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Research Update:

Retail Property Investment Company NEPI Rockcastle PLC Rated 'BBB'; Outlook Stable

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Overview

- All conditions for the merger of New Europe Property Investments PLC (NEPI) and Rockcastle Global Real Estate Company Ltd. into NEPI Rockcastle PLC have been met or waived, and the transaction will be finalized by the end of July 2017.
- With the merger, NEPI will become integral to newly established NEPI Rockcastle, and as a result we align our rating on NEPI with that on NEPI Rockcastle.
- We are assigning our 'BBB' long-term rating to NEPI Rockcastle and raising our rating on NEPI to 'BBB' from 'BBB-'.
- The stable outlook reflects our view that the group will generate resilient cash flows over the next 24 months and maintain a conservative financial policy, with ratios of EBITDA to interest of more than 3.8x and debt to debt and equity of less than 35%.

Rating Action

On July 13, 2017, S&P Global Ratings assigned its 'BBB' long-term corporate credit rating to NEPI Rockcastle PLC. The rating is in line with the preliminary rating we assigned on June 2, 2017 (see "NEPI Rockcastle PLC Assigned 'BBB' Prelim Rating; Outlook Stable," published on RatingsDirect). The outlook is stable.

We also raised our long-term corporate credit rating on New Europe Property Investments PLC (NEPI) to 'BBB' from 'BBB-'. The outlook is stable.

In addition, we raised the issue rating on the bond issued by NE Property Cooperatief U.A. and guaranteed now by NEPI Rockcastle to 'BBB' from 'BBB-'.

Rationale

All conditions for the merger of NEPI and Rockcastle Global Real Estate Company Ltd. (Rockcastle) into NEPI Rockcastle have been met or waived. The final step was the approval of the transaction by the majority of NEPI's shareholders on July 6, 2017. NEPI transferred all of its assets and liabilities to NEPI Rockcastle on July 11, 2017, the merger implementation date. With the merger, NEPI is becoming integral to the recently established NEPI Rockcastle, and we therefore align our rating on NEPI with that on NEPI Rockcastle.

NEPI Rockcastle is focused on retail real estate assets in the Central Eastern European region, with a primary focus on Romania (48% of total asset value, pro forma as of March 31, 2017) and Poland (30%). At the closing of the transaction, the company will own and manage 51 standing assets in six countries, for a total value of more than €3.9 billion, and six additional assets under development.

The group's business risk profile is underpinned by its position as the largest retail property owner in Romania, the fourth-largest in Poland, and the second-largest in Slovakia. It manages a portfolio of prime-quality retail assets. The company enjoys a very high occupancy ratio of 96.4% (pro forma as of March 31, 2017). Most of the company's tenants are creditworthy multinational companies or regional leaders with triple-net lease contracts fixed in euros.

We see limited development risk in the portfolio. NEPI Rockcastle's tenants have a relatively modest occupancy cost (or rent-to-sales ratio) of less than 15%, which somewhat mitigates the risk of increasing rent burden from currency movements (rents are contracted in euros, while tenants' revenues are in local currencies, mostly Romanian leu and Polish zloty).

The business risk profile is constrained by modest geographic diversification, with Romania and Poland representing 78% of asset value, and the company's exposure to developing economies such as Romania.

Our assessment of NEPI Rockcastle's financial risk profile is underpinned by the company's prudent financial policy, centered on a loan-to-value (LTV) ratio of less than 35%, which is low for the industry.

NEPI Rockcastle also holds a significant portfolio of listed securities (gross valuation of $1.3 billion as of June 15, 2017), mostly of large real estate companies operating in the U.S., U.K., and Continental Europe. We believe this portfolio could be recycled into higher yielding new direct property acquisitions.

We expect that the level of NEPI's rental income generated by unencumbered assets will remain higher than 50%. This results in a capital structure where unsecured debt issuance is not structurally subordinated to other debt obligations to the extent that it would affect the rating on this debt.

Our base-case assumptions for NEPI Rockcastle have not changed materially since we assigned the preliminary rating. Under our base-case scenario, we continue to anticipate a debt-to-debt plus equity ratio of about 29%-31% in 2017-2018. We also forecast that the EBITDA interest coverage ratio will be strong, at about 4.4x-4.7x in 2017-2018. We expect total dividend distribution to shareholders to remain stable, although NEPI Rockcastle is not legally required to distribute dividends.

To test NEPI Rockcastle's resiliency to a Romanian sovereign default, we stressed our forecast of the company's liquidity position. Even under this hypothetical scenario, we estimate the company would have sufficient cash flow generation to cover its needs and would maintain liquidity sources over uses of more than 1x for one year. For this reason, we believe NEPI Rockcastle can be rated higher than our sovereign rating on Romania, but by no more than one notch.

Although the current trend for Romanian and Polish retail markets is positive, we see these markets as more volatile and cyclical than those of peers in the same business risk category, such as French retail for Mercialys and German residential markets for Around Town Properties. Moreover, we believe NEPI Rockcastle's credit ratios are weaker than those of peers that we assess in the same financial risk category, such as GlobalSwitch and Hispania. We apply a one-notch negative adjustment to take into account this comparable ratings analysis.

Liquidity

We assess NEPI Rockcastle's liquidity position as adequate for a real estate company. We anticipate that liquidity sources will likely cover liquidity uses for 2017-2018 by more than 1.2x. We assess debt covenant headroom as adequate. NEPI Rockcastle has sound relationships with a diversified group of banks, and a generally satisfactory standing in capital markets.

Principal liquidity sources on March 31, 2017:
- Unrestricted cash balances of about €80 million;
- Undrawn revolving facilities of €230 million;
- An undrawn term loan of €10 million; and
- Funds from operations of about €190 million for the next 12 months.

Principal liquidity uses as of the same date:
- About €20 million of contractual debt repayments for the next 12 months; and
- Capital expenditure needs of approximately €315 million in the next 12 months for the development pipeline.

Outlook

The stable outlook on NEPI Rockcastle reflects our view that the company should continue to benefit from the healthy economic trends in Romania and Poland, thanks to its quality assets. We also believe its debt to debt and equity will be less than 35% and EBITDA interest coverage higher than 3.8x, over the next two years, supported by the company's resilient cash flows and conservative financial policy. We expect NEPI Rockcastle will maintain a large liquidity buffer.

Downside scenario

We could consider taking a negative rating action if, in particular, NEPI Rockcastle's debt to debt plus equity increased above 35% as a result of unexpected asset devaluations or if its EBITDA interest coverage fell below

3.8x. Downward rating pressure might also materialize if we see negative dynamics in its operating performance. We could also take a negative rating action on NEPI Rockcastle if Romania experienced economic, monetary, or political turbulence, leading to a sovereign downgrade.

Upside scenario

An upgrade would hinge on NEPI Rockcastle materially improving its portfolio in terms of size and diversification, while generating positive like-for-like rental income growth and showing positive portfolio revaluation. It would require that the newly formed company establishes a track record of keeping robust credit ratios. A positive rating action on NEPI Rockcastle would also be conditioned on an improvement of Romania's credit quality or on a significant dilution of the company's exposure to Romania to less than 25% of its assets.

Ratings Score Snapshot

Corporate 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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Negative (-1 notch)

Stand-alone credit profile: bbb

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

New Rating

NEPI Rockcastle PLC	
Corporate Credit Rating	BBB/Stable/--

Upgraded

	To	From
New Europe Property Investments PLC		
Corporate Credit Rating	BBB/Stable/--	BBB-/Positive/--
NE Property Cooperatief U.A.		
Senior Unsecured*	BBB	BBB-

*Guaranteed by NEPI Rockcastle PLC.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office

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