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Research Update:

New Europe Property Investments PLC Assigned 'BBB-' Prelim Rating; Outlook Stable

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Research Update:

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Overview

- Property investment company New Europe Property Investments PLC (NEPI) owns and manages a portfolio mostly of prime shopping centers in Romania worth €1.7 billion as of Aug. 31, 2015.
- NEPI is considering issuing a senior unsecured bond, mainly to refinance its secured loans and fund capital expenditures and acquisitions.
- We are assigning our 'BBB-' preliminary long-term corporate credit rating to the company.
- The stable outlook reflects our view that the company will generate resilient cash flows over the next 24 months and maintain a conservative financial policy post bond issuance, with debt-to-EBITDA below 4.5x and a ratio of debt-to-debt and equity of less than 35%.

Rating Action

On Oct. 12, 2015, Standard & Poor's Ratings Services assigned its 'BBB-' preliminary long-term corporate credit rating to property investment company New Europe Property Investments PLC (NEPI). The outlook is stable.

The final rating will depend on our receipt and satisfactory review of all final transaction documentation of the senior unsecured bond issuance under consideration. Accordingly, the preliminary rating should not be construed as evidence of the final rating. If Standard & Poor's does not receive final documentation within a reasonable timeframe, or if final documentation departs from materials reviewed, we reserve the right to withdraw or revise our rating. Potential changes include, but are not limited to, use of bond proceeds, maturity, size, and conditions of the bonds, financial and other covenants, and security and ranking of the bonds

Rationale

The preliminary rating on NEPI reflects our view of the company's "fair" business risk profile and its "modest" financial risk profile, as our criteria define these terms.

NEPI's business risk profile is underpinned by its position as the largest retail property owner in Romania. It manages a portfolio of prime retail and office assets worth of €1.7 billion as of Aug. 31, 2015. The company enjoys a very high occupancy ratio of 98.3%. Most of the company's tenants are strong, multinational companies or regional leaders with triple-net lease contracts

fixed in euro. NEPI's portfolio consists of 30 core assets, including 16 large shopping centers (about 35 thousands square meters of gross lettable area on average; 3 million-10 million visitors per year), representing 80% of NEPI's total rental income, and five office buildings. Another nine assets are currently under construction or permitting and preleasing, while 20 small noncore assets are up for disposal. About 82% of NEPI's rental income is generated by the portfolio located in Romania and 15% in Slovakia.

We see limited development risk in the portfolio, because a large share of development is the extension of existing projects, mostly pre-let. Moreover, the share of assets under development was about 9% of the portfolio as of Aug. 31, 2015. We believe this level remains moderate, although we understand that company's total (committed and uncommitted) development pipeline exceeds €500 million. NEPI has a successful growth track record through acquisitions and development, with the size of its portfolio having increased from about €0.4 billion in 2012 to the current €1.7 billion.

We believe that NEPI's rent stability should be supported by the good asset quality of its portfolio, with prime positions in most of its locations, and a sound lease maturity profile with an average weighted lease maturity of about five years. NEPI's tenants have a relatively modest occupancy cost (or rent-to-sales) ratio of 10%-11%, which somewhat mitigates the risk of increasing rent burden from currency movements (rents are contracted in euros, while tenants' revenues are in Romanian lei). NEPI's top 10 tenants only account for 24.4% of its total rental income, with the largest--retailer Carrefour--accounting for 6.5%.

The business risk profile is mainly constrained by NEPI's relatively modest portfolio scale compared with that of retail peers such as Atrium European Real Estate (82 assets worth €2.7 billion) or Mercialis (59 assets worth €2.7 billion). It is also constrained by modest geographic diversification and the company's exposure to developing economies such as Romania. However, we understand that tenant demand for retail and office space is increasing quickly in this market, and current economic prospects are favorable.

Under our base case, we assume that the company's EBITDA will reach €110 million by 2016, almost double its 2014 value, on the back of full-year contributions of previous acquisitions, new acquisitions, completed developments, and value-enhancing renovations and project extensions. We assess NEPI's profitability as average, and, in our base-case scenario, we forecast NEPI's adjusted EBITDA margin to be in the range of 65%-70% in 2015-2016. At the same time, we note that the company's revenue includes significant costs that are passed on to tenants and, if measured without those costs, the company's profitability would exceed 90%. Our operating base-case scenario for 2015-2016 includes like-for-like rental income growth of 1.0% and stable occupancy.

Our assessment of NEPI's financial risk profile as "modest" is underpinned by the company's financial policy, which is centered on a loan-to-value (LTV) ratio of less than 35% and a debt-to-EBITDA ratio in the range of 4x-6x. Under

our base-case scenario, we forecast debt-to-debt plus equity ratios of about 20% in 2015-2016. We also anticipate that the EBITDA interest coverage ratio will be about 4.5x in 2015-2016. We factor the senior unsecured bond issuance into our scenario and believe that this should lower the company's effective interest rate. We expect total dividend distribution to shareholders to remain stable, although NEPI is not legally required to distribute dividends.

We understand that company has good access to equity capital markets, as shown by its track record of issuing equity of about €1 billion in the recent years to fund its retail-assets acquisition pipeline. The company benefits from the support of its shareholders, three large South African property funds and one pension fund, that own in total 32% of the company's shares, with the rest owned by a large number of investors. NEPI is listed on the Main Board of Johannesburg Stock Exchange, the Alternative Investment Market of the London Stock Exchange, and the regulated market of the Bucharest Stock Exchange.

We expect that the level of NEPI's rental income generated by unencumbered assets will exceed 80% as a result of a large debt repayment using the bond proceeds. This should result in a capital structure where unsecured debt issuance is not structurally subordinated to other debt obligations to the extent that it would affect the issue credit rating.

Liquidity

We assess NEPI's liquidity as "adequate" under our criteria for real estate companies. We anticipate that liquidity sources will likely cover liquidity uses for 2015 by more than 1.2x. We assess debt covenant headroom as adequate. NEPI has sound relationships with a diversified group of banks, and a generally satisfactory standing in capital markets.

As of June 30, 2015, we estimate that liquidity sources over the next 12 months will mostly consist of:

- About €63.5 million of cash and cash equivalent;
- About €62.5 million of available under the committed credit lines;
- Funds from operations (FFO) averaging about €75 million-€80 million; and
- The sizable bond issuance targeted in the short term.

This compares with the following liquidity uses for the next 12 months:

- About €150 million of debt maturities;
- About €150 million-€170 million of planned capital expenditures; and
- Our estimate of about €4 million-€5 million of working capital outflow.

Outlook

The stable outlook on NEPI reflects our view that the company's debt-to-EBITDA ratio will be less than 4.5x over the next two years, supported by company's resilient cash flows and conservative financial policy. The outlook is underpinned by our view of the favorable demand-supply trends in most of NEPI's geographic locations. We expect NEPI will maintain adequate liquidity and a debt-to-debt plus equity ratio of less than 35% after the bond issuance.

Downside scenario

We could consider taking a negative rating action if, in particular, NEPI's debt-to-EBITDA ratio increases to more than 4.5x on a pro forma basis and its debt to debt plus equity increases above 35%. Downward rating pressure might also materialize if we see negative dynamics in its operating performance.

Upside scenario

Rating upside is currently constrained by our assessment of Romania's economy. An upgrade would also hinge on NEPI materially improving its portfolio in terms of size and diversification, while generating positive like-for-like rental income growth and showing positive portfolio revaluation.

Ratings Score Snapshot

Corporate Credit Rating: BBB-(Prelim)/Stable/--

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 And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

New Rating

New Europe Property Investments PLC

Corporate Credit Rating

BBB-(Prelim)/Stable/--

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