Research Update:

Branicks Group AG Downgraded To 'B+' On Reducing Liquidity Headroom; Placed On CreditWatch Negative

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Rating Action Overview

- Branicks Group AG (previously named DIC Asset AG) has approximately €581 million of debt maturities due in 2024, representing about 20% of the company's total gross debt outstanding on Sept. 30, 2023.
- Given the rising interest rate environment, delays in planned disposals, and further pressure on property valuations, we believe that Branicks' already tight covenants headroom under its loan-to-value (LTV) and interest coverage ratio calculation could come under further pressure, although we do not forecast a breach of any financial covenant in the short term.
- Consequently, we lowered our long-term issuer credit rating on Branicks and its senior unsecured debt to 'B+' from 'BB-'. Our recovery rating on the senior unsecured debt remains unchanged at '3'. At the same time we placed the ratings on CreditWatch with negative implications.
- The CreditWatch placement reflects the possibility that Branicks might not secure sufficient liquidity sources over the upcoming few months to cover its 2024 maturities, which could result in its liquidity position deteriorating rapidly.

Rating Action Rationale

Branicks' liquidity headroom has tightened, while company actions in recent months have not been sufficient to cover the company's short-term needs. In October, Branicks repaid the €150 million bond maturity with available cash on balance sheet. We estimate that pro forma the repayment, the company's unrestricted cash position stands at about €118 million. Meanwhile, 2024 debt maturities amount to approximately €581 million (with €477 million due in the 12 months from September 2023). This includes the remaining bridge loan of €200 million and about €160 million of promissory notes due between March and July 2024.

Branicks has not been able to ensure sufficient liquidity sources to cover upcoming debt

maturities yet, and is therefore reliant on a rapid funding solution. We understand that the company is planning several options to be completed over the coming weeks, including the receipt of larger disposal proceeds. However, we remain cautious about the timing and price of further disposals and refinancing solutions, given the volatile market environment and higher interest rate environment.

We also understand that the company's headroom under its bond covenants for loan to value (LTV; set at 60%) remained tight at below 10% as of Sept. 30, 2023. We see an increased risk of decline in the interest coverage ratio from the current reported level of 2.3x. This is also a maintenance-base covenant under the bond documentation, set at a minimum of 1.8x.

Our base case remains broadly unchanged, with sustained high leverage and a relatively low EBITDA interest coverage, stemming from further expected property devaluations and elevated cost of debt. We expect the company's S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio to remain at about 56%-59% (59% as of third-quarter 2023), and adjusted EBITDA interest coverage ratio to remain relatively low at about 1.8x-2x (1.9x as of third-quarter 2023 on a rolling-12-months [RTM] basis) in 2023 and 2024. This mainly reflects the elevated cost of recent refinancing activities, including the extended bridge loan and an increase to floating rated debt to about 24% as of Sept. 30, 2023, versus 15% as of Dec. 31, 2022.

Our base case further assumes that the company will take the necessary steps to address its liquidity concerns, and we forecast about €200 million-€300 million of cash inflow in the next few months as a result of the actions taken (this could include access to various funding sources, such as disposal proceeds or upsizing of existing bank financings, among others). We understand that Branicks did not perform an external valuation test for its properties during the first nine months of 2023, but will report an updated external valuation result in its annual 2023 report. We have assumed a negative property valuation of about 4%-7%, in line with peers operating in a similar market and the company's own forecast, based on first internal assessments and feedback received by evaluators.

We estimate adjusted debt to annualized EBITDA at about 14x-16x (16.4x as of third-quarter 2023 RTM) over our forecast horizon. Following the partial repayment of the bridge loan in July 2023 and an extension of the remaining €200 million to July 2024, the company's average debt maturity profile remained largely stable at 3.6 years (3.8 years excluding the bridge) in comparison with 3.5 years as of Dec. 31, 2022. Meanwhile, the company's average cost of debt increased to 3% from 1.9% at year-end 2022. We forecast the average cost of debt will remain at about 3%-3.5% over the next 12 months.

We expect the operating fundamentals of Branicks' properties to remain broadly stable for the next 12 months. As of September 2023, the fair value of the owned portfolio declined to approximately €4.0 billion from €4.5 billion in December 2022, mainly because about 31 properties were transferred to the recently established VIB retail fund in first-quarter 2023, in addition to some small sales. The European Real Estate Association's (EPRA) vacancy rate for Branicks' owned portfolio stood at a low 5% at the end of third-quarter 2023, slightly higher than the reported 4.3% in December 2022, mainly disposal-driven and because vacancy increased to 8.7% in the office segment versus 7.8% reported in December 2022.

Branicks reported a solid like-for-like rental growth of 6.8% as of third-quarter 2023, benefiting from lease renewals and rent indexation, because more than 90% of the lease contracts are linked to the consumer price index (CPI). We expect stable and positive like-for-like rental income growth of at least 5%-6% in 2023 and 2%-3% in 2024, supported by our CPI inflation expectations for Germany of 6.3% and 2.8% in 2023 and 2024, respectively.

Although the ongoing tough market environment combined with cost-saving initiatives (in the context of the company's "Performance 2024" action plan) and potential reduction of required office space could represent a threat to further operational growth for office real estate landlords--and slowing demand could affect occupancy levels and rental income over the next two to three years--Branicks' lease portfolio is well spread, with only 1.2% of leases (of annualized rental income) maturing in fourth-quarter 2023 and 5.1% in 2024, limiting short-term vacancy risks.

CreditWatch

The CreditWatch negative reflects the possibility of a downgrade by at least one notch within the next few months, if Branicks does not secure sufficient funding sources to meet upcoming short-term financial obligations, including about €160 million of promissory notes due in the second quarter of 2024 and its €200 million bridge loan due in July 2024.

We could affirm the ratings on Branicks if the company successfully executes its refinancing plans, including securing enough liquidity to amply cover its short-term maturities and increase covenant headroom.

Company Description

Branicks is a listed company that specializes in management of commercial real estate properties in Germany. Currently, it manages a portfolio of €13.9 billion (as of September 2023), split into two segments:

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

Liquidity

We assess Branicks' liquidity as less than adequate, because we estimate that the company's liquidity sources will cover uses by less than 1.2x during the 12 months from Sept. 30, 2023.

Principal liquidity sources:

- Unrestricted cash balances of about €118 million, netted with the redemption of the €150 million bond repaid in October 2023;
- Our forecast of cash funds from operations of about €60 million;
- Signed disposal proceeds post reporting period of about €28 million net cash inflow; and
- About €37 million of signed new bank financing.

Principal liquidity uses:

- About €477 million of short-term debt maturities, including the €200 million remaining portion of the bridge loan, but excluding the repaid bond in October 2023;
- About €15 million of committed capital expenditure (capex) for the next 12 months;

- Net cash outflow of committed acquisitions of around €35 million.

Covenants

Branicks has financial covenants under some of its secured and unsecured outstanding debt, related to its LTV, bond LTV, secured LTV, and interest coverage ratio.

The bond carries covenants related to a maximum 60% adjusted LTV, 45% secured LTV, and interest coverage ratio of minimum 1.8x. The calculation of the company's bond covenants differs from the S&P Global Ratings-adjusted ratio calculations.

We understand that Branicks has maintained adequate headroom (at least 10%) for most of its financial covenants. That said, we understand that the covenants of the company's bond related to LTV, and promissory notes related to LTV, as well as its maintenance-based covenant related to interest coverage ratio are tight at below 10% headroom as of the end of September 2023.

We expect the company to take the necessary steps to avoid a breach of any financial covenant and to ensure sufficient headroom under all its covenants.

Issue Ratings - Recovery Analysis

Key analytical factors

- We rate Branicks' €400 million senior unsecured notes at 'B+', in line with the issuer credit rating.
- The recovery rating is unchanged at '3', indicating our expectation of 50%-70% recovery (rounded estimate: 55%) in the event of a payment default. The recovery rating reflects the valuable asset base mostly consisting of stabilized income-producing investment properties.
- Our recovery prospects are constrained by the unsecured nature of the debt instrument and its contractual subordination to the current amount of secured debt.
- In our hypothetical default scenario, we envisage a severe macroeconomic downturn in Germany, resulting in market depression and exacerbated competitive pressure.
- For Branicks' subsidiary VIB, in our recovery analysis we give value to only the 69% stake that Branicks owns.
- We value the group as a going concern. We use a combined approach based on discrete asset value and EBITDA multiple to take into consideration the stressed value of Branicks' owned yielding properties (commercial portfolio) and the EBITDA contribution derived from its fee income business (institutional business).
- 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. Since there is no limitation on the incurrence of additional debt in the bond documentation, recoveries could be much lower if the amount of secured debt at default differs from our projections.

Simulated default assumptions

- Year of default: 2027
- Jurisdiction: Germany

Simplified waterfall

- Consolidated net enterprise value at emergence (after 5% administrative costs): €2.57 billion
- First-lien secured debt (at the Branicks holding level): €967 billion
- Value available for senior unsecured claims: €628 million
- Senior unsecured debt claims (at the Branicks holding level): €1.09 billion
- Recovery rating: 3
- Recovery expectation: 50%-70% (rounded estimate: 55%)

All debt amounts include six months of prepetition interest.

Related Criteria

- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

Related Research

- German Real Estate Company DIC Asset AG Downgraded To 'BB-' On Tightening Liquidity; Outlook Negative, July 10, 2023

Ratings List

Downgraded; CreditWatch Action

	To	From
Branicks Group AG		
Issuer Credit Rating	B+/Watch Neg/--	BB-/Negative/--
Senior Unsecured	B+/Watch Neg	BB-
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 criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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