Compactor Fastigheter AB
Sweden, Investment Holding

BBB- Stable

Ratings & Outlook

Issuer	BBB-/Stable
Short-term debt	S-3
Senior unsecured debt	BBB-

Analyst

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Related Methodology and Related Research

Corporate Rating Methodology; July 2022

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Total cost coverage	3.9x	2.7x	2.1x	2.0x
Scope-adjusted loan/value ratio (LTV)	6.3%	7.3%	13.6%	

Rating rationale

The rating is driven by Compactor's high total cost coverage, based on stable recurring dividend income and very limited mandatory costs, anticipated to remain around 2x going forward. The rating is further supported by the low Scope-adjusted LTV, which provides additional headroom in these currently volatile times. Credit strengths include the liquidity of the company's assets, with almost 100% of gross asset values (GAV) being listed holdings, and its long-term buy-and-hold approach on its two core investments in Fastpartner and SBB i Norden.

The rating is constrained by Compactor's limited diversification in terms of recurring income-providing holdings, and its concentrated portfolio that depends on a medium-cyclical real estate industry exposure. A further constraint is the company's modest geographical diversification with the majority of its income exposed to Sweden, albeit mitigated by the country's mature and stable economy.

Outlook and rating-change drivers

The Outlook for Compactor is Stable and incorporates the assumption of the company continuing to hold its main long-term holdings in Fastpartner and SBB i Norden in addition to liquid Nordic blue-chip stocks. It further incorporates our expectation that the company will not engage in further debt-financed increases in shareholdings and thereby keep its leverage, as measured by Scope-adjusted LTV, between 10-15% while maintaining total cost coverage at around 2x.

A negative rating action would be possible if Compactor's total cost coverage deteriorated below 1.3x on a sustained basis. This could occur if its main holding Fastpartner were unable to pay dividends.

A positive rating action is remote but could be warranted if the company's holdings diversified towards a larger share of non-commercial real estate. This could be the result of a more granular investment portfolio through either the organic growth of its non-commercial real estate exposure or a reshuffling of investments.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
7 Sep 2022	Affirmation	BBB-/Stable
15 Sep 2022	Affirmation	BBB-/Stable
10 Sep 2022	Initial rating	BBB-/Stable

Positive rating drivers	Negative rating drivers
• Very strong cost coverage with expectation of total cost coverage sustained around 2x • Modest LTV at currently 14%, despite significantly reduced market values of holdings • Highly liquid assets as almost 100% of holdings by GAV are listed shares • Long-term strategy regarding two core holdings, Fastpartner and SBB i Norden, assuring stable and recurring revenues	• Limited diversification in terms of holdings that provide recurring revenues, somewhat mitigated by the company's capacity to keep mandatory cost coverage above 1x even without income from core holdings • Concentrated portfolio dependent on the medium-cyclicality real estate industry, somewhat mitigated by underlying tenant/industry diversification • Weak geographical diversification with most recurring income exposed to Sweden

Positive rating-change drivers	Negative rating-change drivers
• Larger share of non-commercial real estate in the portfolio, improving diversification	• Total cost coverage deteriorating to below 1.3x on a sustained basis

Corporate profile

Compactor Fastigheter AB (Compactor), founded in 1988 by Sven-Olof Johansson, is a Swedish investment company specialising in direct and indirect real estate and equity investments. Compactor has two core shareholdings that are also publicly listed, 71.6% of Fastpartner AB and 3.3% of SBB i Norden, alongside a diverse portfolio of listed Nordic blue-chip companies. The investment holding focuses on the receipt of recurring dividend payments from its different shareholdings.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Total cost coverage	3.9x	2.7x	2.1x	2.0x	2.2x
Total cost coverage (recurring – mandatory expenses)	3.9x	5.2x	3.4x	3.1x	3.3x
Scope-adjusted LTV	6.3%	7.3%	13.6%		
Total income in SEK m					
Dividends from Fastpartner	248.9	349.9	312.5	323.3	336.4
Income from associated companies	0.0	0.0	0.0	0.0	0.0
Dividends from investments	15.8	111.9	151.5	158.3	166.0
Interest received	3.8	6.6	0.0	0.0	0.0
Recurring income	**268.5**	**468.4**	**464.0**	**481.6**	**502.4**
Income from asset sales	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**268.5**	**468.4**	**464.0**	**481.6**	**502.4**
Total expenses in SEK m					
Operating expenses	1.0	1.2	1.2	1.3	1.3
Interest expenses	38.5	40.0	46.5	65.2	55.8
Dividend paid	0.0	80.0	80.0	80.0	80.0
Taxes paid	29.1	49.6	89.0	88.7	95.2
Operating expenses	**68.6**	**170.8**	**216.7**	**235.2**	**232.4**
Scope-adjusted debt in SEK m					
Reported gross financial debt	1,051.9	1,861.6	1,861.6	1,861.6	1,861.6
less: subordinated (hybrid) debt	0.0	0.0	0.0	0.0	0.0
less: cash and cash equivalents	-93.8	-113.5	-289.6	-385.8	-505.5
add: non-accessible cash	0.0	0.0	0.0	0.0	0.0
add: pension adjustment	0.0	0.0	0.0	0.0	0.0
add: operating lease obligations	0.0	0.0	0.0	0.0	0.0
Other items	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt	**958.1**	**1,748.1**	**1,572.0**	**1,475.8**	**1,356.1**

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Environmental, social and governance (ESG) profile[1]

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Business risk profile: BB

Weighted average industry risk: BB+

Compactor is predominantly exposed to commercial real estate (industry risk: BB), which represented 81% of its gross asset value (GAV) as of Q2 2022 and 70% of its expected income in 2022. Its second largest exposure is also to real estate, but to the residential and Social infrastructure segments (industry risk: A), with 8% of GAV and 15% of income. In total, the real estate industry accounts for 89% of GAV and 85% of income, dwarfing other exposures to banks, retail corporates and Trucking. The decreased share relating to real estate in 2022 compared to 2021 is explained by i) resumption of banking and retail dividend receipts, and ii) a decline in Swedish real estate share prices in H1 2022.

Figure 1: Industry risk

	Mvalue/ GAV	Income based	Cyclicality	Market entry barriers	Substitution risk	Industry rating
Commercial real estate	80.0%	68.1%	Medium	Medium	Medium	BB
Residential real estate	9.2%	16.7%	Low	Medium	Low	A
Bank	4.4%	7.6%	na	na	na	na
Retail	3.7%	4.4%	Medium	Low	Low	BBB
Business services	0.4%	0.0%	Medium	Medium	Medium	BBB
Trucks	1.6%	2.9%	High	High	Medium	BB
IT	0.3%	0.0%	Medium	Medium	Medium	BBB
Capital goods	0.4%	0.0%	Medium	Medium	Medium	BBB
Healthcare	0.1%	0.0%	Medium	Low	Low	A
FMCG	0.0%	0.0%	Medium	Low	Low	A
Oil & gas upstream	0.0%	0.0%	High	Medium	Low	BB
Weighted Industry risk	**BB+**	**BB+**				

Sources: Company accounts, Bloomberg, Scope estimates

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Long-term holding of core investments Fastpartner and SBB i Norden

Compactor's investment approach is buy-and-hold, which focuses on cash flows from recurring dividends through its investments in real estate corporates. We regard Compactor's investment approach to be rather conservative as it avoids market timing its investments/divestments during periods of shareholding GAV fluctuations. For its core investments, the company has been willing to participate in capital increases and grant shareholder loans, demonstrated through its participation in Fastpartner's D-share issuance in 2021 on a pro-rata basis to defend its 72% shareholding.

Along with the buy-and-hold activities within real estate, the company has a small portion of assets, as measured by GAV/market value, in liquid minority shareholdings. Financial support for such holdings is considered to be very limited. These investments are considered mostly long-term by management and the aim is to receive recurring dividend income and benefit from potential improvements in the market values of shareholdings.

In addition, Compactor has a third pillar of strategic holdings. These include venture capital, among other investments, with limited short-to-medium-term financial performance expectations.

Buy-and-hold strategy providing recurring income streams improves credit quality

We regard a buy-and-hold investment strategy that focuses on cash flows from recurring dividend income to be positive for the credit quality of an investment holding, whereas a dependence on non-recurring income from well-timed asset disposals could create larger swings of cost coverage and lead to fire sales.

Real estate holdings

The two core holdings of Compactor are i) a 71.6% stake in Fastpartner (rated BBB-/Stable by Scope), a medium-sized commercial real estate company based in Sweden with property assets worth SEK 37bn; and ii) 3.3% of the capital and 7.3% of votes in Samhällsbyggnadsbolaget i Norden (rated BBB/Stable by Scope), a residential and social infrastructure real estate company with properties worth SEK 157bn. These two holdings translate into 77% and 9% respectively of the portfolio's market value/GAV as of Q2 2022.

In addition, Compactor indirectly owns 18 investment properties with a value of SEK 237m through its subsidiary HS Fastigheter.

Shareholdings

While there is some level of trading activity, Compactor generally follows a long-term approach to investing. In 2022, Compactor reinvested its 2021 net profit, and also reinvested proceeds from the increased bond refinancing into existing and new investments. Retailer H&M remains the largest investment in the portfolio by GAV at end-June 2022, followed by new investment Atrium Ljungberg (real estate) and existing significant investments in banks (Nordea, Swedbank, Handelsbanken and newly SEB). The exposure to the banking sector (4.4%) is therefore larger than to the retail sector (3.6%) in terms of market capitalisation. The stakes in the aforementioned companies, as well as all other listed companies, are held for purely financial reasons, with the company intending to benefit from recurring dividend income.

Limited diversification with only two core holdings

Compactor's two core holdings – as defined by each representing more than 5% of GAV – make up 86% of its total GAV. This limited diversification leads to higher volatility of the company's LTV, as a decline in value of one of its shareholdings will have a more significant impact.

The remaining seven dividend-paying holdings are distributed across various sectors. The high number of income-generating undertakings benefits Compactor's ability to offset the impact of a missed dividend payment from all shareholdings except for the largest, Fastpartner, and hence leads to more stable cost-coverage.

Compactor's geographical diversification is modest, with 90% of income arising from Sweden and a small amount from across the Nordics. The company's performance therefore hinges on the macroeconomic development of Sweden and, to a lesser extent, on the Nordic countries. However, these countries have mature and stable economies with strong welfare and social systems. The latter softens the economic burden in times of distress, as can be seen during the current pandemic, with labour costs being partially borne by the state and subsidies provided for fixed costs like rent, resulting in negligible rental losses for commercial real estate owners. The remaining investments relate to Nordic or European activities through large-cap banks (though with a bias on Sweden) and global activities through retailer H&M and manufacturing company Volvo.

Highly concentrated income stream by industry

The portfolio is highly concentrated by industry: two industries, commercial real estate and residential/social infrastructure real estate, represented 89% of GAV and 84% respectively of recurring income in 2022. Commercial real estate, the largest industry of Compactor's holdings by far, is exposed to medium cyclicality, resulting in a risk that recurring income could be affected by a weakening in the Swedish economy.

The high concentration in terms of holding industries is somewhat mitigated by the diversity of each holding's sub holdings. Fastpartner, accounting for 79%/66% by GAV/income as of Q2 2022, is exposed to a varied mix of industries through its tenants, with the largest (government) accounting for only 12% of rental income. Supporting the industry diversification is the quality of Fastpartner's tenants. Its top 20 tenants are good investment grade (blue chips/government agencies) and the overall tenant portfolio is assessed as BBB-. In addition, tenant diversification is moderate with the top 10 only accounting for 19.1% of rental income.

The same level of industry diversification also applies to Fastpartner's second largest exposure, SBB i Norden, whose portfolio is split into low-risk residential real estate (42%) and social infrastructure real estate (58%). Of the latter, 64% is exposed to defensive industries like elderly care, hospitals and government infrastructure.

Liquidity is a strength thanks to all holdings being stock-listed

All of Compactor's financially relevant holdings in terms of GAV or income are publicly listed companies. Compactor holds most of its real estate through either Fastpartner or SBB i Norden, both of which are stock-listed companies in well-developed markets with high trading volumes. As such, these holdings could provide cash inflows through partial liquidation if needed.

Given the dominant shareholding in Fastpartner (72%), the company enjoys a relatively limited free-float. Smaller blocks of shares could be sold on the stock exchange, but larger blocks would need a trade sale. Transactions in the Swedish real estate market, such as Vonovia's acquisition of Hembla and Victoria Park and SBB i Norden's acquisition of Hemfosa and the majority of Offentliga Hus, supports this as a viable option. However, Compactor's strong financial risk profile and mission statement to be an owner in Fastpartner means it is unlikely to resort to such an action.

The remainder of Compactor's holdings are in large Nordic blue-chip stocks, which provide a daily trading volume that exceeds Compactor's shareholdings. As such, liquidity is viewed as a strength for Compactor's business risk profile assessment.

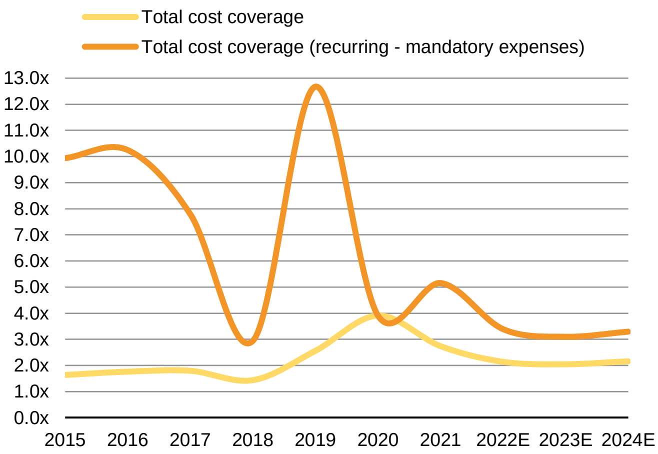
Financial risk profile: A-

For an investment-grade-rated holding, we expect total cost coverage from recurring income streams of well above 1.0x. Compactor has been well above 1.0x in the past, with a low of 1.4x in 2018 due to significant tax payments. In general, the company has very limited overhead costs of around SEK 1.2m due to its buy-and-hold approach, with no interference in its holdings. Its operating expenses consist of salaries, auditor fees, interest payments arising from a low amount of debt and tax payments. In October 2020, a maturing SEK 500m bond was refinanced with a SEK 750m bond, which has since been tapped twice to reach the maximum allowed SEK 1,000m. This bond was at a more favourable spread (3mStibor+250bps), down by 150bps compared to the one it refinanced, reducing the interest burden. In 2021 the company raised additional funds through a SEK 600m bond at even tighter spreads (3mStibor+210bps). Compactor distributes a discretionary dividend to its shareholders, which has been SEK 80m annually for the past five years. The company suspended dividends in Q1 2020 in light of the unfolding pandemic but resumed payments in 2021 at levels similar to previous years. Excluding the discretionary dividend, the company's cost coverage was 3x at its lowest point.

The main contributor to recurring income is the predictably growing dividend from Fastpartner, with additional dividend income from SBB i Norden and Nordic blue-chip companies. In 2020, the contribution from listed Nordic shares dipped compared to that in previous years due to pandemic-induced dividend suspensions. H&M paid no dividends in 2020 and only resumed in autumn 2021. The Nordic banks postponed payments in 2020 due to regulatory pressure. Nordea, Swedbank and Handelsbanken resumed dividend payments in 2021, including previously postponed payments, which boosted Compactors FY2021 result.

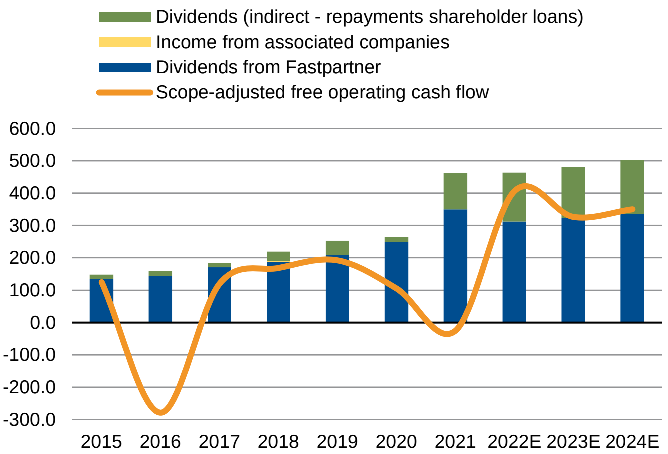
Scope-adjusted free operating cash flow, excluding discretionary investments in its share portfolio, was impacted negatively in 2016 when Compactor participated fully in Fastpartner's capital increase, resulting in cash outflows of SEK 550m. Since then, Compactor had only minor investments into its majority shareholding in Fastpartner until its participation in the D-share issuance in September 2021. Therefore, apart from in 2016, Scope-adjusted free operating cash flow has been positive and is expected to remain so for 2022, demonstrating good earnings capacity.

Figure 2: Total cost coverage



Sources: Compactor, Scope estimates

Figure 3: Cash inflows and outflows (SEK m)



Sources: Compactor, Scope estimates

Mandatory cost coverage is highly resilient to vanishing income streams

We assess Compactor's total cost coverage to be highly resilient to a reduction in income streams. In our stress test, recurring dividend income had to reduce by 90% in the scenario of unchanged outcome for the coverage of mandatory costs (excluding dividends) to fall below 1.0x in 2023 and necessitate the conversion of liquid assets. This also excludes cash on the balance sheet, which would still fully cover costs.

We calculate an investment holding's leverage by taking into account the market value of the portfolio of shareholdings, loans granted and fixed-income products relative to debt (Scope-adjusted debt) at the holding level (LTV). It is noted that such market gearing can be very volatile due to the volatility of share prices and changing valuation multiples, depending on current market conditions.

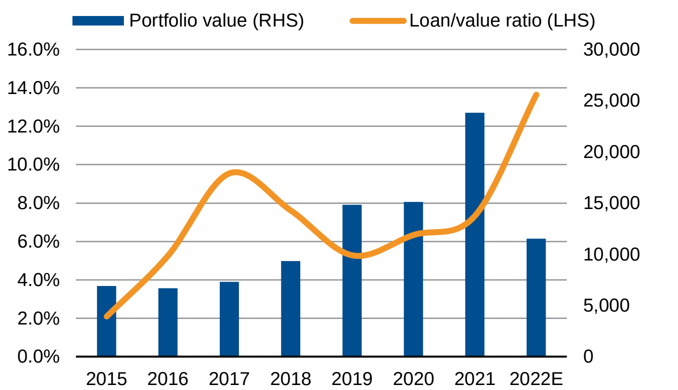
The company's low Scope-adjusted LTV starting point, standing at 7.3% at end-2021, improved as a result of the sell-off in Swedish real estate shares (and equities in general) in H1 2022. Compactor's Scope-adjusted LTV increased to 13.6% at end-August 2022 due to the significantly reduced market value of its holdings. However, Compactor's LTV is still relatively low given market stress, which we views as credit-positive.

Our calculation of LTV has been between 2% and 9.5% over the last six years, which demonstrates Compactor's conservative risk profile.

2020 'stress test' showed resilience of core holdings

Several of Compactor's largest blue-chip investments suspended dividend payments in 2020, resulting in a certain degree of stress testing of Compactor's business model. The performance of its largest exposures, Fastpartner and SBB i Norden, were only negligibly impacted during the current pandemic, demonstrating the resilience of Compactor's business model.

Figure 4: Loan/value and portfolio market value (SEK m)



Sources: Compactor, Scope estimates

Figure 5: Sensitivity of Scope-adjusted loan/value

		Portfolio market value (SEK bn)							
		15.0	13.8	12.7	11.5	10.4	9.2	8.1	6.9
Scope-adjusted debt (SEK bn)		30%	20%	10%	0%	-10%	-20%	-30%	-40%
1.6	0.0%	10.5%	11.4%	12.4%	**13.6%**	15.2%	17.1%	19.5%	22.7%
1.8	12.5%	11.8%	12.8%	14.0%	15.4%	17.1%	19.2%	21.9%	25.6%
2.0	25.0%	13.1%	14.2%	15.5%	17.1%	19.0%	21.3%	24.4%	28.4%
2.2	37.5%	14.4%	15.6%	17.1%	18.8%	20.8%	23.5%	26.8%	31.3%
2.4	50.0%	15.7%	17.1%	18.6%	20.5%	22.7%	25.6%	29.2%	34.1%
2.6	62.5%	17.1%	18.5%	20.2%	22.2%	24.6%	27.7%	31.7%	37.0%
2.8	75.0%	18.4%	19.9%	21.7%	23.9%	26.5%	29.9%	34.1%	39.8%
2.9	87.5%	19.7%	21.3%	23.3%	25.6%	28.4%	32.0%	36.6%	42.6%

Sources: Compactor, Scope estimates

We assess Compactor's liquidity to be adequate given i) positive Scope-adjusted free operating cash flow of SEK 406m forecasted for 2022; ii) the undrawn portion of loan facilities worth SEK 200m; iii) unrestricted cash of SEK 114m (as at end-June 2022); iv) a highly liquid portfolio of blue-chip shares that could be unwound at short notice, worth SEK 1.4bn (as at end-June 2022); and v) Compactor's only short-term debt being bank debt currently valued at 195m outstanding, which is also part of a framework agreement normally rolled over.

Balance in Total income in SEK m	2022E	2023E
Unrestricted cash (t-1)	114	290
Open committed credit lines (t-1)	208	208
Free operating cash flow	406	326
Short-term debt (t-1)	262	1,262
Coverage	**278%**	**65%**

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

At the end of Q2 2022, Compactor had SEK 195m in senior unsecured bank debt in addition to SEK 1,600m in senior unsecured bonds. Senior unsecured debt benefits from a relatively high unencumbered asset ratio of more than 570%, according to our calculations, providing a high pool of collateral to debtholders.

We therefore rate senior unsecured debt at the issuer's level of BBB-.

Short-term debt: S-3

The S-3 short-term rating is supported by adequate liquidity, good banking relationships, and adequate access to diverse funding sources.

Appendix

In order to assess an investment holding company's financial strength we use financial data provided in the standalone (holding company) accounts as the source for calculating key financial credit metrics. We do not include financial data from consolidated financials in our calculations of key credit ratios for the following reasons: i) cash flows or liquidity of portfolio companies as shown in consolidated accounts may not be accessible at the holding company level and ii) an investment holding company may not have any influence over a portfolio company's dividend policy. We use the following key credit metrics to gauge the financial risk profile of an investment holding company:

- Total cost coverage;
- Leverage (LTV);
- Liquidity.

We use total cost coverage as the key indicator. We define the total cost coverage ratio as cash inflows versus non-discretionary cash outflows at the holding company level.

Cash inflows at holding company level included in our calculation are:

- Cash inflows from portfolio companies such as dividends or cash payments triggered by profit-sharing agreements;
- Cash-interest inflows from treasury activities such as investments in debt securities;
- Distributions from other investments such as investment funds or money market funds;
- Any other recurring cash-effective payments received from portfolio companies such as management fees.

Cash proceeds from divestments in portfolio companies are only included as a cash inflow if we expect these to recur annually.

Non-discretionary cash outflows included in our calculation are:

- Cash outflows from debt servicing (cash interest) and, if applicable, non-cash interest accruing on debt instruments;
- Dividend payments made by the investment holding company to its shareholders. We are aware that the nature of dividend payments is more akin to a discretionary cash outflow. For the purpose of calculating total cost coverage, we treat dividend payments as non-discretionary until the investment holding company publicly declares significant changes to its dividend payments.
- General holding company costs such as administrative expenses, staff costs and taxes.

We calculate an investment holding company's leverage by taking into account the portfolio's market value relative to the adjusted debt position (Scope-adjusted debt) at holding company level. The debt position not only includes short-term and long-term financial debt, but also adjustments for pension provisions, operating leases and other off-balance sheet items such as guarantees.

We use the LTV ratio as a supplementary ratio within our financial risk assessment. This is to avoid market prices of listed assets mechanically changing financial ratios, including the financial risk profile. We believe that changes in the market prices of listed assets are only important if an investment holding company faces debt maturities over the course of the next 12-24 months. Purely focussing on LTV can be misleading because this ratio does not capture the dimension of an investment holding company's debt maturity profile. If an investment holding company can cover its non-discretionary cash outflows, as mentioned above, there is no need for additional funding. Therefore, the dependence and relevance of price changes for listed assets can only be judged with regard to debt maturities over the course of the next one to two years.

We assess the liquidity of an investment holding company in the same way as for any other non-financial corporate, taking into account the holding company's ability to pay its short-term debt using free operating cash flow, unrestricted cash and marketable security positions, unused committed bank facilities, and unused committed factoring lines.

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