Research Update:

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

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Rating Action Overview

- We believe social-interaction and travel restrictions to contain COVID-19 will reduce retailers' ability to pay rent, though the impact on Jernhusen should be more moderate than for some of its retail peers, given its diversified portfolio of commercial real estate assets.
- We estimate about 30% of total rental income will be affected by COVID-19 and expect a 10-15% decline in net rental income in 2020 but that Jernhusen can sustain credit metrics commensurate with our ratings, despite reduced headroom.
- Consequently, we are revising our outlook on Jernhusen to negative from stable and affirming our 'A/A-1' ratings.
- The negative outlook indicates that we could downgrade Jernhusen if its performance and credit ratios deteriorate further than we anticipate because of the effect of the pandemic on its retail portfolio, such that the company cannot maintain an S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio of around 50% and debt to EBITDA below 11.0x.

Rating Action Rationale

Social distancing measures to contain COVID-19 have interrupted daily travel patterns and consequently are having a significant impact on Jernhusen's operations. Over the past quarter, as COVID-19 spread across Europe, governments have implemented measures to reduce the spread of the coronavirus. In our view, the pandemic has had a less severe economic effect on the Nordic retail property sector than in the rest of Europe, given less strict social-distancing measures and supportive government initiatives. Measures such as domestic travel restrictions have led to a reduction in train passenger footfall through Jernhusen's stations, which usually see about 570,000 passengers, 250,000 of them through Stockholm's central station. We understand traffic declined by about 70% at the beginning of April, but has since recovered to about 50% of last year's after the government lifted the ban on domestic travelling on June 13.

We estimate that about 30% of Jernhusen's rental income has been affected by COVID-19. Rental income at the stations stems predominantly from retail premises and restaurants, where sales primarily correlate with the number of trains and passengers passing through its stations. Jernhusen has offered discounts of up to 50% for the second quarter to retail shops at stations; in addition, it has offered all tenants the option of being charged monthly in advance from April 2020, instead of quarterly in advance, to ease the burden of rent payments. Jernhusen's other rental operations, including office property (20% of rental income) and depot/freight terminal (43% of rental income) have so far not been affected by the pandemic. We understand depots close to main cities, are essential infrastructure for the ongoing maintenance of trains and the functioning of the railway system. Jernhusen's customers are either public transport authorities or rail traffic operators; therefore, in practice, it has a well-protected market position when it comes to depots. The impact on offices has also been limited due to tenants mainly being large corporations. Yet over the longer term we believe that the prospects of a weaker economy and the increased prevalence of remote working could erode companies' need for traditional office space, although we foresee high-quality, service-oriented, and centrally located offices should fare better.

In our revised base-case, we anticipate a 10%-15% drop in net rental income for 2020 on a like-for-like basis and a partial recovery in 2021. We have revised our base case for Jernhusen in light of the COVID-19 pandemic. Previously, we anticipated that like-for-like net rental income would increase 2%-3% in 2020 and 2021, but we now forecast a drop in revenue of 10%-15% for 2020 on a like-for-like basis. Currently, we expect Jernhusen's railway stations to be the most affected part of its portfolio. We assume that Jernhusen may have to offer rent discounts, terminate contracts, or renegotiate rents in some cases, because of the sharp decline of tenants' sales. We also believe this may continue after travel restrictions are lifted and we expect a small, temporary drop in the occupancy rate. In our view, the pandemic may hamper the retail sector for a long time, which was already suffering because of the rise in e-commerce and changing consumer habits. 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. For 2021, we forecast that rental income will increase by about 10% from the 2020 level on a like-for-like basis. Furthermore, we anticipate that retail property owners, including Jernhusen, are likely to experience a more material decline in asset values than we previously forecast, as appraisers are likely to take a harsher look at their portfolios and assume a drop in future cash flow. Previously, we anticipated that valuations would increase by 1%-2% in 2020-2021. Our revised base case includes a drop in asset values of 6%-8% for its retail portfolio and about 3% for its overall portfolio. Yet, in the longer term, we continue to foresee an increasing number of people choosing trains. Traveling by rail is essential for daily commuters and widely supported by parties across the political spectrum from an environmental perspective. Passenger volumes have been steadily increasing (up 8.1% in 2019) and historically are relatively unaffected by economic downturns, such as the one in 2008/2009. Therefore we anticipate passenger volume growth with return to the underlying trend in the medium to long term.

We expect Jernhusen's credit metrics to remain within our rating thresholds but deteriorate further if market conditions worsen more than expected. Before the pandemic began, we assumed that Jernhusen's credit metrics would be stable over the next 24 months. Specifically, we forecast S&P Global Ratings-adjusted debt to debt plus equity at 50%-51% and debt to EBITDA at 11.0x-11.5x. We have revised our base case, and now anticipate that adjusted debt to debt plus equity will increase slightly to 51%-52% by the end of 2020 and remain at 52% in

2021-2022 versus 50.6% in 2019. At the same time, we forecast the debt-to-EBITDA ratio will peak at about 12.5x in 2020 versus 10.5x in 2019, and reduce moderately to 12.1x-12.2x in 2021-2022. We view positively Jernhusen's efforts to preserve cash and strengthen its balance sheet with its recent announcement of a dividend cut to Swedish krona (SEK) 219 million from the proposed SEK700 million, and we believe this will create some additional headroom for its credit metrics. In addition, Jernhusen has flexibility in its development pipeline, since most of its projects can be postponed. We therefore anticipate only SEK300 million-SEK350 million will be spent on development in 2020 and 2021, compared with SEK500 million-SEK650 million over the past three years, and a forecast SEK1.0 billion annually once zoning is approved for development projects in Gothenburg and Stockholm, likely in 2024.

As a result of our new base case, we have also revised assessment of Jernhusen's financial risk profile to significant. We expect our adjusted debt-to-equity ratio for Jernhusen to remain above 50% for the next 12-24 months and anticipate that debt to EBITDA could move beyond the 11.0x commensurate with a significant assessment. The rating also includes a positive one-notch adjustment for our comparable analysis. This reflects the company's relatively robust position within our significant financial risk profile category, compared with other rated investment-grade peers, and Jernhusen's strong market position within the depots segment (45% market share) with a large share of government-related tenants allowing for stable cash flow generation.

Jernhusen's funding and liquidity profile remains adequate. The company has an adequate liquidity position, with about SEK279 million of cash on hand and available undrawn bank lines of SEK4.5 billion over the next 24 months. This should be sufficient to cover its debt maturities of about SEK3.1 billion, the majority comprising commercial paper. We also forecast that EBITDA interest coverage will remain comfortably above 4.5x over the next two years versus 5.6x as of year-end 2019, as a result of very low cost of debt (1.6%). Jernhusen's financial ratios are however sensitive to changes in interest rates and yield requirements since the debt maturity profile is relatively short dated, at 2.8 years as of first-quarter 2020. Nevertheless, we note that Jernhusen has demonstrated satisfactory access to capital markets and issued senior unsecured notes in April under challenging market conditions.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety

Outlook

The negative outlook indicates that we could downgrade Jernhusen if its credit metrics deteriorate more than in our revised base case and its operating performance is under greater pressure than currently anticipated, owing to the effects of the COVID-19 pandemic.

Downside scenario

We could lower the rating if Jernhusen's operating performance falters in the face of a recovery of footfall at railway stations, rent-free periods, and downward rent renegotiations after the pandemic is contained. It could also weaken if tenants suffer bankruptcies and vacancies increase. As a result, its credit metrics could deteriorate and its business model weaken. 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 13.0x or its liquidity cushion decreases over the next 12-24 months.

Upside scenario

We could revise the outlook to stable if Jernhusen shows resilience during the difficult retail and macroeconomic environment in Sweden. This could happen if the company maintains high occupancy and rent levels. A positive rating action would therefore require:

- Adjusted debt-to-EBITDA ratios trending toward 11x or lower.
- Debt to debt plus equity staying closer to 50% through flat or positive revaluation and strong cash flow generation.

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 March 31, 2020, its properties were valued at SEK17.9 billion (about €1.7 billion) and it had 579,000 square meters of rentable area.

Our Base-Case Scenario

Assumptions

- Annual decline of like-for-like rental income growth of 10%-15% in 2020 with a partial recovery in 2021.
- Slight decrease in EBITDA margin to 45%-46% for the next 12-24 months compared with 48%-49% before.
- About 3% like-for-like decline of overall portfolio value for 2020 and flat revaluation for 2021.
- Annual capital expenditure (capex) of SEK300 million-SEK350 million in the next 12-24 months, including development projects.
- Limited asset rotation.
- Average cost of debt to increase slightly to 1.6%-1.7%.

Key metrics

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

- EBITDA to interest coverage above 4.5x, compared with 5.6x in 2019.

- Adjusted debt to debt plus equity of 51%-52% in 2020 and 2021.
- Debt to EBITDA of 12.0x-12.5x

Liquidity

We assess Jernhusen's liquidity as adequate, based on our estimates that the company's liquidity sources will likely cover uses by about 1.4x in the 12 months started March 31, 2020.

Principal liquidity sources:

- SEK298 million in available unrestricted cash.
- A SEK4.5 billion revolving credit facility maturing beyond 12 months; and
- Our estimate of funds from operations of SEK530 million-SEK550 million.

Principal liquidity uses:

- SEK3.1 billion of contractual debt amortization payments, including debt maturities.
- Dividends of SEK219 million.
- Capex of SEK320 million, although we understand most of it is not committed.

Covenants

Jernhusen's debt is not subject to covenants.

Ratings Score Snapshot

Issuer Credit Rating: A/Negative/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)
- Liquidity: Adequate (no impact)

- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile:

- Group credit profile: bbb
- Entity status within group:
- Sovereign rating: AAA
- Likelihood of government support: High (+3 notches from SACP)

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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed/Outlook Action		
Jernhusen AB		
Issuer Credit Rating	A/Negative/A-1	A/Stable/A-1
Analytical Factors		
Local Currency	bbb	

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 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/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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.