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Research Update:

CPI Property Group Downgraded To 'BB+' On Ongoing Tight Credit Metrics And Financial Policy Deviations; Outlook Negative

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Rating Action Overview

- Commercial real estate company CPI Property Group S.A.'s (CPI's) leverage was higher than expected in 2023 and we anticipate continuous pressure on its credit metrics amid execution risks and a limited track record of successful deleveraging plans.
- Despite last year's solid operating performance, including a 7.9% like-for-like increase in rents, high leverage and increasing cost of funding resulted in CPI's EBITDA interest coverage deteriorating to 1.8x at year-end 2023 from 2.1x as of June 30, 2023, beyond our previous base case and expectation for the 'BBB-' rating.
- Additionally, despite about €930 million in proceeds from asset disposals in 2023, our leverage metric (debt to debt plus equity) deteriorated to 59.8% from 56.4% as of June 30, 2023.
- We therefore lowered our ratings on CPI and its senior unsecured notes to 'BB+' from 'BBB-', and our issue ratings on the subordinated hybrid bonds to 'B+' from 'BB'. We also assigned a recovery rating of '3' to the senior unsecured notes, indicating our expectation of about 65% recovery (rounded estimate) in the event of a default.
- The negative outlook reflects a one-in-three likelihood of a downgrade over the next 12 months if CPI does not manage to execute its deleveraging plan in a timely manner and get closer to its targeted financial policy.

Rating Action Rationale

CPI´s EBITDA interest coverage dropped to 1.8x at year-end 2023 versus our expectation of about 2.0x, following a lack of progress in deleveraging and rising funding costs. We expect CPI's gross debt to reduce significantly in 2024 as a result of asset disposal proceeds of over €600 million year to date, plus an additional forecast €1.1 billion by the end of this year as part of a recently announced supplemental €2 billion asset disposal program to be completed over the next 12 to 24 months. However, we believe the higher cost of funding and lower expected rental income base associated with the disposals will continue to weigh on the company's interest servicing capacity, although we understand this should be limited since the properties sold have very low or no yields. Similarly, we forecast the average cost of debt to rise toward 3.4% in the next 12-24 months from 3.12% as of year-end 2023 and 2.45% in 2022. We have revised down our forecast of EBITDA interest coverage to 1.8x-1.9x over the next 12 months, which is lower than our previous projection of slightly above 2.0x and therefore not commensurate with a 'BBB-' rating. This is even though we forecast rental income growth of 3.5%-4.0% on a like-for-like basis in 2024, partly owing to rental indexation, stable occupancy levels, and rental contribution linked to its capital expenditure (capex) program. The company's asset disposal program, which focuses on selling mainly lower-yielding or vacant assets, should partly offset higher funding costs and support broadly stable EBITDA interest coverage in the future. Despite the company's relatively high proceeds from asset disposals in 2023, execution risks of its deleveraging strategy remain high, in our view. This is because, although investor sentiment is improving, asset sales are taking longer to close, which could result in further delays in deleveraging.

The company's high interest burden and sizable capex plans weigh on cash flow generation and its internal capacity to deleverage relies increasingly on asset sales. CPI's total interest expense increased to €386 million in 2023 from €248.3 million in 2022, resulting in cash flow from operations after interest payments decreasing to €248 million in 2023 from €361 million in 2022. We expect interest expense to continue weighing on the company's cash flow generation capacity due to the higher cost of debt. This, coupled with expected sizable capex investments of €400 million-€420 million in 2024, and €300 million-€350 million in 2025, implies CPI's free operating cash flow (FOCF) will remain negative. Therefore, despite CPI's large income-yielding asset base worth €19.5 billion as of year-end 2023, the high interest burden and sizable capex are hampering its cash flow generation and capacity to reduce leverage, increasing its reliance on asset disposals to reduce leverage.

Shareholder distributions, alongside asset investments that deviated from our previous base case and asset devaluations, resulted in CPI's S&P Global Ratings-adjusted leverage rising to 59.8% in 2023 from 57.5% in 2022.¨ This was despite €930 million of asset disposals closed in 2023. Last year, CPI reported a 5.1% like-for-like valuation decline, following a significant yield expansion in 2023 because of the high-interest-rate environment. The company was able to partly mitigate the yield expansion, thanks to robust operating performance on the back of sustained rental indexation and positive rental growth. However, asset devaluations had a €1.1 billion negative impact on net income, resulting in S&P Global Ratings-adjusted debt to debt plus equity rising to 59.8% at year-end 2023 from 57.5% at year-end 2022. Despite significant asset disposals in 2023 with proceeds exceeding €930 million, the company's sizable capex of about €376 million, cash-funded acquisitions of €111 million, and cash outflows via share repurchases or loans to shareholders totaling about €326 million, limited the positive impact on leverage. We understand CPI will not make further acquisitions and plans to limit shareholder remuneration in favor of deleveraging. Nevertheless, further potential asset devaluations, which we project at 3%-4% over the next 12-24 months, may result in slower deleveraging than expected. We expect total asset disposal proceeds of about €1.75 billion in 2024 and an additional €800 million in 2025 to result in debt to debt plus equity improving to 58%-59% in 2024 and to 56%-57% in 2025. We also expect debt to EBITDA to improve to 14x-15x in 2024, and reduce further to 13x-14x in 2025, after 15.9x at year-end 2023.

The group's complex corporate structure, unanticipated asset investments, and shareholder -friendly transactions, as well as limited access to material cash at subsidiaries S Immo and Immofinanz weigh on CPI's creditworthiness. CPI reported over €1.0 billion in cash and cash equivalents at year-end 2023, but still had €608 million outstanding on its second €635 million bridge loan; it also used close to €460 million of its revolving credit facility (RCF) to repay part of the first bridge loan. Of the over €1.0 billion of reported cash and cash equivalents, close to €700 million were on the books of S Immo and Immofinanz, two fully controlled subsidiaries. CPI has completed asset sales at its subsidiaries to upstream cash to use for debt repayment. We understand the company's objective is to streamline the organizational structure to reduce complexity and liquidity imbalances within the group. This is because about 65% of the group's reported gross debt is owed by the holding company but 70% of the cash is at the two subsidiaries, which have a significant proportion of minority shareholders. Although plans for a squeeze out at S Immo should reduce the group's organizational complexity, it will delay deleveraging, since we expect a cash outflow of €110 million to €130 million related to the share buyout. CPI has a limited track record of successfully executing its deleveraging plans. The company has expanded significantly over the past few years with a series of large acquisitions, including the takeover of Immofinanz and S Immo, and despite sizable disposal proceeds in 2023, a large portion of its cash has been used for non-deleveraging purposes. As a result, its credit metrics have deviated from our previous base case. Similarly, CPI has not been able to comply with its own financial policy target of reported loan to value (LTV) of 40% for the few years.

That said, we view as positive the group's recent €500 million bond issuance, which provided liquidity to repay the remaining bridge loan facility, reducing debt maturities in 2026 and supporting liquidity in the short term. CPI's recently issued €500 million bond not only demonstrates the company's access to bond markets, albeit with a relatively high 7% coupon, but also secures sufficient liquidity to repay the €530 million outstanding amount on its bridge loan as of March 31, 2024, thereby reducing the amount of debt maturing in 2026. Refinancing the bridge loan with a five-year bond also lengthens the company's weighted average debt maturity to 4.6 years-4.8 years pro forma the repayment. This allows for a smoother debt repayment profile, especially in 2026, when close to €2.5 billion (including the bridge loan) was due to mature. But the high coupon will continue to weigh on the company's interest burden. CPI's relatively weak capital market standing, with spreads on bond trading wider than those of peers at comparable rating levels, and current high leverage puts additional pressure on its need to successfully dispose of assets to reduce leverage and secure sufficient liquidity to cover its upcoming debt maturities. As a result of these constraints, we have applied a negative comparable rating analysis modifier to our assessment of CPI's credit profile.

Outlook

The negative outlook indicates that we could lower the ratings within the next 12 months if CPI fails to execute its deleveraging plan in a timely manner, with its reported LTV approaching its own financial policy of 40%.

We could also lower the issuer credit rating if CPI fails to maintain adequate liquidity buffers, such that upcoming debt maturities are not refinanced in a timely manner or undrawn available credit facilities are not rolled over.

Downside scenario

We could lower our rating on CPI if:

- The company fails to maintain a comfortable liquidity buffer;
- Debt to debt plus equity increases to 60% or higher;
- EBITDA interest coverage deteriorates to well below 1.8x; or
- Debt to annualized EBITDA deviates materially from our base case.

This could happen if CPI does not succeed in executing its asset disposal plan, records portfolio devaluations beyond our forecasts, or funding conditions deteriorate beyond our expectations.

We could also take a negative rating action if unexpected events further weaken the company's creditworthiness, such that available cash is used for non-deleveraging purposes such as substantial share buybacks beyond our forecast, provision of shareholder loans, or acquisitions involving future debt repayments to its main shareholder.

Upside scenario

We could revise the outlook to stable if the company restores its credit metrics, with:

- Debt to debt plus equity below 60%;
- EBITDA interest coverage above 1.8x; and
- Debt to annualized EBITDA in line with our base case.

An outlook revision to stable is also contingent on CPI's financial discipline, including adherence to its publicly stated financial policy of 40% LTV, and whether it limits shareholder remuneration via shareholder loans, dividends, or share repurchases. It is also contingent on the company maintaining an adequate liquidity buffer to cover its upcoming debt maturities.

Company Description

CPI is a real estate group focusing primarily on offices (45% of the portfolio's value on Dec. 31, 2023), as well as retail (25%), residential (7%), and hotel properties (6%). It also owns other assets that mostly comprise land banks and development assets (17%).

The company has more than 30 years of experience in the real estate markets and operates in 12 countries in Central and Eastern Europe and Germany. With an overall portfolio value of €19.5 billion as of Dec. 31, 2023, CPI operates primarily in the Czech Republic (28% of the portfolio), Germany (18%), Poland (13%), Romania (8%), Italy (8%), Hungary (7%), and Austria (6%), and is a leading retail and office landlord in these countries. Radovan Vitek is the majority shareholder via the Vitek family trust, which owns 88.41% of CPI. Clerius Properties (an affiliate of Apollo Funds) owns 4.5% and the rest is in free float. CPI is listed on the Frankfurt Stock Exchange.

Our Base-Case Scenario

Assumptions

- Eurozone CPI growth of around 2.6% in 2024, reducing further to 2.1% in 2025; real GDP growth of 0.7% in 2024 and 1.3% in 2025; and stable unemployment of 6.6% in 2024 and 2025.
- Like-for-like rental income growth of 3.5%-4.0% in 2024, and 1.5%-3.0% per year over 2025-2026, mainly benefiting from inflation-linked lease agreements, but partly offset by likely stagnating occupancy levels in the office segment.
- Potential portfolio devaluation of 3%-4% over 2024-2025, with expected yield expansion partly mitigated by the positive rental impact from indexation.
- Net disposal proceeds of about €1.75 billion in 2024 (including a potential minority stake disposal in Poland), an additional €800 million in 2025 and €600 million in 2026, and no acquisitions over 2024-2026.
- Expected cash outflow of about €150 million related to the announced buyout of S Immo's minority shareholders for €130 million-€150 million.
- Annual capex of €400 million-€420 million in 2024, reducing to €300 million-€350 million in 2025, including maintenance and development capex.
- Annual share buybacks of €80 million-€100 million over 2024-2025, close to the 2023 level.
- Debt refinancing--if required--to be at interest rates of 5%-7%, in line with the recently issued bond and CPI's most recent bank refinancings.

Key metrics

- EBITDA to interest coverage of 1.8x-1.9x over 2024-2025.
- Debt to debt plus equity of 58%-59% in 2024, improving to 56%-57% in 2025.
- Debt to EBITDA of 14x-15x in 2024, reducing to 13x-14x in 2025.

Liquidity

We assess CPI's liquidity as adequate. This is based on our forecast that the company's liquidity sources will exceed its funding needs by comfortably more than 1.2x over the 12 months from April 1, 2024. We have amended our liquidity calculation and we now exclude cash at CPI's subsidiaries, S Immo and Immofinanz, since we understand that cash is not fully available. We therefore also exclude the debt maturing at S Immo and Immofinanz, whose cash we understand is readily available to repay their debt.

CPI's recent €500 bond issuance, subsequent bridge loan repayment, and €194 million of net disposal proceeds support liquidity in the short term. That said, we note significant debt maturities at the parent company in 2026 and limited accessibility of cash at CPI's fully controlled subsidiaries S Immo and Immofinanz. We understand CPI is currently working on renewing its committed €700 million RCF in 2024, well ahead of its January 2026 maturity.

Principal liquidity sources over the 12 months started April 1, 2024, include:

- About €274 million of unrestricted cash and cash equivalents;

- €240 million available on the RCF and committed bank lines maturing beyond 12 months;
- Funds from operates that we estimate at €320 million-€330 million;
- €194 million of net proceeds from signed disposals; and
- €500 million in proceeds from the bond issued in May.

Principal liquidity uses over the next 12 months:

- €608 million of contractual debt maturities, including the remaining €530 million outstanding on the bridge loan as of first-quarter 2024 repaid with the bond issuance proceeds; as well as €78 million of maturing bank loans and bonds at the parent company;
- Around €100 million of estimated committed capex; and
- About €80 million of share repurchases in line with the company's distribution policy.

Covenants

We understand the company had adequate headroom (more than 10%) under its bond and bank covenants as of Dec. 31, 2023. We expect CPI will maintain sufficient headroom under these covenants in the future.

Requirements

The main bond covenants (most restrictive) include the following consolidated ratios:

- Leverage to be lower than 60% (versus 51.6% and 50.7% pro forma the signed disposals at year-end 2023);
- Interest coverage ratio higher than 1.9x versus a reported ratio of 2.5x as of year-end 2023; and
- Secured debt to total assets lower than 45% versus a reported 24% as of year-end 2023.

Environmental, Social, And Governance

Governance factors are a moderately negative consideration in our credit rating analysis of CPI Property Group. We believe CPI's recent related-party transactions--such as family-related deals, cross-stake holdings, or growth through joint ventures--create governance-related risks and complexity, which weigh on the company's creditworthiness. In addition, the company has a limited track record of executing strategic decisions and achieving its financial goals in a timely manner. Nevertheless, we understand the company aims to maintain its deleveraging strategy and simplify its corporate structure in the near future.

Environmental and social factors are an overall neutral consideration in our credit rating analysis of CPI Property Group. The company has embedded sustainability in its strategy and targets to reduce greenhouse gas emissions by 32.4% by 2030 from the 2019 levels across scopes 1 to 3 (up from the previous target of 30%). It also aims to transition all electricity purchased by the group to 100% renewable sources by 2024.

Issue Ratings--Recovery Analysis

Key analytical factors

- The issue rating on the senior unsecured notes issued by CPI, with a combined nominal value of €3.6 billion, is 'BB+', in line with the issuer credit rating.
- The noteholders will benefit from a valuable asset base, mostly consisting of stable income-producing investment properties.
- Although we calculate recovery at 100%, we assigned a recovery rating of '3', in line with our criteria. This is due to the notes' unsecured nature, the risk that additional prior-ranking debt could be raised on the path to default, the context of debt restructurings in less proven jurisdictions where the majority of assets are located (68% of the portfolio's gross asset value at year-end 2023), the current volatile valuation environment for the real estate industry, and risks related to the structural subordination of debt at the parent company, with unpredictable residual values for unsecured noteholders in a hypothetical default.
- In our hypothetical default scenario, assumed for 2028, we envisage a severe macroeconomic downturn in Europe resulting in market depression and exacerbated competitive pressures.
- We value the group as a going concern. We use a discrete asset valuation approach to take into consideration the stressed value of CPI's yielding properties as well as development projects. Recovery prospects for the proposed senior unsecured notes are very sensitive to a small change in the amount of senior secured debt or any other priority debt outstanding at default.
- The bond documentation includes limitations on indebtedness--a maximum consolidated leverage ratio of 60%--and a limitation on prior-ranking debt, with secured debt to total assets restricted to a maximum of 45%.

Simulated default assumptions

Year of default: 2028

Jurisdiction: Czech Republic

Simplified waterfall

Gross enterprise value (EV) of CPI plus the residual value from S Immo and Immofinanz after deducting minority interest: €8.1 billion

Net EV at emergence after administrative costs: €7.8 billion

Estimated priority debt at CPI only (credit lines, mortgages, and other secured debt): About €2.7 billion

Net EV available to senior unsecured bondholders: €5.1 billion

Senior unsecured debt claims including unsecured bank loans and senior unsecured notes: €4.9 billion

Recovery expectation: 50%-70% (rounded estimate: 65%)

*All debt amounts include six months of prepetition interest and assume 85% of the RCF and credit lines are drawn on default (CPI's credit lines totaled about €800 million as of Dec. 31, 2023).

Ratings Score Snapshot

Issuer Credit Rating	BB+/Negative/--
Business risk:	Satisfactory
Country risk	Intermediate
Industry risk	Low
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	Moderately Negative (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bb+

Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- 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: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

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

Related Research

- CPI Property Group Outlook Revised To Negative On Tightening Credit Metrics Despite Disposal Success; 'BBB-' Affirmed, Dec. 18, 2023

Ratings List

Downgraded

	To	From
CPI Property Group S.A.		
Issuer Credit Rating	BB+/Negative	BBB-/Negative
Senior Unsecured	BB+	BBB-
Recovery Rating	3(65%)	
Subordinated	B+	BB