Research Update:

CPI Property Group S.A Downgraded To 'BBB-' On Sustained Higher Leverage; Outlook Stable

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Rating Action Overview

- Recent merger and acquisition (M&A) activities and weakening market conditions are keeping CPI Property Group's credit metrics outside of our rating expectations, with S&P Global Ratings-adjusted ratio of debt to debt and equity expected to remain above 50% (51.7% as of June 30, 2022) and EBITDA interest coverage falling to 2.3x-2.5x (2.4x as of June 30, 2022).
- As we believe transaction markets should remain challenging and funding conditions remain unfavorable, we now forecast that the company will maintain its ratio of debt to debt plus equity at about 51%-54%, EBITDA interest coverage of close to 2.3x-2.5x, and debt to EBITDA of about 13x-15x over the next 12-24 months.
- Although the takeover of Immofinanz AG and S-Immo AG has significantly enhanced CPI's scale and portfolio diversification, we do not view those transactions as substantially transformative to offset the weakening of the company's financial risk profile.
- Therefore, we have lowered our long-term issuer credit rating on CPI and our issue rating on its senior unsecured debt to 'BBB-' from 'BBB', and our issue rating on its subordinated debt to 'BB' from 'BB+'.
- The stable outlook on CPI reflects our expectation that the group should be able to integrate recent transactions successfully and maintain a robust operating performance with solid occupancy levels and positive like-for-like rent growth.

Rating Action Rationale

Recent M&A transactions, weakening market conditions, and the ongoing delay in CPI's deleveraging plan will likely keep its leverage elevated over a prolonged period. CPI now owns about 77% of Immofinanz and about 79% of S-Immo. The transactions weakened the company's credit metrics, with an increase in our adjusted ratio of debt to debt plus equity to 51.7% as of June 30, 2022 from 44.4% on Dec. 31, 2022 (52.6% as of June 30, 2021). Furthermore, the company's EBITDA interest coverage has been continually declining from above 3.0x in 2019 to 2.4x as of June 30, 2022. Given the challenging property market outlook, CPI's strategy to raise equity or equity-like instruments and secure sufficient asset disposals to compensate for the rise in leverage has not been executed within our initial expectations. While we note that the company has successfully completed or agreed a total of about €700 million disposals so far in 2022, we believe CPI may struggle to sell the additional €2.0 billion of identified assets (announced in August of 2022), given property investors' weaker appetite since interest rates started to rise. The rising interest rate environment, combined with the risk of an economic recession in Europe, will likely further weaken investor appetite for real estate assets. We therefore now believe that CPI would take more time to dispose of its non-strategic assets than it initially planned. Our revised base case forecasts S&P Global Ratings-adjusted ratio of debt to debt and equity of about 51%-54%, EBITDA interest coverage of around 2.3x-2.5x, and debt to EBITDA of about 13x-15x in the next 12-24 months. Therefore, we view it as unlikely that our requirements for maintaining a 'BBB' rating will be restored, as previously assumed (see "CPI Property Group S.A. Ratings Placed On CreditWatch Negative On Planned Takeover Of S-Immo," published on April 19, 2022). We note CPI would make small acquisitions that would require additional cash proceeds of about €500 million-€600 million in the second half of 2022, further preventing fast deleveraging. While CPI resolved the cross-stake holdings at Immofinanz and S-Immo and simplified corporate structures between the three entities, we remain cautious of any further related-party transactions, family-related deals (initial acquisition of shares in Immofinanz), or growth through joint ventures, which increases complexity and reduces transparency in the company's corporate structure, potentially harming the company's credit profile. We understand that the recent related party transaction or intragroup transactions were performed on an arms-length basis.

CPI's scale and asset diversity have strengthen through recent M&A deals but this has not transformed our current business risk assessment. Under fully consolidated figures (CPI consolidated Immofinanz's and S-Immo's balance sheets as of June 30, 2022), CPI's portfolio expanded to about €20.9 billion (€17.0 billion-€18.0 billion including planned disposals) from €13.1 billion on Dec. 31, 2021. The portfolio is spread across 12 countries--such as Czech Republic (25% of total portfolio value: €20.9 billion), Germany (24%), Poland (13%), Austria (8%), Romania (8%), Hungary (7%), Italy (7%), and others (9%). The company remains focused on office assets, accounting for about 48% of its total portfolio value (€20.9 billion), with the remainder in retail (23%), residential (11%), hotel (5%), and complementary assets (13%). CPI will stay strongly focused on Central and Eastern Europe (CEE) markets, which we generally view as less resilient (except the Czech Republic, as we understand that the barriers to entries are higher there than in Poland, Romania, and Hungary) and as having lower barriers to entry than more mature markets, such as France or Germany. We believe the takeover of Immofinanz and S-Immo is a complementary to its existing asset base, which would keep it well diversified by geography and business segment. Our rating analysis also considers the company's ambitious growth strategy in an unfavorable market environment, which hampers a quick integration of the transaction and maturing of the overall asset base in a timely manner (asset rotation strategy). The real estate industry is undergoing several challenges, which could erode landlords' cash flow generation and profitability metrics.

We expect CPI's liquidity will remain adequate. As of June 30, 2022, CPI had approximately €975.2 million of cash and cash equivalents (excluding those available at S-Immo) and €800 million available under its committed undrawn revolving credit facility (RCF) maturing beyond 12 months (excluding the undrawn RCF available at S-IMMO). This should comfortably cover its upcoming short-term debt maturities of about €300 million in 2022 and about €685 million in 2023. The drawn amount under its bridge facility was around €1.6 billion as of Aug. 31, 2022. We understand the company has extended this facility, it is now maturing in the first half of 2025. We understand the undrawn availability under the bridge remains at around €630 million, which should be sufficient to cover any future required cash amount to close the take-over of S-Immo. Average cost of debt stood at 1.76% as of June 30, 2022, and given CPI's relatively low refinancing needs for the next 12 months, we believe that the rising interest rate environment should only slightly affect the company's funding costs for that period. We note that CPI has around 5.1 years (excluding bridge loans) of weighted-average debt maturity as of June 30, 2022 and enjoys solid relationships with banks. Further, we understand that the company's covenant headroom remains adequate as per the latest testing period, and we expect this to be maintained.

Outlook

The stable outlook on CPI reflects our expectation that the group should be able to integrate recent transactions successfully and maintain solid occupancy rates, achieving positive like-for like rental income growth, supported by its inflation-linked rental contracts. Our base case assumes S&P Global Ratings-adjusted ratio of debt to debt plus equity will be about 51%-54% in the next 12-24 months, with an EBITDA interest coverage ratio of about 2.3x-2.5x and debt to annualized EBITDA at around 15x by the end of 2023.

Downside scenario

We could lower our ratings on CPI if:

- Debt to debt plus equity increases to 60% or above;
- EBITDA interest coverage decreases toward 1.8x or below; or
- Debt to annualized EBITDA materially differs from our forecast.

The above could occur if the company's operational environment deteriorates, with occupancy levels falling or valuations strongly declining or if CPI is unable to execute its disposal strategy or continues its acquisitive direction. We could also take a negative rating action if unexpected events further weaken the company's creditworthiness.

Upside scenario

We could raise the ratings if:

- Adjusted debt to debt plus equity falls and stays well below 50%;
- EBITDA interest coverage increases well above 2.4x; and
- Debt to annualized EBITDA reaches below 13x.

A positive rating action would also require CPI to successfully integrate recent transactions, including finalizing its disposal plans, so that cash flow generation becomes highly visible and predictable again. We would also expect CPI to establish a consistent strategy with the market environment without harming its creditworthiness.

Company Description

CPI is a real estate group focusing primarily on office, retail, residential, and hotel properties in CEE and Germany. The group operates primarily in the Czech Republic (25% of the portfolio by property value of 20.9 billion, as of June 30,2022, excluding disposals), Germany (24%), Poland (13%), Austria (8%), Romania (8%), and Hungary (7%), and is a leading retail and office landlord in this region. Including recent acquisitions of Immofinanz AG and S-Immo, CPI's portfolio of €20.9 billion is mainly invested in offices (48% of portfolio value) and retail (23%), with the remainder being residential and hotel assets. The group has more than 25 years of experience in the real estate market and operates in 12 countries. CPI is 89% owned by Radovan Vitek and 5.5% by Clerius Properties (an affiliate of Apollo Funds). It is listed on the Frankfurt Stock Exchange.

Our Base-Case Scenario

Assumptions

- A slowdown of real GDP growth in the eurozone to 3.0%-3.5% in 2022 and 0.5%-1.0% in 2023; and in the CEE to 3.0%-3.5% in 2022 and 2.0%-2.5% in 2023. We estimate consumer price index (CPI) growth in Poland to be high at about 8.0%-9.0% in 2022 and 5.0%-6.0% in 2023, and in the CEE at about 12%-13% in 2022 and 8.0%-9.0% in 2023.
- Like-for-like rental income growth at about 5.0%-6.0% in 2022 and 2.0%-3.0% in 2023, mainly benefiting from inflation-linked lease agreements, partly offset by our expectations of stagnating occupancy levels and limited rental uplifts from extended or new leases.
- We assume overall flat portfolio valuation growth in 2022 and slightly negative for 2023, with potential yield expansion could be partially mitigated by the positive rental impact from indexation.
- We assume the company would be able to dispose of about €1.0 billion of assets annually over next two years.
- Absolute EBITDA of about €530 million-€560 million in 2022 and €650 million-€670 million in 2023; the latter mainly supported by full-year rental contributions from Immofinanz and S-Immo acquisitions.
- We assume full consolidation of Immofinanz as per March 2022 and S-Immo as of August 2022.
- We understand that the company will focus on pre-let developments and, therefore, we expect annual capex of about €200 million-€250 million in the next 12-24 months.
- Average cost of debt to be close to 2.0% from 1.75% in first half 2022, assuming any refinancing needs for 2022 and 2023 to be priced at the current market yield-to-worst and taking into account the company's exposure to floating interest rates of about 24%, where the majority of it relates to the outstanding bridge facility.

Key metrics

- A debt-to-debt-plus-equity ratio of about 55% in 2022 and 51%-53% in 2023.
- Adjusted EBITDA interest coverage of about 2.3x-2.5x in 2022-2023.

- Adjusted debt to EBITDA decreasing to 14x-15x over the next 12-24 months, including full EBITDA contribution from recent transactions.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/-
Business risk:	Satisfactory
Country risk	Intermediate risk
Industry risk	Low risk
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (No Impact)
Capital structure	Neutral (No Impact)
Financial policy	Neutral (No Impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no Impact)
Comparable rating analysis	Neutral (No Impact)

ESG credit indicators: E-2, S-2, G-3

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- 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: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
CPI Property Group S.A.		
Issuer Credit Rating	BBB-/Stable/--	BBB/Watch Neg/--
CPI Property Group S.A.		
Senior Unsecured	BBB-	BBB/Watch Neg
Subordinated	BB	BB+/Watch Neg