

Vasakronan

Still in the right place

- Rents and property values continue to increase
- Vacancies historically low
- We reiterate our Underperform recommendation

Rents up, valuation yield down

Value gains continue, driven by rents and declining valuation yields. In Q3 alone, value gains amounted to SEK 2bn. The average valuation yield was 4.71% at the end of Q3, down 6bp from Q2. However, there are some tentative signs that the yield compression may be near its end for now. Long-term interest rates have increased over the past few weeks and real estate shares have underperformed broader equity indices since late September.

Historically low vacancies

Strong demand for offices in central Stockholm in particular is leading to higher rents and low vacancies. At the end of Q3, Vasakronan's vacancy rate was only 6.3%. The group's vacancy rate historically has fluctuated around 7.5%.

Unchanged recommendation

We find that Vasakronan's bond spreads remain expensive relative to peers. Accordingly, we reiterate our Underperform recommendation.

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Key figures

Key ratios Vasakronan (SEK m)	Rolling 12	2015	2014	2013	2012
Rental revenues	6,163	6,009	5,899	6,032	5,969
EBIT ex. value changes	4,307	4,185	4,078	4,192	4,190
Net financial items	-1,138	-1,121	-1,256	-1,503	-1,577
Funds from operations	3,056	2,855	2,789	2,600	2,432
Equity	43,749	41,245	35,094	36,357	32,660
Net debt	53,823	48,449	45,082	42,704	43,217
Property value	111,566	103,894	91,889	87,145	84,074
Total assets	119,547	109,786	97,184	93,242	89,319
EBITDA margin, %	70	70	69	70	70
Net debt/Equity, x	1.2	1.2	1.3	1.2	1.3
Equity ratio, %	37	38	36	39	37
Net debt/market value of properties, %	48	47	49	49	51
Total debt/Total assets, %	47	46	48	49	50
LTM Net interest coverage ratio (EBITDA), x	3.8	3.7	3.3	2.8	2.7
LTM Debt/EBITDA, x	12.9	12.1	11.4	10.8	10.7
LTM FFO/debt %	5.5	5.6	6.0	5.7	5.4
Vacancy rate, %	6.3	7.4	8.0	6.6	7.0
Secured financing to total assets, %	13	13	16	17	17

Source: Company reports and Handelsbanken Capital Markets

Recommendation, senior unsecured: Underperform

Recommendation currency: SEK

Public ratings

No public ratings

Company data

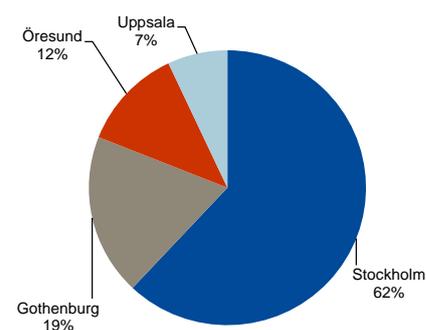
Web address: www.vasakronan.se

CEO: Fredrik Wirdenius

CFO: Christer Nerlich

Treasurer: Thomas Nystedt

Rental value distribution, 2016 Q3



Source: Vasakronan

Credit view

Vasakronan has a strong standalone credit profile but the lowest degree of implicit government support among the government-related issuers under our coverage.

Net-debt-to-property
value below 50%

Intermediate leverage and good quality assets

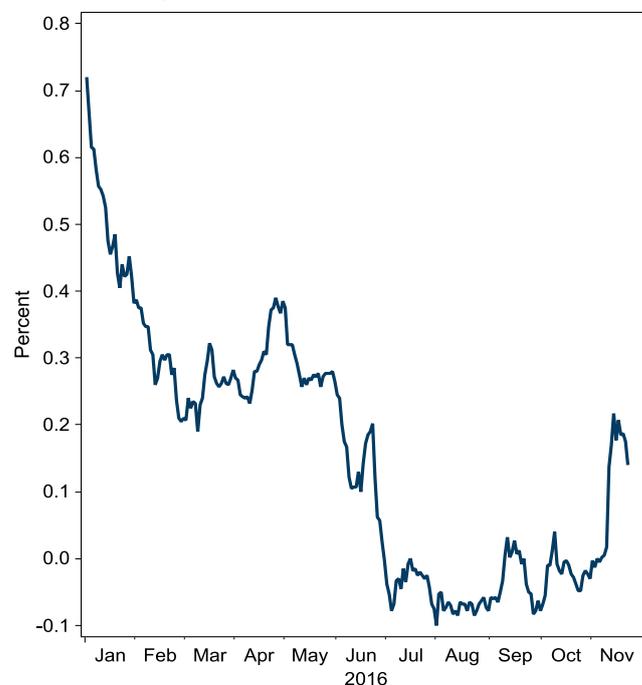
At the end of Q3, net-debt-to-property value was 48% and debt-to-EBITDA was 12.9x. While we place greater emphasis on the former metric, which is showing mild improvement, we note that debt-to-EBITDA over the past few years has increased from around 11x to around 13x.

Vacancies have dropped to 6.3%, whereas the vacancy rate historically is around 7.5%. In our view, Vasakronan has a high-quality, well-located portfolio that continues to benefit from the strong demand for commercial property in the company's markets. Vasakronan said that renegotiated rents in Q3 resulted in an average increase of 16.5% (8% in Q3 2015) and that like-for-like rents were up 3% for the first nine months of the year.

The average valuation yield dropped 6bp over the quarter to 4.71%. Swedish interest rates were marginally lower in the quarter (see Figure 1). Nevertheless, there are some tentative signs that the yield compression may be near its end for now. Interest rates have increased over the past few weeks, although they remain below where they were during the first half of 2016. In addition, real estate shares have underperformed broader equity indices since late September. However, in 2016, increasing rents have played an equally large role in the substantial value gains (as has yield compression) and we do not see signs of a slowdown in rental growth.

Figure 1: SEK, 5-year swap rate

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



Source: Handelsbanken Capital Markets, Macrobond

Purely commercial
role limits implicit
support

At the end of Q3, Vasakronan had projects with a total volume of SEK 3.6bn, which corresponds to 3% of total assets. The limited relative size of the project portfolio means that it plays a relatively minor role as credit driver.

Ownership support

Although we categorise Vasakronan as a government-related issuer, we find that the level of support is the lowest among its peers (in Sweden, the government-related issuers under our coverage are Jernhusen, LKAB, PostNord, Sveaskog, Swedavia and Vasakronan). Unlike these peers, which all are directly government owned, Vasakronan is indirectly government owned. In our view, there is also a difference in purpose, as Vasakronan is a financial investment for the four first AP Funds, whereas peers have some (albeit vague in some cases) policy role for the Swedish government (and the Danish government in the case of PostNord).

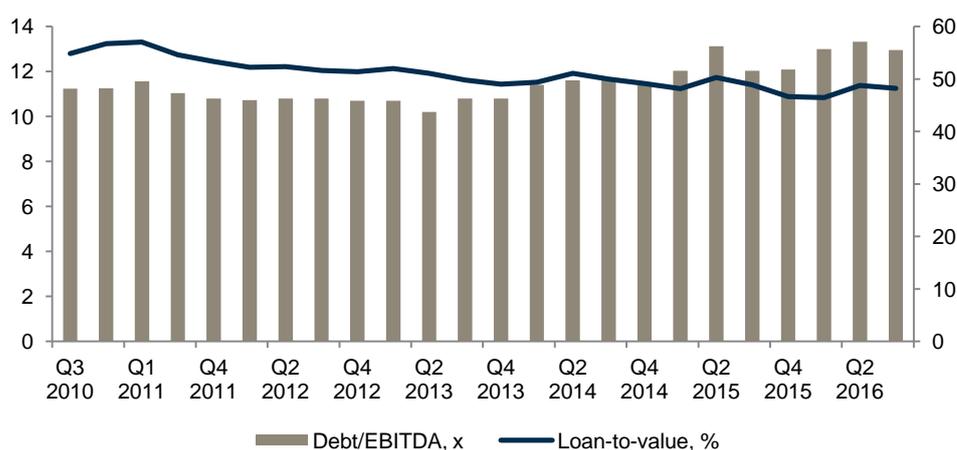
Key credit strengths:

- Large, high quality portfolio provides some diversification
- Manageable leverage (~50%) relative to portfolio quality
- Healthy and improving operating margins
- Change of control clause in borrowings and strong owners

Key credit concerns:

- High leverage versus EBITDA due to relatively low-yielding assets
- High share of short-term funding and generally greater appetite for financial risk than peers
- Commercial paper represents 18% of total funding
- Exposure to the cyclical commercial real estate market

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

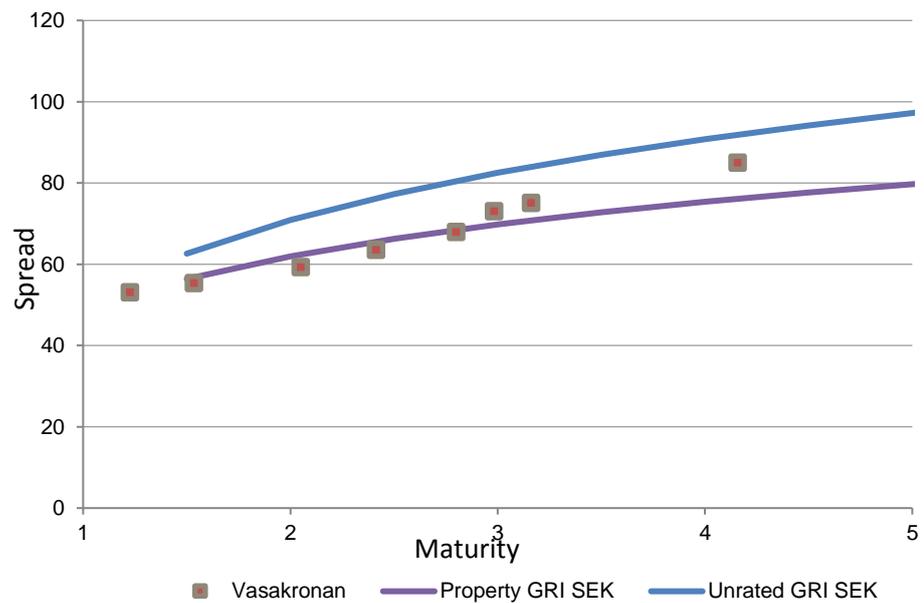


Source: Company reports and Handelsbanken Capital Markets

Recommendation

Vasakronan trades on, or just outside of, our Property GRI curve (which includes Akademiska Hus, Hemsö, Jernhusen, Rikshem, Specialfastigheter, Sveaskog, Vasakronan and Willhem). Specifically, we view Vasakronan as a weaker name than Sveaskog (Market Perform) and Jernhusen (Market Perform), although all three trade on approximately the same curve. Accordingly, we maintain our Underperform recommendation for Vasakronan. The Unrated GRI curve includes LKAB, Jernhusen, PostNord, Sveaskog, Swedavia and Vasakronan.

Figure 3: Vasakronan spread vs. generic curves



Source: Company reports and Handelsbanken Capital Markets

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Recommendations: definitions and allocations

HCM recommendation ¹	HCM universe unsecured ²	HCM universe secured ²	IB services ³
Outperform	17%	20%	6%
Market perform	66%	80%	15%
Underperform	17%	0%	9%

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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

3 Percentage of companies within each recommendation (unsecured) for which investment banking services have been provided in the past 12 months

Source: Handelsbanken Capital Markets, as per 23/11 2016

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