

Research Update:

# Jernhusen AB Outlook Revised To Stable From Negative On Restored Business Conditions And Metrics; 'A/A-1' Affirmed

September 27, 2021

## Rating Action Overview

- The Swedish government should lift COVID-19 social-distancing restrictions on Sept. 29, 2021, including customer limits in stores and recommendations to work from home, as vaccination rates increase.
- We believe this will result in a recovery in passenger numbers and visitors at Jernhusen AB's train stations and ultimately improve operational performance over the next 12-24 months, which should restore and sustain moderate credit metrics over the same period.
- We therefore revised our outlook on Jernhusen to stable from negative and affirmed our 'A/A-1' long- and short-term issuer credit ratings on the company.
- The stable outlook indicates that we expect Jernhusen's operating performance to gradually recover in the next 12-24 months, with adjusted debt to EBITDA returning to 11.0x-11.7x, adjusted debt to debt plus equity remaining at about 50%, and adjusted EBITDA interest coverage comfortably exceeding 4.5x.

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## Rating Action Rationale

**The Swedish government's plans to lift current social-distancing measures this month should improve daily travel patterns and consequently Jernhusen's performance.** We believe that the end of restrictions, expected on Sept. 29, 2021, combined with a high Swedish vaccination rate (75.5% fully vaccinated as of Sept. 23 according to the Public Health Agency) will result in train passengers and footfall through Jernhusen's stations recovering over the next 12-24 months. Consequently, we expect that Jernhusen's operational performance will improve, mainly via rental income from retail premises and restaurants at its stations (about 30% of total revenue), which were severely hit by the pandemic. In our view, the end of limits on customers per restaurant space (a maximum of four people per table) and recommendations to work remotely will increase tenant sales at stations and reduce the need for COVID-19 related rebates. We understand that

traffic in the cities of Gothenburg and Malmo has almost recovered fully compared with pre-COVID-19 levels, following the July 15 easing of restrictions. This included allowing long-distance public transport to operate at full capacity and the removal of limitations on public access to areas where crowding may occur. We now anticipate that traffic at Stockholm Central Station, will gradually increase over the coming months. Before the pandemic, about 250,000 passengers passed through the station per day.

**In our revised base case, we anticipate a 10% like-for-like increase in net rental income for 2021 and flat-to-modest growth in 2022.** Total portfolio like-for-like net rental income increased 9.0% in first-half 2021, primarily due to a lower impact from the COVID-19 pandemic. This was evident in rebates for the first half of Swedish krona (SEK) 25 million compared with SEK60 million in first-half 2020. In addition, property costs decreased 3% due to cost restructuring, with EBITDA margin increasing to 49.3% compared with 47.5% in the previous 12 months. For 2021, we forecast that like-for-like rental income will increase about 10% from 2020 levels, with flat-to-modest growth in 2022. We anticipate that rental income in second-half 2021 will encompass some rent rebates, bringing the total to about SEK72 million for the year. For Jernhusen's other rental operations, such as office property (20% of rental income) we understand it is experiencing some positive rent reversions. However, in depot/freight terminals (43% of rental income), which were not significantly affected by the pandemic, we anticipate only moderate growth in line with inflation.

**Over the long term, we think the retail sector, which was hard hit by the pandemic, will remain affected by the rise in e-commerce and changing consumer habits.** In our view, this is to some extent evident in the higher-than-average vacancy rate of 6.1% reported as of second-quarter 2021, although we understand Jernhusen is replacing vacant premises over the next few quarters. However, we believe that Jernhusen should be less affected than shopping center landlords, given that its sales correlate with the number of people passing through its railway stations and we expect traffic to gradually recover with easing restrictions. The medium-to-long-term prospects of rail passenger traffic are good given it is essential for daily commuters and widely supported by parties across the political spectrum from an environmental perspective.

**We expect Jernhusen's credit metrics to remain within our rating thresholds, with adjusted debt to debt plus equity of 49%-50% in 2021-2022 compared with 52.5% at June 30, 2020.**

Jernhusen recorded a slight decrease in its reported loan-to-value (LTV) ratio to 44.6% as of June 30, 2021, corresponding to S&P Global Ratings-adjusted debt to debt plus equity of 49.1% versus 50.7% as of Dec. 31, 2020. The decrease was mainly driven by a 1.3% increase in portfolio value in first-half 2021, as well as the suspension of dividends for the current year. Furthermore, rolling-12-month S&P Global Ratings-adjusted debt to EBITDA was 11.1x as of second-quarter 2021, given improved operational performance over the first half and lower debt. We expect adjusted debt to equity to remain at about 50% for the next 12-24 months and debt to EBITDA at about 11.0x-11.7x for 2021 and 2022. That said, Jernhusen has some flexibility in its development pipeline, since most of its projects can be postponed. We anticipate capital expenditure (capex) of about SEK600 million in 2021, in line with the average over the past three years. This will likely double to about SEK1.4 billion and SEK2.1 billion in 2023 or 2024 once zoning is approved for development projects in Gothenburg. We view positively Jernhusen's efforts to preserve cash and strengthen its balance sheet with its announcement to suspend dividends for 2021. We believe this shows commitment to maintaining moderate leverage metrics.

**Jernhusen's liquidity and funding profiles should remain solid over the next 12-24 months, despite a relatively a short average debt maturity.** The company enjoys a solid liquidity buffer with the ratio of sources exceeding uses about 1.4x as of June 30, 2021. Jernhusen's debt repayments for the next 12 months total SEK3.7 billion and relate mainly to SEK3.1 billion of commercial paper. We understand the company intends to roll over existing maturities, since it does not currently pay any margins for its paper. Nevertheless, should market conditions toughen, Jernhusen has SEK921 million of cash and cash equivalents and SEK4.5 billion available under its committed undrawn backup facility as of second-quarter 2021. This is to some extent offset by its average debt maturity of 2.7 years, which is shorter than that of other rated peers.

**Jernhusen's interest coverage is strong compared to peers' in the same financial risk category.**

Our rating incorporates the company's relatively robust position within our significant financial risk profile category. Jernhusen has strong EBITDA interest coverage of 4x-6x historically, compared with 2x-4x for most other rated investment-grade peers. In addition, our positive comparison reflects Jernhusen's strong market position within the depots segment, with a large share of government-related tenants allowing for stable cash flow. As a result, we include a one-notch positive adjustment to our stand-alone credit assessment for comparable rating analysis.

## Outlook

Our stable outlook signifies that we expect Jernhusen's operating performance will gradually recover over the next 12-24 months as COVID-19 social-distancing restrictions are lifted. Furthermore, we expect that Jernhusen's properties will continue to benefit from favorable demand trends for rail travel. We expect the company will maintain debt to debt plus equity of about 50%, EBITDA interest coverage of at least 4.5x, and debt to EBITDA of 11.0x-11.7x over the next 24 months.

## Downside scenario

We could lower the rating if Jernhusen's operating performance falters due to a restrained footfall recovery at railway stations, rent-free periods, and downward rent renegotiations after the pandemic is contained, or if bankruptcies or vacancies increase. We could also lower the rating if Jernhusen's financial risk increases, for example, due to higher yields that lead to a drop in property values and a weaker debt-to-debt-plus-equity ratio.

Specifically, we could downgrade the company if its:

- S&P Global Ratings-adjusted debt to debt plus equity increases to 55% or higher.
- Debt to EBITDA increases to above 13x, or its liquidity cushion decreases over the next 12-24 months; or
- Interest coverage ratio falls well below 3x for a prolonged period.

Ratings downside could also develop if we consider that the likelihood of government support for Jernhusen has weakened. This could, for example, result from partial privatization of the company, although we consider this highly unlikely.

## Upside scenario

We could raise the rating if we think Jernhusen's financial risk tolerance has decreased, allowing it to maintain a debt-to-debt-plus-equity ratio of less than 40% on a sustainable basis. We view this as unlikely in the coming two years, due to Jernhusen's ambitious investment plan, and our view that this would only follow a shift in the company's financial policy.

## Company Description

Jernhusen is a niche real estate company focusing on properties related to Sweden's railway system. It owns stations, depots, and cargo terminals, and develops commercial property around central stations. The Swedish government owns 100% of Jernhusen, which was founded in 2001 as a spin-off from the Swedish railway monopoly Statens Järnvägar (SJ). Jernhusen's purpose is to enable more people to travel by rail and thereby contribute to a more environmentally friendly transport system. As of June 30, 2021, its properties were valued at SEK18.3 billion (about €1.8 billion) and it had 572,000 square meters of rentable area.

## Our Base-Case Scenario

### Assumptions

- Revenue growth of 10% in 2021 as the market moves toward gradual recovery, with flat to slightly modest growth anticipated in 2022-2023.
- A slight increase in EBITDA margin to 48%-49% for the next 12-24 months on the back of recovery in rental income and a lower cost base.
- About 1.5% like-for-like positive portfolio value growth for 2021, accounting for a slight yield compression in most of Jernhusen's sub sectors and 1% for 2022.
- Annual capex of SEK670 million for 2021, increasing to SEK1.4 billion the following year, including development projects.
- No material acquisitions or disposals assumed in 2021-2022. However, we expect Jernhusen to deliver on its development projects.
- No cash dividends in 2021 and SEK210 million-SEK230 million per year thereafter.
- Average cost of debt of about 1.4% compared with 1.2% as of June 30, 2021.

### Key metrics

Based on these assumptions, we arrive at the following credit measures over the next 12-18 months:

- Adjusted debt to debt plus equity remaining at about 50% in 2021 and 2022.
- EBITDA interest coverage remaining above 4.5x from 2021, compared with 5.5x for the rolling 12 months as of second-quarter 2021.
- Debt to EBITDA of 11.0x-11.7x.

## Liquidity

We assess Jernhusen's liquidity as adequate, based on our estimate that the company's liquidity sources will likely cover uses by about 1.4x in the 12 months started June 30, 2021.

Principal liquidity sources include:

- SEK971 million in available unrestricted cash.
- A SEK4.5 billion revolving credit facility maturing beyond 12 months; and
- Our estimate of funds from operations of SEK600 million-SEK620 million.

Principal liquidity uses include:

- SEK3.7 billion of contractual debt amortization payments, including debt maturities.
- No dividends expected in 2021 but SEK220 million-SEK250 million in 2022 and 2023.
- Committed capex of about SEK400 million.

## Covenants

Jernhusen is subject to no covenants on its debt lines.

## Ratings Score Snapshot

Issuer Credit Rating: A/Stable/A-1

Business risk:

- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb

- Related government rating: AAA
- Likelihood of government support: High (+3 notches)

## 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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Swedish Property Company Jernhusen Outlook Revised To Negative On Tightening Credit Metrics; 'A/A-1' Ratings Affirmed, June 30, 2020

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Jernhusen AB</b>		
Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1

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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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.

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