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## Research Update:

# Norway-Based Retail Property Company Steen & Strom AS Assigned 'A-' Rating; Outlook Stable

**Primary Credit Analyst:**
Franck Delage, Paris (33) 1-4420-6778; franck.delage@spglobal.com

**Secondary Contact:**
Kathleen Allard, Paris (33) 1 44 20 66 57; kathleen.allard@spglobal.com

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## Overview

- Property investment company Steen & Strøm AS, a subsidiary of the French real estate company Klépierre S.A. (A-/Stable/A-2), owns and manages a large portfolio of 18 prime quality shopping centers in the Scandinavian region, worth approximately €3.7 billion.
- The company is prudently leveraged, with a maximum debt-to-debt-plus-equity ratio of 45%. It is also integral to Klépierre's strategy, and we expect the parent would likely support it in case of need.
- We are therefore assigning our 'A-' corporate rating to Steen & Strøm AS, in line with that on Klépierre, and two notches above its 'bbb' stand-alone credit profile.
- The stable outlook reflects our view that the company's prime assets should remain core for Klépierre and enable the group's EBITDA to interest coverage ratios to remain above 2.4x and debt to debt plus equity below 50% over the next 24 months.

## Rating Action

On Aug. 11, 2017, S&P Global Ratings assigned its 'A-' long-term corporate credit rating to Norwegian retail property investment company Steen & Strøm AS. The outlook is stable.

## Rationale

Steen & Strøm AS is a real estate investment company that focuses on acquiring, developing, and managing retail real estate assets in Norway, Sweden, and Denmark. The company currently owns and manages 18 shopping centers, which were valued at Norwegian krone (NOK) 36,561 billion (about €3.7 billion) at the end of 2016, including transfer taxes. It is a subsidiary of Klépierre, which owns 56.1% of its shares. Its secondary shareholder is APG, which owns 43.9% of its shares.

Our 'bbb' assessment of Steen & Strøm's stand-alone credit profile factors in the robust quality of the company's assets, and their attractiveness to tenants. The company benefits from strong macroeconomic fundamentals in the three countries in which it operates, and from its strategic localizations within these countries. The three countries in which Steen & Strøm operates are characterized by particularly high GDP per capita (around €60,800 in Norway in 2017, €43,000 in Sweden, and €44,300 in Denmark, as per our forecasts, versus €29,800 in France or €30,300 in the U.K.) and low and contracting unemployment rates. Unemployment is forecast to be 4.3% in Norway, 6.7% in Sweden, and 5.9% in Denmark in 2017, compared with 9.4% in the eurozone. This should continue to boost demand in retail markets.

In addition, Steen & Strøm's shopping centers are in major regional cities' catchment areas; for most of the centers, between 100,000 and 1,800,000 people live less than 30 minutes away by car. The portfolio comprises large and modern assets, which we view as attractive to creditworthy potential flagship tenants. The centers are about 34,000 square metres (sqm) in size, on average and have an average value of €6,642 per sqm. For context, Klépierre's centers average about 28,000 sqm in size and are valued at an average €5,000 per sqm, while Citycon's are 24,000 sqm and valued at €4,000 per sqm.

Thanks to these positive factors, Steen & Strøm has developed a solid leadership position in the Nordic real estate market. Therefore, we anticipate that the company will continue to generate high and constant footfall in the coming years, and a good level of occupancy. It currently reports 90 million visitors per year, including 38 million in Norway, 28 million in Sweden, and 22 million in Denmark, and occupancy levels of 96.5% at end of 2016. This is particularly important because we see the risk of increasing competition in Europe as the main long-term threat in the retail property industry, either from e-commerce or from other physical shopping centers. Meanwhile, the prime retailers that anchor shopping centers are becoming increasingly selective.

Steen & Strøm's assets are relatively well balanced across the three countries--47.4% of the company's turnover is generated in Norway, 30.9% in Sweden, and 21.7% in Denmark. This mitigates the company's dependence on a single economy. We also view positively the company's diversity in terms of tenants. In each of the three countries, Steen & Strøm's 10 largest tenants represent less than 33% of that country's total rental income. In our view, this partly protects the company from the risk of rent volatility if a large tenant chooses to exit or renegotiate its rent downward. In addition, development risk is limited, because the share of assets under development will remain less than 5% of the current portfolio value. The development strategy is also subject to a relatively strict pre-letting policy, under which construction will not start until an anchor tenant has been secured.

These strengths are partly mitigated by Steen & Strøm's moderate portfolio size (lower than €5 billion worth) and its relatively low number of assets (18) compared with most higher-rated peers', which implies some revenue volatility in case of asset rotation. The portfolio shows some concentration in the two main assets, Field's and Emporia, each of which represents about 15% of the company's total portfolio value. This could create rent volatility if one of the two assets were to underperform, for example, because of nearby competition. That said, we acknowledge that these two particularly large assets (more than 65,000 sqm each), which are in large and dynamic cities (Copenhagen and Malmö), should continue generating high footfall (above eight million each in 2016). Steen & Strøm's average lease duration is also relatively short on average, at 3.3 years, compared with that of some higher-rated peers. This gives it less cash flow visibility. The issue is partly offset by Steen & Strøm's relatively high tenant retention (72%) and occupancy rates (above 95%).

Under our base case, we assume that the company's EBITDA will decline to slightly above NOK1,400 million in 2017 and 2018, mainly reflecting the disposals of:

- Asane Asane Storsenter and Torp Kopcentrum in November 2016 (for a total amount of NOK2.25 billion);
- Lilletrom Torv in January 2017 (NOK800 million); and
- The noncore office tied to the Emporia asset (Swedish krona 470 million).

EBITDA should bounce back more clearly in 2019 as new assets start producing rent and rents indexed to the consumer price index (CPI) are increased. Our operating base-case scenario for the next 24 months includes relatively stable occupancy and like-for-like rental income growth in line with inflation rate forecasts because most leases are indexed to CPI inflation. We forecast that Steen & Strøm's adjusted EBITDA margin will be 78%-80% over the next two years.

Steen & Strøm's financial risk profile is underpinned by its prudent financial policy, which centers on a loan-to-value (LTV) ratio of less than 40%. This translates into a 46% S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio (mainly inflated by deferred liabilities). We forecast that the adjusted debt-to-debt-plus-equity ratio will remain at 39%-41% in 2017-2019. We also anticipate that the adjusted EBITDA interest coverage ratio will remain strong, at around 3x in 2017-2019. Although we appreciate that credit ratios are currently strong due to the recent debt repayments and improvement in cost of debt, our assessment incorporates some future and hypothetical acquisitions that we believe Steen & Strøm could consider as part of its investment policy.

We assess Steen & Strøm as a core subsidiary of the French real estate company Klépierre and view it as integral to the group's current identity and future strategy. Because their business strategies and asset profiles are well aligned, we view as highly unlikely that Klépierre would sell Steen & Strøm in the coming years. We believe the Nordic market is highly strategic to the group and Steen & Strøm enjoys a strong local reputation there. Although Steen & Strøm currently generates a significant proportion of Klépierre's consolidated net rental income (17.1% as of Dec. 31, 2017) and shares many of its key tenants, we note that its assets regularly outperform the average total portfolio at Klépierre. Therefore, in our view, there is a clear economic incentive for Klépierre to maintain its shareholding in Steen & Strøm. Moreover, we understand Steen & Strøm is the unique vehicle through which Klépierre would invest in the region.

On the financial side, Steen & Strøm's leverage and financial discipline are commensurate with those of Klépierre (which has a 40% LTV policy). Klépierre injected capital into Steen & Strøm several times in 2015 and in 2011, and Steen & Strøm's debt documentation includes change of control clauses that strengthen the strategic aspect of the subsidiary, in our view. Steen &

Strøm's co-ownership by just one other shareholder, APG, is another supportive factor, given that APG is also the second-largest shareholder in Klépierre. The absence of other strong minority shareholders ensures a clear alignment of interests. Finally, Klépierre has developed a long track record of very selective mergers and acquisitions over the past 10 years, demonstrating long-term holding and a deep level of integration (for example, Corio).

We therefore consider that Klépierre is likely to support Steen & Strøm under any foreseeable circumstances and equalize our rating on Steen & Strøm with that on Klépierre at 'A-', which is two notches above Steen & Strøm's 'bbb' stand-alone credit profile.

### Liquidity

We assess Steen & Strom's liquidity as adequate. We anticipate that liquidity sources will likely cover liquidity uses by more than 1.2x for the six months from July 1, 2017. We only use the debt maturities within the next six months as a use of liquidity in our analysis, since the company has an investment-grade rating and has well-established and solid relationships with banks, a generally high standing in credit markets, and a generally prudent risk management. This is emphasized by the fact that the company belongs to a creditworthy group, Klépierre.

We anticipate the company will have the following principal liquidity sources over the next six months:

- Unrestricted cash balances of about NOK567.94 million.
- Undrawn bank lines of about NOK599 million.
- Funds from operations of about NOK1,100 million.

We anticipate the company will have the following principal liquidity uses over the next six months:

- About NOK1,715 million of debt maturities for the next six months.

## Outlook

The stable outlook on Steen & Strøm reflects our view that the company's portfolio of high-quality shopping centers should continue to generate a stable and significant proportion of Klépierre's rental income, as supported by the strong fundamentals of the Nordic retail markets, thanks to high purchasing power in these countries, at least for the next two years.

We also anticipate that the company will maintain a disciplined approach toward the funding of its investments, such that its adjusted debt-to-debt-plus-equity ratio will remain below 50% (corresponding to its 45% LTV policy) until 2019. We also expect that the refinancing of its capital structure and its resilient income should translate into an EBITDA-to-interest coverage ratio exceeding 2.4x over the same period.

The stable outlook is also based on our expectation that Steen & Strøm will remain core to Klépierre's future strategy, and that Klépierre will comply with similar ratio expectations on a consolidated basis.

### Downside scenario

We could consider lowering the rating on Steen & Strøm if there was a change in Klépierre's approach toward its subsidiary that could lead us to revise our view of Steen & Strøm's status within the group. Rating pressure would also arise if Klépierre's EBITDA interest coverage ratio were to fall below 2.4x, which could come from a material deterioration in consumer confidence and footfall in Klépierre's main markets. We could consider lowering the rating if Klépierre's adjusted debt-to-debt-plus-equity ratio increased to more than 50% for a prolonged period, due, for example, to an unanticipated expansion of its funding needs for renovation and developments.

### Upside scenario

We could raise the rating on Steen & Strøm if Klépierre were to adopt a more cautious financial policy, such that its EBITDA interest coverage stayed above 3.8x and debt to debt plus equity fell below 35% on a sustainable basis.

## Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/--

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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

Stand-alone credit profile: bbb
- Group credit profile: a-
- Entity status within group: Core (+2 notches)

## Related Criteria

- 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

## Ratings List

New Rating

| | |
|---|---|
| Steen & Strom AS | |
| Corporate Credit Rating | A-/Stable/-- |

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