

# Vasakronan

## Steady as she goes

- Rental and property markets continue to perform well
- Some improvement in the credit profile
- Bonds remain expensive; Underperform

## Yields down, rents up

Vasakronan, which is skewed toward Stockholm office property, continues to perform strongly in terms of valuation, rents and vacancies (or whatever metric one looks at). Some long-term concerns about retail property in general linger, but Vasakronan's retail exposure is manageable (18% of rent) and centrally located (i.e. hardly the type of assets that are likely to suffer easily).

## Some improvement in the credit profile

The credit profile has improved a touch over the past year due to less reliance on short-term debt and the elimination of shareholder loans in the intermediate holding company, Vasakronan Holding. Also, Vasakronan's debt-to-asset ratio is now typically under 50%.

## Good credit, but expensive bonds

Our Underperform recommendation reflects Vasakronan being a weaker credit than key peers among government-related property companies. In our view, spreads offer too little pick-up relative to peers such as Jernhusen and Sveaskog.

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## Key figures

Key ratios Vasakronan (SEK m)	H1 17 LTM	2016	2015	2014	2013
Rental revenues	6,439	6,251	6,009	5,899	6,032
EBIT ex. value changes	4,520	4,369	4,185	4,078	4,192
Net financial items	-1,177	-1,152	-1,121	-1,256	-1,503
Funds from operations	3,309	3,137	2,855	2,789	2,600
Equity	47,438	46,117	41,245	35,094	36,357
Net debt	56,232	53,093	48,449	45,082	42,704
Property value	121,403	115,922	103,894	91,889	87,145
Total assets	128,394	122,056	109,786	97,184	93,242
EBITDA margin, %	71	70	70	69	70
Net debt/Equity, x	1.2	1.2	1.2	1.3	1.2
Equity ratio, %	37	38	38	36	39
Net debt/market value of properties, %	46	46	47	49	49
Total debt/Total assets, %	46	45	46	48	49
LTM Net interest coverage ratio (EBITDA), x	3.8	3.8	3.7	3.3	2.8
LTM Debt/EBITDA, x	13.0	12.6	12.1	11.4	10.8
LTM FFO/debt %	5.6	5.7	5.6	6.0	5.7
Vacancy rate, %	5.9	5.8	7.4	8.0	6.6
Secured financing to total assets, %	13	13	13	16	17

Source: Company reports and Handelsbanken Capital Markets

## Recommendation, senior unsecured: Underperform

Recommendation currency: SEK

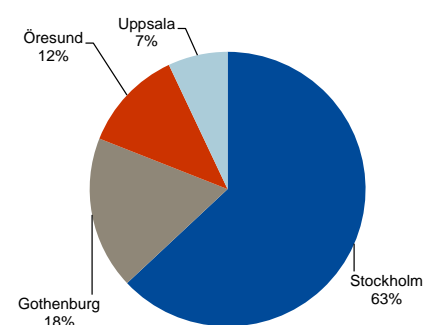
## Public ratings

No public ratings

## Company data

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CEO:	Fredrik Wirdenius
CFO:	Christer Nerlich
Treasurer:	Thomas Nystedt

## Contracted rents (SEKm), H1 2017



Source: Company reports

## Highlights

Higher rents and a lower valuation yield is a well-known story by now. It is difficult for a property company to not perform well under such circumstances. With its portfolio dominated by Stockholm, Vasakronan should (and does) do better than most.

Everybody is doing well, but Vasakronan is doing better than most

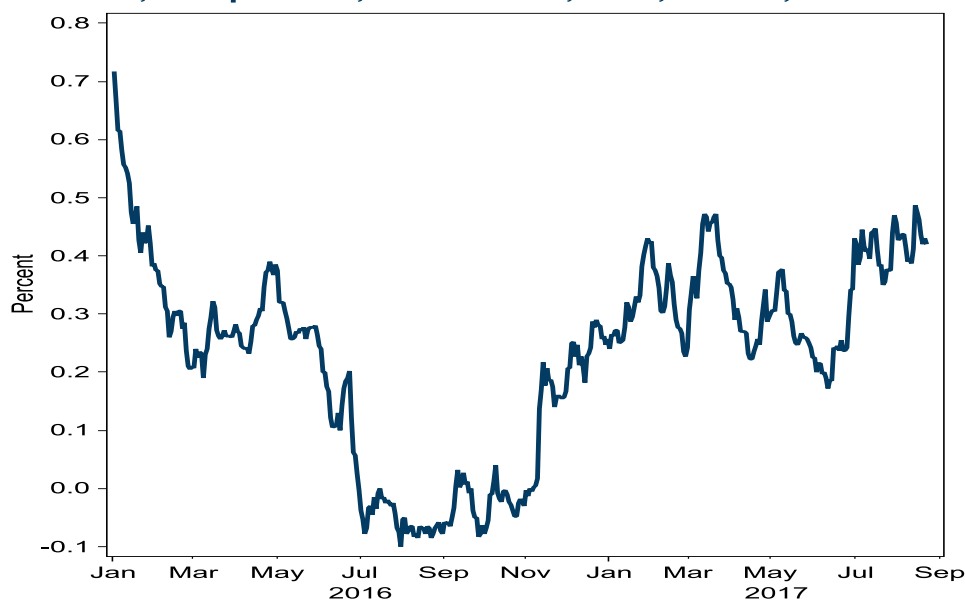
### Rents, valuations and yield

Rents were up 6% y-o-y in H1 and the average valuation yield fell by a further 10bp, to 4.53%. Although we are not fully convinced about the yield gap argument (the spread has historically been very volatile), the yield gap remains wide, despite an uptick in swap rates.

The valuation gain in the period was 4.1%. Management reiterated that it expected the valuation gain to be 5-10% for full-year 2017, but likely toward the upper end of the range. The vacancy rate ended the period at a modest 5.9%.

Figure 1: SEK five-year swap rate

Sweden, Swap Rates, Macrobond, SEK, 5 Year, Mid



Source: Handelsbanken Capital Markets, Macrobond

### What management talks about

At the H1 presentation, the company said that the supply of office property in the Stockholm region is expected to grow by only 5% during 2010-18, yet white-collar employment is expected to grow by 18% over the same period. Even if the trend is for fewer square metres per person, it is difficult to get worried about the supply/demand balance for office property in the Stockholm region. We believe that the situation is broadly similar for Vasakronan's second largest market, Gothenburg.

Manageable supply of new office property

Vasakronan's well-located retail property should be more insulated from shift to online

A current topic that got its fair share of attention at the presentation was the challenging outlook facing retail property in light of the increasing share of shopping migrating online. We find some comfort in retail only accounting for 18% of Vasakronan's contracted rents and that its focus is on high-street shopping, rather than shopping malls in secondary locations. The location of its retail property is generally central, making them hardly the type of assets to suffer easily.

LTV target may be revised, in our view

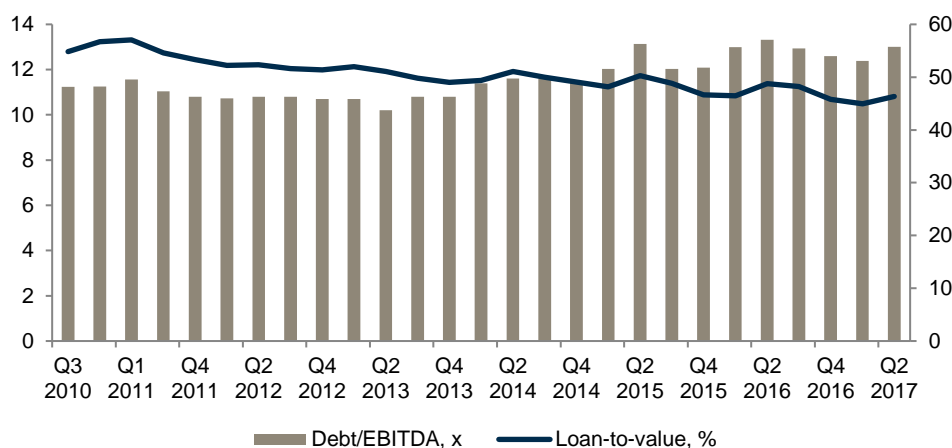
### Stable leverage

Vasakronan ended H1 with net-interest-bearing-debt-to-property-value at a 'lowish' 46%, despite paying a not-so-low SEK 4bn dividend in the period. Actually, the metric has been below 50% in most quarters during the past four years. We struggle to see a scenario where the company would let its net LTV metric go to 60%, although that would still be in line with its financial policy of 45-60%. With many companies lowering their targets, we would not be surprised to see Vasakronan following suit.

No more shareholder loans in Vasakronan Holding

We also note that the shareholder loans in Vasakronan's owner, Vasakronan Holding (an intermediate holding company), from the ultimate owners, the first four Swedish National Pension Funds, were replaced by regular equity in 2016. While we viewed the shareholder loans as practically equity-like, they nevertheless represented a soft claim on Vasakronan to pay a certain dividend. We view it positively that "what you see is what you get" now fully applies to Vasakronan's leverage metrics.

Figure 2. Debt-to-EBITDA and net-debt-to-property-value



Source: Company reports and Handelsbanken Capital Markets

Less short-term debt is a positive development

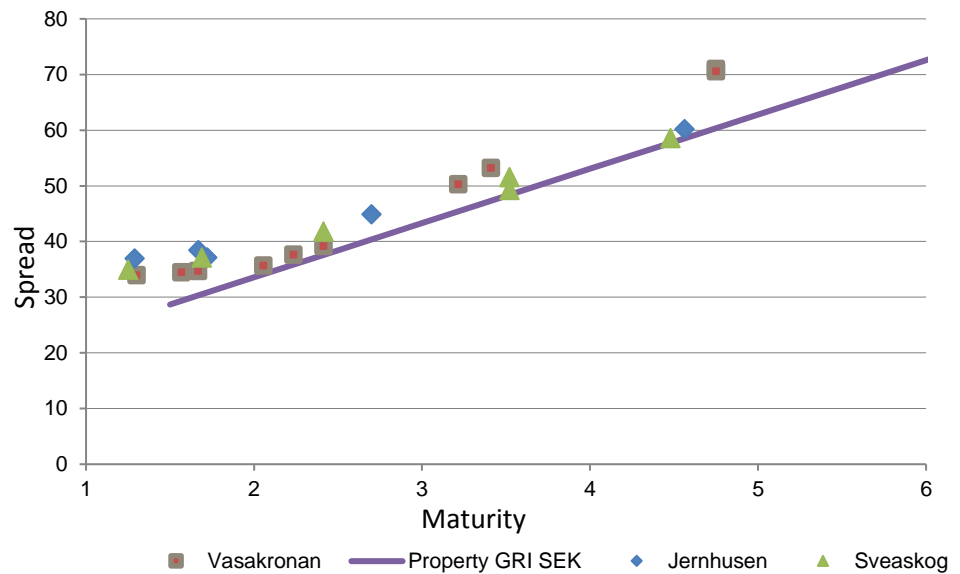
### Funding getting more conservative

Vasakronan's funding has become more conservative over the past year, with a lower proportion of debt maturing within 12 months (26% versus 33% at Q2 2016). Notably, the huge SEK 20bn commercial paper programme saw its outstanding volume decrease to SEK 7.6bn, from SEK 11.1bn a year ago. The share of NOK bonds has grown to a respectable 11% of the SEK 59bn of total funding.

## Recommendation

Vasakronan trades just outside our Property GRI curve (which includes Akademiska Hus, Hemsö, Jernhusen, Rikshem, Specialfastigheter, Sveaskog, Vasakronan and Willhem). We view Vasakronan as a weaker name than other unrated property GRIs, such as Sveaskog (Market Perform) and Jernhusen (Market Perform), which trade closely in spread terms. We therefore maintain our Underperform recommendation on Vasakronan.

**Figure 3. Vasakronan's spreads vs generic property GRI curve and two peers**



Source: Bloomberg and Handelsbanken Capital Markets

## Credit research disclaimer

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HCM recommendation <sup>1</sup>	HCM universe unsecured <sup>2</sup>	HCM universe secured <sup>2</sup>	IB services <sup>3</sup>
Outperform	24%	20%	5%
Market perform	69%	80%	20%
Underperform	7%	0%	5%

#### 1 Recommendation definitions:

- Outperform: Over the next 12 months, the bond's total return is expected to exceed the total return of the relevant benchmark
- Market perform: Over the next 12 months, the bond's total return is expected to be in line with the total return of the relevant benchmark
- Underperform: Over the next 12 months, the bond's total return is expected to be below the total return of the relevant benchmark

#### 2 Percentage of companies under coverage within each recommendation

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Source: Handelsbanken Capital Markets, as per August 24, 2017.

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The recommendation Underperform was set on 2016-08-30 as the first recommendation for the company

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