Research Update:

# Norwegian Shopping Center Landlord Steen & Strom AS 'BBB+' Rating Affirmed On Large Asset Disposals; Outlook Stable

**September 15, 2021**

PRIMARY CREDIT ANALYST

**Teresa Stromberg**
Stockholm
(46) 8-440-5922
teresa.stromberg
@spglobal.com

SECONDARY CONTACT

**Nicole Reinhardt**
Frankfurt
+ 49 693 399 9303
nicole.reinhardt
@spglobal.com

ADDITIONAL CONTACT

**Industrial Ratings Europe**
Corporate_Admin_London
@spglobal.com

## Rating Action Overview

- Steen & Strom AS (S&S) recently disposed of five noncore shopping centers in Norway worth Norwegian krone (NOK) 4.1 billion, leaving it with high-quality assets but a smaller (NOK30.6 billion) and more concentrated portfolio, in our view.
- The disposals will also allow for a leverage reduction, helping the company to sustain metrics well within rating headroom over the next 12-24 months.
- We believe French real estate company Klepierre S.A., which is S&S's largest shareholder with 56.1% of outstanding shares and votes, would likely support its subsidiary in the event of financial distress, given S&S is integral to Klepierre's strategy.
- Consequently, we affirmed our 'BBB+' rating on S&S in line with that on Klepierre (BBB+/Stable/A-2) and our assessment of S&S's stand-alone credit profile remains 'bbb', supported by its solid financial situation.
- The stable outlook reflects our view that S&S's portfolio of high-quality shopping centers should continue providing a stable and significant proportion of Klepierre's rental income, with S&S maintaining moderate leverage over the next 12-24 months including S&P Global Ratings-adjusted debt to EBITDA of 8.5x-9.5x and debt to debt plus equity remaining below 40%.

## Rating Action Rationale

**We expect S&S to maintain a high-quality portfolio with attractive locations, even if the recent disposals leave it with higher concentration compared to that of some retail peers.** Since the beginning of 2021, S&S has disposed of five noncore Norwegian shopping centers for a total consideration of NOK4.1 billion. We understand the proceeds will mainly be used to repay debt up until second-quarter 2022 and for an extraordinary dividend to its main shareholders. In our view, this will support S&S's robust financials, and we anticipate that our adjusted debt to debt plus equity will decline to 37%-38% at year-end 2021 compared with 39.1% at year-end 2020. We view the transactions in line with Klepierre's overall business model focusing on large, modern, and high-quality shopping centers. Overall, we consider the modern premises and the location of S&S's assets as positive for our asset quality assessment, which is also reflected in a high value per square meter of €6,100 and an average yield of 4.6%. This compares well to other rated retail property companies like Citycon Oyj, with a value per square meter of €3,954 and an average yield of 5.4%. However, we acknowledge that the asset sale has resulted in portfolio fair value decreasing to NOK30.6 billion pro forma the second-quarter 2021 transactions, from NOK36.8 billion at year-end 2020, and reduced the number of assets to 13 from 18. In our view, this leaves a more concentrated portfolio with higher dependence on existing assets, with the top five shopping centers accounting for about 75% of portfolio value. This makes the portfolio vulnerable to small changes or losses of key tenants and we are mindful of the future strategy.

**We still anticipate a like-for-like 10%-12% decline in net rental income in 2021, with a gradual recovery from 2022.** In first-half 2021, like-for-like net rental income decreased 8.0%, primarily affected by declines in Denmark (10.1%) and Sweden (10.7%), representing about 70% of the company's reported asset value pro-forma the recent transactions. In Denmark, all centers were fully closed toward the end of April 2021, whereas in Sweden all centers were open but affected by government restrictions and general recommendations to avoid shopping centers. In Norway, the like-for-like-rental income decline was less pronounced, at 3.7%, because some centers operated as usual and retail sales in the country were high as consumers spent less on services and more on certain goods. Overall, S&S experienced mall closures for 1.5 months in first-half 2021, compared with 0.5 months in first-half 2020. In light of the pandemic, we anticipate that S&S's like-for-like rental income will continue to decline in second-half 2021 due to further rent rebates or cancellations and challenging lease conditions, evident in the negative rent reversion of 6.4% in the first half. In addition, we anticipate current vacancy rates will linger at higher-than-average levels of 6%-7%, pressuring rental income as challenging retail market dynamics continue. That said, we also expect further market normalization should mean S&S's centrally located premises continue to attract large international tenants and see footfall recovery.

**We expect a slower recovery as challenging retail market dynamics and structural changes in the sector continue to pressure retail landlord performance.** Even as movement restrictions in some Nordic countries are lifted and footfall recovers, we remain cautious of the recovery post pandemic, with pressure from structural changes in the sector. Over the long term, we continue to see risks to the wider retail real estate sector, including accelerated e-commerce adoption, which has been higher on average in the Nordics than continental Europe; changing consumer behavior; a weaker tenant base; and retailers negotiating rent reductions. The retail market was already under pressure before the pandemic and this has only increased, with accelerated dynamics that will continue to drive weaker operating performance throughout 2021 and 2022. Furthermore, we anticipate competition will remain fierce for S&S given the higher retail space per inhabitant in the Nordics compared to other European countries. Overall, we anticipate only a slow recovery in net rental income in 2022-2023, with an increase of about 2% per year.

**We expect S&S to sustain moderate leverage over the next 12-24 months, remaining well within current rating headroom.** S&S recorded a nominal increase in its reported loan-to-value (LTV) ratio to 32.8% at June 30, 2021, compared with 32.0% at Dec. 31, 2020. This corresponded to S&P Global Ratings-adjusted debt to debt plus equity of 38.8% at June 30, 2021. The slight increase in leverage was mainly driven by a 1.9% decline in portfolio value in first-half 2021. We believe that S&S could see a further decline due to cash flow effects as appraisers may take a harsher view of the company's assets amid long-term structural changes in the retail sector in the wake of the pandemic and a general increase in yields. In our base case, we conservatively anticipate a 3%-5% decline in portfolio valuations for 2021. In terms of asset rotation, we anticipate S&S will be selective in terms of acquisitions but may dispose of additional smaller noncore assets should market conditions allow. We note increasing retail asset sales, which reflect improved interest and some reduced pricing uncertainty between seller and buyer expectations. We forecast S&P Global Ratings-adjusted debt to debt plus equity at 38%-39% over the next 12-24 months, and EBITDA interest coverage of above 5x, supported by a gradual cash flow from operations recovery, low average interest rates of 1.7%, and recent disposals directed toward debt repayment. Accordingly, we expect the company to maintain leverage for the next 12-24 months well in line with its financial policy target of reported LTV below 40%.

**S&S remains solid from a liquidity and funding perspective over the next 12-24 months.** S&S faces debt repayments during the next 12 months including NOK2.8 billion related to NOK1.5 billion of commercial paper and NOK1.1 billion of bonds maturing in first-half 2022. We understand the company intends to repay most of these maturities with proceeds from the NOK4.1 billion of asset disposals and cash and cash equivalents of NOK382 million. In addition, it has NOK2.7 billion available under its committed undrawn back-up facility as of June. 30, 2021, bringing its ratio of liquidity sources to uses above 1.5x.

## Outlook

The stable outlook reflects our view that S&S's portfolio of high-quality shopping centers should continue to generate a stable and significant proportion of owner Klepierre's rental income. We assume a progressive ramp-up of vaccinations in Europe and stabilization of Klepierre's operating performance by 2022, including moderate increases in occupancy, rent collection rates returning to prepandemic levels, and no material changes in the current lease structure. We expect Klepierre to maintain its S&P Global Ratings-adjusted debt to debt plus equity below 50% with debt to EBITDA returning below 11.0x over the next 24 months.

### Downside scenario

We could lower the rating if Klepierre changes its approach to its subsidiary in a way that could lead us to revise our view of S&S's status within the group. Given the rating on S&S is in line with the rating on Klepierre, we could lower our long-term rating on Klepierre--and hence on S&S--in the following cases:

- A resurgence of the pandemic with additional restrictions lasting beyond first-half 2021, and a slower-than-currently expected ramp-up of vaccinations in Europe;
- Prolonged deterioration of operating performance, for example, from a material increase in vacancies as a result of a weakened tenant base, or a higher-than-expected asset portfolio devaluation;
- A shift in lease fundamentals, with, for example, a material increase in the variable portion of total rental income;
- S&P Global Ratings-adjusted debt to debt plus equity moving above 50% for a prolonged period; or
- S&P Global Ratings-adjusted debt to EBITDA failing to revert below 11.0x over the next two

years.

Although it would potentially not result in a downgrade, we would likely revise down our SACP on S&S if further asset rotation results in a smaller and even more concentrated portfolio, or if we revise our liquidity assessment to less than adequate.

### Upside scenario

Given the rating on S&S is in line with the rating on Klepierre, we might consider raising the rating on S&S over the next 24 months in the following conditions:

- If Klepierre makes a sustainable return to positive organic revenue and portfolio value growth, proving stronger-than-anticipated resilience of the company's business model in the currently challenging retail environment; and
- S&P Global Ratings-adjusted debt to debt plus equity (fair-value adjusted) is maintained below 40%, as a result of a change in Klepierre's financial policy.

## Company Description

S&S is a Norwegian retail property company operating in Scandinavia that owns five shopping centers in Norway (29% of portfolio value), five shopping centers in Sweden (35%), and three shopping centers in Denmark (36%), with a portfolio valued at about €2.9 billion at June 30, 2021. The company is a fully integrated subsidiary of France's Klepierre, one of the leading shopping center owners in Europe, with a presence in about 12 countries. Most shares are held by Strøm Holding Norway AS, which is indirectly 56.1%-owned by Klepierre. SAS's secondary shareholder is APG, a Dutch pension fund, which owned 43.9% of its shares at Dec. 31, 2020.

## Our Base-Case Scenario

### Assumptions

- A revenue decline of 15%-20% in 2021 following weak organic performance, along with the loss of contributions from recently disposed assets. We expect revenue growth to pick up gradually with 2.0%-3.0% annual increases in 2022-2023 as the market moves toward gradual recovery.
- Some pressure on the occupancy rate at about 92%-93% in 2021, after a drop recorded in 2020, because the market remains challenging. We expect a gradual recovery in occupancy to historical levels as the recovery kicks in.
- A 3%-5% decline in asset valuations in 2021, and a flat revaluation thereafter.
- A moderate EBITDA margin of about 77%-79%.
- No material acquisitions and recent disposals of about NOK4.1 billion in 2021.
- Annual development capital expenditure (capex) of NOK300 million-NOK320 million, in line with the company's strategy.
- Annual dividend payments of NOK800 million-NOK900 million, along with some extraordinary payments in 2021 following the asset sale.

- An average cost of debt of 1.9%-2.0%.

### 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 38%-39% in 2021.
- Debt to EBITDA of 8.5x-9.5x.
- EBITDA to interest coverage to remain above 4.5x from 2021, compared with 6.3x for the 12 months ended Dec. 31, 2020.

## Liquidity

We assess S&S's liquidity as adequate. We anticipate that liquidity sources will likely cover uses by above 1.5x for the 12 months from July 1, 2021. Sources, such as cash on the balance sheet, combined with proceeds from asset disposals, will leave plenty of headroom for uses. Furthermore, we believe S&S has particularly strong credit characteristics such as well-established and solid relationships with banks and a high standing in the credit markets--partly because it belongs to a creditworthy group--and generally prudent risk management.

Over the 12 months started July 1, 2021, we expect principle liquidity sources will include:

- Unrestricted cash balances of about NOK382 million.
- Undrawn bank lines of about NOK2.2 billion.
- Funds from operations of about NOK950 million-NOK1,000 million.
- Proceeds from committed asset sales of NOK4,100 million.

Principal liquidity uses include:

- About NOK2.8 billion of debt maturities for the 12 months started July 1, 2021.
- Capex of about NOK300 million.
- Dividend payments of about NOK1,600 million-NOK1,700 million.

## Covenants

We understand that S&S has financial covenants for its existing debt. We estimate that the headroom for these covenants is adequate (more than 10%).

S&S has to comply with the following covenants:

- A minimum book equity ratio of 20%.
- Some subsidiaries have loan agreements with a loan-to-value covenant of less than 65%.
- Certain loan agreements contain a change of control event provision that is triggered should the Klepierre Group cease to own (directly or indirectly) 50% of the shares in S&S.

## Ratings Score Snapshot

Issuer Credit Rating: BBB+/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)
- 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

- Group credit profile: BBB+
- Entity status within group: Core (+1 notch 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
- 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

## Ratings List

| Ratings Affirmed | |
|---|---|
| **Steen & Strom AS** | |
| Issuer Credit Rating | BBB+/Stable/-- |