Compactor Fastigheter AB
Sweden, Investment Holding

SCOPE BBB- Stable

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 holds two core shareholdings, 72.3% of stock-listed Fastpartner AB and 3.3% of stock-listed SBB i Norden, beside a diverse portfolio of investments in listed blue-chip companies in the Nordics. The investment holding focuses on the receipt of recurring dividend payments from its different shareholdings.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Total cost coverage (x)	1.4x	2.6x	4.7x	2.0x
Total cost coverage (recurring – mandatory expenses) (x)	2.9x	12.7x	4.7x	3.9x
Scope-adjusted Loan/value ratio (%)	8%	5%	<10%	

Rating rationale

Scope assigns a first-time issuer rating of BBB-/Stable to Compactor Fastigheter AB.

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 above 2x going forward. The rating is further supported by the low loan/value ratio of 6% as at end June 2020, 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 a continuation of the company's main long-term holdings in Fastpartner and SBB i Norden in addition to its investment in liquid blue-chip stocks in the Nordics. 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 loan/value ratio, below 10% while maintaining total cost coverage at around 2x going forward.

A negative rating action would be possible if Compactor's total cost coverage deteriorated below 1.3x on a sustained basis. This could be the result of its main holding Fastpartner not being able to pay dividends.

A positive rating action is remote but could be warranted if the company diversifies its holdings, allowing for 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 exposure to non-commercial real estate or a reshuffle of investments.

Ratings & Outlook

Corporate ratings	BBB-/Stable
Short-term rating	S-3
Senior unsecured rating	BBB-

Analyst

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Related Methodology

Corporate Rating Methodology, February 2020

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Rating drivers

Positive rating drivers	Negative rating drivers
• Very strong cost coverage with expectation of a sustained total cost coverage above 2x • Very modest loan/value ratio at currently 6%, which even under high market volatility (35% drop) would not rise above 10% • Highly liquid assets as almost 100% of Compactor's holdings by GAV are listed shares • Long-term strategy in holding its two core holdings Fastpartner and SBB i Norden assures 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 its core holdings • Concentrated portfolio dependent on the medium-cyclical real estate industry, somewhat mitigated by the underlying tenant/industry diversification of its holdings • Weak geographical diversification with the majority of recurring income exposed to Sweden

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Diversification of holdings, allowing for a larger share of non-commercial real estate	• Total cost coverage to drop below 1.3x on a sustained basis

Financial overview[1]

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Total cost coverage	1.4x	2.6x	4.7x	2.0x
Total cost coverage (recurring – mandatory expenses)	2.9x	12.7x	4.7x	3.9x
Scope adjusted Loan/value ratio	8%	5%	<10%	
Total income in SEK m	**2018**	**2019**	**2020F**	**2021F**
Dividends from Fastpartner	188	209	249	262
Income from associated companies	2	0	0	0
Dividends from investments	29	44	28	51
Interest received	6	4	3	3
Recurring income	225	257	280	316
Income from asset sales	0	0	0	0
Total income	225	257	280	316
Total expenses in SEK m	**2018**	**2019**	**2020F**	**2021F**
Operating expenses	-1	-1	-1	-1
Interest expenses	-32	-33	-32	-32
Tax payments	-44	13	-27	-47
Dividend paid	-80	-80	0	-80
Total expenses	-156	-100	-59	-160
Scope-adjusted debt in SEK m	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	730	795	795	795
less: cash and cash equivalents	-21	-14	-33	-38
add: cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other	0	0	0	0
Scope-adjusted debt	710	782	762	757

[1] All numbers are rounded

Business risk profile: BB

Weighted average industry risk: BB+

Compactor is predominantly exposed to the commercial real estate industry (industry risk: BB), which represents 83% of the company's net asset value and 82% of its income earned in 2019. The second largest exposure remains in real estate, but to social infrastructure and residential real estate (industry risk: A), with 11.2% as measured by net asset value (NAV) and 5.1% as measured by income. Hence 94% of its NAV or 87% of its income is exposed to the real estate industry (see also Scope's Methodology: European Real Estate Corporates), dwarfing the other exposures to banks and retail corporates.

Figure 1: Industry risk assessment: Compactor's portfolio companies

	Mvalue/ NAV	Income based	Cyclicality	Market entry barriers	Substitution risk	Industry rating
Commercial RE	82.8%	82.0%	Medium	Medium	Medium	BB
Residential RE	11.2%	5.1%	Low	Medium	Low	A
Bank	2.8%	4.0%	na	na	na	na
Retail	2.6%	8.9%	Medium	Low	Low	BBB
Business service	0.2%	0.0%	Medium	Medium	Medium	BBB
Trucks	0.1%	0.0%	High	High	Medium	BB
IT	0.0%	0.0%	na	na	na	na
Capital goods	0.0%	0.0%	Medium	Medium	Medium	BBB
Healthcare	0.0%	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+**				

Source: Company accounts, Bloomberg, Scope estimates

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

Compactor's strategy is a so-called 'buy-and-hold' investment approach, which focuses on cash flows from recurring dividends through its investments to real estate corporates. We regard Compactor's investment approach to be rather conservative as the holding avoids the pressure from market timing for its investments and divestments stemming from fluctuations in the net asset value of shareholdings. For its core investments, the company has been willing to participate in capital increases and grant shareholder loans.

Along with the buy-and-hold activities within real estate, the company has a small portion of assets in liquid minority shareholdings. We consider financial support for such holdings 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 shareholdings' market value.

In addition, Compactor has a third pillar of strategic holdings which includes venture capital, among other investments, with limited financial performance expectations.

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

We regard the impact of such a buy-and-hold investment strategy, which focuses on cash flows from recurring income in terms of dividend streams, to be positive for the credit quality of an investment holding. On the contrary, the dependence on non-recurring income from well-timed asset disposals would create larger swings of cost coverage and could lead to unfavourable fire-sales.

Real estate holdings

The two core holdings of Compactor are i) a 72.3% stake in Fastpartner (rated BBB-/Stable by Scope), a medium-sized commercial real estate company based in Sweden with property assets worth SEK 30bn; and ii) the ownership of 3.8% of capital/7.7% of votes in SBB i Norden (Samhällsbyggnadsbolaget i Norden – 'society building company in the Nordics'), a residential and social infrastructure real estate company with properties worth SEK 73bn. In terms of Compactor's portfolio share, these two holdings translate into 83% and 11% as measured by market value/GAV of holdings as of Q2 2020.

In addition, Compactor owns through its subsidiary HS Fastigheter 18 investment properties with a value of SEK 194m.

Shareholdings

While there is some level of trading activity, Compactor generally follows a long-term approach to investing. In 2020, Compactor has been investing its significant annual result from 2019 into several new investments. H&M remains the largest investment in the portfolio by GAV, followed by significant investments in the banking sector, namely Nordea, Swedbank and Handelsbanken (SHB). Compactor's investments in the banking sector (2.8%) therefore overtake those in the retail sector in terms of market capitalisation (2.6%). The stakes in the aforementioned companies as well as all other listed companies are held for purely financial reasons, with the company intending to gain from recurring dividend income.

Limited diversification with only two core holdings

The two core holdings – holdings with a share in excess of 5% of the company's total GAV – of Compactor represent 93% its total GAV. By extending the metrics to recurring dividend income, the core group improves slightly to three holdings, with H&M having contributed 8.9% of income (above the 5% hurdle). We believe that this comparatively limited diversification of the company's GAV leads to higher volatility of the company's loan/value ratio, as a decline in value of one of its undertakings will have a more significant impact.

The remaining 12 dividend-paying holdings are distributed across various sectors and the relatively high number of income-generating undertakings benefits Compactor's ability to offset the impact of an absent dividend payment from one or several undertakings (except for the largest, Fastpartner) and hence leads to a more stable cost-coverage.

Compactor's geographical diversification is modest, with most of the income (87%) benefitting from a diverse spread across Sweden and to a smaller degree across the Nordics. The company's performance will therefore hinge on the macroeconomic development of predominantly Sweden and to a smaller degree on the Nordic region countries, 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 crisis), with labour costs being partially borne by the state and subsidies provided for fixed costs like rent, resulting in decreased rental losses for commercial real estate owners. The remaining investments' activities are of Nordic/European geographical reach for the large-cap banks (though with a home bias) and truly global for the retail exposure through H&M.

Highly concentrated income stream by industry

Compactor shows a highly concentrated portfolio by industry, as it is predominantly exposed to two industries (commercial and residential/social infrastructure real estate) representing 94% of the company's NAV and 87% of its recurring income. As commercial real estate, the largest industry of its holdings by far, is exposed to medium cyclicality, this could impact Compactor's recurring income stream if Swedish economy weakens.

The high concentration in terms of holding industries is somewhat mitigated by moving one layer below. Fastpartner, accounting for 83%/82% (GAV/income) and therefore a driver of the concentration, is exposed to a varied mix of industries of its tenants, with the largest accounting for only 9% of rental income (government). Supporting the industry spread is the quality of tenants in Fastpartner, with the top 20 assessed as good investment grade (blue chips/government agencies) and a total tenant portfolio assessed as BBB-; in addition to a moderate tenant diversification with the top 10 accounting for 18.6%.

This is underpinned by a limited negative impact on rental income of around 2% due to Covid-19-related non-payment or rent relief/discounts. Thanks to significantly lowered operating costs in Q2 2020 due to the pandemic – overcompensating for the slightly reduced income – Fastpartner's cash flow generation actually improved and, with that, its future dividend potential to Compactor.

The same in terms of a broader industry diversification applies for the second largest exposure, SBB i Norden, whose top three underlying industries are education (24%), regulated rent tenants (17%) and government agencies (12%).

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

All of Compactor's financially relevant holdings in terms of GAV or income contribution 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 benefitting from high trading volumes, and as such could provide cash inflows through partial liquidation if needed.

Given the dominant shareholding of Compactor in Fastpartner (73%), the company enjoys a relatively limited free-float. Smaller blocks of shares could therefore be sold on the stock exchange, but for larger blocks Compactor would have to resort to a trade sale. Recent transactions in the Swedish real estate market, with Vonovia buying Hembla and Victoria Park and SBB i Norden acquiring Hemfosa, prove that this would also be a valid option, though unlikely given that the relatively strong financial risk profile will not require such an action in any case and that Compactor's mission statement is to be an owner of Fastpartner.

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, we view liquidity as a strength for Compactor's business risk profile assessment.

Financial risk profile: A-

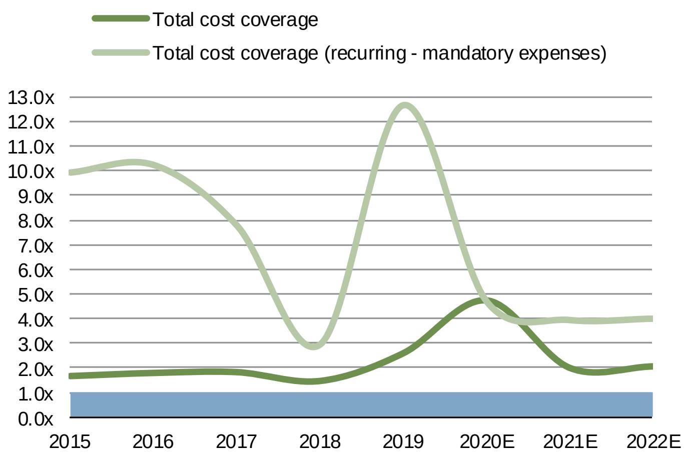
Strong total cost coverage

For an investment-grade-rated holding, we expect a total cost coverage from recurring income streams to be well above 1.0x. Compactor has been well above 1.0x in the past, with the low point at 1.4x in 2018 due to significant tax payments. In general, the company has a very limited overhead costs of below SEK 1m due to its buy-and-hold approach with no interference in its holdings. Its operating expenses result from salaries, auditor fees, interest payments for its low amount of debt, and tax payments. Compactor distributes a discretionary dividend to its shareholders, which has been SEK 80m per annum for the past five years. For 2020 the company has decided to suspend the dividend payment in Q1 2020 in light of the uncertainties of the unfolding crisis and is expected to resume at previous years' levels from 2021. Excluding the discretionary dividend, the company's cost coverage was at 3x at the lowest point.

The main contributor to recurring income is the predictably growing dividend from Fastpartner, with additional dividend income from SBB i Norden and its investments in Nordic blue chips. In 2020 the contribution from listed Nordic shares will likely dip compared to that in previous years along with its dividend potential, due to suspended dividends prompted by the Covid-19 crisis. H&M has already decided not to pay out dividends in 2020 for 2019, while the Nordic banks have postponed the decision upon regulatory pressure to October 2020. Nordea, Swedbank and Handelsbanken have the capacity to pay and intend to do so if allowed by regulators, as demonstrated by deducting the so far unpaid dividend from its CET1 capital ratio, implying a payout.

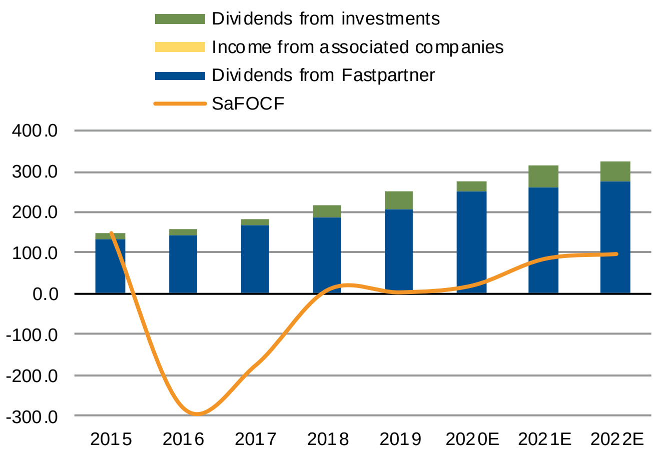
Scope-adjusted free operating cash flow (SaFOCF) was impacted negatively in 2016 when Compactor participated fully in a capital increase of Fastpartner, with cash outflows of SEK 550m. In 2017, the company invested heavily into its stock portfolio, financed with the issuance of its first SEK 500m bond – something that could also be classified as discretionary cash flow – which kept SaFOCF negative. Before and after these events, FOCF has been positive, demonstrating the good earnings capacity of Compactor.

Figure 2: Total cost coverage



Source: Scope estimates

Figure 3: Cash flows (SEKm)



Source: Compactor, Scope estimates

Mandatory cost coverage is highly resilient to vanishing income streams

In order to demonstrate the resilience of Compactor's financial risk profile in terms of total cost coverage, we have stress-tested Compactor's business model by removing dividends to see how much it needs to bring total cost coverage of mandatory costs (ex-dividends) below 1.0x in 2021. 90% of recurring income through dividends needed to be removed in our scenario from Compactor's income stream before the company is required to sell liquid assets to cover mandatory costs (ignoring the cash on 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 the debt position (Scope-adjusted debt) at the holding level (loan/value ratio). Scope notes that such market gearing can be very volatile due to the volatility of share prices and changing valuation multiples depending on current market conditions.

Compactor's Scope-adjusted loan/value (LTV) as at end-June 2020 was assessed at 6.2%, a leverage level deemed adequate for the company's relatively strong investment grade financial risk profile. On our calculation, the company's LTV has been between 2% and 9.5% over the last five years, which demonstrates its conservative risk profile.

Low LTV is a credit strength in the current uncertain market environment

The company's low LTV is credit-positive, particularly in the current market environment. While the LTV remains strongly exposed to the volatility of its underlying holdings' share prices, our sensitivity analysis shows that it would take a further decrease of 35% from today's share prices (debt unchanged) to take LTV above 10% (a still very low level).

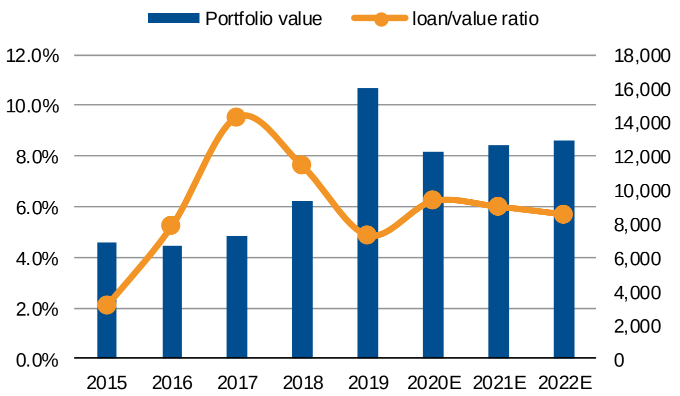
Several of Compactor's largest blue-chip investments have suspended dividend payments or are debating such an action. As such, dividends from that part of the portfolio are at risk. Mitigating that risk is the largest exposure to Fastpartner, which shows only negligible impacts from the current pandemic and is well-positioned to maintain dividend payments at previous years' levels.

Figure 4: Sensitivity of Scope-adjusted loan/value

Scope-adjusted debt (SEK bn)		Portfolio market value (SEKbn) 14.68	13.46	12.24	11.01	9.79	8.56	7.34	6.12
		20%	10%	0%	-10%	-20%	-30%	-40%	-50%
0.76	0.0%	5.2%	5.7%	**6.2%**	6.9%	7.8%	8.9%	10.4%	12.5%
0.86	12.5%	5.8%	6.4%	7.0%	7.8%	8.8%	10.0%	11.7%	14.0%
0.95	25.0%	6.5%	7.1%	7.8%	8.6%	9.7%	11.1%	13.0%	15.6%
1.05	37.5%	7.1%	7.8%	8.6%	9.5%	10.7%	12.2%	14.3%	17.1%
1.14	50.0%	7.8%	8.5%	9.3%	10.4%	11.7%	13.3%	15.6%	18.7%
1.24	62.5%	8.4%	9.2%	10.1%	11.2%	12.6%	14.5%	16.9%	20.2%
1.33	75.0%	9.1%	9.9%	10.9%	12.1%	13.6%	15.6%	18.2%	21.8%
1.43	87.5%	9.7%	10.6%	11.7%	13.0%	14.6%	16.7%	19.5%	23.3%

Source: Scope estimates

Figure 5: Loan/value and portfolio market value (SEKm)



Source: Compactor, Scope estimates

We assess Compactor's liquidity to be adequate given i) the positive SaFOCF even during a difficult 2020; ii) the undrawn portion of loan facilities worth SEK 115m; iii) the unrestricted cash of SEK 21m (as at end-June 2020); iv) a highly liquid portfolio of blue-chip shares that could be unwound at short notice, worth SEK 1.9bn (as at end-June 2020); and v) maturing bond debt of SEK 500m in October 2020. The latter is intended to be refinanced with a new SEK 500m bond.

Figure 6: Liquidity in SEK, millions

Position	2020E		2021E	
Unrestricted cash (t-1)	SEK	14	SEK	33
Open committed credit lines (t-1)	SEK	115	SEK	115
Free operating cash flow (t)	SEK	220	SEK	235
Short-term debt (t-1)	SEK	795	SEK	295
Coverage		**0.4x**		**1.3x**

Source: Scope estimates

Long-term and short-term debt ratings

Senior unsecured debt: BBB-

At the end of Q2 2020 Compactor had SEK 295m in unsecured bank debt in addition to SEK 500m in unsecured bond. Senior unsecured debt benefits from a relatively high unencumbered asset ratio of more than 1,500%, 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.

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