MOODY'S
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# Credit Opinion: Hyprop Investments Limited

Global Credit Research - 05 Jun 2015

*South Africa*

## Ratings

| Category | Moody's Rating |
|---|---|
| Outlook | Stable |
| NSR LT Issuer Rating | A3.za |
| NSR ST Issuer Rating | P-2.za |

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## Key Indicators

[1]**Hyprop Investments Limited**

| | 12/31/2014(L) | 6/30/2014 | 6/30/2013 | 12/31/2012 | 12/31/2011 |
|---|---|---|---|---|---|
| FFO Payout | 92.1% | 101.1% | 100.0% | 98.7% | 115.8% |
| Amount of Unencumbered Assets | 34.5% | 30.8% | 31.5% | 21.9% | 24.8% |
| Debt / Gross Assets [2] | 25.8% | 26.8% | 23.4% | 24.1% | 27.4% |
| Net Debt / EBITDA | 3.9x | 4.4x | 7.2x | 3.5x | 5.5x |
| Secured Debt / Gross Assets | 16.7% | 13.7% | 14.7% | 19.1% | 27.4% |
| Gross Assets (ZAR Million) | 27,387 | 26,827 | 22,975 | 21,526 | 20,187 |
| Development Pipeline | 0.4% | 8.1% | 7.8% | 8.9% | 1.0% |
| EBITDA Margin (YTD) | 90.5% | 81.8% | 85.7% | 83.4% | 80.8% |
| EBITDA Margin Volatility | 3.7% | 3.4% | 3.4% | 3.3% | 8.0% |
| EBITDA / Fixed Charges (YTD) [3] | 3.5x | 3.3x | 3.4x | 3.4x | 3.9x |
| Joint Venture Exposure (YTD) | 2.0% | 0.0% | 0.0% | 0.0% | 0.0% |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics [2] Debt includes a portion of hybrid securities considered to have debt like features as explained in Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations revised December 2010 [3] Fixed Charges includes capitalized interests explained in Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations revised December 2010.

*Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.*

## Opinion

### Rating Drivers

- High-quality retail portfolio in prime locations with good anchor tenants

- Smaller scale and greater income concentration risk than similarly rated real estate peers

- Stable cash generation supported by low vacancy rates and a moderate lease profile

- Low leverage and strong coverage metrics

- Expansion into the rest of Africa offers growth opportunities but increases business risk

### Corporate Profile

Hyprop Investments Limited ("Hyprop") is one of South Africa's largest Johannesburg Stock Exchange (JSE) listed specialist shopping centre Real Estate Investment Trust ("REIT"), and one of South Africa's oldest listed property companies (1988). Its activities include direct investments in predominately retail property assets in South Africa, and a growing exposure to retail properties in Sub-Saharan African (excluding South Africa), through AttAfrica (37.5% direct equity holding), a joint venture between Hyprop, Attacq Limited and Atterbury Group, and through Manda Hill Mauritius (50% direct equity holding and 68.8% effective equity holding), a joint venture between Hyprop and AttAfrica. Hyprop's head office is in Johannesburg, South Africa.

As of 31 December 2014, Hyprop's investment in South Africa consisted of 16 properties valued at ZAR25.1 billion ($2.1 billion), and investments totalling ZAR2.0 billion ($170.9 million) in AttAfrica and Manda Hill Mauritius. For the last twelve months (LTM) to 31 December 2014, consolidated revenues amounted to ZAR2.1 billion ($193.7 million) with EBITDA of ZAR1.8 billion ($166.1 million), according to our standard definitions and adjustments.

### Rating Rationale

Hyprop's A3.za/P-2.za national scale rating is supported by the high quality retail portfolio, which benefits from active management producing solid, recurring retail income, supported by low vacancies (1.8% as of 31 December 2014) and well-positioned retail assets. The ratings also incorporate relatively strong credit metrics (according to our standard definitions and adjustments) as measured by total debt-to-gross assets of 25.8% and high fixed-charge cover of 3.5x and factor in Hyprop's conservative approach to development risk.

At the same time, the ratings assigned also factor (1) the moderate size of the portfolio and smaller scale of operations relative to local peers, as measured by total assets; (2) the high exposure to the retail sector, as well as high geographic concentration in the Gauteng province (56% of the South African property assets); (3) the small but growing exposure to retail properties across the rest of Africa (currently Ghana and Zambia) and (4) high percentage of secured debt (64.7% of total debt) in its capital structure and the high percentage of gross assets that are encumbered (65.5% as a percentage of gross assets). All figures are as of LTM 31 December 2014 and adjusted per Moody's standard definitions and adjustments.

### DETAILED RATING CONSIDERATIONS

LARGEST LISTED RETAIL FOCUSED REIT IN SOUTH AFRICA IN PRIME LOCATIONS WITH GOOD ANCHOR TENANTS

Retail properties account for 98% of Hyprop's ZAR25.1 billion property assets under management portfolio, which we view as the most resilient property sector in South Africa (Baa2 stable). Management's strategy is to invest in sizable shopping centres in the major metropolitan areas, currently including Johannesburg, Cape Town, Pretoria as well as in identified countries in Africa, being Ghana and Zambia, with a primary focus on high quality retail assets and growing income. We view Hyprop's asset quality as excellent, supported by the number of prime quality shopping centres located in key retail nodes.

Hyprop's investment in shopping centres is focused on those that are dominant in their catchment area, where the vast majority of tenants' revenues are generated locally, making the centres more resilient to downturns in consumer spending and supportive of stable, long-term occupancy rates, rental income and property values. The success of this strategy is demonstrated by the maintenance of a high overall occupancy rate over the past few years, 98.2% as of 31 December 2014, across the retail portfolio, despite general economic weakness in South Africa.

Hyprop's entire property portfolio is independently valued on a semi-annual basis, which is more frequent compared to its local peer group. The valuations are performed using the discounted cash flow method and was last carried out in December 2014. The portfolio value increased by 3.7% on a like for like basis from 30 June 2014 to 31 December 2014, given improved low vacancies and good income growth.

We consider Hyprop as having a well diversified tenant mix with a high proportion of key anchor tenants. At 30 June 2014, Hyprop had around 2691 tenants, with the top 10 tenants contributing 31.9% of annual rental income (44.4% of GLA). Hyprop has a large amount of high-quality tenants, comprising 64% "A" quality tenants, 22% "B" quality tenants and 14% "C" quality tenants (by GLA). Tenant classifications are as follows: "A" quality - large national tenants, large listed tenants, government and major franchisees; "B" quality - national tenants, smaller listed tenants, franchisees and medium to large sized professional firms; and "C" quality - smaller tenants. We note that Hyprop's largest tenant is Edcon Limited (Caa1 stable), contributing 6.1% of total annual rental income. Edcon's low rating is a result of our view that its capital structure is unsustainable and not a result of poor operating performance. We expect Hyprop to remain active in its engagement with all its tenants and take comfort that given the properties prime locations Hyprop is best positioned to benefit from demand for prime retail space from local and international brands.

SCALE AND CONCENTRATION RISK CONSTRAIN THE RATING

Hyprop's scale, as measured by the number and value of its property assets, is relatively small compared with similarly rated peers both in South Africa and globally. We view Hyprop's diversification as limited in terms of (1) the relatively small number of properties under management (16 properties); (2) predominant focus on retail property sector (96% of gross lettable area (GLA)); and (3) geographic concentration in three major metropolitan areas across South Africa, namely Johannesburg (39% of South African GLA); Pretoria (18% of South African GLA) and Cape Town (43% of South African GLA). Hyprop's exposure into Sub-Saharan African (excluding South Africa) through its investment in AttAfrica and Manda Hill Mauritius is viewed positively from a diversification point of view, representing 7.5% (ZAR2.0 billion or $170.9 million) of Hyprop's total portfolio value.

CASH GENERATION SUSTAINED BY HIGH OCCUPANCY RATES AND MODERATE LEASE PROFILE

The stability of Hyprop's cash flow and earnings is credit positive and is due in large part to Hyprop's high occupancy rates, currently 98.2%. In addition, rental income is underpinned by medium- to long-term tenancy agreements, with a weighted average lease expiry (WALE) across the portfolio of 3.3 years (30 June 2014). In South Africa, commercial property leases contain annual rent escalation clauses, which in Hyprop's portfolio, currently ranges around 8%, providing rental growth and inflation protection. For LTM to 31 December 2014, 81% of Hyprop's reported revenues of ZAR2.7 billion ($245 million) comprised contractual rental income and 19% municipal service charge recoveries (Hyprop pays all utility costs and then recoups them from tenants).

Hyprop's LTM to 31 December 2014 EBITDA margin of 84.2% (according to our standard definitions and adjustments) is relatively high compared with that of global peers, as well as higher than that of local peers Growthpoint Properties Limited (Baa2/A1.za stable) and Redefine Properties Limited (Baa3/A3.za stable) but lower than Capital Property Fund (A3.za stable). We anticipate Hyprop to continue to maintain its high EBITDA margins given the defensive nature of its portfolio.

We also recognise Hyprop's conservative approach to new developments, focusing on expanding and rejuvenating the existing portfolio. A moderately sized development and/or redevelopment pipeline can help grow the portfolio and improve quality, which are credit positives. However, this needs to be managed in the context of exposing Hyprop to potential volatile cash flows and/or mistiming the market demand. We view the recent, successful completion of the redevelopment of Rosebank Mall as credit positive, highlighting Hyprop's ability to meet its redevelopment schedule on time and on budget. At 31 December 2014, Hyprop's development pipeline equated to ZAR112 million ($9.6 million), representing 0.4% of gross assets, which includes committed capital expenditure for development.

LOW LEVERAGE AND GOOD COVERAGE CREDIT METRICS IS CREDIT POSITIVE

At 31 December 2014, Hyprop's leverage, as measured by adjusted total debt/gross assets and adjusted net debt / EBITDA was relatively low at 25.8% and 3.9x respectively, allowing Hyprop some flexibility to pursue debt funded acquisitions and/or withstand potential moderate declines in property values. The board has determined that leverage, as defined by net debt/property assets (25.4% as of 31 December 2014), can be increased to levels between 30%-40%, mainly through corporate activity and developments, although REIT legislation (through the South African Income Tax Act and JSE listing requirements) currently allows leverage of up to 60%.

South African property companies have traditionally financed their assets with secured bank loans. Hyprop has followed the same approach. However, since the rating was assigned Hyprop has successfully reduced its secured debt exposure from 100% to 64.7% while the level of encumbered assets stabilized around 65.5% of its gross assets as of 31 December 2014. Hyprop's ratio of secured debt/gross assets at 31 December 2014 was 16.7%, which falls in the Baa range in the rating grid and unencumbered assets of 34.5% falls in the B rating range.

EXPANSION INTO THE REST OF AFRICA INCREASES GEOGRAPHIC DIVERSIFICATION BUT EXPOSES THE COMPANY TO HIGHER RISK

Hyprop has grown its presence into Sub-Saharan African (excluding South Africa) through its 37.5% interest in AttAfrica, a joint venture between Hyprop, Attacq Limited and Atterburg Group, as while as through its effective 68.8% interest (direct interest of 50%) in Manda Hill Mauritius, a joint venture between Hyprop and AttAfrica. This broadens Hyprop's geographic footprint outside of South Africa and is projected to be yield enhancing. Hyprop has committed, since November 2012, to invest ZAR3 billion ($256 million) to its African expansion over a five year period, to date this amounts to ZAR2 billion ($170.9 million) and equates to 7.5% of the total portfolio value, which is not material to have a notable effect on the overall performance in the next 12 to18 months.

However, although Hyprop is improving its geographic diversification this strategy must be viewed in the context of increasing exposure to markets which have higher risk profiles compared to South Africa, particularly Ghana (B3 negative) and Zambia (B1 stable). We are reticent of the unique risks inherent in investing into these markets, but we also recognise a number of opportunities that they offer, most notably higher economic growth rates. We view Hyprop's expansionary approach to investing in these markets positively through joint ventures with experienced management companies, which spreads the risk of operating in these markets. We also note that Hyprop targets key, large urban areas where there is sufficient infrastructure to service its malls.

### Liquidity Profile

Hyprop's liquidity is deemed sufficient to meet its near-term obligations which includes debt refinancing totalling ZAR1.1 billion ($94 million, as of 31 December 2014), supported by (1) available committed liquidity facilities of ZAR2.1 billion ($179.5 million); and (2) stable internal cash flow generation. Hyprop's current credit facilities are provided by a variety of domestic banks and are subject to covenants and material adverse change clauses. At present, there is good headroom in the covenants and Hyprop has in the past successfully managed to renegotiate its bank facilities.

### Rating Outlook

The stable outlook on the rating reflects our view that Hyprop will at least maintain its current operating profile in terms of occupancy and renewal rates and EBITDA margin, even if faced with a more severe economic downturn.

### What Could Change the Rating - Down

Downward pressure on the ratings or outlook could result from (1) Hyprop's failure to maintain an adequate liquidity profile; (2) a debt-financed acquisition or change in capital structure, such that leverage in terms of adjusted total debt/gross assets is trending above 30% or fixed-charge coverage trends below 3.0x on a sustainable basis; or (3) unexpected operating difficulties that negatively affect operational performance or cash flows. All metrics are according to our standard definitions and analytic adjustments.

### What Could Change the Rating - Up

Upward pressure on the rating or outlook could develop with a longer track-record as a rated entity, demonstrating prudent financial and operating policies and if Hyprop continues to exhibit stable to growing size and geographic footprint with stable to improving operating margins, while maintaining overall strong liquidity profile and ample headroom on its covenants. Quantitatively, given Hyprop's smaller size compared with its two larger domestic peers, Growthpoint Properties Limited and Redefine Properties Limited, upward pressure could build if Hyprop were to maintain leverage - as measured by adjusted total debt/gross assets - below 25% on a sustainable basis.

### Other Considerations

Hyprop through its 100% holding in Hyprop Investments Mauritius has a 37.5% equity stake in AttAfrica (a joint venture between Hyprop, Attacq Limited and Atterbury Group) and a 50% equity holding in Manda Hill Mauritius (a further 18.75% is held through AttAfrica). As a result Hyprop's consolidated financials reflect Hyprop Investments Mauritius which includes the equity value of its investment and ZAR1.9 billion of shareholder loans to fund development activity of its investments in Sub-Saharan African (excluding South Africa), as well as Manda Hill. Hyprop's consolidated financials thus ignores Hyprop's effective share of any in-country debt and the current property asset values. We estimate if Hyprop's share of in-country debt and current property values were consolidated into Hyprop's operation leverage, as measured by debt to gross assets, would have a marginal impact on leverage (less than 2% increase). As Hyprop's proportion of properties outside of South Africa increases to a more meaningful percentage, we may consider consolidating Hyprop's effective stakes for the basis of our credit assessment.

MAPPING TO THE RATING METHODOLOGY

The principal methodology used in rating Hyprop was our "Approach for REITs and Other Commercial Property Firms", published 30 July 2010. Based on the most recent published accounts, at LTM 31 December 2014, Hyprop's overall performance measurements from the rating grid indicate a rating outcome of Baa2. Moody's assigned national scale issuer rating of A3.za would map to a global scale rating in the range of Baa3 or Ba1 which is one to two notches different from the grid implied rating. The key reason for the rating difference is due to Hyprop's relatively small scale combined with income concentration risk and financial flexibility to accommodate higher leverage.

## Rating Factors

**Hyprop Investments Limited**

| **REITs and Other Commercial Property Firms Industry Grid** [1][2] | **Current LTM 12/31/2014** | | [3]**Moody's 12-18 Month Forward ViewAs of 6/3/2015** | |
|---|---|---|---|---|
| **Factor 1: Liquidity and Funding (24.5%)** | **Measure** | **Score** | **Measure** | **Score** |
| a) Liquidity Coverage | Ba | Ba | Ba | Ba |
| b) Debt Maturities | B | B | B | B |
| c) FFO Payout | 92.1% | Ba | 90% - 100% | Ba |
| d) Amount of Unencumbered Assets | 34.5% | B | 34% - 38% | B |
| **Factor 2: Leverage and Capital Structure (30.5%)** | | | | |
| a) Debt / Gross Assets [4] | 25.8% | A | 25% - 30% | A |
| b) Net Debt / EBITDA | 3.9x | A | 4x - 4.5x | Baa |
| c) Secured Debt / Gross Assets | 16.7% | Baa | 15% - 17.5% | Baa |
| d) Access to Capital | Ba | Ba | Ba | Ba |
| **Factor 3: Market Position and Asset Quality (22%)** | | | | |
| a) Franchise / Brand Name | Baa | Baa | Baa | Baa |
| b) Gross Assets(USD Million) | $2,367.3 | Baa | $2400 - $2600 | Baa |
| c) Diversity: Location / Tenant / Industry / Economic | B | B | B | B |
| d) Development Pipeline | 0.4% | Aa | 1% - 3% | Aa |
| e) Asset Quality | A | A | A | A |
| **Factor 4: Cash Flows and Earnings (23%)** | | | | |
| a) EBITDA Margin (YTD) | 90.5% | Aa | 80% - 85% | Aa |
| b) EBITDA Margin Volatility | 3.7% | Baa | 2% - 5% | Baa |
| c) EBITDA / Fixed Charges (YTD) [5] | 3.5x | A | 3.2x - 3.6x | A |
| d) Joint Venture Exposure (YTD) | 2.0% | Aa | 2% - 5% | Aa |
| **Rating:** | | | | |
| a) Indicated Rating from Grid | | Baa2 | | Baa2 |
| b) Actual Rating Assigned | | A3.za | | |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures. [4] Debt includes a portion of hybrid securities considered to have debt like features as explained in Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations revised December 2010 [5] Fixed Charges includes capitalized interests explained in Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations revised December 2010.