Research Update:

Property Firm IGD Siiq S.P.A Downgraded To 'BB+' On Challenging Italian Retail Environment; Outlook Negative

March 23, 2020

Rating Action Overview

- In response to the COVID-19 pandemic, the Italian government decided to close all nonessential retail shops on March 12, 2020.
- IGD Siiq S.P.A's (IGD's) Italian malls, which represent 67.6% of total rental income, have been closed since then and we do not know when they will reopen, leading us to anticipate a significant effect on rents from negotiations with affected tenants.
- Given financial ratios were already under pressure following a challenging 2019, we now believe that IGD's credit metrics will remain under pressure so that it will no longer be able to sustain an intermediate financial risk profile.
- Consequently, we are lowering our long-term issuer credit and issue ratings on IGD and its unsecured bonds to 'BB+' from 'BBB-', and assigning our '3' recovery rating to the latter.
- The negative outlook reflects our view that we could downgrade IGD if its operating performance remains under pressure, due to the challenging Italian retail environment and measures taken in response to the COVID-19 pandemic, and its credit metrics deteriorate.

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Rating Action Rationale

IGD´s operating performance will be significantly affected by the closure of its Italian malls. Italy is among the most affected countries in Europe by the COVID-19 pandemic, with more than 55,000 identified cases as of March 23, 2020. In response, the Italian government closed all nonessential retail on March 12, 2020. IGD's Italian malls (67.6% of its total rental income) have remained closed since then and we have no clarity on when they will re-open. We anticipate a significant effect on IGD's rents, as a consequence of potential negotiations with affected tenants, which will see a sharp drop in sales due to the closure. IGD has already announced that it is contemplating rescheduling payments for second-quarter 2020, but we do not discard potential rent discounts or even nonpayments (linked to tenant bankruptcies or force majeure allegations) if the situation deteriorates further. We estimate at this point that IGD's like-for-like rental income could decline up to 15% in 2020 on the back of rent losses or potential occupancy declines. This includes some rent losses due to the closure but also an anticipated slow recovery when the shopping centers reopen. That said, we note that IGD's Italian hypermarkets, which represent 25.4% of total rental income, will remain open and are performing well in the existing environment.

In this environment, we assume that IGD´s planned asset disposals could be delayed and that asset values could deteriorate further, negatively affecting credit metrics. Under our new base-case assumptions, we assume a 5%-10% valuation decline for 2020, which pushes IGD's debt to debt plus equity up to 50%-53% for this year from about 49% as of Dec. 31, 2019). We believe additional pressure on asset values will most likely come from declining future cash flow projections but also yield expansion. Moreover, IGD's contemplated asset disposals may become more difficult in the current market environment, pressuring its leverage ratio and potentially leading debt to debt plus equity further toward 55% or above. Despite the potential effect on rents, we expect EBITDA interest coverage will remain robust at well above 3x, from about 4x at year-end 2019, thanks to the company´s refinancing activities and lower cost of debt (2.35% as of year-end 2019 versus 2.65% at year-end 2018), with debt to EBITDA of 10x-11x. That said, we recognize the company´s commitment to reduce its loan-to-value (LTV) ratio to 45% or lower (debt to debt plus equity of about 46% or below) by 2021, from 47.6% at year-end 2019, but believe it may take the company longer to reach that level.

IGD´s funding and liquidity profile remains robust. We understand IGD is reorganizing and reducing cash outflows, especially investments and other deferrable commitments. The company does not face any significant debt repayments in the next 12 months (debt repayments for 2020 are €44 million related to secured bank debt), and its cash position is adequate (€128.7 million of cash and cash equivalents and €60 million available under its committed undrawn back up facility as of Dec. 31, 2019). Therefore, we see limited rating pressure stemming from the company's current liquidity position.

Outlook

The negative outlook reflects our view that we could downgrade IGD further if its operating performance remains under pressure, affected by the challenging Italian retail environment and measures taken in response to the COVID-19 pandemic, and if its credit metrics deteriorate. 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 credit metrics.

Downside scenario

We could lower the rating if IGD's operating performance remains under pressure, for example, due to the continued closure of shops in Italy or potential bankruptcies at retail tenants, leading credit metrics to deteriorate. In particular, we could downgrade the company if its debt to debt plus equity increases above 55% or its liquidity cushion decreases.

Upside scenario

We could revise the outlook to stable if IGD shows more resilience to the challenging retail and macro environment in Italy, generating positive like-for-like rental growth, maintaining high occupancy levels, and obtaining positive valuations in its portfolio. This would result in debt to debt plus equity staying sustainably below 55%, in line with 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 Dec. 31, 2019. 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 9.86%. These two entities are among the largest retail cooperatives in Italy, part of COOP network. The remaining 49.22% is free float and the company is listed on the Italian stock exchange.

Issue Ratings - Recovery Analysis

Key analytical factors

- We have lowered our 'BBB-' issue rating on IGD's senior unsecured bonds to 'BB+' and assigned a recovery rating of '3', in line with our issue ratings criteria for speculative-grade issuer credit ratings. Our ratings reflect the company's robust asset base and the limited amount of prior-ranking debt (secured debt was 28.9% of total debt as of Dec. 31, 2019). We expect meaningful recovery for IGD's unsecured lenders (50%-70%; rounded estimate: 65%) in the case of payment default.
- The bondholders will benefit from a significant asset base composed of liquid, good-quality, stable-income-generating properties. However, we view Italy´s jurisdiction as weaker than that of Germany or the U.K. Hence, we cap our recovery ratings for IGD at '3', the level of the issuer credit rating. We also note that the bond documentation includes limitations to total indebtedness (maximum LTV ratio of 60%) and a minimum interest coverage ratio at 1.7x.
- In our hypothetical default scenario, we assume a severe macroeconomic downturn in Italy that translates into rental pressure, exacerbated by an increase in competition and material declines in asset values.
- We value the company as a going concern, given its relationships with existing tenants, COOP brand recognition, and good quality portfolio. We use a distressed asset valuation to reflect IGD's robust asset base valued at €2.4 billion.

Simulated default assumptions

- Year of default: 2024
- Jurisdiction: Italy

Simplified waterfall

- Gross recovery value: €1,450 million

- Net recovery value for waterfall after administrative expenses (5%): €1,380 million
- Senior secured claims: €330 million
- Value available for senior unsecured claims: €1,050 million
- Senior unsecured claims: €990 million
- Recovery range: 50%-70% (round estimate: 65%)

***All debt amounts include six months of prepetition interest.**

Ratings Score Snapshot

Issuer Credit Rating: BB+/Negative/--

Business risk: Fair

- Country risk: Moderately high
- 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: Fair (no impact)
- Comparable rating analysis: Positive (+1notch)

Stand-alone credit profile: bb+

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 | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 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
- Criteria | Corporates | General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Italy's Widening Of Coronavirus Measures May Hurt Mall Owner IGD, March 11, 2020

Ratings List

Downgraded

	To	From
IGD Siiq S.P.A		
Issuer Credit Rating	BB+/Negative/--	BBB-/Negative/--
Senior Unsecured	BB+	BBB-
New Rating		
Recovery Rating	3(65%)	