MOODY'S RATINGS

Rating Action: Moody's Ratings affirms DEMIRE's Caa2 CFR, upgrades bonds to Caa2, outlook changed to stable

08 Nov 2024

Frankfurt am Main, November 08, 2024 -- Moody's Ratings (Moody's) has affirmed the Caa2 long term corporate family rating ("CFR") of DEMIRE Deutsche Mittelstand Real Estate AG's ("DEMIRE" or "the company"). At the same time the senior unsecured rating of its €600 million note issuance now maturing in December 2027 was upgraded to Caa2 from Caa3. The outlook changed to stable from negative.

RATINGS RATIONALE

The rating affirmation and the outlook change to stable follows the implementation of DEMIRE's restructuring proposal, which we have considered a distressed exchange. Key elements of the restructuring included the extension of the remaining bonds to 2027 with a 5% cash interest and a 3% PIK interest in 2027, and provided some security to noteholder. In total the restructuring will reduce the bond volume by a total of notional of roughly €250 million resulting from cash payment of €50 million at par and a tender for €196 million of bonds at a maximum price of 76.25%. The company uses cash on balance sheet including disposal proceeds and a €93 million liquidity injection from shareholders to fund the payments. We do consider the shareholder loan provided by Apollo affiliates as debt given it does not meet our criteria to receive equity credit.

The upgrade of the bond rating reflects the new capital structure that contains a mix of instruments pro-forma for the restructuring. While the majority class of debt may remain unsecured for the next 12 to 18 months, unsecured debt remains structurally subordinated to sizeable secured debt, but is now senior to the shareholder loan.

The stable outlook balances improving gross leverage expectations with ongoing operational headwinds in the portfolio, structural concerns and execution risk for the disposal plan.

Going forward DEMIRE will aim to reduce debt through disposals as leverage remains high and disposals are an essential part of the restructuring plan, including further paydown targets. We see material execution risks in selling DEMIRE's assets in a still weak German transaction market with economic weakness reducing investor appetite, but see high disposal volumes with moderate discounts as the main path to a sustainable capital structure.

We expect Moody's-adjusted debt/gross assets remaining below 60% (Q3 2024 was 59%). Our assumptions driving down balance sheet leverage expectations include some further single digit value decline expectations, CAPEX spending including tenant incentives required to manage an asset management intensive portfolio, adjustments to some balance sheet items like claims related to Cielo and LIMES, and our inclusion of the shareholder loan in debt. Those adjustments are overcompensated by the positive impact from bond repayments, including €30-50 million annual repayments from future disposal expectations, in the next 12-18 months.

As a consequence of our assessment of the shareholder loan being debt, a currently weakening earnings base from the asset pool, and the increased interest rate on the bond, Moody's-adjusted fixed charge cover will drop below 1x. Excluding the effect of the shareholder loan, on which interest can be deferred at the option of the issuer, fixed charge cover will stay above 1.5x in 2025. We do not consider EBTIDA created by discounted buybacks as sustainable earnings and would hence remove it from the calculations. At the same time we did not incorporate potential penalties in case of lack of bond repayment in 2025 and 2026 in our projections. Ultimately, DEMIRE will be required to find an equity solution for the shareholder loan in the next years, or sell materially more assets than we anticipate.

LIQUIDITY

Following the restructuring, DEMIRE's liquidity remains tight and relies on refinancing of secured debt. As part of the restructuring, we estimate about €200 million has been spent post Q3 reporting on the repayment and repurchase of the bonds as agreed in the restructuring. The company had €165 million cash on balance sheet as of June 2024 and will use up to €93 million shareholder loan. We expect Moody's-adjusted CFO below €10 million for 2024 and 2025. €35 million outstanding debt is due in November 2024 and €38 million in 2025, which we understand the company aims to extend, but we consider may require asset management or some debt deduction. DEMIRE also aims to actively dispose of assets to address its liquidity needs and has started to sign first smaller disposals.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade could occur if

- The company successfully disposes assets to meet the expected annual paydown of debt in the restructuring agreement

- DEMIRE manages to crystalise value in its Fair Value REIT stake and other complex claims like Cielo

- DEMIRE manages to roll its upcoming secured debt

- Moody's-adjusted debt/assets reduces well below 60%, including Moody's adjustments on balance sheet items next to investment properties

- Interest cover remains above 1x

A downgrade may occur if

- DEMIRE's liquidity weakens

- Operational weakness in the asset portfolio makes further disposal and refinancing activities challenging

Structural Considerations

Unsecured bonds and secured property debt will be the main sources of debt for DEMIRE going forward. While the balance of unsecured debt will drop materially from the restructuring, secured debt will also decline compared to its H1 2024 balance as a consequence of the LIMES portfolio default and deconsolidation. Hence bonds will remain the majority class of debt by end of 2024 but trending down over time. At the same time, the bonds benefit from structural seniority to the initially €193 million shareholder loan provided by an Apollo affiliate, which supports the rating of the bonds despite subordination to material secured debt volumes.

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms published in February 2024 and available at https://ratings.moodys.com/rmc-documents/414558 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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