S&P Global Ratings

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Jernhusen AB

Primary Credit Analyst:
Teresa Stromberg, Stockholm (46) 8-440-5922; teresa.stromberg@spglobal.com

Secondary Contact:
Marie-Aude Vialle, Paris (33) 6-1566-9056; marie-aude.vialle@spglobal.com

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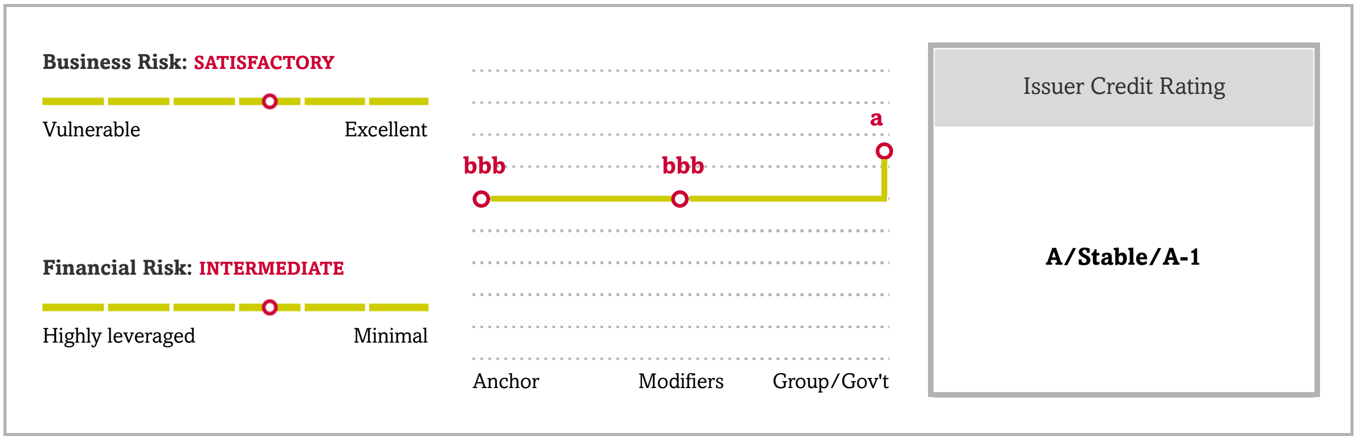
Jernhusen AB



Credit Highlights

Overview

Key Strengths	Key Risks
Niche real estate company, focused on railway-related properties.	Relatively small portfolio of SEK17 billion with limited international geographic diversity compared with other rated real estate companies.
High-quality property portfolio, with about 80% of assets in prime locations in Sweden's main three growth regions Stockholm, Gothenburg, and Malmö.	A degree of exposure to higher-risk development activities that could result in weaker credit metrics, mitigated to some extent by the prime locations of projects.
Ownership of unique assets, such as Stockholm's central station and train depots close to major cities.	Lower average debt maturity (three years in the next 12 months) than peers.
Low-risk business model, including low tenant and vacancy risk, due to favorable property locations and a strong market position for depots.	Relatively high tolerance for leverage, with a minimum equity ratio of 35% and debt to EBITDA of 11x-12x, but in line with peers.
Consistent and committed support from Swedish government through 100% ownership.	

Favorable macroeconomic dynamics of Sweden will continue to support Jernhusen's core business. We expect stable unemployment in Sweden at about 6.3% in 2020-2021, and population increase by 1% each year. The population in metropolitan cities keeps rising, which combined with ongoing urbanization trends supports an increase in demand for transportation in these regions. There has been an acceleration in the number of passengers on the railway system over the past two years; as of first-half 2019, passenger volumes measured by number of trips by trains increased by 6.5%. These factors will support Jernhusen's core railway stations and depots business.

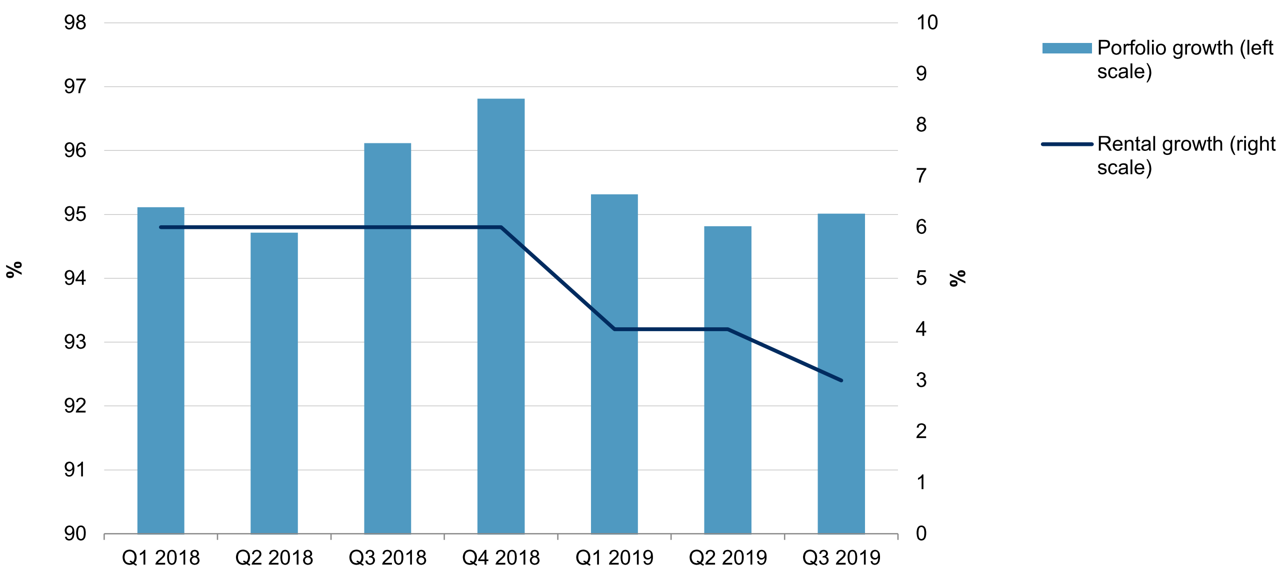
Strong office demand in the Swedish market will further support Jernhusen's unique position as train station and depot provider. We anticipate a healthy labor market and strong business expansion will support further decline in office vacancy rates in the three major Swedish cities of Stockholm, Gothenburg, and Malmö. The growing office segment marks an increase in the proportion of daily commuters and passenger volumes. With Jernhusen providing easy connection through its train stations, it enjoys a prime position in the market.

Consistently stable operating performance mitigates the risk of significant exposure to development activities. Jernhusen's development pipeline accounts for about 13%-14% of the portfolio's value, which could pose risks related to pre-letting during the construction cycle. However, the business unit that includes property development also has investment properties generating annual cash flow, but with potential for being developed further. In addition, we believe the specialized nature, location, and track record of Jernhusen's properties, in terms of strong occupancy of

96%-97% and portfolio growth, decreases the risk for the development portfolio.

Chart 1

Occupancy Development - Jernhusen



Sources: Company reports, S&P Global Ratings.

Outlook: Stable

Our stable outlook on Swedish government-owned real estate company Jernhusen AB reflects our expectation that Jernhusen's properties will continue to benefit from strong economic fundamentals in Sweden, and favorable demand trends for rail travel. We expect the company will maintain ample headroom to comply with its stated financial policy, and that the sale of development rights or decrease in investments could counteract any unforeseen drops in the market value of its portfolio. We also expect that management will continue to monitor risks in the development portfolio. For the current rating, we expect the company will maintain a ratio of debt-to-debt-plus-equity of about 50%, and EBITDA interest coverage of at least 4.0x over the next 24 months.

Downside scenario

We could lower the rating if Jernhusen's financial risk increased, for example, due to higher yields that led to a drop in property values and a weaker debt-to-debt-plus-equity ratio. We would view a debt-to-debt-plus-equity ratio above 55% for a prolonged period as inconsistent with the current rating. We could also lower the rating if Jernhusen's EBITDA interest coverage ratio fell well below 3.5x for a prolonged period, for example due to markedly higher borrowing costs.

Ratings downside could also develop if we considered that the likelihood of government support for Jernhusen had weakened, which could, for example, result from partial privatization of the company. We consider this to be highly unlikely at the moment.

Upside scenario

We could raise the rating if we thought that Jernhusen's financial risk tolerance had decreased, allowing it to maintain a debt-to-debt-plus-equity ratio 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.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Sweden of 1.8% in 2020 and 2.0% in 2021, and a stable unemployment rate of about 6.3%.
- Stable occupancy at about 96%, supported by favorable locations, with access to prime areas in Sweden.
- Stable EBITDA margin at about 47%-48%.
- Growth of portfolio value of about Swedish krona

Key Metrics

	2018A	2019E	2020E
EBITDA margin (%)	46.5	46-47	46-47
EBITDA interest coverage (x)	5.0	4.5-5.0	4.5-5.0
Debt-to-debt plus equity (%)	49.1	49.0-53.5	51.0-53.0
Debt-to-EBITDA (x)	10.3	10-12	10.5-12.5

A--Actual. E--Estimate.

(SEK) 200 million-SEK250 million (about €18 million-€23 million) in 2020-2021, primarily reflecting investment and upside from rental income, assuming yields remain stable.

- Investments in 2020 of about SEK650 million, increasing to SEK1.1 billion in 2021, depending on the timing of large development projects.
- Asset sales generating about SEK400 million in 2019 and additional disposals in the coming years as Jernhusen sells property development rights on land close to central stations.

Base-case projections

Supportive macroeconomic dynamics, combined with completion of property development projects, should translate into 3%-4% revenue growth per year in 2019-2020. We take into account Jernhusen's continuously strong like-for-like rental income growth of about 3% in 2019 and 2020, due to contract renegotiations as well as completion of new developments, primarily in the south of Sweden (Foajen in Malmö). We anticipate this, in addition to stable and high occupancy across the portfolio, will generate a rental growth of about 3%-4% in the next 12-24 months.

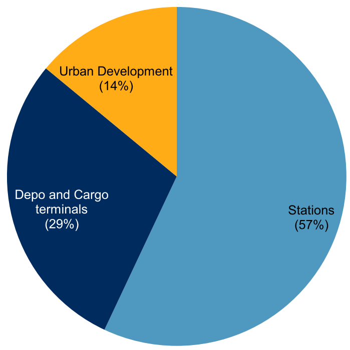
Despite an extraordinary dividend in 2019 and a fairly large development pipeline, we expect credit metrics to remain broadly stable and commensurate with the rating. Jernhusen made a significant dividend distribution of SEK700 million in second-quarter 2019, which caused the debt plus debt over equity to increase to 52.3% from 49.7% at year-end 2018. Going forward we project Jernhusen's debt-to-debt-plus-equity ratio will stay at approximately 50% due to solid cash generation (close to SEK500 million-SEK600 million in reported cash flows from operations) and a relatively prudent financial policy, enabling the company to invest in its development program without impairing its financial metrics.

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 Järvägar (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 Sept. 30, 2019, its properties were valued at SEK17.7 billion (about €1.7 billion) and it had 577,000 square meters of rentable area.

Chart 2

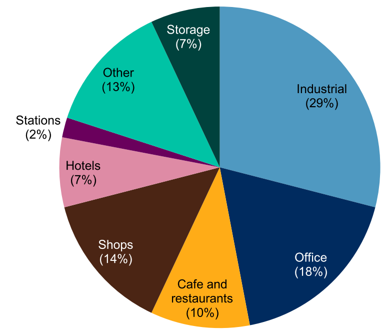
Portfolio Value Breakdown By Segment
Dec-18



Source: Company data.

Chart 3

Shares Of Rental Value Per Segment
Dec-18



Source: Company data.

Business Risk: Satisfactory

Our assessment of Jernhusen's satisfactory business risk profile reflects our view of the company's resilient asset portfolio with stable rental income further supported by its unique property portfolio, which mainly consists of railway stations (57% of value and 54% of revenues) and depots/cargo terminals (29% of value and 40% of revenues) in Sweden's largest cities. Every day about 500,000 passengers pass through its stations, 250,000 of them through Stockholm's central station. Traveling by rail is essential for daily commuters and widely supported by parties across the political spectrum. We recognize that passenger volumes have been steadily increasing and are relatively unaffected by economic downturns, such as the one in 2009.

The portfolio contains very high-quality assets, since about 80% consists of properties in prime locations in Sweden's three main growth regions, Stockholm, Gothenburg, and Malmö, which imply low vacancy risk and high rents. Property value of the portfolio increased by SEK246 million as of third-quarter 2019. Yield was 5.2% in third-quarter 2109, down from 5.4% one year earlier, but has remained stable over the course of 2019. Compared with other commercial real estate companies, in our view, this yield compression appears conservative.

Vacancy rates have increased sequentially over the past three quarters to 5.0% (primarily due to terminations of retail premises in Stockholm and industrial premises in Borlänge and Helsingborg) from 3.2% at year-end 2018, but we expect the vacant premises to be replaced by new tenants in 2020.

With a value of SEK10.1 billion, or 57% of the total portfolio value, the 37 owned stations dominate Jernhusen's portfolio. Rental income at the stations stems predominantly from retail premises and restaurants, where sales are relatively stable and primarily correlated to the number of trains and passengers. Rental contracts typically include both a base rent and a turnover related add-on rent. We expect rental revenues from stations to remain considerably more stable and with lower vacancies than for commercial properties in general.

Jernhusen owns and operates 22 train depots and 5 cargo terminals with a total value of SEK7 billion. Although Jernhusen's tenants for its depots are mainly private maintenance companies, we view tenant risk as very low, since a defaulting tenant would most likely be replaced by another very quickly to avoid disruptions to the railway system. The depot business resembles a monopoly where rents are set at cost plus margin. We also view as positive Jernhusen's ownership of railway depots close to main cities, since these are essential infrastructure for the ongoing maintenance of trains. Sales generated from office and freight terminals are more exposed to changes in economic activity.

We view Jernhusen's urban development business as somewhat riskier than its core business due to the nature of development activities, including for example, the risk of cost overruns, capital intensity, and uncertainty regarding preletting. However, Jernhusen already owns the developable land plots, that are in good locations and the company has built a track record of these activities over the past 10 years.

We consider Jernhusen's profitability as average--the EBITDA margin was 47% in the 12 months to Sept. 30, 2019. Compared with peers in the same category, margins appear lower, but this includes adjustments for depots, which are characterized by a cost-based rental scheme, in addition to higher maintenance cost at central stations compared with regular office premises.

Jernhusen's portfolio of SEK17.7 billion is much smaller than that of other real estate companies we rate, such as Akelius Residential Property AB (€12.2 billion as of third-quarter 2019) and Fastighets AB Balder (SEK133.2 billion), which we view as constraints to the company's business profile. In addition, Jernhusen conducts all its business activities in Sweden, primarily in Stockholm (51%), whereas Akelius and Balder are diversified geographically.

Peer comparison

Table 1

Jernhusen AB--Peer Comparison

Industry sector: Real estate investment trust or company

	Jernhusen AB	Akelius Laegenheter AB	Fastighets AB Balder	Citycon Oyj
Ratings as of Dec. 3, 2019	A/Stable/A-1	BBB/Stable/A-2	BBB/Stable/--	BBB-/Negative/A-3
	--Fiscal year ended Dec. 31, 2018--			
(Mil. SEK)				
Revenue	1,545.1	4,904.2	6,714.0	2,186.5
EBITDA	717.7	2,401.2	4,421.0	2,032.4
Funds from operations (FFO)	572.1	869.9	2,962.5	933.4
Interest expense	143.5	1,572.0	1,153.8	594.4
Cash interest paid	145.6	1,500.8	1,113.5	1,097.0
Cash flow from operations	693.4	992.0	3,735.5	986.3
Capital expenditure	555.7	3,551.0	6,210.0	959.5
Free operating cash flow (FOCF)	137.7	(2,558.9)	(2,474.5)	26.8
Discretionary cash flow (DCF)	(41.3)	(11,049.7)	(2,637.1)	(1,150.4)
Cash and short-term investments	233.4	132.3	1,328.0	42.7

Table 1

Jernhusen AB--Peer Comparison (cont.)

Industry sector: Real estate investment trust or company

	Jernhusen AB	Akelius Laegenheter AB	Fastighets AB Balder	Citycon Oyj
Debt	7,410.3	61,536.7	65,020.5	22,150.3
Equity	7,679.7	54,200.7	49,206.0	21,255.0
Valuation of investment property	16,944.1	125,556.0	118,140.0	42,034.8
Adjusted ratios				
Annual revenue growth (%)	6.3	2.8	13.5	(6.0)
EBITDA margin (%)	46.5	49.0	65.8	93.0
Return on capital (%)	5.7	2.2	5.1	4.3
EBITDA interest coverage (x)	5.0	1.5	3.8	3.4
Debt/EBITDA (x)	10.3	25.6	14.7	10.9
FFO/debt (%)	7.7	1.4	4.6	4.2
Debt/debt and equity (%)	49.1	53.2	56.9	51.0

SEK--Swedish krone.

Financial Risk: Intermediate

Our assessment of Jernhusen's financial risk profile is supported by the company's moderate debt leverage, in our view with debt-to-debt plus equity slightly above 50% over the next 12-24 months, depending on the execution of its development pipeline and depending on its dividend policy. However, should the market deteriorate and debt ratios weakens, we think Jernhusen has the flexibility to adjust its investment plan.

The company decided on an extraordinary dividend in second-quarter 2019 of SEK700 million, in line with its financial policy to distribute any surplus cash not required in the operations. As a result, debt plus debt plus equity rose to 52.3% from 49.2% at year-end 2018. However, we expect the ratio to decrease toward 50% at year-end 2019, driven by strong cash flow and some further portfolio uplift.

We acknowledge that the company's financial policy allows for higher leverage, since it stipulates an equity ratio in the 35%-45% range, where the minimum level corresponds to a debt-to-debt-plus-equity ratio of approximately 60%. However, we also think Jernhusen's more defensive portfolio could support somewhat higher leverage in the coming years. We expect that the company will maintain ample headroom with regards to this ratio.

Jernhusen generated a return on equity of 7.3% in 2018 while the 10-year average is 8.5% (as of Sept. 30, 2019) which is below the company target of 12%. Given the relatively low yield of the portfolio, the targeted return on equity is reliant on significant property development, which is subject to volatility depending on timing of completion, or positive portfolio revaluation. We consider the currently historically wide gap between valuation yields and interest rates to be supportive for property values.

Due to the general low-interest-rate environment in Sweden and ongoing refinancing activities, Jernhusen has improved its cost of debt further to 1.5% as of Sept. 30, 2019, from 1.6% on Sept. 30, 2018. We therefore forecast a strong EBITDA interest-rate-coverage ratio at about 4x over the next 12-24 months.

Jernhusen's financial ratios are sensitive to changes in interest rates and yield requirements. Moreover, the debt maturity profile is relatively short dated, with a debt maturity of 3.1 years. However, we regard as positive Jernhusen's access to an unused credit facility corresponding to 157% of its short-term debt, as well as its hedging strategy to manage interest rate exposure. Should property values decline and put pressure on the debt-to debt-to-debt-plus-equity ratio, we think Jernhusen has some flexibility to adjust its large investment plan.

Financial summary

Table 2

Jernhusen AB--Financial Summary

Industry sector: Real estate investment trust or company

	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
(Mil. SEK)					
Revenue	1,545.1	1,453.3	1,368.3	1,272.8	1,181.0
EBITDA	717.7	683.2	640.2	562.0	480.6
Funds from operations (FFO)	572.1	535.3	503.0	428.3	320.1
Interest expense	143.5	157.0	137.1	131.9	167.5
Cash interest paid	145.6	147.9	137.2	133.7	160.5
Cash flow from operations	693.4	681.5	(91.4)	496.2	361.9
Capital expenditure	555.7	660.8	573.7	1,400.6	1,138.2
Free operating cash flow (FOCF)	137.7	20.7	(665.1)	(904.4)	(776.3)
Discretionary cash flow (DCF)	(41.3)	(157.3)	(1,165.1)	(1,017.4)	(876.3)
Cash and short-term investments	233.4	73.6	170.1	283.4	100.8
Gross available cash	233.4	76.3	170.1	283.4	100.8
Debt	7,410.3	7,339.7	7,339.5	6,832.1	6,111.7
Equity	7,679.7	7,426.6	6,955.8	6,157.7	5,262.0
Valuation of investment property	16,944.1	16,233.6	15,546.9	14,416.8	12,164.2
Adjusted ratios					
Annual revenue growth (%)	6.3	6.2	7.5	7.8	7.0
EBITDA margin (%)	46.5	47.0	46.8	44.2	40.7
Return on capital (%)	5.7	6.1	12.7	10.9	6.4
EBITDA interest coverage (x)	5.0	4.4	4.7	4.3	2.9
Debt/EBITDA (x)	10.3	10.7	11.5	12.2	12.7
FFO/debt (%)	7.7	7.3	6.9	6.3	5.2
Debt/debt and equity (%)	49.1	49.7	51.3	52.6	53.7

SEK--Swedish krone.

Liquidity: Adequate

We regard Jernhusen's liquidity position as adequate. We anticipate that liquidity sources will likely cover liquidity uses by more than 1.2x for the 12 months started Jan. 1, 2019.

We view as positive that Jernhusen's long-dated committed bank lines, currently maturing beyond May 2020, cover its SEK3 billion commercial paper program in full and the company faces limited debt maturities in next 12 months. We note that Jernhusen has had satisfactory access to credit markets for more than 10 years with access to its medium-term note program since 2013. In addition, Jernhusen has relationships with diverse banks that are large Swedish banks with strong credit quality.

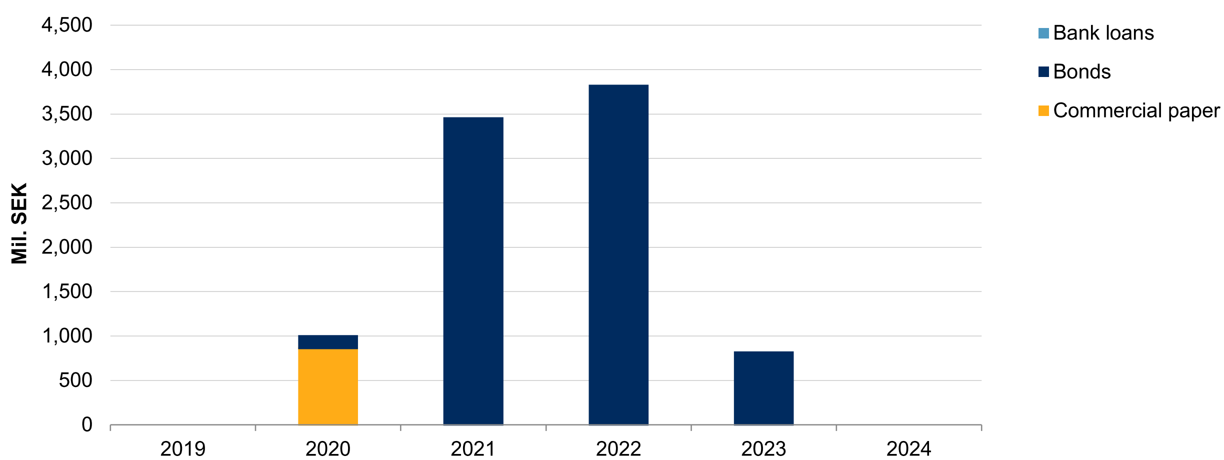
Principal Liquidity Sources	Principal Liquidity Uses
As of Sept. 30, 2019, liquidity sources comprised of: • Cash and equivalents of SEK266.1 million; • Available line from the Euro medium term note program of SEK4,136 million; • Access to SEK4.7 billion of committed bank lines maturing in May 2020; and • Expected funds from operations of about SEK570 million for the next 12 months.	• At the same date, uses of liquidity include: Investments of about SEK900 million in 2020 and SEK1.2 billion in 2021; • Annual working capital outflow of SEK20 million; • Repayment of SEK2.6 billion of short-term debt which relates to commercial paper that we expect will be rolled over; and • Annual dividend payments, which we forecast at about SEK700 million in 2019.

Debt maturities

As of September 2019, average debt maturity stood at 3.1 years.

Chart 4

Jernhusen's Debt Maturities
As of December 2018



SEK--Swedish krone. Source: Company data.

Covenant Analysis

Compliance expectations

Jernhusen is subject to no covenants on its debt lines.

Government Influence

Jernhusen is 100% owned by the Swedish government and managed by the Ministry of Enterprise; we therefore classify it as a government-related entity (GRE). We consider that there is a high likelihood of government support to Jernhusen from Sweden (AAA/Stable/A-1+), and therefore apply three notches uplift to our assessment of the company's 'bbb' stand-alone credit profile. Our assessment of government support is based on our view of Jernhusen's:

- Important role for the Swedish government due to its unique real estate holdings, which are essential for the Swedish railway network. We think that Jernhusen plays an important role in meeting political objectives relating to public transport. Although we think that part of Jernhusen's activities could be managed by private real estate companies, we view it as highly unlikely that the large central stations (such as those in Stockholm, Göteborg, and Malmö) and depots would be sold to private owners, due to their vital functions in the railway system; and
- Very strong link with the Swedish government, which is actively involved in defining the company's strategy, appoints its board, and has a long-term commitment to the company. We view it as unlikely that the government would consider privatizing Jernhusen, since it owns critical real estate assets tied to the Swedish railway sector. In addition, an ownership clause in the company's debt documentation stipulates that the government should own 100% of Jernhusen. In addition, the Swedish government has a track record of supporting the GRE sector, and any unremedied financial distress at the company would pose significant reputation risk for the government.

Reconciliation

Table 3

Reconciliation Of Jernhusen AB Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. SEK)

	--Fiscal year ended Dec. 31, 2018--					
Jernhusen AB reported amounts						
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**
Reported	7,943.6	7,647.7	723.6	844.5	139.1	717.7
S&P Global Ratings' adjustments						
Cash taxes paid	--	--	--	--	--	--
Cash taxes paid: Other	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(145.6)
Accessible cash and liquid investments	(233.4)	--	--	--	--	--
Capitalized interest	--	--	--	--	4.4	--
Income (expense) of unconsolidated companies	--	--	(5.9)	--	--	--

Table 3

Reconciliation Of Jernhusen AB Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. SEK) (cont.)						
Nonoperating income (expense)	--	--	--	0.5	--	--
Noncontrolling interest/minority interest	--	32.0	--	--	--	--
Debt: Derivatives	(299.9)	--	--	--	--	--
Total adjustments	(533.3)	32.0	(5.9)	0.5	4.4	(145.6)
S&P Global Ratings' adjusted amounts						
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**
Adjusted	7,410.3	7,679.7	717.7	845.0	143.5	572.1
SEK--Swedish krone.						

Table 4

Jernhusen Portfolio Summary	
Total portfolio value (mil. SEK)	17,369.0
No. of properties	154
Average rent in SEK per square meter	2,015.2
Rental yield (%)	5.2
Occupancy rate (%)	95
Weighted average lease term (years)	4.0
SEK--Swedish krone. Source: Company report Q3 2019.	

Ratings Score Snapshot

Issuer Credit Rating

A/Stable/A-1

Business risk: Satisfactory

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

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

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:** Neutral (no impact)

Stand-alone credit profile : bbb

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

Related Criteria

- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- 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: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of December 16, 2019)*	
Jernhusen AB	
Issuer Credit Rating	A/Stable/A-1
Issuer Credit Ratings History	
29-Aug-2017	A/Stable/A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com