

ISSUER COMMENT

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DEMIRE Deutsche Mittelstand Real Estate AG

DEMIRE taps HY bond for refinancing, a slight Credit Positive

On 18 September 2017, DEMIRE Deutsche Mittelstand Real Estate AG (DEMIRE, Ba2 stable) announced the tapping of its 2022 senior unsecured notes by €130 million to refinance existing secured debt but also raise additional debt for general corporate purposes. The transaction is slightly credit positive, because it will improve DEMIRE's liquidity due to lower debt amortization and a higher amount of unencumbered assets. The increase of debt will, however, at least temporarily increase DEMIRE's loan-to-value (LTV) slightly and thus leave the rating weakly positioned.

With the transaction, DEMIRE will refinance €94 million of debt of its fully consolidated subsidiary Germavest, where it holds a 94% stake. The debt essentially comprises of A notes (€55 million, due February 2023, 3.91% coupon) and B notes (€35.5 million, due February 2021, 5.25% coupon), in addition to breakup and other transaction costs. Moreover, DEMIRE will raise additional €35 million of bond proceeds, envisaged for general corporate purposes, including the acquisition of properties to expand the real estate portfolio.

The transaction will materially improve the amount of unencumbered real estate assets, by around €190 million to around €400 million, from €216 million at the end of June 2017 and therefore improve liquidity. The increase in unencumbered assets will improve the credit position of unsecured bondholders and provide the company with more flexibility in managing its liquidity. Based on Moody's calculation, which includes cash, trade and financial receivables, we expect the total amount of unencumbered assets to increase to around €550 million, will cover around 49% of the company's total assets, well in line with a Ba subfactor score according to our Global Real Estate Rating Methodology. Moreover, the refinancing will eliminate debt amortization of around €9 million a year for the previous notes, thus further gradually improving DEMIRE's liquidity.

The refinancing will also have a marginally positive impact on interest expenses of around €0.4 million, which will slightly improve the fixed charge coverage (FCC), which however, will remain below 2.0x (1.65x as of LTM March 2017).

DEMIRE's loan-to-value (LTV) will increase as a result of the transaction, as the company raises around €35 million debt on top of debt redemptions. Based on Moody's calculations, the gross debt / gross assets ratio (Moody's adjusted) will increase by around 100 basis points to around 61.5%, compared to 60.3% as of March 2017. We note that our rating reflects the company's strategy to reduce its LTV towards 50%, which will require equity contributions for the targeted expansion of the asset portfolio to €2 billion, from currently €1 billion in the medium term. Whilst the bond tapping at least temporarily increases the

LTV against our expectations and leaves the rating weakly positioned, we expect that further real estate acquisitions will be refinanced with equity and thus bring the LTV in line with our expectations for the Ba2 rating.

DEMIRE's rating remains weakly positioned in the Ba2 rating category. The rating could come under pressure, if the company fails to de-lever from current levels of around 60% Moody's adjusted debt / gross assets, or fixed charge coverage remained below 2.0x on a sustained basis.

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