

Vasakronan AB

Q3 23: Strong financial position amid weakening rental market

Vasakronan delivered a credit-neutral report for Q3 23, with a solid operational performance. Rental income and net operating profit rose substantially, while net letting came in positive at SEK17m for the quarter. However, over the last 12 months, net letting was negative SEK85m; the company said that potential tenants are increasingly cautious and that the rental market has become increasingly soft, especially in H2 23. Property values declined by 0.8% in the quarter, making the decline 9% over the past five quarters. Despite the decline, adjusted net LTV was unchanged from Q2 23 at 42%. Adjusted interest coverage weakened slightly to 3.6x from 3.7x a quarter earlier. The metric thus remains close to Moody's 3.5x downgrade threshold. However, headroom is becoming increasingly limited and we expect the metric to average around 3.5x over the coming year. We continue to regard the company's bonds as fairly valued and maintain our Marketweight recommendation.

In Q3 23, Vasakronan's rental income and net operating income increased by 13% and 16% y/y, respectively. In a comparable portfolio, the figures were 11% and 13% y/y. The LTM NOI margin improved slightly to 74% from 73% a year earlier. Net letting in the quarter came in at SEK17m, thereby breaking the previous trend of two consecutive quarters with negative net letting. Although a positive movement, the company stated that it is witnessing increasingly cautious potential tenants in a weakening rental market. Occupancy decreased slightly to 91.1% from 91.5% in Q2 23.

Property value changes amounted to negative SEK1.5bn in the quarter, or -0.8%, as the valuation yield was lifted by 5bp to 4.24%. Over the past five quarters, Vasakronan has increased its average valuation yield by around 50bp, with a resulting -9% change to property values. Despite the decline in the quarter, adjusted net LTV was unchanged at 42% compared with Q2 23. We estimate that Moody's debt/assets ratio was 40% at the end of the quarter, and thus continues to have ample headroom to the 45% downgrade trigger.

Key figures

SEKm	Q3 22	Q2 23	Q3 23	y/y	q/q
Rental income	2,132	2,283	2,322	8.91%	1.71%
EBITDA (rep.)	1,488	1,592	1,757	18.08%	10.36%
Net income	-832	-1,252	-647	-22.24%	-48.32%
Investment properties	194,037	181,926	181,088	-6.67%	-0.46%
Total debt	83,830	82,378	82,300	-1.83%	-0.09%
Ratios	Q3 22	Q2 23	Q3 23	y/y	q/q
Gross LTV	40.5%	42.5%	42.6%	2.1pp	0.1pp
LTM NOI margin	70.9%	74.1%	77.5%	6.6pp	3.4pp
LTM EBITDA interest coverage (x)	4.8	3.7	3.6	-1.2pp	-0.1pp
Net debt/LTM EBITDA (x)	14.0	12.7	12.0	-1.9pp	-0.6pp
Total debt/total capital	47.1%	49.2%	49.3%	2.2pp	0.2pp

Source: Company data, Danske Bank Credit Research

Marketweight

Real Estate Holding, Development

Corporate ticker: FASTIG

Equity ticker: 1276Z SS

Ratings:

S&P: NR / NR

Moody's: A3 / S

Fitch: NR / NR

ESG rating:

Sustainalytics ESG Risk Rating: 7.1

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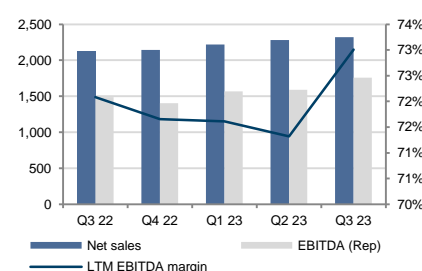
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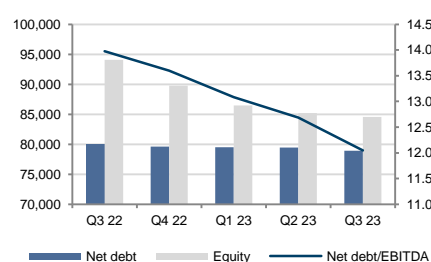
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Profitability (SEKm)



Source: Company data, Danske Bank Credit Research

Financial metrics (SEKm)



Source: Company data, Danske Bank Credit Research

Vasakronan's reported interest coverage ratio declined to 3.8x from 4.0x a quarter earlier. Our estimated adjusted interest coverage ratio came in at 3.6x, down from 3.7x in Q2 23. Compared to most peers, the metric remains quite strong. Nevertheless, the headroom to Moody's 3.5x downgrade trigger is decreasing.

Declining interest coverage ratio could impact Moody's rating

In April 2023, Moody's affirmed its 'A3' rating on Vasakronan, with a stable outlook. According to the rating agency, the rating reflects, among other things, Vasakronan's high-quality property portfolio, healthy credit metrics, high share of environmentally certified properties, and strong links to its owners – the First, Second, Third, and Fourth Swedish national pension funds.

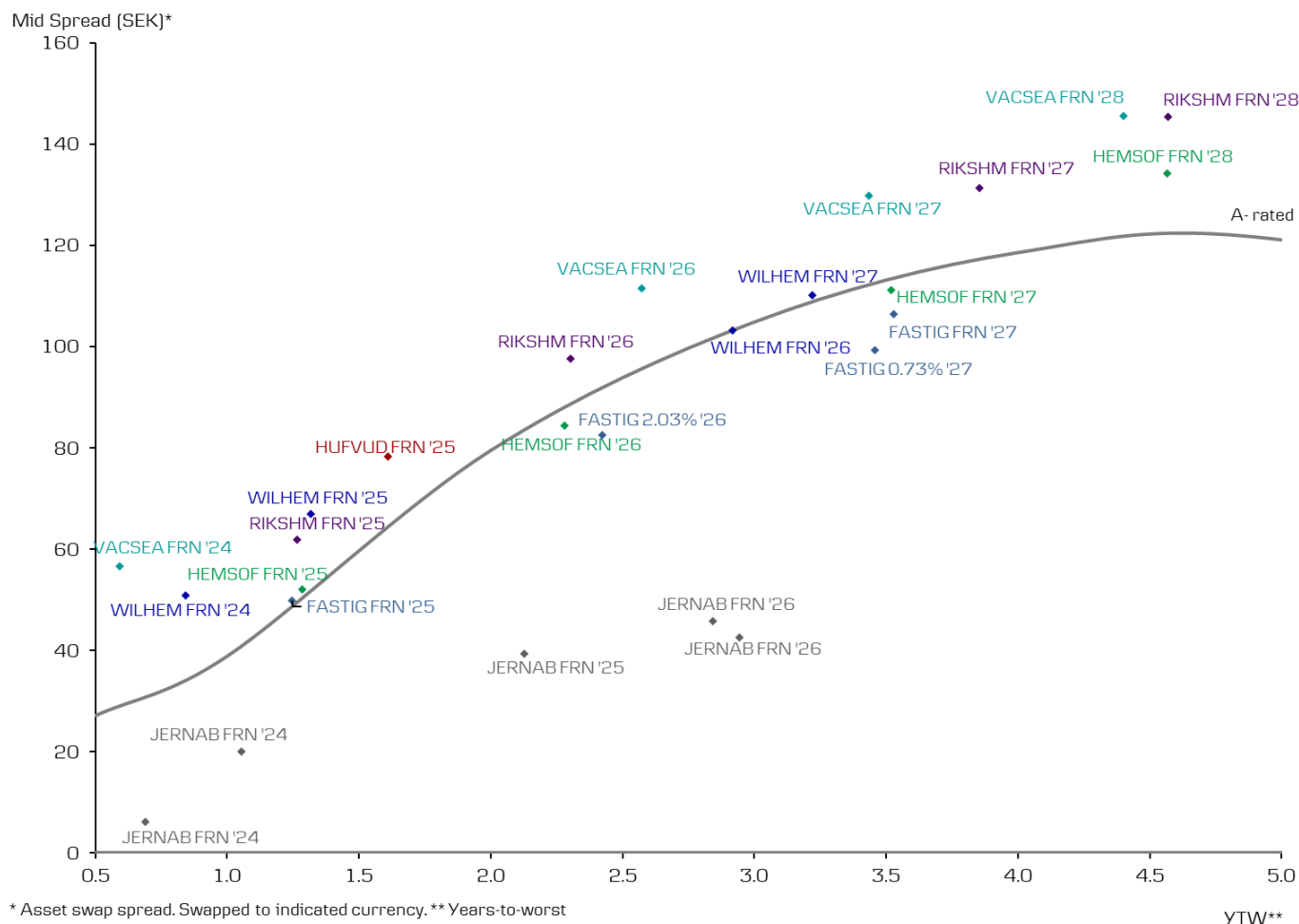
As higher interest rates keep feeding into Vasakronan's financial statements, we expect adjusted interest coverage to decline slightly beyond Moody's 3.5x downgrade trigger by end-2024 (3.4x in our base case scenario). Consequently, we do not rule out that Moody's could change Vasakronan's outlook to negative in H1 24.

Recommendation

Vasakronan benefits from its comparatively solid balance sheet and strong relationships with its government-related owners. We expect these factors to support the company in a real estate market that remains challenging. Even in a scenario where funding conditions become increasingly difficult, we expect Vasakronan to be one of few companies with access to several funding channels.

In our view, Vasakronan's credit profile remains strong relative to peers. However, we believe this is already reflected in the company's bond spread. Consequently, we see Vasakronan's bonds as fairly valued and maintain our Marketweight recommendation.

Relative value (SEK)



Source: Bloomberg, Danske Bank Credit Research

Company summary

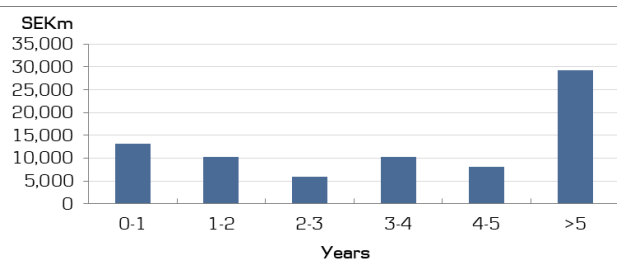
Company description

Vasakronan is one of Sweden's largest property companies. The property portfolio constitutes a mix of commercial properties in Sweden's largest cities. The current company structure was formed following AP Fastigheter's (controlled by the state-owned AP funds) acquisition of all shares of Vasakronan from the Swedish government in 2008. The merged corporation changed its name to Vasakronan. The company's strategy is focused on properties which provide a stable return over time, especially in Sweden's growth regions.

Key credit strengths

- High-quality properties, typically in strong locations
- Strong ownership from government pension funds
- Diversified tenant base with large portion of public sector tenants
- Proven access to debt capital markets

Debt maturity profile

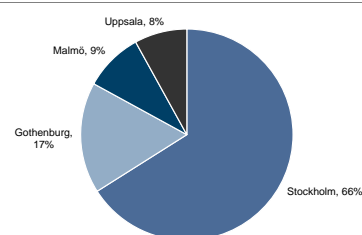


Selected outstanding bonds

Isin	Coupon	Currency	Maturity /Call	Seniority	Rating*
SE0010599183	1.265%	SEK	20/12/2023	Sr Unsecured	NR/NR
XS1956027277	FRN	SEK	26/02/2024	Sr Unsecured	NR/NR
XS2110248528	FRN	SEK	27/01/2025	Sr Unsecured	NR/NR
XS2150179237	2.03%	SEK	02/04/2026	Sr Unsecured	NR/NR
XS2286295881	0.73%	SEK	15/04/2027	Sr Unsecured	NR/NR

*Moody's/S&P

Sales breakdown, segments



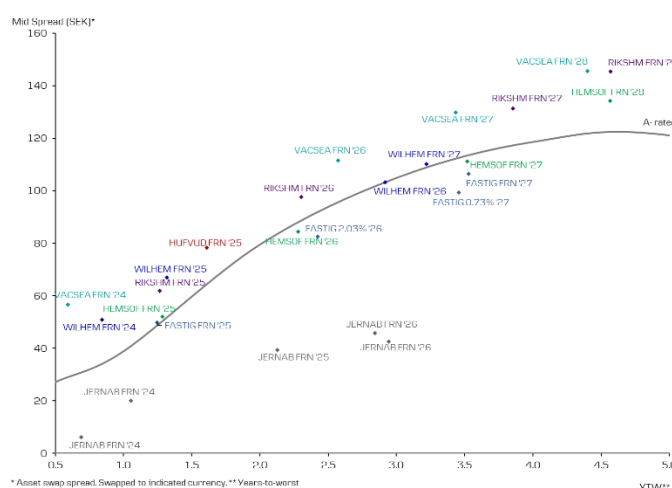
Key credit challenges

- Earnings exposed to swings in economic cycles
- Some, albeit manageable, exposure to project development
- Some sensitivity to interest rate movements, although mitigated by strong balance sheet

Main shareholders

Name	Votes (%)	Capital (%)
AP1	25.0%	25.0%
AP2	25.0%	25.0%
AP3	25.0%	25.0%
AP4	25.0%	25.0%

Relative valuation



Source: Company data, Bloomberg, Danske Bank Credit Research [all charts and tables]

Summary tables

Income statement (SEKm)	2020	2021	2022	2023E	2024E
Rental income	7,006	7,425	8,167	9,148	9,890
Other operating income	0	0	0	0	0
Total revenue	7,006	7,425	8,167	9,148	9,890
Total property related costs	1,817	1,892	2,199	2,343	2,596
Net operating income (NOI)	5,189	5,533	5,968	6,805	7,294
EBITDA	5,071	5,409	5,852	6,689	7,176
Net interest expenses	1,275	1,211	1,368	1,910	2,082
Profit from property management	3,571	4,379	4,325	4,665	5,087
Change in property values	1,083	15,255	4,917	-12,836	-13,822
Change in financial derivatives	167	938	1,291	-855	0
Other	-219	193	-151	-108	0
Pre-tax profit	4,821	20,572	10,533	-9,026	-8,735
Current tax	-203	-223	-135	-260	262
Deferred tax	-903	-3,990	-1,932	1,754	415
Net income	3,715	16,359	8,466	-7,531	-8,058
Balance sheet (SEKm)	2020	2021	2022	2023E	2024E
Market value properties	162,420	181,575	188,317	178,091	166,982
Other fixed assets	47	102	153	9,075	9,075
Intangible assets	2,044	2,044	2,018	2,020	2,020
Deferred tax assets	0	0	0	0	0
Investments in associated companies					
Cash and cash equivalents	2,558	3,521	2,984	4,240	7,961
Total assets	175,196	196,115	208,585	201,260	193,872
Equity	70,869	85,290	89,767	82,236	74,177
Shareholder loans	0	0	0	0	0
Deferred taxes	22,269	26,273	28,212	26,458	26,043
Total debt	74,481	78,996	82,576	82,571	83,657
Other liabilities	8,353	5,635	8,030	9,995	9,995
Total equity and liabilities	175,972	196,194	208,585	201,260	193,872
Cash flow statement (SEKm)	2020	2021	2022	2023E	2024E
FFO (adjusted)	3,547	3,572	4,272	4,608	5,349
Cash flow from operations (FFO)	3,818	3,947	4,436	4,420	5,349
Investment (properties)	-181	-214	-21	0	0
Disposals (properties)	229	449	562	0	0
Investments other (net)	-37	-88	33	-18	0
Capex	-5,314	-4,137	-2,366	-2,610	-2,714
Free operating cash flow	-1,455	37	2,611	1,811	2,635
Dividends and share repurchased	-3,000	-2,000	-4,000	0	0
Debt financing (net)	4,196	3,132	1,650	221	1,086
Change in cash	-957	963	-537	1,256	3,721

Source: Company data, Danske Bank Credit Research estimates

Summary tables

Adjusted ratios (SEKm)	2020	2021	2022	2023E	2024E
Sales growth	-0.5%	6.0%	10.0%	12.0%	8.1%
EBITDA margin	72.4%	72.8%	71.7%	73.1%	72.6%
NOI margin	74.1%	74.5%	73.1%	74.4%	73.8%
EBITDA interest coverage (x)	4.0	4.5	4.3	3.5	3.4
FFO/interest coverage (x)	3.8	3.9	4.1	3.4	3.6
FFO/debt (x)	4.8%	4.5%	5.2%	5.6%	6.4%
Net debt/EBITDA (x)	14.8	13.5	14.0	11.9	10.5
Gross LTV	45.9%	43.5%	43.8%	46.4%	50.1%
Net LTV	44.3%	41.6%	42.3%	44.0%	45.3%
Equity ratio	40.5%	43.5%	43.0%	40.9%	38.3%
Total debt/total capital	51.2%	48.1%	47.9%	50.1%	53.0%
Quarterly overview (SEKm)	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23
Rental income	2,132	2,143	2,221	2,283	2,322
EBITDA	1,488	1,402	1,567	1,592	1,757
Net interest expenses	359	421	449	472	493
Net income	-832	-4,321	-3,310	-1,252	-647
CFO	1,270	1,433	967	872	1,338
Investment properties	194,037	188,317	183,809	181,926	181,088
Total debt	83,830	82,576	81,597	82,378	82,300
Net debt	79,963	79,592	79,508	79,436	78,896
Equity	94,064	89,767	86,458	85,205	84,558
Ratios					
LTM NOI margin	70.9%	72.7%	72.9%	74.1%	77.5%
LTM EBITDA margin	72.1%	71.7%	71.6%	71.3%	73.0%
Direct yield	3.0%	3.2%	3.4%	3.5%	3.7%
Gross LTV	43.2%	43.8%	44.4%	45.3%	45.4%
LTM EBITDA interest coverage (x)	4.8	4.3	4.0	3.7	3.6
Net debt/LTM EBITDA (x)	14.0	13.6	13.1	12.7	12.0
Total debt/total capital	47.1%	47.9%	48.6%	49.2%	49.3%
FFO/debt	1.3%	1.4%	1.3%	1.2%	1.5%

Source: Company data, Danske Bank Credit Research estimates

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