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Research Update:

Germany-Based DIC Asset AG Assigned 'BB+' Rating; Outlook Stable

February 26, 2021

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Rating Action Overview

- DIC Asset AG (DIC) is a Germany-based real estate holding company, owning and operating a commercial property portfolio currently valued at about €2 billion, mainly focusing on office assets with moderate exposure to other asset classes (mainly mixed-use and retail properties and a growing logistics portfolio).
- In addition, the company generates 42% of its EBITDA (excluding disposal gains) from real estate management fee income and co-investment income of an additional €8.3 billion (pro forma including RLI Investors) assets under management (AUM).
- Our business risk assessment reflects the potential for volatile earnings as a result of changes in rents and long-term trends, such as working from home and online shopping, despite solid market fundamentals of the German office market.
- We are analyzing the company based on its existing capital structure, because its planned senior unsecured bond issuance has been postponed.
- We are assigning our 'BB+' long-term issuer credit rating to DIC and withdrawing the preliminary 'BBB-' rating on the proposed bond issuance.
- The stable outlook reflects our view that the company's income from asset and property management, including rents, will generate stable cash flows over the next 12 months.

Rating Action Rationale

DIC has a relatively small portfolio of currently about €2 billion owned commercial properties. As of Dec. 31, 2020, the portfolio comprises 91 assets. This is smaller than higher-rated peers, such as Alstria Office REIT AG or Immofinanz AG. The portfolio consists mainly of office properties (70% by market value), mixed use (13%), retail (14%), and logistics and others (together about 3%). The portfolio is well spread across Germany with the majority of assets located in small and midsize cities (about 60% of annualized gross income), as well as in Germany's seven main metropolitan areas (around 40%). Although some of DIC's properties are in secondary locations, such as Mannheim or Ludwigshafen, whose commercial real estate (CRE) markets are less dynamic than those in the larger metropolitan areas, and it might require more time to find replacements if a tenant moves out once the lease contract expires, the majority of DIC's locations are in or close to metropolitan areas with good infrastructure and positive macroeconomic fundamentals. We understand that DIC's strategy toward its owned commercial property portfolio is to grow it to about €2.5 billion in the medium term. With about 800 tenants, DIC's portfolio is well diversified. The top 10 tenants represent 39.5% of total rental income, with the largest tenant being the German Stock Exchange (about 5.5% of total annual rental income), followed by the City of Hamburg (5.2%). We view favorably DIC's exposure to public sector tenants (22% of total rental income), which provide stable and predictable cash flows. We understand that the majority (about 75% of all properties) of buildings are multitenant properties and DIC's largest asset accounts for approximately 6% of total portfolio value. We believe the asset and tenant diversification will also position DIC well in the current environment, which should allow the company to absorb the reduction in demand for office space for some types of tenants or industries.

We view DIC's portfolio quality in line with the German industry standard. The properties are rented below market level, with an average monthly office rent per square meter at €10.81 as of Dec. 31, 2020. Most of the lease contracts are double net leases and linked to indexation, in line with the industry standard. DIC spends about €25 million annually for capital expenditure (capex), mainly related to asset refurbishment and repositioning. We view positively the company's weighted average lease length of 6.5 years, with the majority (about 67.8%) of leases expiring in 2025 or later. DIC benefits from a strong operational track record and reducing European Public Real Estate Association vacancy rate over the past few years to 5.4% currently from 11.8% in 2016. Occupancy levels are now slightly ahead versus other rated Germany-based office peers such as Alstria Office-REIT AG or Summit Properties. We view positively that the company is not involved in any direct development activities.

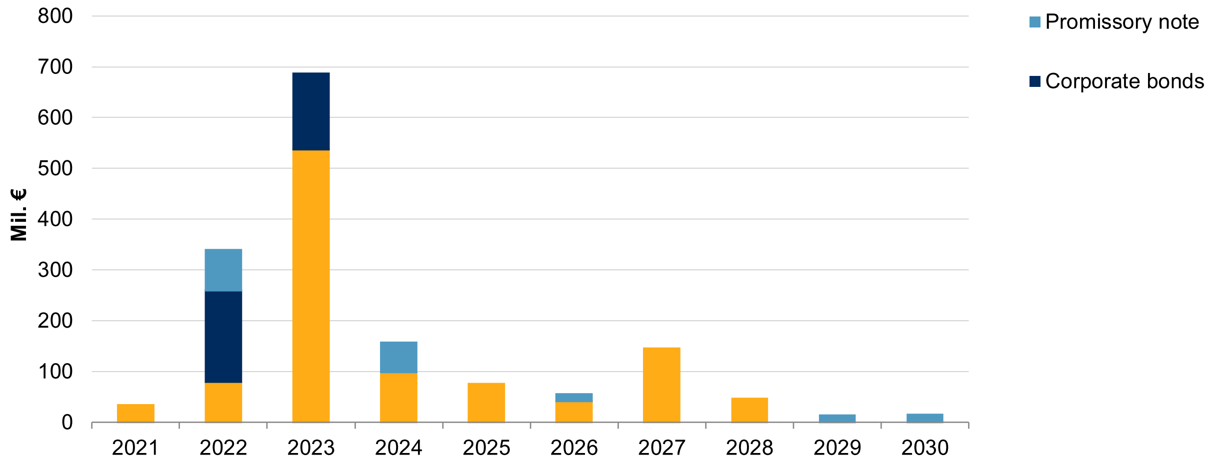
DIC's overall rental income in 2021 will likely stabilize, although the future of retail and office demand remains unclear. Following like-for-like net rental income decline of 3.1% in 2020, which was mainly driven by individual cases and the renegotiation of two lease contracts with former major retail tenant Galeria Karstadt Kaufhof, we expect a flattening of like-for-like rents for DIC's commercial portfolio in 2021. We have incorporated the potential rent concession from its retail assets in case of a prolonged lockdown (currently about 13% of total annual rental income), which in our view is offset by the relatively stable performance of its office premises, as well as mixed-use and logistics assets. We understand that, excluding GALERIA Karstadt Kaufhof, half of the company's retail assets are food-anchored or essential stores, which have remained open throughout the pandemic and several lockdowns. That said, we believe a larger share of affected rental income will stem from its seventh-largest tenant, the department store chain GALERIA Karstadt Kaufhof (representing about 3.2% of total annual rental income, spread across two properties). Overall, in our view, longer-term trends will likely affect the retail and office segments. The pandemic is accelerating the penetration of e-commerce and remote working trends, thereby putting pressure on the demand for physical space. Our analysis also takes into account the company's upcoming lease maturities, which remain low for 2021 at only 5%. However, we note that DIC has a moderate amount of lease maturities in 2022, accounting for about 9% of annualized contractual rental income for the whole commercial portfolio. The releasing of these properties is not certain, nor are rent levels for new leases. That being said, we understand that DIC is addressing its upcoming lease maturities well ahead and is already negotiating any unextended leases or unrenewed lease agreements for those upcoming lease expiries. In 2020, the rent level for renewed contracts (excluding GALERIA Karstadt Kaufhof) was up 2.6% over the previous level.

We view DIC's fee income business, which provides products along the whole real estate chain to a varied investor base, as an additional earnings source, though less stable than traditional rental income streams. In addition to its yielding commercial real estate portfolio, DIC manages approximately €7.6 billion of assets for third parties (institutional business) as of Dec. 31, 2020. Of those assets, 91% are office properties (thereof 14% public sector tenants), 5% retail, 2% hotel, and 2% residential. This year to date the AUM business has grown to €8.3 billion, taking into account the acquisition of RLI Investors at the beginning of 2021. The majority of the assets are located in Germany's seven largest cities. The company generates about 42% of its EBITDA (excluding disposal gains) from real estate management fee income, as well as co-investment income, and we expect this proportion to remain relatively stable in the near future. We understand that DIC uses an integrated real estate management platform for all of its AUM (pro forma including RLI Investors' €10.3 billion commercial yielding portfolio and institutional business), creating synergies with both operational lines. We consider about 50% of the fee income as recurring, in particular fees generated from asset management, property management, and development. We believe the remaining share, which either comes from fee income from the transaction business or is performance linked, is more volatile and highly market driven. Even though DIC's transaction-based business performed solidly during 2020, in our view, cash flows from transaction or performance-linked income streams are likely to see a larger impact from the COVID-19 pandemic and the economic crisis it triggered eventually than those generated by rental income.

DIC's financial risk profile is underpinned by its moderate debt leverage. We analyze the company's financial risk profile based on its existing capital structure, because the planned senior unsecured bond issuance has been postponed. We forecast that S&P Global Ratings-adjusted ratio of debt to EBITDA will be around 11x for the next 12-24 months. We view positively management's commitment to maintaining its target reported loan-to-value (LTV) ratio of around 45% and its net debt-to-capital ratio below 50%. We forecast this ratio will remain at 47%-50% over the near term. We therefore expect the company will use an adequate mix of debt and equity to support any further portfolio growth. Given that the value of DIC's investment properties is held at historical book values in its financial accounts rather than current market values, we add back to equity the market value uplift for the company's investment properties and consider the ratio of debt to debt plus equity (fair value) in our analysis of DIC's credit metrics. The company also benefits from a solid EBITDA interest coverage of about 3x. Its cost of debt stood at 2% on Dec. 31, 2020, and we do not anticipate a major change to DIC's funding costs in the next 12-24 months. The company's average debt maturity remains low at 3.6 years versus that of peers in the German real estate market. We understand DIC has largely used bank mortgages to complete the planned refinancing activities and growth opportunities, without the proceeds of the bond we assumed it would use in our analysis for the preliminary ratings. DIC has limited debt maturities in 2021; however, about €340 million of debt will be due in 2022. We expect, DIC to tackle those maturities ahead of the due date to ensure a sufficient liquidity buffer.

Chart 1

Maturities Of Loans And Borrowings*



*Nominal values as of Dec. 31, 2020. Source: S&P Global Ratings.

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The rating incorporates a one-notch upward adjustment based on our comparable rating analysis. Compared with peers with the same business risk assessment, such as DEMIRE or Summit Properties, we view DIC as better positioned, thanks to its larger portfolio size and higher exposure to public tenants, which generate more stable and predictable rental income. Although DIC's institutional business is less stable than the rental business, we believe that DIC gains synergies with the additional income stream from institutional business. In addition, our rating assessment takes into account the company's solid operational track record as a long-term asset manager in the German commercial real estate market.

Outlook

The stable outlook is based on our view that the company's income from asset and property management, including rents, will generate stable cash flows over the next 12 months. We expect the company will withstand the negative impacts of the pandemic on the back of its long lease terms, its exposure to public tenants, and continuous growth in its commercial real estate investments located in and around Germany's metropolitan cities, with stable market fundamentals.

In our base-case, EBITDA interest coverage will remain at about 3x and debt to debt plus equity will stay slightly below 50% over the next 12-24 months. For the same period, we assume the ratio of debt to EBITDA will be around 11x.

Downside scenario

We could lower the rating if:

- The company fails to keep its ratio of debt to debt plus equity below 55%, e.g., as a result of debt-financed acquisitions or a revision of its financial policy;

- Debt to EBITDA increase above 13x, e.g., the company would suffer from a significant EBITDA drop due to a stronger-than-expected market downturn; or
- Its EBITDA interest coverage declines to below 2.4x.

In addition, we may change our rating approach if the company were to increase its EBITDA contribution from its institutional business significantly, which could impact the rating negatively.

Upside scenario

We could raise the rating if:

- DIC enhanced the scale and scope of its yielding portfolio and real estate segments and locations with solid market fundamentals, similar to rated CRE peers in the lower investment-grade category, while vacancy levels remain well below 10%, including any new growth;
- Debt to debt plus equity declines to below 45% while EBITDA interest coverage remains at least 3x or more; and
- Debt to EBITDA decreases to below 9.5x on a sustainable basis.

Company Description

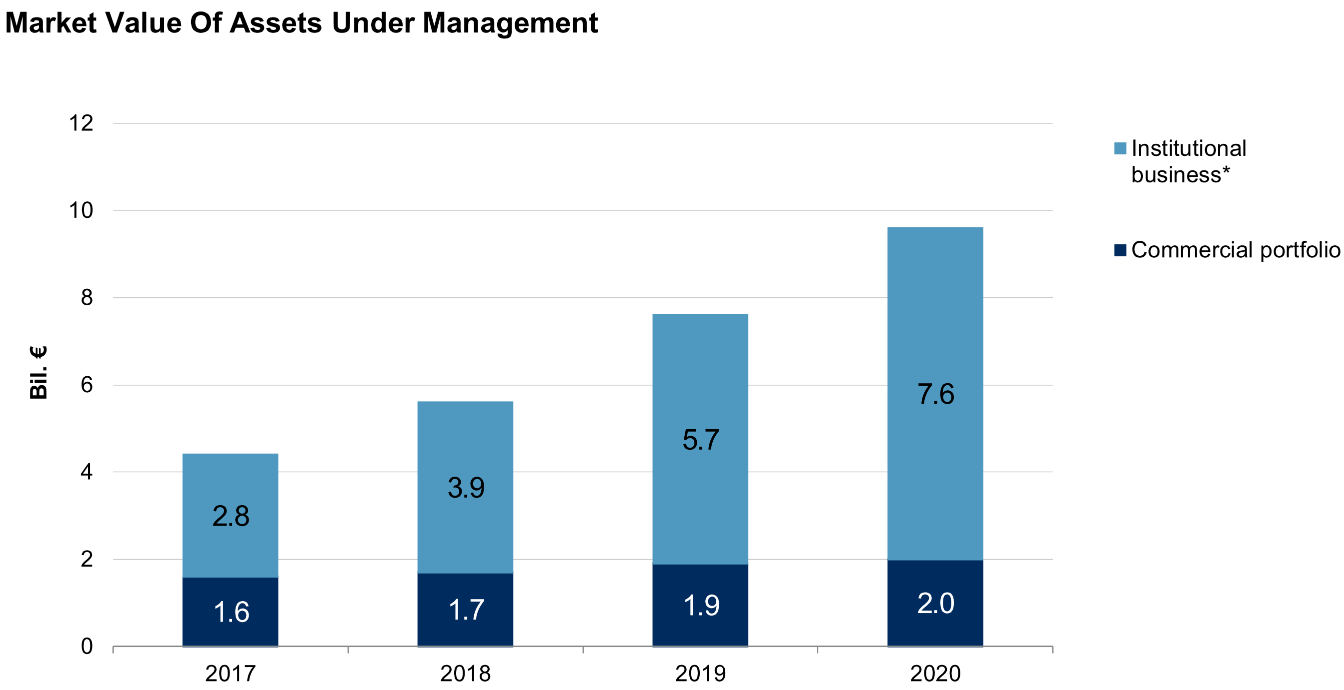
DIC is a listed German real estate holding company, which invests directly and indirectly in commercial real estate assets in Germany.

The company operates through two business segments:

- Its commercial portfolio as a property landlord (about 60% of its adjusted EBITDA contribution as of 2020); and
- Its institutional business as an asset manager (about 40% as of 2020).

The company currently owns a portfolio of about €2 billion with an additional €7.6 billion AUM as of Dec. 31, 2020.

Chart 2



*Institutional business refers to a sum of other investments and funds reported by the company in 2017.
Source: S&P Global Ratings.
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DIC is listed in the standard German stock index (SDAX) with an average market capitalization of about €1.085 billion as of Dec. 31, 2020. The largest shareholders are Deutsche Immobilien Chancen Group (34.6%), Yannick Heller (10.1%), and RAG Foundation (10.0%), with 45.3% free float.

Our Base-Case Scenario

Assumptions

- German GDP growth to recover at 3.7% in 2021 and 3.2% in 2022 after an estimated compression of 5.7% in 2020 because of the pandemic, with unemployment at 4.8% in 2021 and 4.3% in 2022.
- Annual consumer price index growth in Germany of around 1.5% in 2021 and 2022.
- Overall flat like-for-like net rental income in 2021 for its owned portfolio, which incorporates the potential rent concessions to tenants affected by COVID-19 under extended lockdowns, mainly in the retail and hotel segments.
- Our conservative expectation that the company may experience a marginal like-for-like rental income dip in 2022, with our assumption that part of the lease maturities in that year would not

be directly re-let.

- Around €100 million-€200 million of net acquisitions for its owned portfolio in 2021 in line with the company's guidance.
- Flat like-for-like revaluation for DIC's owned portfolio for the same period.
- About 8%-9% growth of fee income for the institutional business in 2021, primarily supported by growth of its AUM exposure with €700 million already realized through the acquisition of RLI Investors in January 2021.
- Average cost of debt to remain at around 2%.

Key metrics

DIC Asset AG--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. €)	2019a	2020a	2021e	2022f	2023f
Total revenue	150.8	161.9	171-174	181-184	186-189
EBITDA	119.9	114.9	115-118	122-125	122-125
EBITDA margin (%)	79.5	71	67-69	66-69	66-69
Debt to EBITDA (x)	10.3	10.3	11.1-11.4	11-11.5	11-11.5
EBITDA interest coverage (x)	2.9	3.1	3-3.3	2.9-3.2	2.9-3.2
Debt to debt plus equity (x)	49.6	45.6	47-49	48-50	49-51

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess DIC's liquidity as adequate. We believe the company's liquidity sources covered its uses by more than 1.2x for the 12 months ended Dec. 31, 2020.

Principal liquidity sources as of Jan. 1, 2021:

- Unrestricted cash balances of about €310 million;
- Our forecast of cash funds from operations of €70 million-€75 million; and
- About €50 million of committed proceeds from the asset disposals.

Principal liquidity uses as of the same date:

- About €33 million of short-term debt maturities, including amortization;
- About €67 million of committed payments on acquisitions;
- About €5 million of committed capex for the next 12 months; and
- About €56 million of announced dividend distribution, which we conservatively assume as cash payment.

Covenants

DIC has financial covenants under some of its secured bank loans and the promissory notes, related to its LTV, interest coverage, and debt service coverage ratios. We understand that the company has adequate headroom (more than 10%) under all of its financial covenants.

We forecast that the company will keep sufficient headroom (greater than 10%) under all of its covenants of the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/--

Business risk: Fair

- Country risk: Very low
- Industry risk: Low
- Competitive position: Fair

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb

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 rating analysis: Positive (+1 notch)

Related Criteria

- 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

- 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

- Germany-Based DIC Asset AG Assigned Preliminary 'BB+' Rating; Outlook Stable, Sept. 1, 2020

Ratings List

New Rating; Preliminary Ratings Withdrawn	To	From
DIC Asset AG		
Issuer Credit Rating	BB+/Stable/--	BB+(prelim)/Stable/--
Senior Unsecured	NR	2(Prelim)(85%)
Senior Unsecured	NR	BBB-(Prelim)

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.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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