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Research Update:

Finland's Citycon Upgraded To 'BBB/A-2' From 'BBB-/A-3' On Successful Capital Increase, Off Watch Pos; Outlook Stable

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Overview

- On July 8, 2014, Finland-based Citycon Oyj announced its successful directed share issue of approximately €200 million, following the rights issue of approximately €200 million announced on June 9, 2014.
- As a result, we believe Citycon's leverage will likely decrease and its financial profile will improve.
- We are therefore raising our long-term and short-term ratings on Citycon to 'BBB/A-2' from 'BBB-/A-3' and removing them from CreditWatch positive.
- The stable outlook reflects our view that, after the transaction, Citycon's EBITDA interest coverage will be higher than 2.5x and debt to debt and equity ratio lower than 50%, and that Citycon will maintain these ratios over the long term.

Rating Action

On July 8, 2014, Standard & Poor's Ratings Services raised its long-term and short-term ratings on Finland-based retail property investment company, Citycon Ojy, to 'BBB/A-2' from 'BBB-/A-3' and removed them from CreditWatch, where we placed them with positive implications on June 6, 2014. The outlook is stable.

Rationale

The upgrade follows Citycon's announcements today of its successful directed share issue of approximately €200 million, which follows the rights issue of approximately €200 million announced on June 9, 2014. We believe that the transaction will result in significantly quicker deleveraging than we previously anticipated. We believe the proceeds of this capital increase will likely go toward reducing Citycon's debt by about €300 million, thereby significantly decreasing its financial expenses in the future. Consequently, we forecast that the company's EBITDA-to-interest ratio will rise to 2.5x-3x and its ratio of debt to debt and equity will decrease below 50% over the three months following the transaction. We view these ratios as commensurate with an "intermediate" financial risk profile and a 'BBB' rating.

We acknowledge management's strong commitment to maintaining moderate and stable debt leverage, with Citycon targeting a maximum loan-to-value ratio of 45%-50% (50.3% reported as of March 31, 2014).

We believe the transaction will also be positive for Citycon's asset portfolio, although our assessment of its business risk profile still remains at "strong" because the remaining proceeds (€100 million) will be reinvested in accretive redevelopment and extension projects.

Furthermore, we see as positive the resulting change in Citycon's corporate governance with the entry of institutional investor Canadian Pension Plan Investment as a strong second minority shareholder (15% shares) and the subsequent dilution of the stake held by Gazit Globe to 42% from 49%. We believe the appointment of two more independent directors signals further positive steps in governance and supports our "satisfactory" management and governance assessment.

Our comparable rating analysis, however, still constrains the rating on Citycon by one notch. This reflects our view that Citycon's business risk profile remains at the lower end of our "strong" category. This is because we believe the company's portfolio will still be smaller (in terms of leasable area and market value) and less diverse than that of peers with a "strong" business risk profile (such as Gecina, Klépierre, Icade, or Corio). However, we believe Citycon's business risk profile remains stronger--in terms of asset location and property segment--than that of peers we consider to have "satisfactory" business risk profiles (such as Mercialys, Atrium, Prologis European Properties Fund II, or Goodman European Logistics Fund).

In our base case, we assume:

- Low-single-digit percentage revenue growth in 2014 and 2015, reflecting the completion of asset extensions (IsoKristiina in Finland and Stenungs Torg in Sweden) and indexation rates, partly offset by limited rent increases and declining retail sales in Europe;
- Flat market valuations, factoring in stabilized property capitalization rates; and
- Increasing capital expenditures, but broadly neutral asset rotation, as acquisitions may be funded from the proceeds of asset disposal.

Based on these assumptions, we arrive at the following credit measures:

- The EBITDA-to-interest ratio, which we view as a core ratio under our methodology, will likely improve to 2.5x-3x in 2014 and 2015, from 2.4x as of March 31, 2014; and
- Debt to debt and equity will likely decrease to lower than 50% in 2014, from 52.9% on March 31, 2014, and remain stable in 2015.

Liquidity

We assess Citycon's liquidity as "adequate" under our criteria. We estimate that liquidity sources will exceed uses by more than 1.2x over the next 12 months.

Liquidity sources for the 12 months following March 31, 2014, comprise:

- Funds from operations of about €75 million-€85 million;
- €380 million in undrawn credit lines; and

- Unrestricted cash balances of €17 million.

Over the same period, principal liquidity uses are likely to include:
- Debt maturities of about €144 million, which should to a large extent be repaid with the proceeds from equity issues, although we do not capture them in the liquidity sources at this stage;
- A planned dividend of €65 million-€70 million; and
- Planned capital expenditures of €160 million-€170 million, which include current property extension projects.

We understand that Citycon could derive additional liquidity from its pool of assets because 99% of its assets were unencumbered as of Dec. 31, 2013.

Outlook

The stable outlook reflects our view of Citycon's resilient retail property portfolio and high occupancy rate, which will likely enable it to continue generating stable and predictable income. Our stable outlook also takes into account the company's maintenance of a moderate financial policy and the resilient performance of retailers in the Nordic region.

Downside scenario

We might take a negative rating action if the company adopted a more aggressive financial profile through large debt-financed acquisitions or increased shareholder distributions. This would likely result in ratios of debt to debt and equity and EBITDA to interest consistently above 50% and lower than 2.5x, respectively.

Upside scenario

We might consider raising the ratings if the company's strategy of organic growth and gradual reduction in debt leverage resulted in ratios of debt to debt and equity, and EBITDA to interest, to less than 40% and more than 3x, respectively, on a sustainable basis.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

Business risk: Strong
- Country risk: Low
- Industry risk: Low
- Competitive position: Strong

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 rating analysis: Negative (-1 notch)

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Citycon Oyj		
Corporate Credit Rating	BBB/Stable/A-2	BBB-/Watch Pos/A-3
Senior Unsecured	BBB	BBB-/Watch Pos

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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.