Research Update:

Branicks Group AG Downgraded To 'CCC+' On Weak Liquidity And Tight Covenant Headroom; Outlook Negative

January 24, 2024

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Rating Action Overview

- Germany-based real estate holding company Branicks Group AG (Branicks) has sold properties with a gross amount of about €285 million in 2023, which is slightly below their target of €300 million-€600 million. Therefore, the company currently does not have the necessary funds to serve the €569 million debt maturing in 2024 as of today. We believe Branicks depends on favorable business, financial, and economic conditions to meet its financial commitments.
- On Jan. 22, 2024, the company announced that it entered negotiations with the debtholders of the bridge loan and the promissory notes to stabilize the company's capital structure. At this stage, the outcome of these negotiations is not clear, and the risk of a liquidity shortage is considerable.
- If negotiations are successful, we anticipate that the interest margin of the related facilities will increase and may put additional pressure on Branicks' already strained S&P Global Ratings-adjusted interest coverage metrics as well as the financial covenants, the latter with an already tight headroom of just about or less than 10%.
- Therefore, we lowered our long-term issuer credit rating on Branicks and its senior unsecured debt to 'CCC+' from 'B+'. Our recovery rating on the senior unsecured debt remains unchanged at '3'.
- The negative outlook reflects the risk that the company may fail to refinance its short-term debt in a timely manner or pursue a debt restructuring that we could view as a distressed exchange over the next couple of months.

Rating Action Rationale

On Jan. 22, 2024, Branicks announced that it is in negotiations for an extension of its €200 million bridge financing, due in July 2024, and invited promissory noteholders for an extension negotiation of its 2024 maturities, which amount to approximately €225 million. Approximately

€225 million of Branicks' €569 million debt maturities in 2024 are in promissory notes at Branicks' holding level, of which about €136 million will mature in the first half of 2024. In addition, €200 million of its bridge loan are due in July 2024. The company has received disposal proceeds of about €211 million in the second half of 2023 and raised funding on existing mortgage loans of approximately €60 million. Despite those transactions, which were mainly used to reduce gross debt, the liquidity deficit further intensified. Although our ratings currently factor in a successful and orderly refinancing of 2024 maturities, we believe that the sustainability of Branicks' capital structure is highly dependent on the successful execution of its future disposal plans. We note the company's positive rental performance for its commercial portfolio, with solid like-for-like rental income growth in 2023 as well as reported funds from operations of about €50 million, is in line with its target and view positively the company's decision to suspend dividends in 2024.

Although we currently do not anticipate a covenant breach, the tight covenant headroom and current bond trading underpin liquidity concerns. The company's spreads of its traded bonds continue to exceed the sector average. We think Branicks' ability to access debt capital markets is limited. While the company's financial covenants under its bond documentations remain tight, this increases the risk of a covenant breach if the company is unable to renegotiate its upcoming financial commitments at favorable terms and to reduce leverage in a timely manner. The bond carries covenants related to an adjusted LTV of up to 60%, a secured LTV of 45%, and an interest coverage ratio of at least 1.8x. We estimate that the covenant headroom as of Dec. 31, 2023, was below 10% for Branicks' maximum 60% LTV and about 10% for the 1.8x minimum interest coverage covenant. While we expect the very tight headroom will remain in place this year, we do not anticipate a covenant breach. A covenant breach would lead to an event of default under the company's bond documentation, leaving bondholders with an acceleration right in such a scenario.

While our base case remains broadly unchanged, funding costs will likely increase on the back of refinancings and delayed disposals. We expect average cost of debt will further increase to about 3.5%-4.0% over the next 12 months, leading to a S&P Global Ratings-adjusted interest coverage ratio of 1.6x in 2024, from 1.9x in September 2023 and 2.7x in December 2022. The calculation of the S&P Global Ratings-adjusted ratio differs from the company's bond covenants. In line with our previous forecast, we expect adjusted debt to debt plus equity will remain at about 58%-59% and debt to EBITDA at about 16x-18x over the next 12 months. As a result, we have revised our financial risk profile to aggressive from significant.

We lowered to 'CCC+' our issue ratings on Branicks' senior unsecured debt. The issue ratings on the senior unsecured debt remain in line with the issuer credit rating. Our recovery rating on Branicks' debt is unchanged at '3', indicating our expectation of a 50%-70% recovery (rounded estimate: 55%) in the event of a payment default (see "Branicks Group AG Downgraded To 'B+' On Reducing Liquidity Headroom; Placed On CreditWatch Negative," Nov. 15, 2023).

Outlook

The negative outlook reflects the risk that the company may fail to refinance its short-term debt in a timely manner or pursue a debt restructuring that we could view as tantamount to a default over the next couple of months. The negative outlook also reflects our view that Branicks' debt trading levels could incentivize the company to pursue a subpar debt exchange.

Downside scenario

We could downgrade Branicks if:

- The company failed to refinance its short-term debt maturities and did not reach consensual agreements with bridge and promissory note lenders;
- We consider the terms of any currently negotiated agreements, including forbearance agreements with creditors, as a distressed exchange under our criteria;
- We assess a breach under the financial covenants as unavoidable; or
- A conventional default becomes more likely.

Upside scenario

We could revise the outlook on the rating on Branicks to stable if the company raised sufficient capital and restored its liquidity while maintaining adequate headroom of at least 15% under its financial covenants.

Company Description

Branicks is a listed company that specializes in the management of commercial real estate properties in Germany. As of Sept. 30, 2023, it managed a portfolio of €13.9 billion, split into two segments:

- Commercial portfolio: Comprising about 172 properties with a market value of €4.0 billion and generating about 88% of annualized EBITDA; and
- Institutional business: Comprising 183 properties with a value of €9.9 billion and generating about 12% of annualized EBITDA.

Liquidity

We have revised our liquidity assessment of Branicks to weak and expect a liquidity sources will cover liquidity uses well below 1x over the 12 months from Dec. 31, 2023. Our assessment is constrained by Branicks' non-existent credit line availability, meaning the company is unlikely to absorb low-probability adversities. Its debt trading levels indicate that it will be unable to access capital markets in the near term.

Principal liquidity sources over the 12 months from Dec. 31, 2023, include:

- Unrestricted cash balances of about €157 million;
- Our forecast of cash funds from operations of €50 million-€55 million;
- Signed bank funding post the reporting date of about €20 million-€25 million; and
- Net cash inflows from asset disposals of about €12 million.

Principal liquidity uses over the same period include:

- Short-term debt maturities of about €569 million, including the €200 million bridge loan and

€248 million in promissory notes;

- Committed capital expenditure of about €15 million; and
- Net cash outflows of committed acquisitions of about €35 million.

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: 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: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Branicks Group AG Downgraded To 'B+' On Reducing Liquidity Headroom; Placed On CreditWatch Negative, Nov. 15, 2023

Ratings List

Downgraded

	To	From
Branicks Group AG		
Issuer Credit Rating	CCC+/Negative/--	B+/Watch Neg/--
Senior Unsecured	CCC+	B+/Watch Neg
Recovery Rating	3(55%)	3(55%)

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