

Rating Action: Moody's affirms Castellum AB's Baa2 issuer rating; outlook stable

04 Aug 2021

Stockholm, August 04, 2021 -- Moody's Investors Service ("Moody's") has today affirmed Swedish real estate company Castellum AB's (Castellum) long-term issuer rating of Baa2. Concurrently, Moody's has affirmed the ratings on the Euro Medium Term Note Programme of (P)Baa2 and the senior unsecured bond Baa2. The outlook remains stable.

RATINGS RATIONALE

On 2 August, Castellum announced that it has launched a public offer to acquire all shares in Kungsleden AB (Kungsleden). Total offer value amounts to SEK 26.86 billion and will be paid up to 70% via shares in Castellum, with the remainder 30% to be paid in cash. The bid represents a premium of ca. 20% compared to Kungsleden's share price during the last 90 trading days.

We view the transaction as initially credit negative for Castellum because it will reduce the company's rating capacity as it will effectively elevate its financial leverage to ca. 47% Moody's-adjusted debt to assets (pro-forma for the combined entity as of end June 2021), leaving it outside of the current rating guidance. The temporary increase in leverage will be balanced by the company's strong commitment to its current Baa2 rating and the targeted reduction of leverage towards a level of below 45% by year-end 2021 to be supported by disposals of non-core assets, additional refinancing measures including the issuance of hybrid capital, among others. The targeted disposals of non-core assets will also likely improve the overall portfolio composition and strategic focus in terms of locations and asset classes.

In spite of the typical execution risks associated with a large merger, we recognize that for the transaction at stake, these are well balanced by the positive recommendation by Kungsleden's board of directors as well as the 26% acceptance rate already secured from main shareholders of Kungsleden.

More positively the transaction takes advantage of consolidation opportunities within the Swedish real estate market, by potentially creating a combined company with a notable scale of around SEK140 billion pro forma end of June 2021 or SEK157 billion, if considering recent acquisitions and Castellum's share in Entra ASA (currently at 18%). The combined entity will benefit from a strong overlap in terms of cities and asset classes that will likely offer operational and financial synergies along the integration process. The combined entity will remain focused on the office segment (58%) in strong locations including Stockholm (32% of GAV) and benefit as well as from an important component of rental income derived from public sector tenants (23% as estimated by the company). The combined property portfolio will remain broadly diversified across other asset classes such as warehouses and logistics properties (13% of GAV), retail (7%), a development project portfolio (6%) and others (3%). Castellum also has an important landbank that spans 1.5 million square metres, which is largely earmarked to develop new prime office properties or prime logistics assets, with equally or even higher quality compared to the recent disposed logistics portfolio sold to Blackstone.

OUTLOOK

The stable view incorporates our expectation that value and earnings-based leverage metrics will return to levels commensurate with the company's Baa2 rating guidance, in line as well with historical levels. We also expect the company to maintain an unchanged solid liquidity, accessing capital markets and securing sufficient liquidity in the context of the transaction, including any imminent refinancing needs triggered by the potential change of control at Kungsleden at the end of October 2021.

Finally, the stable outlook also incorporates the expectation that Castellum's business strategy, development and other investment activities remain commensurate with a conservative financial policy and business management.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Over the last months governance concerns at Castellum included the resignation of both CEO and CFO, with

no replacements announced. The fact that Rutger Arnhult, the group's chairman owns a material share in Castellum as well as in two other competing real estate companies Klöver and Corem; which raised the risks of conflicts of interests with a potential reduction in reporting transparency. In this context, the intended onboarding of the existing Kungsleden's Management into Castellum's top management structure can be regarded as a credit positive, also considering the solid track record of Kungsleden's CEO and CFO.

As a listed company, Castellum's financial policy is to keep its reported LTV below 50%. However, the company has sustainably kept its effective leverage below the 45% level, consistent with the requirements for its Baa2 rating. Company's commitment to financial policies that support its current rating have been confirmed in the context of the aimed merger.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of the ratings could occur if:

- Effective leverage goes below 40%, as measured by Moody's-adjusted gross debt/assets, together with a declining trend from net debt to EBITDA and financial policies that support the lower leverage
- Fixed charge coverage is above 4.5x on a sustained basis
- Increasing senior unsecured borrowing lead to an increase of the pool of unencumbered assets to above 60% whilst at the same time further improves liquidity and the average length of its debt maturity profile

A downgrade of the ratings could occur if:

- Effective leverage sustained above 45% or net debt to EBITDA not returning to historical levels
- Fixed charge coverage sustained below 3.5x
- Heavy reliance on short-term funding, especially if it is no longer backed by undrawn longer-dated credit facilities
- Weaker market fundamentals, resulting in falling rents and asset values
- More aggressive growth strategy leading to higher business risks or greater capital needs in the future.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms Methodology published in July 2021 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1272320 . Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

COMPANY PROFILE

Castellum is a major listed real estate company in Sweden. The company's SEK97 billion portfolio of office, retail, warehouse and logistics properties spans 3.8 million square metres and generates about SEK5.9 billion in rental income annually. The company has a decentralized organisational structure and a strong presence in Sweden, Denmark and Finland.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288435.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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