Research Update:

Italian Retail Property Co IGD Outlook Revised To Neg On Challenging Retail Environment, Weaker Operating Performance

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Rating Action Overview

- IGD has reported weaker operating performance than we expected in first-half 2019, with negative like-for-like (LfL) rental growth, increasing vacancy, and declining values in its portfolio.
- IGD's credit metrics have also deteriorated and its debt-to-debt plus equity ratio has increased to about 49.5%, near our 50% threshold for a downgrade.
- We are therefore revising our outlook on IGD to negative from stable, and affirming our 'BBB-' rating.
- We could downgrade IGD if its operating performance remains under pressure, affected by the challenging retail environment in Italy or if its debt-to-debt plus equity ratio increases above 50%.

Rating Action Rationale

Our assessment of IGD's credit quality remains unchanged for the time being. Our negative outlook reflects the risk that IGD could deviate from our base case, mainly if IGD's operating performance remains weak, with continuously negative LfL growth in rents and portfolio valuation, and no improvement in vacancy. We also see risks in IGD's debt-to-debt plus equity ratio increasing above 50% as a consequence of further pressures on values and delays in its planned disposals.

On Aug. 2, 2019, IGD reported negative LfL rental growth of 0.6% and negative LfL valuation of 1.1% (-1.32% in malls and -0.38% in hypermarkets) in its Italian portfolio, which represents 94% of the total portfolio value. In addition, IGD has seen about one percentage point increase (+0.9%) in vacancy compared with the end of 2018, which stood at 3.7% (3.4% if we take into account new leases signed in July).

The challenging retail and macro environments in Italy have affected IGD's operating performance, which as of Dec. 31, 2018, remained relatively solid with positive rental LfL growth of 1.3% (+1.5% in malls and +0.9% in hypermarkets) and LfL valuation gains about 0.7% in its Italian portfolio. Tenant sales and footfall trends continue to be under pressure in 2019 compared with 2018. The first quarter saw a decrease of 0.4% in tenant sales and 6.2% in footfall. The second quarter has shown some signs of recovery, but still tenant sales and footfall continue to be in negative territory (-0.1% and -2.9%).

We also note that IGD's ability to increase rents is also deteriorating, with an average upside of 1.1% in new contracts in second-quarter 2019 (including an inflation impact of about around 70 basis points [bps] in the same period) versus 4.1% in first-quarter 2019. In addition, we believe that political uncertainty has further grown with the recent breakup of the existing coalition government and call by Deputy Prime Minister and Interior Minister Matteo Salvini for new elections, followed by Prime Minster Giuseppe Conte's resignation. It is unclear how it could ultimately affect economic expansion and consequently consumer sentiment. In this context, IGD has revised downward its FFO growth guidance for the year to 4%-5% from 6%-7%.

IGD's credit metrics have also worsened, especially its leverage ratio, with a reported loan-to-value (LTV) ratio increasing to 48.2% (under International Financial Reporting Standard [IFRS] 16) as of June 30, 2019, from 45.8% (pre-IFRS 16) as of Dec. 31, 2018. This translates into a debt-to-debt plus equity ratio of about 49.5% (versus 48.2% as of Dec. 31, 2018), which is close to our 50% threshold for a downgrade. We understand that 60% of the ratio deterioration is caused by a change in market rates (around +15 bps versus 2018) and 40% owes to changes in cash flow or lower revenues or lower occupancy in certain malls. We understand that the lower occupancy might be temporary and IGD is already working on filling the vacant space. However, timing of increasing occupancy and, especially, further widening of yields as a consequence of continuous pressures on the retail market or increasing political risk, could impact valuations in the future.

IGD's planned asset disposals of about €150 million-€200 million have not been materialized yet. In this market environment and given the company's willingness to sell at book value, there is a chance that these disposals might be postponed. This has also affected the deleveraging path we anticipated for the company, with its debt-to-debt plus equity ratio moving toward 45% in the next two years, as IGD had planned to use part of the proceeds to repay existing debt.

IGD's negative operating performance and increase in its debt-to-debt plus equity ratio represent a significant deviation from our previous base case and explain our revision of the outlook on IGD.

Having said that, we expect IGD's debt-to-debt plus equity ratio to remain below 50%, in line with the company's unchanged commitment to reduce its LTV below 45% in the near term. We now forecast this ratio will remain around 48.5%-48.0% in 2019 and 2020, assuming negative LfL growth in its portfolio of 1% in 2019 and flat LfL growth in 2020. We assume that IGD's planned €150 million-€200 million disposals will be delayed but nevertheless materialize in the near term, and that it will use part of the proceeds to repay existing debt.

We also recognize IGD's solid reported EBITDA interest coverage of 3.8x, benefiting from a low average cost of debt of 2.4% as of June 30, 2019. We expect EBITDA interest coverage will remain well above 3x and debt to EBITDA below 10x in the next two years, despite our revised LfL rental growth assumption for the next two years (about 0%-0.5%).

IGD's next significant debt maturity is the €300 million bond due in 2021. We understand that the company is willing to work on an early refinancing of the instrument; therefore, we do not foresee any liquidity pressure in the next 12 months. The company has sufficient headroom under its covenants, as its more restrictive total debt-to-total assets covenant is set at 60%.

Outlook

The negative outlook reflects our view that we could downgrade IGD if its operating performance remains under pressure from the challenging market environment in Italy. We believe that there is a good likelihood that IGD's rental income growth, occupancy, and asset values will remain stressed in the near future, affecting IGD's credit metrics.

Downside scenario

We could lower the rating if we continue to see IGD's operating performance under pressure from the challenging market environment in Italy. We could also downgrade the company if its credit metrics continue to deteriorate, in particular if its debt-to-debt plus equity ratio increases above 50% or if the company's liquidity cushion decreases.

Upside scenario

We could revise the outlook to stable if IGD's operating performance shows more resilience to the challenging retail and macro environment in Italy, generating positive LfL rental growth, increasing occupancy back to levels achieved in 2018, and obtaining positive valuations in its portfolio. We could also revise our outlook to stable if IGD's debt-to-debt plus equity ratio improves toward 45%, in line with the management's commitment to reduce its LTV below 45% by 2021.

Company Description

IGD is one of the main players in Italian retail real estate, with a portfolio valued at €2.4 billion as of June 30, 2018. The company mainly operates 27 shopping malls and 25 hypermarkets across Italy (94% of total portfolio value) and 14 shopping malls in Romania (6%).

COOP Alleanza 3.0 holds 40.92 of IGD and Unicoop Tirreno 12.3%. These two entities are part of COOP, one of the largest cooperatives in Italy. The remaining 47% is free float and the company is listed on the Italian stock exchange.

Ratings Score Snapshot

Issuer Credit Rating:	BBB-/Negative/--
Business risk:	Fair
Country risk:	Moderately high
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)
Financial policy:	Neutral (no impact)
Liquidity:	Adequate (no impact)
Management and governance:	Fair (no impact)
Comparable rating analysis:	Positive (+1 notch)
Stand-alone credit profile:	bbb-

Related Criteria

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

Ratings List

Ratings Affirmed; Outlook Action

	To	From
IGD Siiq S.P.A		
Issuer Credit Rating	BBB-/Negative/--	BBB-/Stable/--
Senior Unsecured	BBB-	BBB-

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.