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Research Update:

DIC Asset AG 'BB+' Ratings Affirmed After Announced Partial Takeover Offer On VIB; Outlook Stable

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Rating Action Overview

- On Jan. 31, 2022, DIC Asset AG announced its intention to submit a voluntary partial offer for a majority stake of 51% in commercial real estate peer VIB Vermögen AG at €51 per share.
- A successful transaction would result in the combined group's property value reaching around €3.6 billion compared with DIC's current €2.2 billion as of Sept. 30, 2021; total assets under management (AUM) would increase to about €13.0 billion from €11.4 billion.
- We understand the company is committed to its financial policy and plans to fund the acquisition of about €731 million with available cash and capital market instruments, including both equity and debt such that its debt-to-debt and equity and debt-to-EBITDA will stay in the 50%-53% and 10x-11x ranges, respectively.
- We therefore affirmed our 'BB+' long-term issuer credit rating on DIC and our ratings on the company's senior unsecured debt.
- The stable outlook reflects our view that DIC will maintain its credit ratios within thresholds for the rating, independently of the result of the proposed transaction, with EBITDA interest coverage well above 2.4x and debt to debt plus equity at less than 55%.

Rating Action Rationale

DIC's planned bid for 51% of VIB would enlarge the company and increase its diversification. Pro forma the acquisition, the combined portfolio would amount to about €3.6 billion, consisting of 208 properties across Germany. The transaction would lead to an increase in portfolio size for DIC by about 70%, and the company's segment diversification would improve, with offices accounting for about 40.9% of the combined portfolio value (compared with 69.5% currently), logistic assets increasing to about 30.6% (2.4%), and retail exposure being broadly stable at around 18% (13.3%). The remaining exposure is to mixed-use assets. We would view the higher weight of logistic assets in the combined portfolio as favorable, given the strong demand for that asset type given growing e-commerce and limited new supply. The vacancy in VIB's portfolio is also lower with 1.2% compared with DIC's 6.5% on Sept. 30, 2021, improving slightly the overall vacancy to 4.3%. We understand that the combined portfolio would also improve the tenant base, with the top 10 tenants accounting for 26.6% from 37.3% currently. The largest exposure would be to German Garden-Center Dehner, accounting for only 3.8% of total annual rental income. But we understand that this exposure would also be spread across several rental agreements, be very diversified, and represent a minor portion of DIC's total rental income. The average lease maturity would be broadly unchanged at 5.7 years.

We view the large share owned by minority interest shareholders in VIB as a risk for DIC fully and freely accessing the acquired portfolio. Besides the positive implications for the group's total portfolio, we believe the transaction may not be transformative for its business risk assessment, given the uncertainty around DIC's final stake in VIB, as VIB's shareholding base is currently fragmented (no single shareholder holds more than 5% after DIC) and hence, could limit DIC's control of VIB in case of low acceptance level. Even if DIC were to gain control of VIB after the transaction, we understand it would likely be limited to 51% and due to the absence of a profit and loss transfer agreement, full access to VIB's cash flow base by DIC might be limited. Although we view positively the diluted share of its institutional business to about 24% of EBITDA compared with 35% in2021, the exposure to fee income remains less resilient compared with rental income.

We expect DIC to maintain its credit metrics within the rating thresholds. Including the planned transaction and assuming a successful transaction, we expect cash outflow to amount around €731 million. We understand that the transaction will be funded with available cash of about €281 million and a signed bridge facility of €450 million, the latter being refinanced in the following months with a 10% equity increase of DIC and debt. In addition, we factor in DIC's intention to sell assets by year-end to stabilize its credit metrics. In our updated base-case scenario, we assume the company will maintain debt to debt plus equity of below 55% (specifically, 50%-53% depending on the pace of disposals), a solid interest coverage of close to 4% and debt to EBITDA of about 11x in 2022. We further expect it will take the necessary steps to maintain its credit metrics within those ranges should the uptake in VIB would be less than 51% or the company not be consolidated in DIC's financial statements. Our rating assessment also views positively the company's publicly announced financial policy with a medium-term loan-to-value target of below 45% (including only the owned yielding commercial portfolio; translating into S&P Global Ratings-adjusted debt to debt plus equity of close to 50%). DIC's cost of debt stood at 1.8% and the average debt maturity length at 4.4 years. We understand VIB's funding metrics are similar.

We continue to view DIC's liquidity as adequate pro forma the acquisition. We understand the company has signed a bridge facility, to fund the transaction. In addition, we understand that the company has a back-up facility for VIB's total debt to cover any potential execution of change of control clauses of the target debt. DIC has a large cash position of over €500 million and about €230 million of committed net proceeds from the sale of the Uptown Tower in Munich to be received in the next weeks. This covers well its short-term debt maturities of about €264 million for the next 12 months. In addition, DIC has sufficient headroom (more than 10%) under its financial covenants, including the recently signed bridge facility, and we expect the company to maintain similar headroom.

Outlook

We base the stable outlook on our view that DIC's income from asset and property management, including rents, will generate stable cash flow over the next 12 months. We expect the company will withstand the pandemic's negative impact through its long lease terms, its exposure to public tenants, and continuous growth in its commercial real estate investments in and around Germany's metropolitan cities, with stable market fundamentals. We believe that pro forma the takeover of VIB, DIC's portfolio will benefit from an increased geographic diversification across Germany and that the increased exposure to the logistic segment should support a growing and stable cash flow base, given the strong demand for this asset class. In our base-case scenario, EBITDA interest coverage will remain at 3x-4x and debt to debt plus equity will stay at 50%-53% over the next 12 months. For the same period, we assume debt to EBITDA will be around 11x.

Downside scenario

We could lower the rating if:

- DIC fails to keep debt to debt plus equity below 55%, for instance following debt-financed acquisitions, the failure of the planned equity increase for VIB's takeover, or if the company does not manage to reduce leverage in line with our thresholds for the rating post-transaction.
- Debt to EBITDA increases above 13x--that is, the company would suffer from a significant EBITDA drop due to a stronger-than-expected market downturn.
- Its EBITDA interest coverage declines to below 2.4x.

Upside scenario

We could raise the rating if:

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

Company Description

DIC is a listed German real estate holding company, which invests directly and indirectly in commercial real estate assets in Germany. It operates through two business segments:

- Its commercial portfolio as a property landlord (about 65% of its adjusted EBITDA contribution as of 2021); and
- Its institutional business as an asset manager (about 35% as of 2021).

The company owns a portfolio of about €2.2 billion. Total AUM are €11.4 billion as of Dec. 31, 2021.

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: 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
- 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

Ratings List

Ratings Affirmed

DIC Asset AG	
Issuer Credit Rating	BB+/Stable/--
Senior Unsecured	BB+
Recovery Rating	3(60%)