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ISSUER COMMENT

NEPI's Plan to Merge with Rockcastle Is Credit Positive

From Credit Outlook

Analyst Contacts:

LONDON	+44.20.7772.5454
Roberto Pozzi *Vice President - Senior Credit Officer* roberto.pozzi@moodys.com	+44.20.7772.1030
Yulia Syerova *Associate Analyst* yulia.syerova@moodys.com	+44.20.7772.1075

Last Wednesday, New Europe Property Investments plc (NEPI, Baa3 stable), Romania's largest retail property owner, announced that it had signed a framework agreement to merge with Rockcastle plc (unrated), a commercial property company and investor registered in Mauritius. If completed, the transaction would be credit positive for NEPI because it would increase its geographic diversification away from Romania while only moderately increasing leverage. The transaction is subject to customary approvals of their respective regulatory bodies and shareholders, the latter of which will vote on the proposed merger at their respective shareholder meetings.

Rockcastle reported net rental and related revenue of $24.6 million for the 15 months that ended 30 September 2016 and total assets of approximately $2.9 billion as of 30 September 2016. Rockcastle owns five income-producing shopping centres in Poland with a combined fair value of approximately €700 million, one shopping centre in the Czech Republic valued at €82.1 million and one shopping centre in Zambia valued at €28.2 million. Rockcastle also owns $1.8 billion of listed securities including shares in Hammerson plc (Baa1 negative, $436.5 million), Simon Property Group, L.P. (A2 stable, $353.0 million), Unibail-Rodamco SE (unrated, $262.4 million), Prologis, L.P. (A3 stable, $198.2 million). And, the company had reported gross debt of $1.2 billion as of 30 September 2016.

Pro forma for the merger, we estimate that the combined entity would have total assets of around €5.6 billion and gross debt/total assets of around 32.5%, compared with NEPI's 22.7% as of 30 September 2016. We view NEPI's potentially greater geographical diversification as more important than the increase in its leverage. The merged entity plans to gradually sell the listed securities and reinvest the proceeds into retail properties in Central and Eastern European countries, while maintaining leverage in the 30%-35% range, in line with NEPI's long-term financial target.

The planned merger would change NEPI's geographic exposure, with a major reduction of the weight of Romania in its property portfolio. Currently, around 73% of the value of NEPI's portfolio is from properties in Romania. Pro forma for the envisaged transaction, Romania will constitute approximately half of the value of the combined real estate income-producing assets of the merged entity and around one third of its total income-producing assets, including listed investments.

Compared with its investment-grade-rated peers, NEPI's financial metrics are strong but its rating is constrained by the company's geographic concentration. Most of its assets are located in Romania, a developing property market where asset values could prove volatile given the limited number of market comparables for prime retail assets and its modest scale.

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At this point, there are a number of unknowns, including shareholders' approvals, the future size and geographic exposure of the combined entity and the timing of the expected reinvestments of the available and of additional financial resources. Although there is potential for NEPI to receive an upgrade from becoming a larger and geographically more diversified group, significant uncertainties remain regarding the company's strategy, the composition of its property portfolio, and its leverage during the transition phase given its exposure to volatile equity market valuations.

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Authors
Roberto Pozzi
Yulia Syerova

Production Associate
Sunith Kashyap