by its concentration on a limited number of assets, restricting asset and geographical diversification.

Key Assumptions

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

- Rent changes arising from acquisitions, disposals or developments coming on stream annualised rather than accounted on a part-year basis

- Rents for 2022 to include the adverse effect of a further 5% decrease in rents from expiring leases, a decrease in occupancy to below 95%, and the adding back of most of FY21's rent concessions

- Over EUR110 million of net acquisitions spending in FY21

- Over EUR850 million of capex between FY21 and FY24, including EUR28 million a year spent on non-income-yielding reinvestments.

- EUR213 million cash dividend in FY21 and 90% of FFO in a given year thereafter

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- 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/EBITDA below 7.0x on a sustained basis

- Average debt maturity no shorter than five years

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Material expansion in 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 loan to value (adjusted net debt/investment properties) consistently exceeding 45% or net debt/EBITDA surpassing 8.0x on a sustained basis

- A liquidity score below 1.25x on a sustained basis

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Liquidity and Debt Structure

Strong Liquidity: At end-June 2021, NEPI had EUR362 million readily available cash and EUR570 million of available revolving credit facilities maturing not earlier than January 2023. This compares with around EUR4 million of secured loans maturing in 2021 and EUR58 million in 2022. The next meaningful debt repayment is scheduled for May 2023, when EUR496 million of bonds fall due.

In July 2021 NEPI drew a EUR73.5 million unsecured term loan, maturing June 2028, provided by the International Finance Corporation, a member of the World Bank Group.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Issuer Profile

NEPI is a retail-focused property company with an income-producing portfolio of regionally dominant shopping centres spread over nine CEE countries, valued at EUR5.6 billion at end-June 2021.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
NEPI	LT IDR	BBB	Affirmed		BBB

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Rockcastle plc					
• senior unsecured	LT	BBB	Affirmed		BBB
NE Property B.V.					
• senior unsecured	LT	BBB	Affirmed		BBB

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.15 Oct 2021) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub.15 Oct 2021)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

NE Property B.V.	EU Issued, UK Endorsed
NEPI Rockcastle plc	EU Issued, UK Endorsed

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