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Research Update:

Italian Retail Property Company IGD Assigned 'BBB-' Rating; Outlook Stable

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Rating Action Overview

- IGD Siiq S.P.A is a key player in Italy's real estate industry, with a portfolio worth €2.4 billion comprising 27 shopping malls and 25 hypermarkets, mostly in central and northern regions of Italy.
- IGD's revenue is quite concentrated (27%) on its unique hypermarket tenants and 53% shareholders, Coop Alleanza 3.0 and Unicoop Tirreno, two of the largest cooperatives in Italy.
- However, the company shows strong capacity to cover its interest burden with EBITDA interest coverage above 3x and prudent gearing, with debt-to-debt plus equity and debt-to-EBITDA ratios remaining below 50% and 10x.
- On April 23, 2019, S&P Global Ratings assigned its 'BBB-' long-term issuer credit rating to IGD.
- The stable outlook reflects our view that IGD will likely continue to generate stable and predictable rental income, despite the challenging retail and macro environments in Italy.

Rating Action Rationale

IGD's portfolio mainly comprises midsize shopping centers with an average of about 25,000 square meters per asset, and hypermarkets located across midsize cities in Italy, with a focus on northern and central Italy, where about 80% of the total portfolio is located. IGD combines the ownership of a hypermarket with a shopping center in 16 of its assets, which we view as a competitive advantage in terms of implementing asset management initiatives and synergies. We think IGD's assets are well adapted to the Italian market, which mainly comprises small and midsize cities and shopping centers (less than 40,000 square meters). We also note that the food anchor in shopping centers is key for the Italian market in order to attract footfall since, according to IGD, seven out of 10 visitors to its shopping centers come concurrently with a visit to a hypermarket. In this context, where only about 3% of the shopping centers in Italy do not have a food anchor, we view positively this combined ownership in comparison with other split management shopping centers. IGD's assets are relatively new, with an average age of about seven years, and are well located in good catchment areas fairly close to city centers.

IGD is currently operating under challenging market conditions. There is an uncertain macroeconomic environment in Italy and it is unclear how the political situation could ultimately affect economic expansion and consequently consumer sentiment (see "Outlook On Italy Revised To Negative On Risks To Economic Growth Following Budget Plan; Ratings Affirmed At 'BBB/A-2'", published Oct. 26, 2018, on RatingsDirect) and disruption in the retail industry, mainly from accelerating e-commerce growth and shifting consumer tastes. We expect tougher competition between existing shopping centers, since prime international retailers are becoming more selective in choosing their limited number of physical store locations and styles. We also expect high competition will continue between hypermarkets, such as COOP, with discounters continuing to gain market share. We take these challenges into account in our analysis of IGD's credit quality, especially when we compare positive dynamics in other segments, such as logistics or German residential, and more stable economies.

We think all these trends are likely to reduce retailers' margins and their need for physical space in the longer term. IGD, similarly to other retail landlords, is adapting to customers' new habits by seeking innovative tenants that prioritize shopping experience, such as restaurants, services, or entertainments, manage their cost base, and focus on the quality of their shopping spaces. For example, IGD's focus on restaurants (7% of malls' merchandising mix) is higher than the average in Italy (2% according to CBRE Global Research) and IGD aims to further increase this focus. Moreover, e-commerce penetration in Italy is still very low (approximatively 3% of total retail sales versus 17% in the U.K. and 8% in France) and consumer confidence is currently above historical levels in the regions where the company mainly operates, benefiting from GDP growth that has generally been above the E.U. average. The competitive environment could be tougher for IGD in the future, but we note that shopping center density in Italy is relatively low--250 square meters per 1,000 inhabitants--compared with in the U.S. (2,200 square meters per 1,000 inhabitants). Furthermore, there are high barriers to entry, such as planning and regulatory permissions, which protects established players like IGD against competition from potential new entrants. Moreover, IGD has a reasonable cost occupancy (or rent-to-sales) ratio of about 12%, which limits the risk of tenants wanting to renegotiate rents downward.

This is further demonstrated by IGD's solid track record in operating performance, with occupancy constantly above 96% since its initial purchase offer in 2005 and like-for-like (LfL) rental growth that has regularly outperformed Italian GDP growth. We also note that, despite the uncertain environment in Italy in 2018, the company reported net rental income LfL growth of 1.3% and positive LfL growth in its Italian portfolio (0.4% in its malls and 1.3% in its hypermarkets). We also view positively that IGD's rents have remain relatively stable over the past five years and that IGD's tenant sales (up 2.2% in 2018) have usually outperformed household consumption expenditure.

IGD's business profile is also constrained by the company's concentration as regards its main tenants and its main shareholders, Coop Alleanza 3.0 and Unicoop Tirreno, which together represented 27% of the total rental income of the company at year-end 2018. We think these entities are less creditworthy than IGD and could expose it to a risk of reduced revenue in case of lease renegotiation, expiry, or rent delinquencies. We understand that the credit profile of Coop Alleanza 3.0 (tenant of about 75% of the hypermarkets) is relatively weak; however, it recently announced its 2019-2022 business plan, which intends to bring EBITDA back to positive territory from 2021. That said, we understand the financial specialties of a cooperative (not set up to make profit) and we do not anticipate any irregularity in rent payment to IGD.

We note that the company has recently reached an agreement to reduce its exposure to Coop Alleanza 3.0, which will reduce IGD's exposure to hypermarkets to 21%-22% in the coming two years. The deal will allow IGD to remodel its assets by freeing up hypermarket space for tenants in the malls. This space might reduce further via the sale of certain noncore hypermarkets. We view favorably the commitment from the company to further reduce its hypermarket exposure, as well as the terms agreed with Coop Alleanza 3.0, which will extend the life of all the leases to 2037 with no break option. The rents have been set at market levels and will now progressively grow, indexed to inflation.

However, IGD's tenant base in the malls of the shopping centers is diversified, with no single tenant representing more than 3.5% of IGD's total rental income. IGD's tenants are mostly large Italian brands (60% rent) such as Piazza Italia and OVS; large international names such as H&M make up the remainder. IGD's tenants are generally of good credit quality; IGD monitors their creditworthiness using independent third-party credit reports, and the company estimates that more than 80% of its tenants are of good creditworthiness.

We also see positively the company's prudent strategy for the coming two to three years, focused on asset management initiatives and selling noncore assets, especially in the currently challenging market environment. IGD will focus on upgrading its existing portfolio, delivering its existing pipeline, and selling noncore assets.

We see IGD's business risk profile at the high end of the fair category because it compares more favorably than most rated peers with business risk profiles in the same category.

Our assessment of IGD's financial risk profile is supported by the company's commitment to further improve its capital structure and reduce its loan to value (LTV) ratio below 45% (equivalent to debt to debt plus equity of about 46%) by 2021, thanks to asset disposals and a limited appetite for acquisitions. IGD also enjoys a relatively low cost of debt (2.7% as of Dec. 31, 2018) and a staggered debt maturity profile with no material maturities until 2021, when its €300 million public bond is due.

The company has limited foreign exchange exposure in its small operations in Romania, since the lease agreements are denominated in euros but the rent is collected in RON (Romanian leu). This could weaken tenants' ability to pay rents in the event of RON depreciation, but we see the potential harm to IGD as limited due to the small scale of operations in the country (6.5% of total portfolio value). IGD manages its exposure to interest rates through hedging, and more than 90% of its debt is hedged or has a fixed coupon.

We expect IGD's debt-to-debt plus equity and debt-to-EBITDA ratios to reduce toward 45% and 9x in the coming two to three years, from 48% and 9.5x, respectively, as of Dec. 31, 2018. This is in line with the company's commitment to strengthen its capital structure. We understand that IGD plans to reduce existing debt by about €100 million in the short term using some of the proceeds from the disposal of noncore assets. We also expect EBITDA interest coverage to remain robust, between 3.8x and 4.0x in the coming 24 months.

Our forecast is also supported by the company's prudent strategy for the coming years, focused on asset management initiatives, with total capital spending (capex) of about €100 million and planned disposals of noncore assets of about €150 million-€200 million.

Outlook

The stable outlook reflects our view that IGD's asset portfolio will likely continue to generate stable and predictable rental income, despite the challenging retail and macro environment in Italy. We think IGD will maintain high occupancy levels of about 97% in its assets, thanks to their dominant positions and management's commitment to continue reducing the exposure to COOP's hypermarkets. We also note management's commitment to reaching an LTV ratio below 45% (equivalent to a debt-to-debt plus equity ratio of about 46%) in 2021. Consequently, we project that IGD's debt-to-debt plus equity ratio should move toward 45%, with EBITDA interest coverage above 3x in the next 12-24 months.

Downside scenario

We could lower the rating if we saw a sustained deterioration in IGD's operating performance, such as an increase in vacancy, negative LfL rental growth, or declining values in its portfolio. We could also lower the rating if pressures on the business translated into a debt-to-debt plus equity ratio above 50% or EBITDA interest coverage close to 2.4x.

We would also consider a downgrade if a deterioration of COOP Alleanza 3.0's credit quality harmed IGD's operating stability.

Upside scenario

In our view, given IGD's current strategy focused on asset management initiatives, rating upside is remote and hinges on the company's financial risk profile. An upgrade would also depend on the company's ability and willingness to decrease its debt-to-debt plus equity ratio consistently below 35%, while increasing its EBITDA interest coverage above 3.8x.

A positive rating action might also require IGD to have enough liquidity resources to absorb an economic stress scenario in Italy, given our current negative outlook on the sovereign rating.

Company Description

IGD is one of the main players in the Italian real estate industry with a portfolio valued at €2.4 billion as of Dec. 31, 2018. The company operates 27 shopping malls and 25 hypermarkets across Italy (93% of total portfolio value) and 14 shopping malls in Romania (6.5%).

COOP Alleanza 3.0 and Unicoop Tirreno are the main shareholders of IGD with a total stake of about 53% (40.92% and 12.3%, respectively). These two entities are part of COOP, one of the largest cooperatives in Italy. The remaining stake is free float and the company is listed on the Italian stock exchange.

Our Base-Case Scenario

In our base case for IGD, we assume:

- Real GDP growth in Italy of 0.1% in 2019 and 0.6% in 2020 and 2021, with a consumer price index of about 1.0%-1.5%.
- LfL rental growth of about 0.5%-1.0% in the coming two years, with occupancy remaining high at current levels of about 97%.
- We expect overall revenue to increase, mainly due to asset management initiatives in the existing portfolio and delivery of the existing pipeline. We do not factor into our analysis material acquisitions.
- Flat LfL growth in the overall portfolio's market valuation in the coming years, in connection with the somewhat negative sentiment in the retail industry and recent slowdown in investment volumes in Italy.
- Stable EBITDA margins of about 85% in the next few years.
- Capex about €100 million across 2019-2021 mainly linked to the refurbishment of existing assets and delivery of current pipeline. Maintenance capex is low at €30 million in the same

period.

- Disposals of noncore assets of about €150 million in the short term. We assume that IGD will use some of the proceeds to reduce debt.
- Dividend distributions of about €55 million-€60 million per year.

Based on these assumptions, we arrive at the following credit measures:

- EBITDA interest coverage ratio at 3.8x-4.0x in the coming 24 months.
- Debt-to-debt plus equity ratio moving toward 45%, from the current 48% as of Dec. 31, 2018.
- Adjusted debt to EBITDA of 9.2x-9.4x in the coming two years.

Liquidity

We anticipate IGD's liquidity sources will likely cover liquidity uses by about 1.5x in the 12 months from March 31, 2019. IGD's limited debt maturities and committed capex support the company's liquidity position. We assess IGD's liquidity as adequate.

We note that IGD has kept a low level of cash--less than €5 million--in its balance sheet over the past three years and that the size of its €60 million back-up facilities could compare negatively with other investment grade peers.

We estimate principal liquidity sources for the 12 months from March 31, 2019, will be:

- €36 million in available unrestricted cash;
- Funds from operations of about €80 million; and
- €60 million undrawn under its back up facilities.

We estimate the following principal liquidity uses for the same period:

- About €45 million of debt repayment;
- About €30 million of committed capex; and
- About €41 million of minimum mandatory dividend distribution.

Covenants

We estimate adequate headroom for the covenants included in IGD's documentation.

Other Credit Considerations

We factor into our analysis the long and solid operating track record of IGD and its management--with many members present for more than 10 years--in comparison with Polish retail property owner EPP N.V, created in January 2016. We also note the high barriers to entry in Italy due to fragmented regulation and the high level of bureaucracy, in contrast with the Polish market, where barriers to entry are limited.

We think IGD also compares positively with other 'BB+' rated companies. IGD's business, focused purely on rental income generation, is less volatile than that of U.K. property company Grainger PLC (BB+/Stable/--), in which a large part of the business focuses on property sales. We also think IGD's portfolio compares favorably with that of German office property owner Summit Property Ltd. (BB+/Stable/--) in terms of scale (€1.5 billion), asset quality (secondary locations), and operating performance (vacancy of about 8%).

We therefore think IGD compares better than most 'BB+' rated real estate entities and we view the company's business risk profile at the high end of the fair category, so we apply one upward notch from the anchor to reflect our positive comparable ratings assessment.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Fair

- Country risk: Moderately High Risk
- Industry risk: Low
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

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: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb-

Related Criteria

- Guidance | 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Outlook On Italy Revised To Negative On Risks To Economic Growth Following Budget Plan; Ratings Affirmed At 'BBB/A-2', Oct. 26, 2018

Ratings List

New Rating	
IGD Siiq S.P.A	
Issuer Credit Rating	BBB-/Stable/--

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. 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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