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Jernhusen AB

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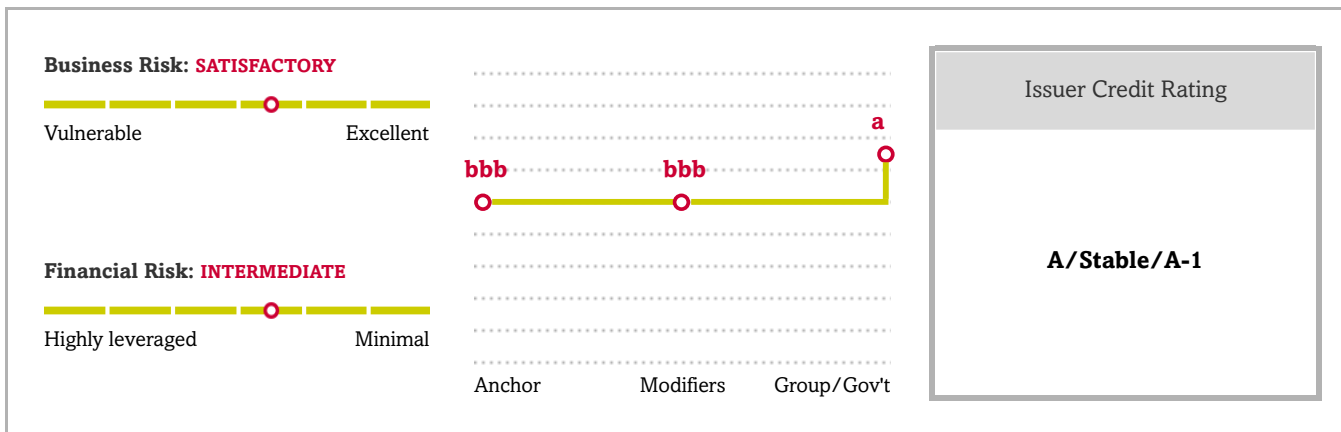
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Jernhusen AB



Credit Highlights

Overview

Key Strengths

A high-quality property portfolio, with assets close to Sweden's railway lines.

Ownership of unique assets, such as Stockholm's central station and train depots close to major cities.

A low-risk business model, including low tenant and vacancy risk, due to favorable property locations and a strong market position for depots.

Key Risks

A degree of exposure to higher-risk development activities.

Relatively limited geographic diversity compared with other rated real estate companies.

Significant debt maturities in the next 12 months, alongside high usage of commercial paper.

Sweden's robust economy, strong population growth, and increasing number of rail passengers will support Jernhusen's core business. Unemployment in Sweden will likely drop below 6% in 2018, thanks to employment growth of about 2.3% this year; and employment numbers are expected to increase by 1.7% in 2019. What's more, the population in metropolitan cities keeps rising. These factors, combined with ongoing urbanization trends, will result in an increasing number of passengers on the railway system, which will support Jernhusen's core railway stations and depots business.

Leverage should remain stable as investment deliveries and property revaluations offset debt increases. S&P Global Ratings' adjusted debt-to-debt-plus-equity ratio for Jernhusen is set to remain at around 50%, since increases in the company's net debt will likely be counterbalanced by higher investment values and appreciation of the property portfolio.

Strong demand for office space and Jernhusen's unique position as train station and depot provider mitigate significant exposure to development activities. Jernhusen's development pipeline accounts for about 13% of the portfolio's value, which could pose risks related to preletting during the construction cycle. However, part of the business unit with property development includes 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 decrease risk for the development portfolio. Sweden's strong commercial property market, with historically high office rental levels and low vacancy rates, further support its operations.

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 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 3.0x for a prolonged period, for example due to markedly higher borrowing costs.

Ratings downside could 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	Key Metrics			
<ul style="list-style-type: none"> • Real GDP growth in Sweden of 2.7% in 2018 and 2.2% in 2019, and a stable unemployment rate of about 6.4%. • Portfolio growth of about Swedish krona (SEK) 500 million (about €48 million) in 2018 and SEK200 million in 2019, primarily reflecting investment and upside from rental income, assuming yields remain stable. • Investments in 2018 of about SEK500 million, rising to SEK1.1 billion-SEK1.4 billion in 2020 and 2021, depending on the timing of large development projects. • Asset sales generating about SEK30 million in 2018 and additional disposals in the coming years as Jernhusen sells property development rights on land close to central stations. 	2017	2018E	2019E	
	EBITDA margin (%)*	47.5	46.2-46.6	45.8-46.6
	EBITDA interest coverage (x)*	4.4	4.3-4.5	4.1-4.4
	Debt/debt+equity (%)*	49.7	50.3-50.7	48.4-49.3
	<p>*Adjusted by S&P Global Ratings .] A--Actual. E—Estimate</p>			

Base-Case Projections

We expect income growth to increase by 3%-4% per year in 2018-2019. In our view, Jernhusen's income should start trending upward, supported by the finalization of new developments in Stockholm, Uppsala, and Malmö, as well as contract re-negotiations in the depo segment.

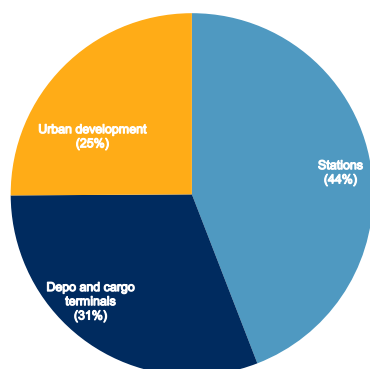
Credit ratios should remain fairly stable. We project Jernhusen's debt-to-debt-plus-equity ratio will stay at about 50% as solid cash generation (close to SEK500 million in reported cash flows from operation) and a relatively prudent financial policy enable the company to invest in its development program without impairing its financial metrics.

Company Description

The Swedish government fully owns Jernhusen, which owns properties related to the country's railway network. Train stations represent the main real estate holding but Jernhusen also owns depots and cargo terminals, and develops commercial real estate in central locations. Jernhusen's purpose is to enable more people to travel by rail and thereby contribute to a more environmentally friendly transport system. The company was founded in 2001 as a spin-off from the Swedish railway monopoly Statens Järnvägar (SJ). As of Sept. 30, 2018, its properties were valued at SEK16.6 billion (about €1.6 billion) and it had 597,000 square meters of rentable area.

Chart 1

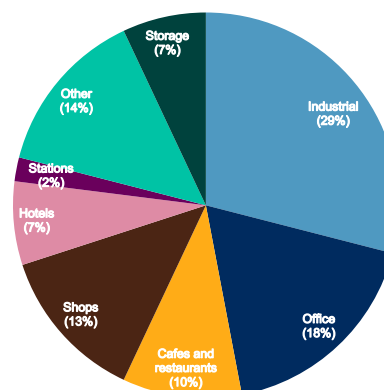
Jernhusen AB--Property Value by Type



Source: Company data for the nine months to Sept. 30, 2018.
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Chart 2

Jernhusen AB--Rental Value By Business Type



Source: Company data for the nine months to Sept. 30, 2018.
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Business Risk: Satisfactory

We think that Jernhusen's business risk profile is supported by its unique property portfolio, which mainly consists of railway stations (44% of value and 54% of revenues) and depots/cargo terminals (31% 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.

Rental income at the stations stems predominantly from retail premises and restaurants, where sales are linked to the number of trains and passengers. Sales generated from office and freight terminals are more exposed to changes in economic activity. 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.

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.

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, the developable land plots are in good locations and the company has built a track record of these activities over the past 10 years.

Jernhusen's portfolio of SEK16 billion is much smaller than that of other real estate companies we rate, such as Akelius Residential Properties (SEK131.6 billion) and Balder (SEK114.6 billion), which we view as constraints to the company's business profile. In addition, all of Jernhusen conducts all its business activities in Sweden, primarily in Stockholm (51%), compared with Akelius and Balder, which are diversified internationally.

Peer comparison

Table 1

Jernhusen AB--Peer Comparison				
Industry Sector: Real Estate Investment Trust or Company				
	Jernhusen AB	Akelius Residential Property AB	Fastighets AB Balder	Citycon Oyj
Rating as of Nov. 1, 2018	A/Stable/A-1	BBB/Stable/A-2	BBB/Stable/--	BBB/Negative/A-2
(Mil. SEK)	--Average of past three fiscal years--			
Revenues	1,365	4,190	4,666	3,071
EBITDA	633	2,173	2,938	1,878
Funds from operations (FFO)	491	646	1,773	1,356
Net income from continuing operations	964	8,321	5,836	1,131
Cash flow from operations	362	699	1,882	1,242
Capital expenditures	878	2,661	2,818	1,656
Free operating cash flow	(516)	(1,962)	(936)	(415)
Discretionary cash flow	(780)	(6,500)	(977)	(1,487)
Cash and short-term investments	176	177	1,367	169
Debt	7,170	44,288	50,147	20,224
Equity	6,847	35,852	30,739	21,476
Valuation of Investment Property	15,399	85,613	84,331	40,020
Adjusted ratios				
EBITDA margin (%)	46.4	51.9	63.0	61.1
Return on capital (%)	9.2	2.8	5.0	4.7
EBITDA interest coverage (x)	4.5	1.5	2.7	3.2
FFO cash int. cov. (X)	4.5	1.6	2.7	3.0
Debt/EBITDA (x)	11.3	20.4	17.1	10.8
FFO/debt (%)	6.8	1.5	3.5	6.7
Cash flow from operations/debt (%)	5.0	1.6	3.8	6.1
Free operating cash flow/debt (%)	(7.2)	(4.4)	(1.9)	(2.1)
Discretionary cash flow/debt (%)	(10.9)	(14.7)	(1.9)	(7.4)
Total debt/debt plus equity (%)	51.2	55.3	62.0	48.5

SEK--Swedish krona.

Financial Risk : Intermediate

Our assessment of Jernhusen's financial risk profile is supported by the company's moderate debt leverage, in our view. In our base-case scenario, we forecast that Jernhusen should maintain an adjusted debt-to-debt-plus-equity ratio slightly below 50% in the next 12-24 months, depending on the execution of its development pipeline. However, should the market deteriorate and debt ratios weakens, we think Jernhusen has the flexibility to adjust its investment plan.

We acknowledge that the company's financial policy allows for higher leverage, since it stipulates a minimum equity ratio ratio of 35%, which corresponds to a debt-to-debt-plus-equity ratio of approximately 60%. However, we think that the company will maintain ample headroom to this ratio in the coming five years.

Due to the general low-interest-rate environment in Sweden and ongoing activities in the derivative portfolio, Jernhusen has improved its cost of debt further to 1.6% as of Sept. 30, 2018, from 1.9% on Sept. 30, 2017. This allows for a strong EBITDA interest-rate-coverage ratio of well above 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 43% of borrowings maturing within 12-24 months. 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-plus-equity ratio, we think Jernhusen has some flexibility to adjust its large investment plan.

Jernhusen AB -- Financial Summary

Financial summary

Table 2

Jernhusen AB -- Financial Summary					
Industry Sector: Real Estate Investment Trust or Company					
	--Fiscal year ended Dec. 31--				
(Mil. SEK)	2017	2016	2015	2014	2013
Revenues	1,453	1,368	1,273	1,181	1,104
EBITDA	698	640	562	481	394
Funds from operations (FFO)	540	503	429	312	222
Net income from continuing operations	649	1,259	984	389	513
Cash flow from operations	682	(91)	496	362	360
Capital expenditures	661	574	1,401	1,138	1,277
Free operating cash flow	21	(665)	(904)	(776)	(918)
Discretionary cash flow	(157)	(1,165)	(1,017)	(876)	(1,018)
Cash and short-term investments	74	170	283	101	0
Debt	7,340	7,340	6,832	6,112	5,746
Equity	7,427	6,956	6,158	5,262	4,973
Debt and equity	14,766	14,295	12,990	11,374	10,719
Valuation of Investment Property	16,234	15,547	14,417	12,164	11,327

Table 2

Jernhusen AB -- Financial Summary (cont.)

Industry Sector: Real Estate Investment Trust or Company					
--Fiscal year ended Dec. 31--					
(Mil. SEK)	2017	2016	2015	2014	2013
Adjusted ratios					
EBITDA margin (%)	48.0	46.8	44.2	40.7	35.7
Return on capital (%)	5.7	11.9	10.4	6.2	6.1
EBITDA interest coverage (x)	4.4	4.7	4.3	2.9	2.3
FFO cash int. cov. (x)	4.7	4.7	4.2	3.0	2.3
Debt/EBITDA (x)	10.5	11.5	12.2	12.7	14.6
FFO/debt (%)	7.4	6.8	6.3	5.1	3.9
Cash flow from operations/debt (%)	9.3	(1.2)	7.3	5.9	6.3
Free operating cash flow/debt (%)	0.3	(9.1)	(13.2)	(12.7)	(16.0)
Discretionary cash flow/debt (%)	(2.1)	(15.9)	(14.9)	(14.3)	(17.7)
Debt/debt and equity (%)	49.7	51.3	52.6	53.7	53.6

SEK--Swedish krona.

Liquidity: Adequate

We regard Jernhusen's liquidity position as adequate mainly because of its ample access to committed bank lines, available funding from its medium-term note (MTN) program, and other sources, such as bank loans and commercial paper issuance. We forecast that the company's liquidity sources will exceed its funding needs by more than 1.2x over the next 12 months.

We view as positive that Jernhusen's long-dated committed bank lines, currently maturing beyond September 2019, cover its SEK3 billion commercial paper program in full. Although the company faces large debt maturities in 2019, we think it will address them in time, as it has done in the past. We note that Jernhusen has had satisfactory access to credit markets for more than 10 years, and in March this year, upsized its MTN program to SEK10 billion from SEK6 billion. In addition, Jernhusen has relationships with diverse banks, namely large Swedish banks with strong credit quality.

Principal Liquidity Sources (as of Sept. 30, 2018)	Principal Liquidity Uses (as of Sept. 30, 2018)
<ul style="list-style-type: none"> • Cash and equivalents of SEK76.5 million; • Access to SEK4.7 billion of committed bank lines maturing after September 2019; and • Expected funds from operations of about SEK587 million for the next 12 months. 	<ul style="list-style-type: none"> • Investments of about SEK500 million in 2018 and SEK1 billion in 2019; • Working capital outflow of SEK20 million; • Repayment of SEK3.4 billion of short-term debt, of which SEK2.6 billion relates to commercial paper that we expect will be rolled over; the remaining SEK850 million relates to MTN; and • Annual dividend payments, which we forecast at about SEK179 million.

Debt maturities

- >1 year: SEK3,425 mil.
- >2 years: SEK651 mil.
- >3 years: SEK400 mil.
- >4 years: SEK1,353 mil.
- >5 years: SEK1,804 mil.

Total: SEK7,633 mil.

Government Influence

Jernhusen is 100% owned by the Swedish government and managed by the Ministry of Enterprise; therefore we 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.

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)

Reconciliation

Table 3

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

--Fiscal year ended Dec. 31, 2017--

Jernhusen AB reported amounts					
	Debt	EBITDA	Operating income	Interest expense	EBITDA
Reported	7,738	690	892	154	690
S&P Global Ratings' adjustments					
Interest expense (reported)	--	--	--	--	(154)
Interest income (reported)	--	--	--	--	--
Current tax expense (reported)	--	--	--	--	(1)
Surplus cash	(76)	--	--	--	--

Table 3

Reconciliation Of Jernhusen AB Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. SEK) (cont.)					
Capitalized interest	--	--	--	3	(3)
Non-operating income (expense)	--	--	1	--	--
Debt - Derivatives	(322)	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	7	7	--	7
EBIT - Income (expense) of unconsolidated companies	--	--	(7)	--	--
Total adjustments	(399)	7	1	3	(151)
S&P Global Ratings' adjusted amounts					
	Debt	EBITDA	EBIT	Interest expense	Funds from operations
Adjusted	7,340	698	893	157	540

SEK--Swedish krona.

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

Business Risk Profile	Financial 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 17, 2018)**Jernhusen AB**

Issuer Credit Rating	A/Stable/A-1
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Issuer Credit Ratings History

29-Aug-2017	A/Stable/A-1
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*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.

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