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Research Update:

German Real Estate Company DIC Asset AG Downgraded To 'BB' On Still High Leverage; Outlook Negative

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Rating Action Overview

- DIC Asset's credit metrics did not improve sufficiently in the second half of 2022, leaving S&P Global Ratings-adjusted debt-to-debt plus equity at a high 59.4% and therefore outside of our thresholds for the 'BB+' rating.
- We forecast that persisting economic challenges, delays in planned disposals, and minimal expected upside for property valuation will limit DIC's ability to improve metrics, keeping adjusted debt to debt plus equity between 56% and 58%, EBITDA interest coverage at about 2.5x, and debt to EBITDA around 14x over the next 12 months.
- Additionally, sizable debt maturities in 2024 would hurt DIC's liquidity profile unless the company takes action within the next few quarters.
- Consequently, we lowered our long-term issuer credit and issue ratings on DIC and its senior unsecured debt to 'BB' from 'BB+'. Our recovery rating on the debt remains at '3'.
- The negative outlook reflects the risk that DIC may not be able to timely and sufficiently address its 2024 financial needs in the next few quarters, thereby provoking a deterioration of its liquidity profile or its credit metrics deteriorates further.

Rating Action Rationale

We assume DIC's leverage will remain elevated for a prolonged period, with S&P Global Ratings-adjusted debt to debt plus equity above 55%. This stems from the debt-funded takeover of logistic property company VIB Vermögen AG at the start of 2022, weakening market conditions, and the ongoing delay in DIC's deleveraging plan. At end-December 2022, S&P Global Ratings-adjusted ratio of debt to debt plus equity stood high at 59.4% (versus 52.2% at end-2021) and its EBITDA interest coverage was 2.7x (3.3x end-2021). Debt to EBITDA also remained high at 16.6x, partially distorted by only nine months of VIB's EBITDA contribution. Furthermore, the challenging prospects for the property market have delayed DIC's execution of its strategy to raise

equity and secure sufficient asset disposals to compensate for the rise in leverage,, which assumed the company would have done following the VIB transaction. Although the company will receive a total of about €71 million disposals proceeds post reporting date, in our view, DIC will likely struggle to follow through with deleveraging to below 55% (adjusted debt to debt plus equity). Moreover, we assume the planned asset disposals and equity increase will take longer than initially planned. Under our revised base-case forecasts for the coming 12 months, S&P Global Ratings-adjusted ratio of debt to debt and equity will be 57%-59%, EBITDA interest coverage will be 2.5x-2.7x, and debt to EBITDA should be around 14x. We therefore view it as unlikely that DIC will be able to restore its metrics in line with our 'BB+' rating (see "German Real Estate Landlord DIC Asset AG Outlook Revised To Negative On Delayed Deleveraging; 'BB+' Ratings Affirmed," published Oct. 13, 2022, on RatingsDirect). Despite management's commitment to strengthen its reported loan-to-value (LTV) ratio to below 50.0% (57.8% year-end 2022), we noted the company's recent increase in VIB's stake, to 68% from 61%, through a non-cash contribution of €99 million in November 2022 and a dividend proposal of €0.75 per share for the 2022 financial year, to be paid in Q2 2023 (up to about €55 million cash outflow), further preventing fast deleveraging.

DIC's liquidity remains adequate for the next 12 months but material debt maturities will occur in 2024. On Feb. 28, 2022, VIB announced the conclusion of a new syndicated loan agreement for around €505 million, with a term of seven years, to repay existing loans ahead of schedule. We assume that DIC will use the loan mainly to refinance outstanding debt due within the next 18 months. Considering an unrestricted cash balance of about €161 million at year-end 2022 and committed disposal proceeds post reporting date of about €71 million, DIC should be able to comfortably cover the next 12 months of liquidity needs. That said, a bulk of debt maturities, including the bridge facility of currently outstanding €400 million, due first-quarter 2024, and €248 million ESG-linked promissory notes, due throughout 2024. We understand that DIC is highly committed to raising sufficient funding and refinancing any debt facilities so that the average debt maturity remains well above our three-year requirement (3.5 years as of year-end 2022, excluding recent refinancing, but including bridge loan) and average cost of debt close to 2.5% to 3% (2.4% year-end 2022, excluding recent refinancing but including bridge loan). Furthermore, the company´s headroom under its bond covenants for LTV (set at 60%) has not widened, contrary to our previous projection, and tightened further; the lowest headroom stood below 10% as of Dec. 31, 2022. We will monitor the company´s liquidity situation, including compliance with its financial covenants, very closely over the next few quarters and update our analysis if necessary.

We expect operating fundamentals to remain stable for DIC´s properties. The acquisition of VIB has benefited the company's scale and scope, as well as its portfolio diversification. As of Dec. 31, 2022, the fair value of its commercial portfolio, which includes only owned yielding assets, stood at €4.5 billion, comprising 207 properties. The company's total assets under management increased to €14.7 billion from 11.9 billion at year-end 2021. The share of logistics properties increased to 39% from 2% in the commercial portfolio with the share of office properties diluting to 34% from 68% and enhancing its segment diversification. The European Real Estate Association (EPRA) vacancy stood at only 4.3% for the combined entities. DIC managed a solid like-for-like rental growth of 3.6% in 2022, mostly benefiting from lease indexations. The growing inflationary environment, forecast at 7.3% growth in Germany in 2023 and 3% for 2024, is expected to benefit DIC's rental income, as the majority (91%) of its rental contracts are linked to the consumer price index. However, in our view, the ongoing challenging market environment, combined with cost-saving initiatives and potential reduction of required office space, represents

a high threat for further operational growth for the office real estate landlords, and slowing demand could impact occupancy levels and rental income over the next two to three years. REITs might also invest less in further acquisitions, partially driven by increasing construction raw materials and energy supply prices, leading to lower asset rotations and flat-to-negative property portfolio valuation trend.

Outlook

The negative outlook reflects the possibility of a downgrade by at least one notch within the next 12 month if DIC does not secure sufficient funding to meet upcoming short-term financial obligations, including its bridge loan due in 2024, in a timely manner and thereby avoid a material weakening of its liquidity.

A negative rating action could also stem from further deterioration of the company's credit metrics beyond our current rating thresholds.

Downside scenario

We would lower the rating if:

- Over the coming few quarters, DIC fails to address its upcoming 2024 debt maturities while retaining sufficient headroom under all of its financial covenants.
- Debt to debt plus equity ratio surpasses 60%;
- Debt to annualized EBITDA deviates strongly from our forecast; or
- EBITDA interest coverage declines to 1.8x or below over the forecast period.

Upside scenario

We could revise our outlook to stable if:

- DIC secures sufficient liquidity sources to cover its liquidity needs in the next 18 to 24 months;
- Debt to debt plus equity remains well below 60%;
- Debt to EBITDA does not deviate from our current base case at 12x-13x;
- EBITDA interest coverage remains well above 1.8x.

A stable outlook would also depend on the company continuing to generate steady, predictable cash flows, including the maintenance of high occupancy levels.

Company Description

DIC Asset AG (DIC) is a listed company, specialized in management of commercial real estate properties in Germany. The company manages a total portfolio of €14.7 billion (as of December 2022), split in two segments:

- Commercial Portfolio: Comprising about 207 properties with a market value of €4.45 billion, generating around 78% of EBITDA.

- Institutional Business (IB): Composed of 153 properties with a value of €10.2 billion, generating 22% of EBITDA.

Our Base-Case Scenario

Assumptions

- Our expectations of real GDP in Germany to contract by 0.5% in 2023 then recover to 1.0% in 2024. We estimate CPI growth in Germany to be about 7.3% in 2023 and 3.0% in 2024.
- Like-for-like rental income growth of 2%-3% in 2023, benefiting from the company's inflation-linked lease agreements, and our expectations of overall flat occupancy levels.
- A slightly negative portfolio valuation of around 5% over the next 12-18 months.
- Our estimates of property disposals of up to €500 million within the upcoming 12 months, including the recently set up logistic fund at VIB.
- Average cost of debt to increase to 2.5%-3.0% (excluding bridge) in 2023, given our expectations of higher interest costs on future debt issuances at 3.5%-4.5%.
- Annual cash dividends of up to€55 million.
- We do not include any equity raising in our base case.

Key metrics

A debt-to-debt plus equity ratio of 57%-59% in 2023 and slightly improving to 56%-57% in 2024.

Adjusted debt to annualized EBITDA at 13x-14x over the next 24 months.

Adjusted EBITDA interest coverage ratio of 2.5x-2.7x over our forecast period.

Liquidity

We assess DIC's liquidity as adequate, anticipating that liquidity sources will likely cover the company's uses by more than 1.2 x over the 12 months started Dec. 31, 2022.

We estimate principal liquidity sources for the 12 months from Dec. 31, 2022, to include:

- Unrestricted cash balance of about €161 million;
- Our forecasted cash funds from operations of approximately €90 million to €95 million;
- Net inflow from signed assets disposals post reporting date of about €71 million; and
- Secured funding of €505 million at VIB level.

Principal liquidity uses over the same period include:

- Contractual short-term debt maturities of around €236 million, excluding debt related to assets held for sale;
- Assumed repayment of €450 million-€500 million from the recently issued loan;
- Committed capex of about €15 million for the next 12 months; and

- Estimated cash dividends of about €55 million.

Covenants

Requirements

DIC 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 ICR of minimum 1.8x. The calculation of the company's bond covenants differs from S&P Global Ratings' adjusted ratio calculations.

We understand that DIC has maintained adequate headroom (at least 10%) for the majority 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, is tight at below 10% per year-end December 2022 and pro-forma committed sales year-to-date.

We expect the company to ensure sufficient headroom under all of its covenants going forward.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors are an overall neutral consideration in our credit rating analysis of DIC . As of February 2023, Deutsche Immobilien Chancen Group held 34.4% in the company, and we don't believe there is any negative influence from the shareholder, which mainly comprises long-term institutional investors, such as investment and insurance companies, as well as family offices. We further note that DIC has issued ESG-linked promissory notes that link interest rates to sustainability metrics. The company's goal is to have 20% of its buildings green by the end of 2023; currently 31% of DIC's portfolio by market value is certified, in line with the company's green bond framework.

Issue Ratings - Recovery Analysis

Key analytical factors

- We rate DIC's €400 million senior unsecured notes at 'BB', in line with the issuer credit rating.
- The recovery rating is unchanged at '3', indicating our expectation of 50%-70% recovery (rounded estimate 55%, down from 60% following a review of the valuation prospects for owned real estate assets) 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 VIB, in our recovery analysis we give value to only the 68% stake that DIC owns.
- We value the group as a going concern. We use a combined approach on the basis of discrete asset value and EBITDA multiple to take into consideration the stressed value of DIC's 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: 2028
- Jurisdiction: Germany

Simplified waterfall

- Consolidated net enterprise value at emergence (after 5% administrative costs): €2.96 billion
- First-lien secured debt (at the DIC holding level): €1.13 billion
- Value available for senior unsecured claims: €685 million
- Senior unsecured debt claims (at the DIC holding level): €1.23 billion
- Recovery Rating: 3
- Recovery expectation: 50%-70% (rounded estimate: 55%)

*All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating	**BB/Negative/--**
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)
Financial policy	Neutral (no impact)

Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)

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 | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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 Landlord DIC Asset AG Outlook Revised To Negative On Delayed Deleveraging; 'BB+' Ratings Affirmed, Oct. 13, 2022

Ratings List

Downgraded

	To	From
DIC Asset AG		
Issuer Credit Rating	BB/Negative/--	BB+/Negative/--
Senior Unsecured	BB	BB+
Recovery Rating	3(55%)	3(60%)

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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; or Stockholm (46) 8-440-5914

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