

# Vasakronan

Sweden | Construction and Real Estate

## The flagship of the Swedish property market

Vasakronan is Sweden's biggest property owner, with a strong track record in property management, high-quality assets, a solid financial risk profile and state risk owners. We consider the company to be well-established in prime micro locations in Sweden's most attractive office markets. Its sole focus on the Swedish market has proven a successful strategy, but over time the lack of international diversification could imply an increasing risk for bondholders. High-profile development projects in the Stockholm CBD imply continued growth in its top-quality asset base. Although several investment projects are far from complete, the company's strong financial flexibility points to an overall robust risk profile. We assign Market Perform recommendations to two of Vasakronan's longer SEK bonds and Underperform recommendations on two shorter SEK bonds.

### Prime property portfolio in sustainable locations

Vasakronan enjoys a very large office portfolio in what we consider the best micro locations in Sweden's most attractive macro locations. We believe these assets hold a strong likelihood of remaining attractive across the cycle, and the vast tenant granulation should balance a potential economic slowdown in the Swedish market. Still, Vasakronan has 18% retail tenants, and in the changing retail landscape, this could impact the company. Its focus on only one sovereign market weakens its geographical diversification in the credit profile, even though the local submarkets are strong.

### Solid financial risk profile

The owners of Vasakronan are Swedish AP funds – government agencies that are essential to the Swedish welfare system. In that sense, we consider the ownership support to be extraordinarily strong. Vasakronan's profitability is adequate and sustainable, in our view, and its gearing is conservative considering the asset quality, while its financial flexibility is solid.

### Nordea Markets - Analysts

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### KEY INFO

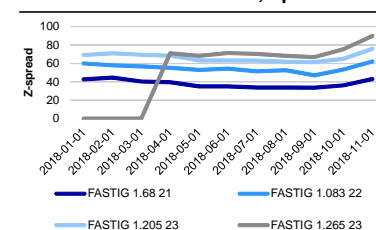
Country	Sweden
Bloomberg debt	FASTIG
Bloomberg equity	1276Z SS
Moody's	A3/Stable
S&P	NR/--
MSCI ESG rating	No rating
Market cap. (bn)	n.a.
Company website	www.vasakronan.se
Next report date	31 Jan 2019

### BOND RECOMMENDATIONS

Security Name	Rec.	Price	YTW	Z	Fair
SEK: FASTIG 1.68 21	UP	102.6	0.4%	43	55
SEK: FASTIG 1.083 22	UP	100.8	0.8%	61	74
SEK: FASTIG 1.205 23	MP	100.2	1.1%	76	83
SEK: FASTIG 1.265 23	MP	99.5	1.4%	88	89

Source: Bloomberg and Nordea estimates;  
UP=Underperform, MP=Market Perform,  
OP=Outperform, NR = No Recommendation

### SPREAD DEVELOPMENT, bp



Source: Bloomberg and Nordea

### KEY CREDIT METRICS AND RATIOS SEKm

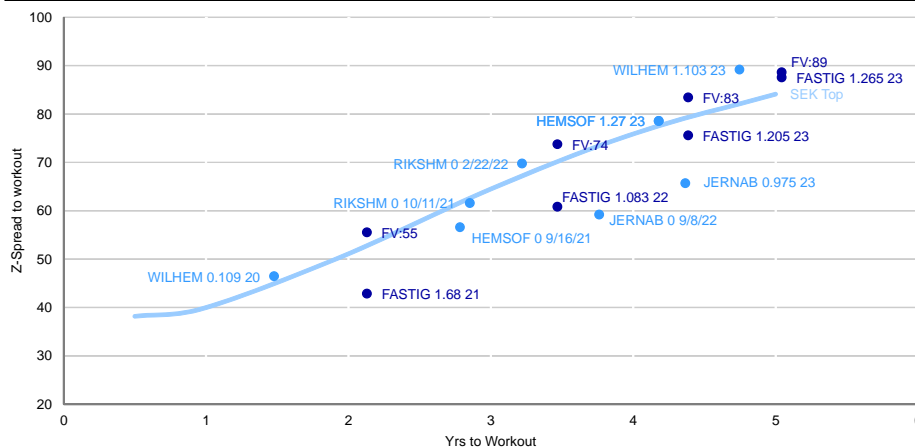
	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
SEK										
Total revenues	6,048	5,969	6,032	5,899	6,009	6,251	6,490	6,660	6,934	7,313
NOI	4,211	4,272	4,279	4,172	4,274	4,459	4,678	4,795	4,992	5,266
- margin	69.6%	71.6%	70.9%	70.7%	71.1%	71.3%	72.1%	72.0%	72.0%	72.0%
EBITDA	4,211	4,272	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
Loan-to-value	53.2%	51.4%	49.0%	49.1%	46.6%	45.8%	44.9%	42.7%	44.2%	45.3%
Equity ratio	33.5%	36.6%	39.0%	36.1%	37.6%	37.8%	38.8%	40.1%	38.8%	37.5%
<b>Credit adjusted</b>										
Debt/(Debt+Equity)	60.9%	57.9%	55.5%	57.2%	55.2%	54.5%	53.2%	51.4%	52.6%	54.1%
FFO/Debt	5.5%	6.0%	5.8%	6.0%	5.9%	5.7%	5.8%	5.9%	5.9%	5.9%
Loan-to-value	56.2%	53.3%	52.0%	51.0%	48.8%	47.7%	46.0%	44.1%	44.6%	45.6%
Equity ratio	33.5%	36.6%	39.0%	36.1%	37.6%	37.8%	38.8%	40.1%	38.8%	37.5%
EBITDA interest coverage	2.5	2.7	2.8	3.2	3.7	3.7	3.9	4.7	4.4	4.3
Fixed-charge coverage	2,554.0	2,695.0	2,638.0	2,802.0	2,994.0	3,192.0	3,388.0	3,687.8	3,786.9	3,948.9

Source: Company data and Nordea estimates

# Bond recommendations

Our fair value model indicates widening risk along the reference curve. We set a Market Perform recommendation for the FASTIG 1.205 23 and FASTIG 1.265 23 bonds. We assign Underperform recommendations on two bonds on the shorter side of the curve.

## FAIR VALUE ASSESSMENT, bp



Source: Bloomberg and Nordea estimates

### Fair value assessment reflects the following adjustments

- We make a 10% addition to the reference curve spread for the somewhat weaker credit quality that we see compared with the reference bonds composing the curves.
- We make a 5% addition to the reference curve spread to reflect the general spread premium for real estate issuers in the SEK market.
- We make a 10% deduction from the reference curve due to the strong ownership.

### WALK-THROUGH OF OUR FAIR SPREAD ASSESSMENT, bp

Bloomberg ticker	JV645825 Corp	AN655412 Corp	AP606565 Corp	AS243883 Corp
Security Name	FASTIG 1.68 21	FASTIG 1.083 22	FASTIG 1.205 23	FASTIG 1.265 23
Currency	SEK	SEK	SEK	SEK
Outstanding (LCL)	1,235,000,000	830,000,000	1,250,000,000	1,000,000,000
Coupon type	FIXED	FIXED	FIXED	FIXED
Payment Rank	Sr Unsecured	Sr Unsecured	Sr Unsecured	Sr Unsecured
Recommendation	Underperform	Underperform	Market perform	Market perform
Curve spread	52.8	70.2	79.4	84.4
Credit quality vs reference	5.3	7.0	7.9	8.4
Issuer score vs reference	0.0	0.0	0.0	0.0
Rated/Unrated	0.0	0.0	0.0	0.0
Bond liquidity	0.0	0.0	0.0	0.0
Demand saturation	2.6	3.5	4.0	4.2
Ownership etc	-5.3	-7.0	-7.9	-8.4
Fair Value	55.5	73.7	83.4	88.6
Market Spread	42.9	60.8	75.5	87.5
Spread from fair value	-12.6	-12.9	-7.9	-1.1
Spread from fair value (%)	-22.8%	-17.5%	-9.4%	-1.2%

Source: Bloomberg and Nordea estimates

## Recent events

Vasakronan delivered a stable Q3 report and during 2018 has been a net seller in the market. It has paid out substantial dividends in 2018, in line with the 2017 level, while major ongoing investments in Sergels Torg in Stockholm CBD continue to affect free cash flow.

The Q3 report showed steady growth and there has been a substantial value uptick so far in 2018

### Strong value uptick in property portfolio

The Q3 report showed continued gradual growth in the top line, while the NOI margin remained flat, since costs increased at the same pace as income. The occupancy rate remained flat at 92.8% (92.7%). The property portfolio increased by 5.4%, which was mainly attributable to rising market rents in Stockholm.

Vasakronan recorded rental income for January-September 2018 of SEK 5bn versus SEK 4.8bn in 9M 2017, an increase of 5% y/y. NOI increased to SEK 3.6bn (3.5bn), implying a margin of 72% (72%).

Changes in the value of properties amounted to SEK 11.3bn, which was dominated by yield decreases (73% of total value adjustments). The valuation yield was lowered to 4.4% (4.5%) in the period, implying a value increase of SEK 6.7bn or 60% of the whole value increase so far in 2018. The remaining value increase was related to higher cash flow in the portfolio as well as project realisations.

During the period January-September, the company made investments in the existing portfolio of SEK 2.4bn (1.7bn). In addition, it was a net seller of property after making acquisitions worth SEK 534m and disposals for SEK 2.2bn.

The ongoing investment portfolio amounted to SEK 10.3bn, equivalent to 8% of the total portfolio. The occupancy rate for major projects was 38% in Q3 2018. We note that the Sergels Torg project accounted for one-third of the total project volume – and this project is being conducted on a speculative basis.

The portfolio has grown by 6% in 2018, primarily owing to lowered yield requirements

The two major transactions so far in 2018 have been the disposals to Oscar Properties/Starwood in Stockholm and to Platzer in Gothenburg. The property value amounted to SEK 134bn at the end of the period.

### VASAKRONAN: PROPERTY PORTFOLIO 2018

	Value, SEKbn	Number of properties
<b>Property portfolio Jan 2018</b>	<b>126.9</b>	<b>178</b>
Acquisitions	0.5	4
New developments etc	2.4	
Disposals	-2.2	-6
Unrealised value changes	6.7	
Currency translation	0.0	
<b>Property portfolio Sept 2018</b>	<b>134.3</b>	<b>176</b>

Source: Company data and Nordea

We would not be surprised if a further value uptick is recorded in the Q4 report. This is based on the strong rental markets in Stockholm and Gothenburg, where Vasakronan enjoys high-quality portfolios. The Stockholm office market in particular has improved strongly in recent years, putting the company in a strong negotiating position when existing leases come to an end.

# The property market

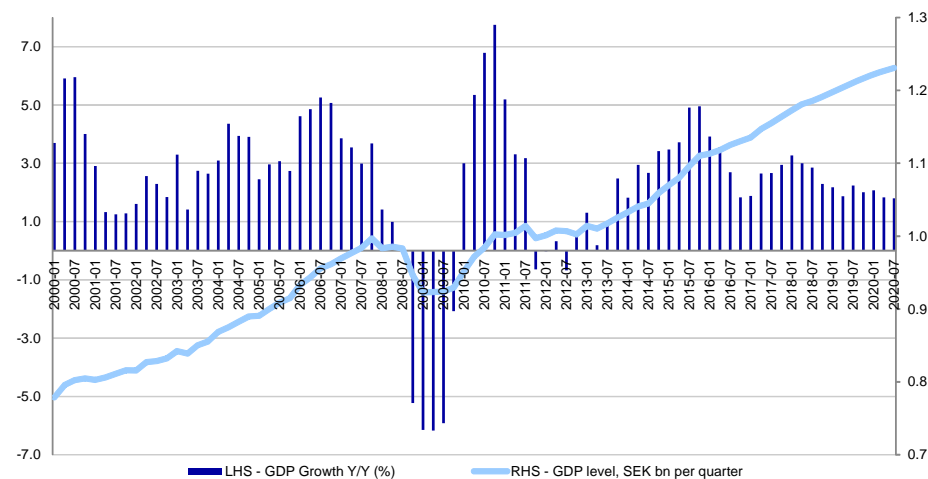
The ongoing stable macro outlook provides the foundation for continued strong performance for Swedish property companies. Still, cyclical swings will affect some segments more than others and general market risks still apply for all property companies.

Nordea forecasts Swedish GDP growth of 2.8% for 2018, and expects it to decline to 2.1% in 2019 and to 1.8% in 2020. Although this is a clear slowdown compared to the recent years' strong growth, it is still in line with estimated GDP growth in the Eurozone. We conclude that near-term expectations remain relatively positive for the economy, which will hence benefit the real estate sector.

The following chart depicts the annual GDP growth rate over the past 18 years and the expected development for the next two years.

**SWEDISH GDP GROWTH: HISTORY AND FORECASTS**

Slightly weakening GDP growth but still at very comforting levels, implying continued benign market conditions for Vasakronan



Source: Nordea Economic Outlook, no 3, 2018

Below, we summarise the property segments in which Vasakronan is active. As can be seen, we are positive on the office, logistics, public and residential sectors. The only sector clearly facing a challenging environment in the near term is the retail sector, to which Vasakronan has exposure.

## COMMERCIAL PROPERTY SEGMENTS – VASAKRONAN EXPOSURE

Asset Type	Vasakronan Exposure	Status	Trend	Cyclical Exposure	Comments
Office	74%	●	➔	▲	Prime office enjoys solid demand with low vacancy levels in the biggest cities. Sustainable Swedish macro development coupled with narrow geographic targets and limited new supply in attractive CBD areas is the foundation.
Retail	18%	▲	➡	◆	The retail segment faces double headwind: Structural changes in consumption patterns where online outcompetes physical stores. In the event of deterioration in the Swedish housing market (falling prices/rising interest), it will affect spending ability of private consumers.
Logistics	0%	●	➔	▲	Logistics strongly on the rise on the back of growing e-commerce and higher demand for efficient handling of goods. High yielding assets with unclear economic life span due to low replacement cost.
Public	0%	●	➔	●	Public properties have evolved as a commercial property segment in the wake of a disposal strategy in cities and municipalities. The long-term lease structure and high quality tenant implies long-term safe assets.
Residential	0%	●	➔	●	Rental housing with low stable yield targeted by international/institutional capital. Structural deficit in housing in Swedish growth areas, coupled with demographic growth ensures continued demand for "ordinary living". N.B. Weakening market for upscale owner-occupied developers.

Source: Company data and Nordea estimates

In the table below, we highlight the fundamental factors relevant to consider when evaluating the Swedish market. We remain positive on the majority of aspects. However, recent macro indicators are fading and bond spreads have widened, indicating slightly weakened funding opportunities.

#### PROPERTY MARKET FUNDAMENTALS

	<u>Status</u>	<u>Trend</u>	<u>Comments</u>
<b>Macro</b>	●	↘	The commercial property market is typically a derivative of its geographic region. Positive Swedish macro outlook implies a stable foundation, even though growth is slowing. Structural changes in online consumption and the residential market sentiment are disturbances to the market.
<b>Asset Demand</b>	●	→	Domestic and international corporates compete with institutional capital willing to accept a very low return (yield). Substantial demand differences if assets qualify for institutional attention. Top three biggest Swedish markets in its own league, when it comes to investor appetite.
<b>Market Liquidity</b>	●	→	Healthy transaction activity in Sweden, trailing slightly below recent years' record levels. Prime commercial objects in strongest markets find buyers at record levels. Slightly less attractive assets may not be transacted as sellers are too hopeful.
<b>Profitability</b>	●	→	General high demand for space ensures rising rental levels and high occupancy levels, resulting in solid operating results. On top, low funding levels generate strong return on total investment.
<b>Debt Metrics</b>	●	→	LTV levels have dropped owing to improving property values. Nominal debt amount has increased in tandem, although not at the same pace. Debt service ability is fairly stable over the cycle. Unhedged or highly-g geared companies are in a riskier position when funding costs rise.
<b>Funding</b>	●	↘	The property funding market remains benign. Quality borrowers pick and choose between bank loans and corporate bond funding. Preference shares and hybrids add further liquidity to the sector. Ordinary stock market activity largely on hold as external capital is accessible.
<b>Regulation</b>	▲	→	Sweden is generally conceived as a transparent and stable investment environment. The introduction of limitation on tax deductions (2019) will curb return in highly-g geared structures. The previous proposal (to eliminate packaged transactions) has been put on ice.

Source: Nordea estimates

# Business overview

Vasakronan is Sweden's biggest property owner, with a strong track record, high-quality assets, a solid financial risk profile and state risk owners. The ongoing development projects imply continued growth in the asset base at better returns than could be achieved acquiring properties in the expensive Swedish CBD markets.

## Business risk profile

The company, in its present-day form, was established in 2008 when AP Fastigheter acquired the former Vasakronan and continued operations under the same name. The company is owned by the four Swedish pension funds, the AP Funds 1-4. These funds are government authorities (Swedish: Statlig myndighet), which means that the board is appointed by the Swedish government. Given the strong governmental links, and essential position in the Swedish pension system, we equate the AP funds with Swedish state risk. Vasakronan hence enjoys a very strong ownership and its bonds are issued with a change-of-control mechanism.

Fredrik Wirdenius has been CEO since 2008. Mr Wirdenius was initially employed by AP Fastigheter and was involved in acquiring Vasakronan a few months after his appointment. The board consists of several distinguished names including the CEOs of AP Funds 1-4. Our take is that Vasakronan benefits from high-quality management and governance resources.

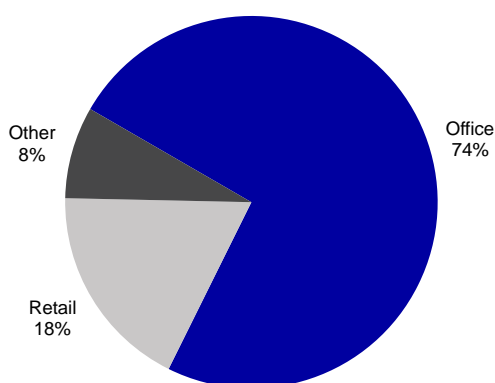
Vasakronan holds Sweden's biggest commercial property portfolio. The market value of the total portfolio amounts to SEK 134bn, a solid foundation for the company's credit profile. The asset base is focused on offices, accounting for 74% of rental income, followed by retail (18%). Geographically, Vasakronan is based in Sweden's four biggest cities, with Stockholm dominating the rental income (62%). It is the company's ambition to remain in these four markets, but future entries into new markets cannot be ruled out. The prerequisite for Vasakronan entering a new market would be building up a substantial volume, to justify the profitable operation of such a portfolio. Going forward, the company anticipates the highest growth potential in the Stockholm and Gothenburg office markets.

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## VASAKRONAN: CONTRACTED RENT BY PROPERTY TYPE

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Strong asset base  
diversification with offices as  
the dominant segment




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Source: Company data and Nordea

The office properties are typically located in prime micro-locations and generally are of high technical and aesthetic standards. The portfolio mainly consists of office buildings with retail areas on the ground floor. In Vasakronan's view, these retail premises are value adding, providing services and footfall around the buildings. Generally, Vasakronan's retail tenants are smaller stores and the company does not own any pure retail properties or shopping centres. In a scenario of weakening demand, Vasakronan can to some extent reconfigure these retail areas to office space, mitigating the increasing risks within physical retail. Nevertheless, the exposure might be a burden should the negative trends in retail continue.

The occupancy rate is 93% which has been stable for the last five years and is an adequate level for the asset composition. Ongoing projects account for 2% of the current vacancy. The number of leases, excluding flats and garages, amounts to approximately 4,300. The largest tenants represent 3% of total contracted rent, which demonstrates the low concentration risk.

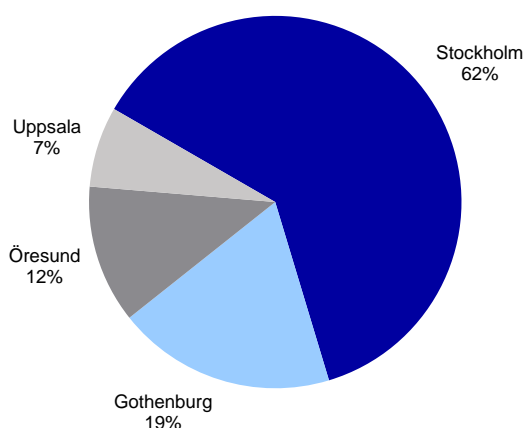
Vasakronan sees the biggest future growth potential within project development, rather than acquiring assets at very low yield levels. When engaging in new development, Vasakronan is keen to manage the letting risk. This means that for new projects in Malmö and Uppsala, it would virtually require fully pre-let arrangements. In Gothenburg, around half of the projected area would need to have tenants in place before project start. For the inner parts of Stockholm, Vasakronan is currently prepared to take on speculative development risk. We believe that its approach is reasonable in the currently very hot office markets in the Stockholm and Gothenburg CBD areas.

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#### VASAKRONAN: CONTRACTED RENT BY REGION

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Vasakronan is active in Sweden's biggest and strongest office markets



Source: Company data and Nordea

Ongoing projects amount to SEK 10bn, and the company targets new property investments at a rate of SEK 3bn per annum. The biggest ongoing project is the Sergels Torg redevelopment, which after completion in 2021 will imply total investments of SEK 3.7bn. This massive project entails speculative construction, as no tenants are officially in place. Given the prime office location and with three years remaining until completion, Vasakronan is still in a comfortable position to fill the properties.

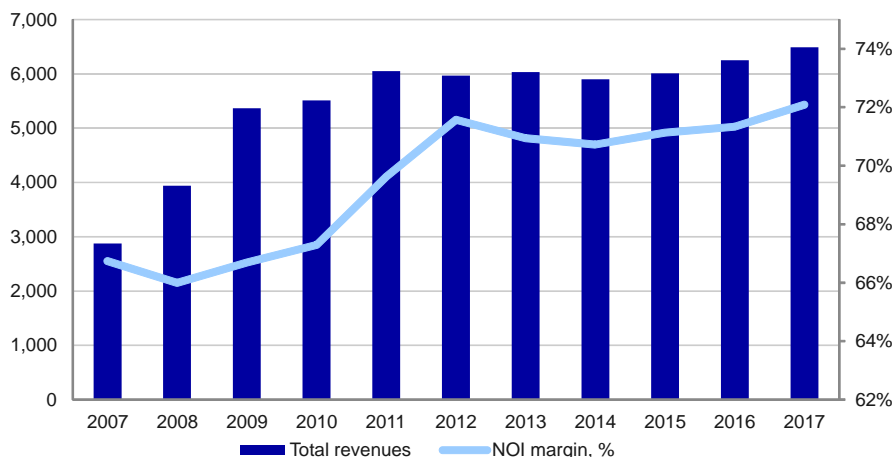
Its property portfolio is valued at an average yield requirement of 4.4%, which indicates that it is of high quality. Looking ahead, Vasakronan sees continued value potential in its portfolio – but the value driver is expected to be improving NOI, rather than even lower yield levels. Our conclusion is that Vasakronan's property portfolio boasts solid macro- and micro-locations with a strong and sustainable risk profile.

#### Financial risk profile

Vasakronan has a stable and predictable financial risk profile, in our view. During the last ten years, the company has delivered rental growth and gradually improving margins. Even though the margin has flattened out during the last five years, we consider the profit margin healthy considering the asset mix. Given the fairly long average lease duration (4.2 years) and upside potential in Stockholm and Gothenburg, we see no immediate risk of a weakening performance.

**VASAKRONAN: RENTAL DEVELOPMENT, SEKm, AND MARGIN**

The chart depicts gradual rental growth combined with steadily increasing margins



Source: Company data and Nordea estimates

**VASAKRONAN: FINANCIAL POLICY AND COMMITMENTS IN CREDIT AGREEMENTS**

The table shows Vasakronan's detailed and transparent financial policy; the company is overshooting its minimum targets across the board

Financial risks	Financial policy in brief	Actual, 30 Sep 2018
<b>Financing risk</b>		
Loan-to-maturity	min. 2 years	3.8
Loans maturing, 12 months	max. 40%	25%
Credit commitments and cash/loans maturing 12 months	min. 100%	130%
<b>Interest-rate risk</b>		
Interest coverage ratio	min. 2.0x (LTM)	4.3
Fixed-interest period	min. 2 years	4.4
Interest maturity within 12 months	max. 55 %	41%
<b>Credit risk</b>		
Counterpart's rating	min. A-, or BBB+ with CSAs	met
<b>Currency risk</b>		
Currency exposure	No exposure	met

Source: Company data and Nordea

In addition to financial risk management, Vasakronan has several operational targets, of which the two most relevant are:

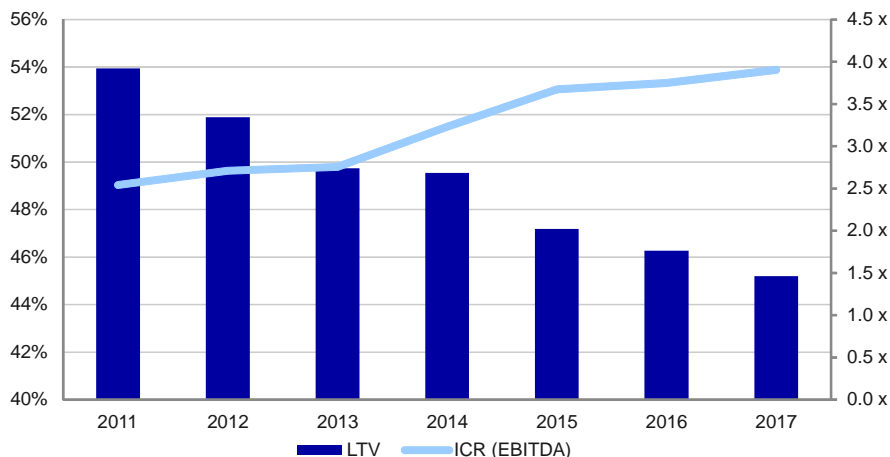
- A total yield of at least 6.5% per year and on average over a rolling ten-year period. In 2017, Vasakronan delivered an 11% total yield, and in 2016 16%. Over the last ten years, the company has delivered a 8.6% total yield.
- An occupancy rate of at least 93.5% at the end of 2018. This level is in line with current levels and should be attained in today's strong rental market unless any major brownfield project is initiated.

In 2018, Vasakronan has decided to increase annual spending on investment projects from SEK 2.5bn to SEK 3bn. When breaking down the invested amount, it is important to highlight that some 65% of annual spending is related to discretionary expansionary investments in greenfield or brownfield projects. Another 20% goes towards tenant improvements. This means that only 15% of annual investments are periodical investments needed to maintain the technical standard of the properties.



**VASAKRONAN: HISTORICAL LTV AND INTEREST COVERAGE**

The graph depicts an extended period of conservative LTV and strong ICR levels



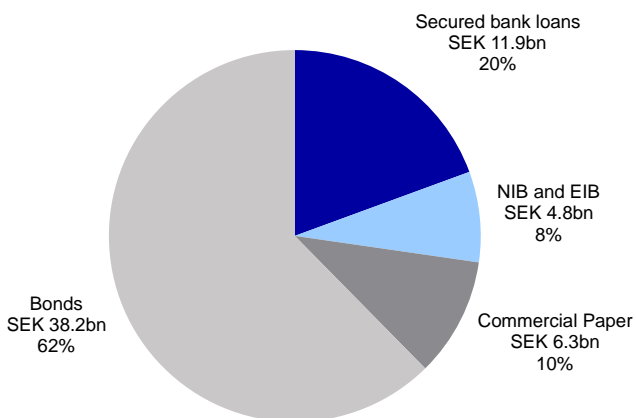
Source: Company data and Nordea estimates

Vasakronan's liquidity position is solid with a major cash position (SEK 2.1bn), complemented by a SEK 18bn subscription agreement from its owners. The subscription agreement is a commitment from the AP funds to buy commercial papers up to SEK 18bn. This owner commitment serves as a backup facility and is never utilised in the normal course of business. Hence, if the open CP market were to cease to function, Vasakronan would instead have its financing secured by its owners. Please note, the commitment has no limitations for what it can be used for; essentially, Vasakronan can issue commercial paper to cover all general corporate purposes and it is available immediately. We consider this a very satisfactory solution for the company and it brings the total available liquidity to SEK 20.1bn as of Q3 2018.

Vasakronan enjoys well-diversified funding sources: banks (20%), NIB and EIB (8%), the commercial paper market (10%), and the bond market (62%). The bank facilities are currently fully drawn. The company has SEK 6.3bn outstanding under the SEK 25bn commercial paper programme. Finally, the company has SEK 38bn outstanding under its SEK 50bn bond programme. Secured bank loans amount to 8% of total assets.

**VASAKRONAN: FUNDING PORTFOLIO, SEK 61bn**

The company enjoys well-diversified funding sources from commercial banks, NIB and EIB, the commercial paper market, and the bond market



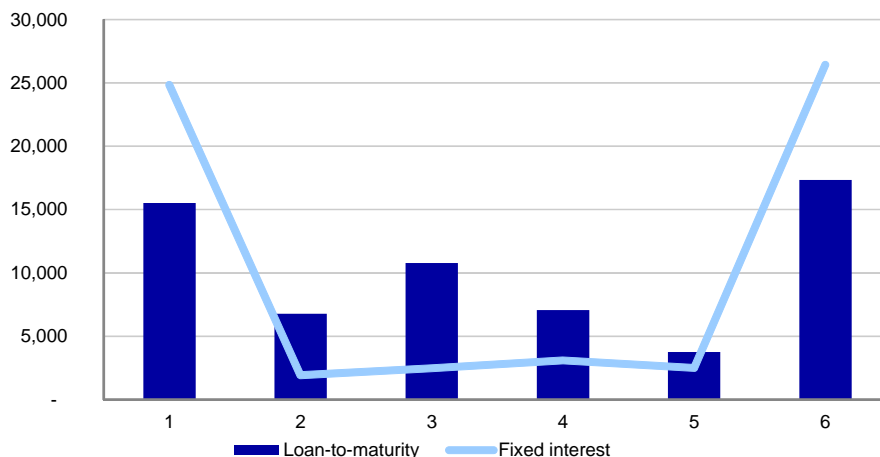
Source: Company data and Nordea

In terms of financial flexibility, Vasakronan has diverse resources for funding. Apart from the available liquidity, it has established relationships with banks and the capital markets. We expect that Vasakronan can increase the nominal debt amount quickly.

To manage financial risk, Vasakronan presents several ratios to identify risk management. As of Q3 2018, the company is in a strong position to manage all of these commitments. We believe that the loan duration (3.8 years) and the interest duration (4.4 years) create stability for the financial performance in the coming years.

**VASAKRONAN: LOAN AND INTEREST DURATION, YEARS, SEKm**

Vasakronan shows a U-shaped duration in both loan and interest rate management, which boils down to strong levels of 3.8 and 4.4 years, respectively.



Source: Company data and Nordea estimates

Vasakronan was recently awarded an investment grade rating, further securing access to the capital markets over time

In May 2018, Vasakronan was awarded an A3 rating from Moody's, which implies an investment grade rating and improved transparency for bond investors. As part of its sustainability efforts, the company has issued green bonds and green certificates of an aggregate volume of SEK 15.5bn. In addition, Vasakronan enjoys funding from NIB and EIB that is linked to green projects.

**VASAKRONAN: KEY CREDIT DRIVERS AND RISKS**

Credit-supportive factors	Credit Constraining Factors
Strong track record and established management	Limited geographic diversification (Sweden 100%)
Massive property portfolio, SEK 134bn	Limited asset diversification (office 74%)
Premier micro locations in strong macro markets	Speculative development entails risk
Long average lease tenor and no concentration risk	
Solid financial risk profile	

Source: Company data and Nordea estimates

**Conclusion**

We conclude that Vasakronan is a major property owner with a long track record in the Swedish market. Combined with experienced management and board resources, this means Vasakronan enjoys a high level of competence and corporate governance.

The total portfolio contains 176 high-quality properties (Q3 2018), generally in strong micro-locations in Sweden's leading office markets. Based on the strong diversification in the tenant base and geographical exposure, the overall business risk profile is solid. The sole exposure to the Swedish market is a weakness, even though Vasakronan's submarkets are expected to perform strongly in the years to come. Vasakronan continues to pursue its strategy of focusing on prime assets in strong markets, which in conjunction with its established property operation entails strong corporate governance. Over the cycle, we conclude that Vasakronan's micro- and macro-locations are sustainable.

Vasakronan operates with adequate duration on both capital (3.8 years) and interest (4.4 years). In tandem with strong debt service and modest gross LTV (44%), this results in a conservative financial risk profile.

The strong ownership and asset base and the ample financial flexibility ensure a sustainable risk profile. In late 2018, with strong property market fundamentals and a stable Swedish macroeconomic outlook, our assessment is that Vasakronan's credit profile remains rock-solid.

**VASAKRONAN: BONDHOLDERS' GENERAL RISK SCENARIOS**

Event/development	Implications for performance & financial position	Probability of event	Expected impact on bondholders	Comments
Property yields growing wider	The property yield may increase due to deteriorating asset quality, macro events or investor sentiment - which in turn would affect property value	Moderate to High	Moderate	The property investment market looks fairly robust and no major yield increases are expected. Vasakronan's asset quality is expected to remain strong. However, value decreases cannot be ruled out in a changing investment landscape. With rating expectations to remain close to 45% LTV, rising yields could potentially affect the credit rating. A change of rating would impact bond pricing negatively.
Interest rate increases	Strong increases in the interest rates could diminish the profitability of highly geared property companies	Moderate to High	Moderate	Vasakronan enjoys fairly long interest fixing (4.4 yrs) which is clearly above industry average. The long lease duration and discretionary investment levels entails stability on the income side.
Macro slowdown/recession affecting the tenant base	An economic recession could have a negative impact on rental income, with a negative impact on earning levels	Low to Moderate	High	This scenario could materialise if tenants decide to move (or go bankrupt). Vasakronan is well protected through its very diverse tenant base and strong locations.
Low-value-added property investments/developments	Could adversely affect the key credit ratios	Low	Moderate	Large or low-value-added investments could impair the company's credit profile. Given the company's solid track record, major losses linked to this scenario is unlikely

Source: Company data and Nordea estimates

# Financial forecasts

Vasakronan will achieve rental growth primarily through continued strong rental market conditions, especially in Stockholm and Gothenburg. The substantial investment pipeline will affect free cash flow in the short term but over time will secure the high quality of Vasakronan's portfolio.

Future rental growth is driven by strong office rental market momentum, further enhanced by major expansionary investments

## Base-case key assumptions:

- Rental income increases in the coming years thanks to strong rental markets and continued investments in the existing portfolio.
- Underlying rental growth is calculated at 1.5% in the existing portfolio, reflecting modest expectations for increased market rent levels.
- The project portfolio delivers additional rental income at a 6.5% NOI yield, accounting for the incremental revenue growth in 2019-20.
- The NOI margin remains at 72% which is the average for the last five years.
- Capital expenditure is SEK 3bn during 2018-20.
- Dividend distribution remains at SEK 4bn.

## Credit-case key assumptions:

- Rental income increases in line with the base-case scenario for the full-year 2018.
- Rental income slows down to 0%, implying a weaker uplift from the general rental market than in the base case.
- The investment pipeline delivers a 5% yield on NOI, due to slightly weaker revenue growth than in the base-case scenario.
- The NOI margin falls back to 68% in 2020, somewhat below the historical level.
- Capital expenditure and dividends are maintained at base-case levels, reflecting locked-in construction agreements.

## Comments

Vasakronan presents a solid financial risk profile even in a scenario with slowing growth

We believe that the base-case scenario is realistic given the strong rental market and additional support from pipeline investments. In the credit scenario, the top-line effect from investments is weaker, and thus it is likely that profit margins will weaken in comparison with the levels seen in recent years.

In both scenarios, LTV in 2020 ends up at around 46%, which is a modest gearing level compared with the industry average, which is around 54%. The ICR levels remain robust in both scenarios, as debt is locked into swap agreements and we do not expect any major interest rate increase in the near term.

Vasakronan's massive investment portfolio is dominated by value-enhancing, expansionary investments which are carried out at its sole discretion

As Vasakronan is investing heavily in its existing portfolio (>SEK 3bn a year), the free operating cash flow generation is being materially affected. It is important to highlight that 65% of the ongoing investments consist of expansionary investments (newbuilds and rebuilding), which are carried out at Vasakronan's discretion. An additional 20% of the ongoing investments consist of tenant improvements. Depending on market and property quality, tenant improvement investments could either be value enhancing or value neutral. In the case of Vasakronan, we expect that a major share of tenant improvements can be viewed as value enhancing. The residual 15% of investments are periodical maintenance/upkeep. This implies that free cash flow (FOCF) could be adjusted upwards by at least SEK 2bn, indicating a substantially stronger cash surplus than initially meets the eye.

The fact that credit ratios move sideways in these forecasts is explained by the substantial investments and dividend commitments. However, an upgraded portfolio should enhance value in the long term. Hence, we believe that carrying out property upgrades is appropriate when the rental market is strong and the opportunity to acquire affordable assets in Vasakronan's natural habitat is limited. This is a clear trend being adopted by several Swedish companies in the current market conditions. Over time, well-kept properties will attract tenants and eventually increase asset value.

**VASAKRONAN: FINANCIALS****SEK(m)**

Credit adjusted figures								Base Case			Credit Case		
	2012	2013	2014	2015	2016	2017	Q3 LTM	2018E	2019E	2020E	2018E	2019E	2020E
Revenues	5,969	6,032	5,899	6,009	6,251	6,490	6,660	6,660	6,934	7,313	6,660	6,705	6,856
- growth	-1%	1.1%	-2.2%	1.9%	4.0%	3.8%	2.6%	2.6%	4.1%	5.5%	2.6%	0.7%	2.3%
NOI	4,272	4,279	4,172	4,274	4,459	4,678	4,795	4,795	4,992	5,266	4,795	4,694	4,662
NOI-margin, %	72%	71%	71%	71%	71%	72%	72%	72%	72%	72%	72%	70%	68%
Property value	84,074	87,145	91,889	103,894	115,922	126,875	134,303	137,460	140,511	143,509	137,460	140,477	143,473
Debt	44,833	45,274	46,839	50,750	55,240	58,421	59,630	60,621	62,621	65,421	60,421	63,021	66,282
Equity	32,660	36,357	35,094	41,245	46,117	51,377	56,279	57,430	56,362	55,455	57,431	56,131	54,745
FFO	2,678	2,625	2,822	2,979	3,144	3,373	3,435	3,588	3,684	3,842	3,542	3,350	3,201
Change in NWC	-91	202	113	355	284	-272	154	51	82	114	51	14	45
OCF	2,280	2,753	2,902	3,239	3,439	3,088	3,578	3,639	3,767	3,956	3,593	3,363	3,246
Capex	0	0	0	0	-2,040	-2,543	-3,197	-3,197	-3,051	-2,998	-3,197	-3,017	-2,996
FOCF	2,280	2,753	2,902	3,239	1,399	545	381	442	716	957	397	346	250
Net acquisitions	-820	-1,119	-1,243	-1,775	2,063	-442	895	1,812	0	0	1,812	0	0
Dividends	-1,273	-1,177	-4,000	-4,924	-7,382	-4,000	-4,000	-4,000	-4,021	-3,988	-4,000	-4,022	-3,987
<b>LTV</b>	<b>53%</b>	<b>52%</b>	<b>51%</b>	<b>49%</b>	<b>48%</b>	<b>46%</b>	<b>44%</b>	<b>44.1%</b>	<b>44.6%</b>	<b>45.6%</b>	<b>44.0%</b>	<b>44.9%</b>	<b>46.2%</b>
ICR (EBITDA)	2.7 x	2.8 x	3.2 x	3.7 x	3.7 x	3.9 x	3.8 x	4.7 x	4.4 x	4.3 x	4.7 x	4.2 x	3.7 x
<b>FFO/debt</b>	<b>6.0%</b>	<b>5.8%</b>	<b>6.0%</b>	<b>5.9%</b>	<b>5.7%</b>	<b>5.8%</b>	<b>5.8%</b>	<b>5.9%</b>	<b>5.9%</b>	<b>5.9%</b>	<b>5.9%</b>	<b>5.3%</b>	<b>4.8%</b>
DCF/debt	7.9%	8.7%	14.7%	16.1%	15.9%	7.8%	7.3%	7.3%	7.6%	7.6%	7.3%	6.9%	6.4%
<b>Debt/EBITDA</b>	<b>10.5x</b>	<b>10.9x</b>	<b>11.5x</b>	<b>12.3x</b>	<b>12.7x</b>	<b>12.8x</b>	<b>12.9x</b>	<b>12.9x</b>	<b>12.8x</b>	<b>12.7x</b>	<b>12.9x</b>	<b>13.7x</b>	<b>14.5x</b>

Source: Company data and Nordea estimates

# Reported numbers and forecasts

## INCOME STATEMENT

SEKm	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
Total revenue	6,048	5,969	6,032	5,899	6,009	6,251	6,490	6,660	6,934	7,313
- growth	9.8%	-1.3%	1.1%	-2.2%	1.9%	4.0%	3.8%	2.6%	4.1%	5.5%
NOI	4,211	4,272	4,279	4,172	4,274	4,459	4,678	4,795	4,992	5,266
- margin	69.6%	71.6%	70.9%	70.7%	71.1%	71.3%	72.1%	72.0%	72.0%	72.0%
EBITDA	4,211	4,272	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
- margin	69.6%	71.6%	68.7%	68.8%	68.5%	69.7%	70.2%	70.5%	70.5%	70.5%
EBITA	4,093	4,129	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
- margin	67.7%	69.2%	68.7%	68.8%	68.5%	69.7%	70.2%	70.5%	70.5%	70.5%
EBIT	4,090	4,128	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
- margin	67.6%	69.2%	68.7%	68.8%	68.5%	69.7%	70.2%	70.5%	70.5%	70.5%
Value changes	3,773	1,254	1,952	3,519	10,212	12,053	7,970	9,200	0	0
Pre-tax profit	5,283	3,252	5,741	3,329	13,803	14,491	11,828	12,888	3,787	3,949
Taxes	-1,345	671	-923	-642	-2,859	-3,019	-2,559	-2,835	-833	-869
Net profit, continuing operation:	3,938	3,923	4,818	2,687	10,944	11,472	9,269	10,053	2,954	3,080
Discontinued operations	0	0	0	0	0	0	0	0	0	0
Net profit to equity	3,938	3,923	4,818	2,687	10,944	11,472	9,269	10,053	2,954	3,080
EBITDA (credit adj)	4,211	4,272	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
EBIT (credit adj)	4,090	4,128	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
Interest expense (credit adj)	-1,657	-1,577	-1,503	-1,256	-1,121	-1,162	-1,167	-1,008	-1,102	-1,207

Source: Company data and Nordea estimates

## BALANCE SHEET

SEKm	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
Goodwill	0	0	0	0	0	0	0	0	0	0
Other intangibles	0	0	0	0	21	2,171	2,145	2,145	2,145	2,145
Tangible assets	82,370	84,074	87,145	91,889	103,894	115,922	126,875	137,460	140,511	143,509
Shares associates	0	0	0	0	0	0	0	0	0	0
Interest bearing assets	0	0	0	0	0	0	0	0	0	0
Deferred tax assets	0	0	0	0	0	0	0	0	0	0
Other non-interest bearing non-	0	0	0	0	0	0	0	0	0	0
Other non-current assets	2,950	2,878	2,827	2,839	2,775	907	969	969	969	969
Non-current assets	85,320	86,952	89,972	94,728	106,690	119,000	129,989	140,574	143,625	146,623
Inventory	0	0	0	0	0	0	0	0	0	0
Accounts receivable	846	751	700	699	795	909	871	894	931	982
Other current assets	0	0	0	0	0	0	0	0	0	0
Cash and cash equivalents	2,480	1,616	2,570	1,757	2,301	2,147	1,423	1,877	572	342
Current assets	3,326	2,367	3,270	2,456	3,096	3,056	2,294	2,771	1,502	1,323
Assets held for sale	0	0	0	0	0	0	0	0	0	0
Total assets	88,646	89,319	93,242	97,184	109,786	122,056	132,283	143,345	145,127	147,946
Shareholders equity	29,716	32,660	36,357	35,094	41,245	46,117	51,377	57,430	56,362	55,455
Minority interest	0	0	0	0	0	0	0	0	0	0
Deferred tax	7,993	6,942	7,859	8,532	11,356	14,362	16,824	19,559	20,290	21,052
Convertible debt	0	0	0	0	0	0	0	0	0	0
Long term interest bearing debt	31,786	31,599	31,534	34,640	34,984	39,334	44,711	46,911	48,911	51,711
Non-current liabilities	0	0	0	0	0	0	0	0	0	0
Pension provisions	0	0	0	0	0	0	86	86	86	86
Other long-term provisions	1,127	1,612	440	0	0	278	55	55	55	55
Other long-term liabilities	79	62	64	3,610	3,067	3,383	2,699	2,699	2,699	2,699
Non-current liabilities	40,985	40,215	39,897	46,782	49,407	57,357	64,375	69,310	72,041	75,603
Short-term provisions	0	0	0	0	0	0	0	0	0	0
Accounts payable	0	0	0	0	0	0	0	0	0	0
Other current liabilities	3,437	3,210	3,248	3,109	3,368	2,676	2,821	2,895	3,014	3,179
Short term interest bearing debt	14,508	13,234	13,740	12,199	15,766	15,906	13,710	13,710	13,710	13,710
Current liabilities	17,945	16,444	16,988	15,308	19,134	18,582	16,531	16,605	16,724	16,889
Liabilities for assets held for sa	0	0	0	0	0	0	0	0	0	0
Total liabilities and equity	88,646	89,319	93,242	97,184	109,786	122,056	132,283	143,345	145,127	147,946
Cash and cash eq (credit adj)	2,480	1,616	2,570	1,757	2,301	2,147	1,423	1,877	572	342
Total assets (credit adj)	88,646	89,319	93,242	97,184	109,786	122,056	132,283	143,345	145,127	147,946
Shareholders equity (credit adj)	29,716	32,660	36,357	35,094	41,245	46,117	51,377	57,430	56,362	55,455
Debt (credit adj)	46,294	44,833	45,274	46,839	50,750	55,240	58,421	60,621	62,621	65,421

Source: Company data and Nordea estimates

**CASH FLOW STATEMENT**

SEKm	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
EBITDA	4,211	4,272	4,141	4,058	4,115	4,354	4,555	4,696	4,889	5,156
Adj due to change in group stru	0	0	0	0	0	0	0	0	0	0
Change in Provisions	0	0	0	0	0	0	0	0	0	0
Other non-cash adjustments	-27	-13	0	0	8	0	11	0	0	0
Net financials	-1,687	-1,728	-1,577	-1,309	-1,323	-1,191	-1,191	-1,008	-1,102	-1,207
Dividends received	0	0	0	0	0	0	0	0	0	0
Paid taxes	-17	-17	-13	20	-15	-48	-15	-100	-103	-107
Other	0	0	0	20	99	40	0	0	0	0
Operating cash flow before NW	2,480	2,514	2,551	2,789	2,884	3,155	3,360	3,588	3,684	3,842
Change in NWC	288	-91	202	113	355	284	-272	51	82	114
Operating cash flow	2,768	2,423	2,753	2,902	3,239	3,439	3,088	3,639	3,767	3,956
CAPEX	0	0	0	0	0	-2,040	-2,543	-3,197	-3,051	-2,998
Free Operating cash flow	2,768	2,423	2,753	2,902	3,239	1,399	545	442	716	957
Dividends paid	-1,465	-1,273	-1,177	-4,000	-4,924	-7,382	-4,000	-4,000	-4,021	-3,988
Share issues / buybacks	0	0	0	0	0	0	-359	0	0	0
Discretionary cash flow	1,303	1,150	1,576	-1,098	-1,685	-5,983	-3,814	-3,558	-3,305	-3,030
Other investments / divestment	-2,036	-5,190	-4,107	-2,817	449	0	-1,054	162	0	0
Other	0	0	-6	-30	-29	0	0	0	0	0
Proceeds from sale of assets	1,058	4,370	2,988	1,574	-2,224	2,063	612	1,650	0	0
Net change to group borrowing	-196	-1,469	475	1,558	4,033	3,766	3,509	2,200	2,000	2,800
Other	0	0	0	0	0	0	23	0	0	0
Change in cash	11	-1,282	926	-813	544	-154	-724	454	-1,305	-230
Adjusted metrics										
Funds from operations (FFO) (€)	2,537	2,678	2,625	2,822	2,979	3,144	3,373	3,588	3,684	3,842
Operating cash flow (OCF) (adj)	2,650	2,280	2,753	2,902	3,239	3,439	3,088	3,639	3,767	3,956
Free operating cash flow (FOC)	2,650	2,280	2,753	2,902	3,239	1,399	545	442	716	957
Discretionary cash flow (DCF) (€)	1,185	1,007	1,576	-1,098	-1,685	-5,983	-3,455	-3,558	-3,305	-3,030

Source: Company data and Nordea estimates

**KEY RATIOS**

Profitability	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
ROC	5.0%	4.9%	4.8%	4.5%	4.2%	4.0%	3.8%	3.6%	3.5%	3.7%
ROIC after tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROE after tax	14.0%	12.6%	14.0%	7.5%	28.7%	26.3%	19.0%	18.5%	5.2%	5.5%
Debt & Interest coverage	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
FFO/Debt	5.5%	6.0%	5.8%	6.0%	5.9%	5.7%	5.8%	5.9%	5.9%	5.9%
FOCF/Debt	5.7%	5.1%	6.1%	6.2%	6.4%	2.5%	0.9%	0.7%	1.1%	1.5%
DCF/Debt	2.6%	2.2%	3.5%	-2.3%	-3.3%	-10.8%	-5.9%	-5.9%	-5.3%	-4.6%
EBITDA interest coverage	2.5	2.7	2.8	3.2	3.7	3.7	3.9	4.7	4.4	4.3
Fixed-charge coverage	2,554.0	2,695.0	2,638.0	2,802.0	2,994.0	3,192.0	3,388.0	3,687.8	3,786.9	3,948.9
Leverage	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
Loan-to-value	56.2%	53.3%	52.0%	51.0%	48.8%	47.7%	46.0%	44.1%	44.6%	45.6%
Equity ratio	33.5%	36.6%	39.0%	36.1%	37.6%	37.8%	38.8%	40.1%	38.8%	37.5%
Debt/(Debt+Equity)	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Capital expenditure	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
CAPEX/Depreciation and amor	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.
CAPEX/Sales	0.00	0.00	0.00	0.00	0.00	-0.33	-0.39	-0.48	-0.44	-0.41
Working capital ratios	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
Inventory turnover (days)	0	0	0	0	0	0	0	0	0	0
Receivables turnover (days)	51	46	42	43	48	53	49	49	49	49
Days sales outstanding (days)	0	0	0	0	0	0	0	0	0	0
Per share data	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
EPS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
EPS (adj.)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BVPS	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.
Equity valuation and yield	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
Market cap.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Enterprise value	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
P/E	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
P/BV	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EV/Sales	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EV/EBITDA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Dividend yield	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Payout ratio	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Company data and Nordea estimates



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**Recommendation definitions****Outperform**

Over the next three months we expect the performance of this fixed income instrument to exceed the performance of the relevant index, sector or benchmark

**Market perform**

Over the next three months we expect the performance of this fixed income instrument to be in line with the performance of the relevant index, sector or benchmark

**Underperform**

Over the next three months we expect the performance of this fixed income instrument to fall short of the performance of the relevant index, sector or benchmark

The relevant benchmark is set at the individual bond level, and determined by factors such as the currency, time to maturity and the credit quality of the bond. All research is produced on an ad hoc basis and will be updated when the circumstances require it.

**Distribution of recommendations**

Recommendation	Count	% Distribution
Outperform	155	32%
Market perform	211	43%
Underperform	121	25%
<b>Total</b>	<b>487</b>	<b>100%</b>

As of 1 Oct 2018

**Market-making obligations and other significant financial interest**

Nordea Markets has no market-making obligations in Vasakronan.

**Investment banking transactions**

Nordea has been lead or co-lead manager in a public disclosed offer of financial instruments issued by Vasakronan over the previous 12 months.

**Distribution of recommendations (transactions)\***

Recommendation	Count	Distribution
Outperform	59	32%
Market perform	73	40%
Underperform	51	28%
<b>Total</b>	<b>183</b>	<b>100%</b>

As of 1 Oct 2018

\* Companies under coverage with which Nordea has ongoing or completed public investment banking transactions.

**Completion Date**

30 Nov 2018, 14:59 CET

**Issuer Review**

This report has not been reviewed by the Issuer prior to publication.

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