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Research Update:

New Europe Property Investments PLC Outlook Revised To Positive; 'BBB-' Rating Affirmed

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Overview

- Isle of Man-registered property investment company New Europe Property Investments PLC (NEPI) and Mauritius-registered Rockcastle Global Real Estate Company (Rockcastle) signed a framework agreement signifying their intent to merge into an entity newly incorporated in the Isle of Man, NEPI Rockcastle PLC, through an all-share transaction.
- The combined entity should exhibit greater size and geographical diversity than NEPI has on a stand-alone basis, while retaining a similar level of debt leverage, such that its loan-to-value ratio should not exceed 35%.
- We are therefore revising our outlook on NEPI to positive from stable and affirming our 'BBB-' long-term corporate credit rating.
- The positive outlook reflects our view that we may raise our rating on the company in the next six months if NEPI and Rockcastle complete their merger and thereby improve the portfolio in terms of size and diversification, while financial policy and liquidity remain supportive of a higher rating.

Rating Action

On Dec. 20, 2016, S&P Global Ratings revised its outlook on property investment company New Europe Property Investments PLC (NEPI) to positive from stable and affirmed its 'BBB-' long-term corporate credit rating on the company.

We also affirmed our 'BBB-' issue rating on NEPI's €400 million senior unsecured bond.

Rationale

The outlook revision reflects our view that there is a one-in-three chance that we might raise our rating on NEPI if NEPI and Rockcastle Global Real Estate Company merge into an entity newly incorporated in the Isle of Man, NEPI Rockcastle PLC, through an all-share transaction and the new company's financial policy and liquidity management remains supportive of the higher rating.

The combined entity's portfolio is expected to have better scale and diversification than NEPI's current portfolio. If the merger is completed, we expect the newly incorporated entity, NEPI Rockcastle PLC, to have an income-producing property portfolio value of about €3.4 billion (versus €2.2

billion for NEPI as of Nov. 15, 2016). It would also inherit the €1.4 billion portfolio of listed securities in large property companies in the U.S. and Europe now owned by Rockcastle.

The combined company will have improved geographical diversification and be less vulnerable to Romania's developing economy. Romania-based, income-producing assets would represent less than half (or one-third including listed securities) of NEPI's gross asset value (GAV) after the merger, down from 79% currently.

Up to 30% (or approximately 20% including listed securities) of the combined entity's GAV would be in the more-mature Polish market after the merger. In our view, these assets are well-aligned to NEPI's current asset profile. They are mainly large (25,000-50,000 square meters of gross lettable area), high-quality assets in areas that are densely populated or have good macrodynamics, and they have demonstrated low vacancy levels of less than 10%.

On Sept. 30, 2016, Rockcastle's portfolio of investment properties comprised seven income-producing retail properties, two developments under construction, and three extensions, together valued at €878.6 million. Rockcastle's gross debt totaled €1.2 billion as of the same date. Its portfolio is estimated to have increased to €1.2 billion by Nov. 30, 2016.

We understand that Rockcastle was implementing a strategy of selling its listed investments and reinvesting the proceeds in direct properties and developments. The combined entity's policy regarding its portfolio of listed stock and the growth of its property portfolio would be key areas for us to monitor. We expect NEPI's management to obtain bondholders' consent to waive change-of-control clauses in order to complete the merger.

We understand that both NEPI and Rockcastle are listed on the Johannesburg stock exchange and benefit from the support of South African investors. Two large South African property funds and one investment management company own a total of 38% of NEPI's shares.

We continue to assess NEPI on a stand-alone basis in our base-case scenario, which remains unchanged. NEPI's business risk profile, currently unchanged, is underpinned by its position as the largest retail property owner in Romania. About 79% of NEPI's rental income is generated in Romania, 15% in Slovakia, and 4% in the Czech Republic. It manages a portfolio of prime retail and office income-producing assets worth €2.2 billion as of Nov. 15, 2016. The company enjoys a very high occupancy ratio of 98%. Most of the company's tenants are strong, multinational companies or regional leaders with triple-net lease contracts fixed in euros. NEPI's rent stability is supported by a sound lease maturity profile with an average weighted lease maturity of about five years.

The business risk profile is mainly constrained by modest geographic diversification and the company's exposure to developing economies, such as Romania. The rating is also constrained by foreign currency exposure through euro-denominated tenant agreements with customers whose retail turnover is in local currencies.

We see limited development risk in the portfolio, because a high proportion of the company's developments is to extend existing projects, and the new space is mostly prelet. Moreover, as of Sept. 30, 2016, only about 8% of the total portfolio was under development.

Our assessment of NEPI's financial risk profile is currently unchanged. It is underpinned by the company's financial policy, which centers on maintaining a loan-to-value (LTV) ratio of less than 35% and a debt-to-EBITDA ratio of 4x-6x. Under our base-case scenario, we forecast debt-to-debt plus equity ratios of about 26%-32% in 2016-2017. We also anticipate that the EBITDA interest coverage ratio will be more than 5x in 2016-2017.

We understand that company has good access to equity capital markets, as shown by its track record of issuing equity of about €1.5 billion in the recent years to fund its retail-assets acquisition pipeline.

Liquidity

We assess NEPI's liquidity as adequate. We anticipate that liquidity sources will likely cover liquidity uses for the 12 months from Sept. 30, 2016, by about 1.4x. We assess debt covenant headroom as adequate, and we expect this to continue. NEPI has sound relationships with a diversified group of banks, and a generally satisfactory standing in capital markets.

As of Sept. 30, 2016, we estimate that liquidity sources over the next 12 months will mostly consist of:

- About €122 million of cash and cash equivalents;
- About €130 million available under the committed credit lines; and
- Funds from operations averaging about €130 million.

This compares with the following liquidity uses for the same period:

- About €57 million of short-term debt;
- About €238 million of capital expenditures already executed after September; and
- Our estimate of about €5 million-€6 million of working capital outflow.

Outlook

The positive outlook on NEPI reflects our view that we might raise our rating on the company in the next six months if the announced merger is completed. We assume that the company's financial policy will remain supportive of a higher rating. Currently, NEPI's financial policy centered on an LTV ratio of less than 35%. The outlook is underpinned by our view of the favorable demand-supply trends in most of NEPI's geographic locations and the likelihood that NEPI will become less vulnerable to the Romanian economy if the transaction completes.

Downside scenario

We could consider revising outlook to stable if the announced merger does not materialize or if the company's financial policy became significantly more aggressive. This could be demonstrated by NEPI's debt-to-debt plus equity ratio increasing above 35% or if liquidity management were to deteriorate.

Upside scenario

An upgrade hinges on the merger of NEPI and Rockcastle leading to an improvement in its portfolio in terms of size and diversification, and on the combined entity's financial policy not materially deviating from NEPI's current financial policy.

In addition, the combined entity would have to pass our sovereign stress test if more than 25% of the combined entity's assets and rental income are still derived from Romania and we revise its stand-alone credit profile above our rating on Romania (currently, BBB-/Stable/A-3). To pass the stress test assumes that, for example, the combined entity's liquidity sources would be sufficient to allow it to service its short-term debt, even if Romania experienced a sovereign default.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Positive/--

Business risk: Fair
- Country risk: Moderately high
- Industry risk: Low
- Competitive position: Fair

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: Neutral (no impact)

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: Country Risk Assessment Methodology And Assumptions, 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: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 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

Related Research

- New Europe Property Investments PLC, Nov. 30, 2016

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
New Europe Property Investments PLC		
Corporate Credit Rating	BBB-/Positive/--	BBB-/Stable/--

Ratings Affirmed

NE Property Cooperatief U.A.		
Senior Unsecured*	BBB-	

*Guaranteed by New Europe Property Investments 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

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