

Vacse AB (publ)

Full Rating Report

LONG-TERM RATING

A-

OUTLOOK

Stable

SHORT-TERM RATING

N-1+

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RATING RATIONALE

Our 'A-' long-term issuer rating on Swedish property manager Vacse AB (publ) reflects the company's strong portfolio of modern, tailor-made properties leased on long contracts to highly creditworthy public-sector authorities that are essential to Sweden's public security. It is supported by Vacse's strong financial position, low risk appetite, and relatively moderate leverage. We consider Vacse's approach to sustainability a supportive factor in our assessment of its property portfolio, primarily because we expect demand from government tenants for sustainability credentials to increase as Sweden strives to meet its commitments to the Paris Agreement.

These strengths are somewhat offset by the limited number of Vacse's properties (19) and tenants, with the top 10 tenants generating virtually all of the company's revenues. We believe Vacse's tenant concentration creates some risk at contract expiry, though this is low as only 16% of the company's contracts (by value) expire within the next three years.

STABLE OUTLOOK

The stable outlook reflects our expectation that Vacse will continue to focus on similar types of properties and tenants, and long lease terms. We expect the company to keep development projects at around 5% of the overall portfolio by area and maintain its low-risk financial profile. The outlook reflects our expectation that the company will continue to obtain certification of new properties and maintain its proactive attitude towards sustainability. It also reflects our stable economic outlook for Sweden's wider community-service sector.

POTENTIAL POSITIVE RATING DRIVERS

- Significant portfolio growth and diversification without compromising low-risk business profile and credit metrics.

POTENTIAL NEGATIVE RATING DRIVERS

- Net loan to value (LTV) above 45% and EBITDA/net interest below 5.0x over a protracted period.
- Deviation from low-risk business profile.

Figure 1. Vacse key credit metrics, 2017–2023e

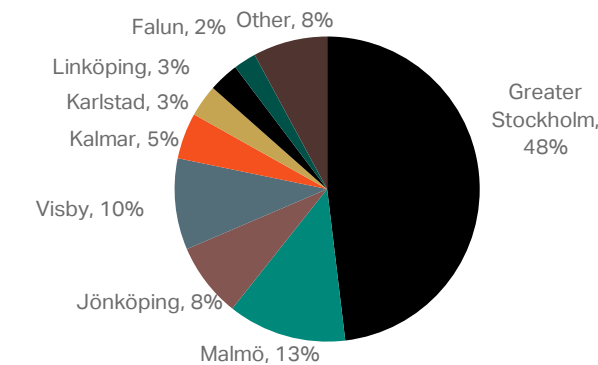
SEKm	2017	2018	2019	2020	2021e	2022e	2023e
Rental income	334	340	369	384	425	441	450
NCR-adj. EBITDA	264	263	282	296	327	339	346
NCR-adj. EBITDA margin (%)	79.1	77.4	76.5	77.2	77.0	76.9	76.8
NCR-adj. investment property	5,257	5,943	6,525	7,169	8,438	8,668	8,922
NCR-adj. net debt	2,046	2,416	2,657	2,793	3,361	3,413	3,481
Total assets	5,389	6,166	6,702	7,431	8,798	8,999	9,222
NCR-adj. net debt/EBITDA (x)	7.7	9.2	9.4	9.4	10.3	10.1	10.1
NCR-adj. EBITDA/net interest (x)	3.9	4.1	5.1	5.6	5.6	5.6	5.8
NCR-adj. net LTV (%)	38.9	40.7	40.7	39.0	39.8	39.4	39.0

Based on NCR estimates and company data. e—estimate. All metrics adjusted in line with NCR methodology.

ISSUER PROFILE

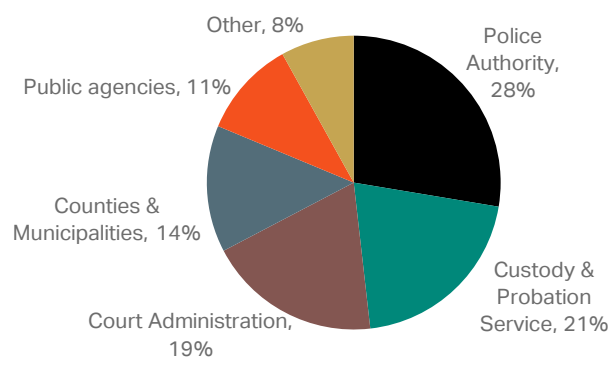
Vacse was founded in 2009 by pension foundations associated with Apoteket AB, Atlas Copco AB, Ericsson AB, Sandvik AB, Skanska AB, Stora Enso AB and AB Volvo. The company is a Swedish property provider focused on owning, managing and developing public-sector properties leased under long-term contracts to agencies of the Swedish government (mainly the police, custody services and courts administration) and municipalities. As of 30 Jun. 2021, the company's property portfolio consisted of 19 properties valued at SEK 8.4bn.

Figure 2. Vacse rental value by area, 30 Jun. 2021



Source: company.

Figure 3. Vacse rental value by tenant type, 30 Jun. 2021



Source: company.

BUSINESS RISK ASSESSMENT

Business risk assessment is 'a-'

Our business risk assessment reflects the stable operating environment, and Vacse's low-risk property portfolio and very high operating efficiency. It further reflects the company's long remaining lease terms at its 100%-occupied properties. Tenant concentration and overall size offset some of these strengths.

Strong operating environment supported by government creditworthiness

Operating environment scores 'a'

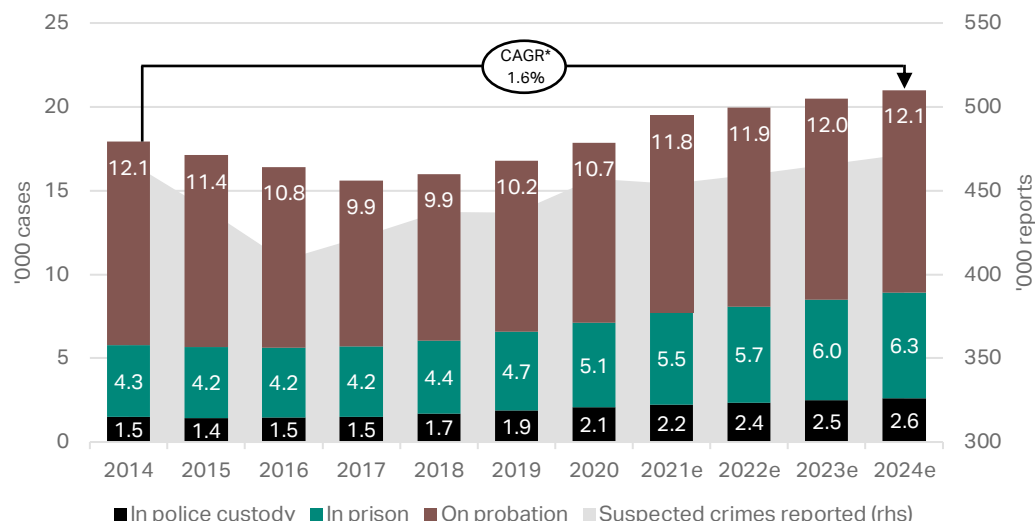
Vacse operates in the Swedish community-service property market, with 99% of revenues coming from public and government bodies. The sector has undergone a structural shift in recent years and a large proportion of public-tenant properties are now owned by private companies. An increasing number of Swedish municipalities are heavily debt-laden with limited possibilities of increasing tax revenues, and consequently need to review their investments.

Over the years, Vacse has proven successful in acquiring and developing properties for community services such as custody, court and police authorities. We view most of the company's tenants as essential to Sweden's public security, and our understanding is that most political parties in Sweden are committed to increasing resources for the police and judiciary. The need for law enforcement services is also increasing; Swedish prisons are at maximum capacity while levels of processed crimes and supervised sentences are likely to increase (see Figure 4).

Furthermore, there is widespread political acceptance that community services will require more investment due to the country's increasing population, which we expect to continue to show strong growth, especially within the age groups above 75 and below 20. As the dependent part of the population grows, municipalities will likely face increasing pressure to provide community services amid increasing public sector debt, the constraints of COVID-19, related costs, and loss of revenues. This supports the business case for companies such as Vacse, as municipalities increasingly outsource ownership of community service properties.

In recent years, Sweden's real estate sector has benefited from falling interest rates, steady yield compression, and increasing rent levels. The demand for properties for public use has also been increasing. These favourable market forces are positive for property providers such as Vacse. Accordingly, we expect the operating environment to remain stable.

Figure 4. Swedish crime statistics, 2014–2024e



Source: Swedish Prison and Probation Service. *Compound annual growth rate.

Small portfolio and high tenant concentration, but strong market position in niche segment

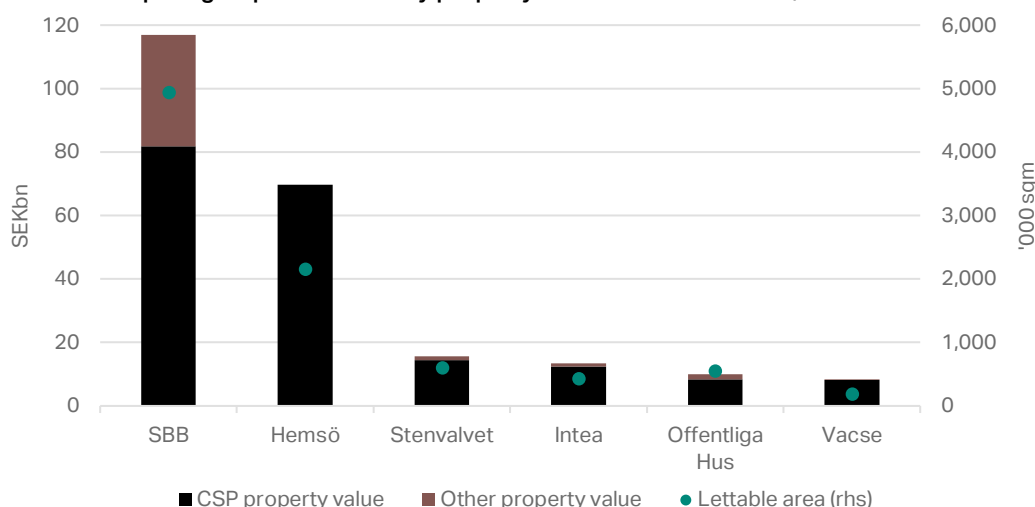
Market position, size and diversification scores 'bb-'

As of 30 Jun. 2021, Vacse's property portfolio consisted of 19 buildings totalling 190,000 sqm with a market value of SEK 8.4bn. Most of the properties are located in the Greater Stockholm region (48%) with the municipality of Sollentuna just north of the capital representing the largest single exposure. The geographic concentration arises from the proximity of complementary community services including custody and probation services and the national courts administrator.

Vacse's property portfolio is limited in size. However, the company has gained a strong foothold in a niche market. Some tenants occupy multiple buildings in several locations, and the company's long-term focus and stable ownership supports long-term contracts with demanding, socially important tenants.

Vacse is small in comparison with its peers (see Figure 5). The largest are Samhällsbyggnadsbolaget i Norden AB and Hemsö Fastighets AB which, thanks to their size, have greater tenant diversity. Smaller peers, such as Stenvalvet AB, Intea Fastigheter AB, and Offentliga Hus i Norden AB, also have greater tenant diversity but lower levels of public-sector tenants.

Figure 5. Vacse peer group breakdown by property value and lettable area, 30 Jun. 2021



Source: companies. CSP–Community-service property.

Vacse's top 10 tenants generate close to 94% of the company's revenues. While the company's tenant concentration is significant, the quality of the tenants reduces this risk in our view. We view virtually

all of the company's tenants as highly creditworthy as 99% of revenues are funded through regional or national government budgets.

Figure 6. Vacse tenant concentration, 30 Jun. 2021

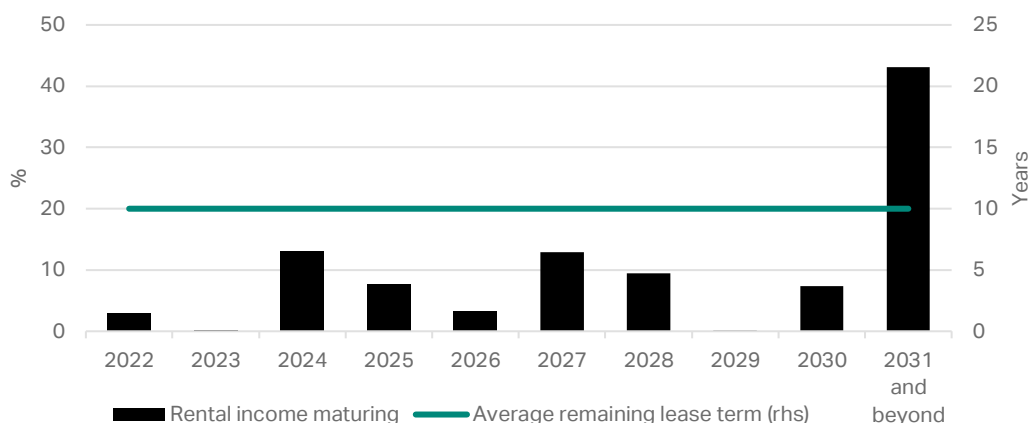
Tenant	Type of tenant	Share of rental income
The Swedish Police Authority	Public	27.6%
The Swedish Custody and Probation Service	Public	20.6%
The Swedish National Courts Administration	Public	19.1%
Gotland municipality	Public	7.5%
The Swedish Board of Agriculture & Swedish Forest Agency	Public	7.0%
The Swedish Civil Contingencies Agency	Public	3.6%
Linköping municipality	Public	3.3%
The Royal Library	Public	2.1%
Öckerö municipality	Public	1.9%
Uppsala municipality	Public	1.2%
Top 10 tenants	-	94.1%

Source: company.

Project portfolio reduced due to finalisation of several development projects

Most of Vacse's properties (85%) are custom-built and highly specialised, encouraging tenant loyalty. The company has a very long remaining lease-term of 10 years (see Figure 7), in high quality properties with a weighted average age of 10 years.

Figure 7. Vacse lease maturity profile, 30 Jun. 2021



Source: company.

According to the Swedish Environmental Protection Agency, the real estate sector accounts for one-fifth of Sweden's emissions and one-third of its waste, with the majority arising during development and refurbishing. As most of Vacse's tenants are publicly funded, and the Swedish government is committed to the Paris Agreement, we expect that Vacse's tenants will become more demanding in terms of sustainability. Most of Vacse's properties are certified within the BREEAM or LEED frameworks, and the company aims to obtain similar certifications for all new developments and acquisitions. There is a risk that new tenants might not be forthcoming if existing contracts are not extended, and alternative use of specialised properties could result in increased capital spending. However, we see the company's proactive stance on certification and sustainability as supportive of its property values and a positive factor in extending contract maturities.

During 2020 and early 2021, Vacse finalised four development projects, leaving the project portfolio with only one development project, a court building in Norrköping. The project will increase the company's lettable area by 4,200sqm on completion, which we expect in 2023 or 2024. Since the project

Portfolio assessment scores 'a+'

is small in relation to Vacse's total property portfolio (2%), we view overall development risk as low. We expect the company to enter into new project developments during our forecast period through 2023. However, we expect the level of such exposure to remain at below, or around, 5% of the value of the total portfolio.

Figure 8. Vacse sole project in progress, 30 Jun. 2021

Project	Location	Lettable area (sqm)	Total investment (SEKm)	Estimated completion
District Court	Norrköping	4,200	250	2023/2024

Source: company.

Strong operating efficiency

As most of Vacse's properties are modern and highly specialised, typically with one long-term tenant, operating efficiency in terms of occupancy rates and EBITDA margins is high. The average 10-year remaining maturity in the virtually 100%-occupied property portfolio (including the development project), provides transparency into the company's income prospects. We further expect the company's EBITDA margin to remain above 75% as a result of negligible tenant turnover, the newness of the properties, and outsourced maintenance contracts. A large number of triple net contracts reduces most of the volatility in the operational costs of property management.

Revenue stability is further supported by lease contracts that effectively guarantee long-term relationships and stable rental income that has low correlation with the economic cycle. Vacse has reported no financial effects on revenues due to COVID-19. All of the company's tenants have made their rental payments on time in accordance with the contracted terms since the onset of the pandemic.

We expect Vacse to continue to operate with very high occupancy rates of close to 100%. The risk of increased vacancy rates and reduced revenues due to project development is offset by the fact that the company's development properties are generally pre-let and that new contracts typically have long lease terms of around 20 years with highly creditworthy tenants.

Operating efficiency scores 'aa'

Figure 9. Vacse revenues, net operating income, EBITDA, and margins, 2017–2023e

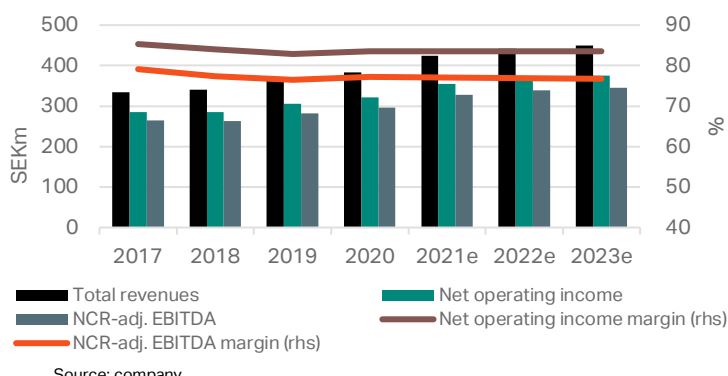
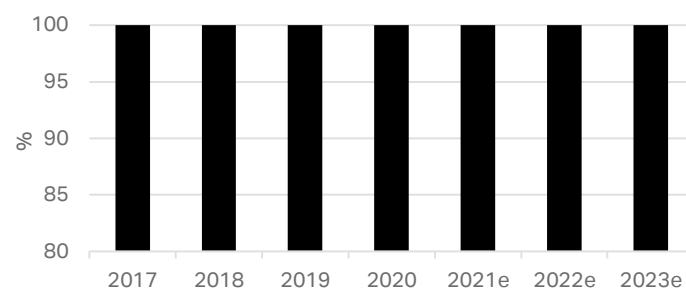


Figure 10. Vacse occupancy rate, 2017–2023e



Source: company.

FINANCIAL RISK ASSESSMENT

Our financial risk assessment reflects Vacse's relatively modest and stable leverage and strong net interest coverage. We view the company's overall financial policies and risk appetite as relatively prudent and supported by long-term, risk-averse owners.

Low leverage in comparison with peers provides stable returns

Over the past few years, Vacse has maintained a relatively constant financial position with NCR-adjusted net LTV of 39–41% and net debt/EBITDA of 9.2–9.4x. NCR-adjusted net interest coverage has improved from 4.1x to 5.6x. In the short term, we expect Vacse to keep only a small number of development projects relative to the overall portfolio and maintain a stable financial position. In our forecast, we expect the company's financial metrics to remain at around current levels. In our base-case scenario, we assume the following:

Financial risk assessment is 'a-'

Ratio analysis scores 'a-'

- rental income growth of 11% in 2021, 4% in 2022, and 2% in 2023,
- an EBITDA margin of above 75%;
- interest costs on external debt reflecting an annual interest rate of 1.7–1.8%;
- investments in existing properties and new projects of about SEK 200m annually during our forecast period through 2023; and
- no increase in the value of the existing portfolio other than increases from completion of new projects.

On the basis of these assumptions, we arrive at the following projected metrics for 2021–2023:

- NCR-adjusted net LTV of 39–40%;
- NCR-adjusted EBITDA to net interest of 5.6–5.8x; and
- NCR-adjusted net debt to EBITDA of 10.1–10.3x.

While projected net debt/EBITDA of around 10x weighs negatively on our assessment of Vacse's financial risk, the impact is offset by the company's long remaining average lease term. Compared with its peers, Vacse has a high proportion of government-related tenant revenues, which supports our view that the company's risk appetite is commensurate with our financial ratio analysis.

Figure 11. NCR's adjustments to Vacse's credit metrics, 2017–2023e

SEKm	2017	2018	2019	2020	2021e	2022e	2023e
EBITDA	264	263	282	296	327	339	346
NCR-adj. EBITDA	264	263	282	296	327	339	346
Gross debt	2,138	2,604	2,774	3,001	3,608	3,631	3,669
Leasing liabilities	0	0	3	2	2	2	2
NCR-adj. total debt	2,138	2,604	2,777	3,003	3,610	3,633	3,671
Cash and cash equivalents	92	188	120	210	249	219	189
NCR-adj. cash and equivalents	92	188	120	210	249	219	189
NCR-adj. net debt	2,046	2,416	2,657	2,793	3,361	3,413	3,481
Net financial items (incl. financial cost of leasing)	-68	-64	-55	-53	-59	-61	-60
NCR-adj. net interest	-68	-64	-55	-53	-59	-61	-60
Investment property	5,257	5,943	6,522	7,167	8,436	8,666	8,920
Non-current right-of-use assets	0	0	3	2	2	2	2
NCR-adj. investment property	5,257	5,943	6,525	7,169	8,438	8,668	8,922

Based on NCR estimates and company data. e–estimate.

Figure 12. Vacse NCR-adj. investment properties, net debt, and net LTV, 2017–2023e

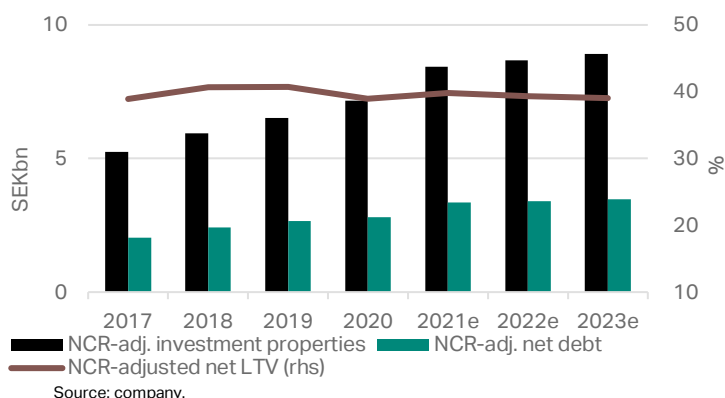
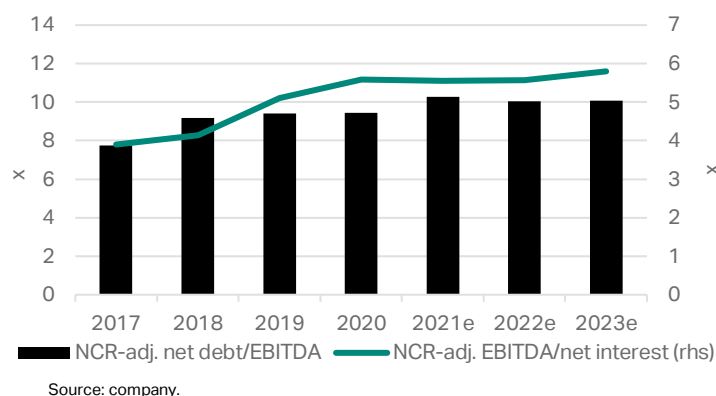


Figure 13. Vacse NCR-adj. net debt/EBITDA and EBITDA/net interest, 2017–2023e



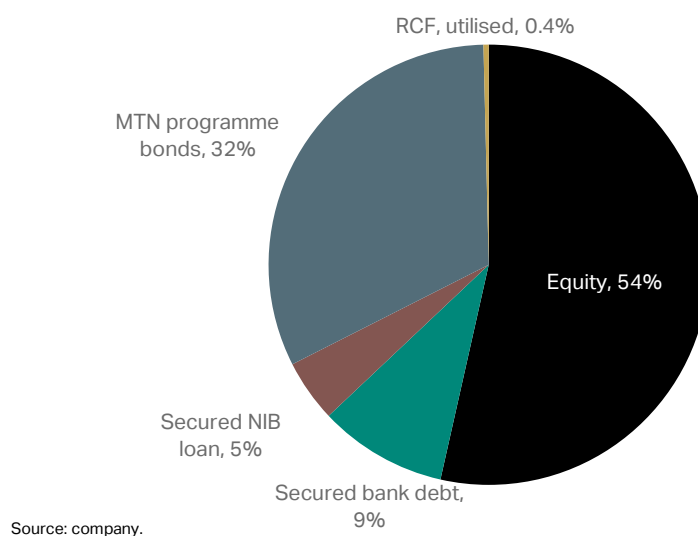
Low risk appetite supports overall financial analysis

Vacse finances its operations through equity, secured bank debt, a secured loan from Nordic Investment Bank (NIB), and senior unsecured bonds (see Figure 14). As of 30 Jun. 2021, reported outstanding debt stood at SEK 3.6bn, of which senior unsecured bonds represented SEK 2.5bn, secured bank debt SEK 705m, and the NIB loan SEK 355m. We note that 100% of Vacse's external financing is

Risk appetite scores 'a-'

green. The company uses interest rate swaps to limit its exposure to interest-rate risk. As of 30 Jun. 2021, the average interest fixing period amounted to 5.3 years, which we consider as high and supportive of the company's financial risk appetite. Long-term interest rate hedging reduces Vacse's average interest cost, reflecting the company's focus on reducing long-term risk at the expense of short-term metrics.

Figure 14. Vacse funding profile, 30 Jun. 2021



Vacse paid SEK 70m in dividends annually in 2019 and 2020 and increased the dividend pay-out to SEK 100m in 2021. The company remains well within its financial policies and we expect it to continue to pay dividends of about SEK 100m a year.

Vacse was created to provide its owners with long-term low-risk returns. Following relatively rapid growth between 2011 and 2015, the current management has been prudent in its approach to growth and financing, in our view. In the face of low property yields and tough competition in the community service property subsector, Vacse is focused on controlled growth and lowering its financial risk, which we believe is also the objective of the company's owners. We view the lengthening of the average debt maturity profile as positive in terms of credit risk. Accordingly, Vacse's overall risk appetite supports our view of the company's financial risk profile.

Figure 15. Vacse debt maturity profile, 30 Jun. 2021

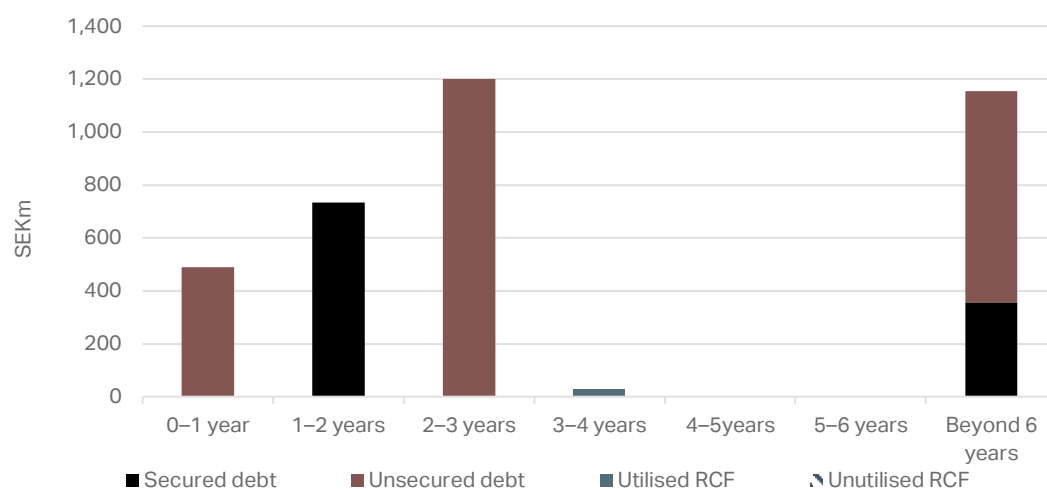


Figure 16. Vacse financial covenants, policies and reported metrics

Metric	Financial policy/targets	Reported 30 Jun. 2021
Secured debt/total assets (%)	<20%	12.8%
Net LTV (%)	<50%	41.4%
Interest coverage ratio	>2x	5.8x*
Debt maturities in any 12-month period	>2 years	4 years**
Average interest rate maturity	>2 years	5.3 years

Source: company. *Year to date. **Excl. RCF, 4.5 years incl. RCF

ADJUSTMENT FACTORS

Adjustment factors are neutral

Adjustment factors are assessed as neutral and have no effect on our stand-alone credit assessment.

Liquidity

Liquidity assessed as adequate

Our 12-month liquidity analysis is based on a stressed scenario under which the company cannot access the capital markets or extend its bank loans, and therefore has to rely on internal or committed external funding sources to cover its liquidity needs. We typically expect an investment grade company to cover all liquidity needs over the next 12 months.

We assess Vacse's liquidity profile as adequate as our analysis indicates that the company's sources of liquidity would outweigh uses in our stressed scenario. Our assessment is supported by Vacse's good access to multiple capital sources, satisfactory standing in the capital markets, and good relationships with major Swedish banks. In addition, the company has the support of its owners, which have previously injected funds and made available committed capital when needed.

We estimate the following primary liquidity sources for the 12 months to 30 Jun. 2022, amounting to SEK 1bn:

- SEK 130m, representing 100% of cash and equivalents as of 30 Jun. 2021;
- SEK 200m, reflecting 75% of funds from operations in the 12-month period; and
- SEK 670m through an unused committed credit facility maturing in 2024.

We estimate the following uses of funds for the 12 months ending 30 Jun. 2022, amounting to 0.6bn:

- SEK 523m in maturing debt and amortisation of secured debt; and
- SEK 85m in committed capital spending.

Vacse also has access to SEK 1.1bn in committed capital from its owners, under certain conditions. Accordingly, we assess that it has sufficient liquidity and available funding sources.

Environmental, social and governance factors

ESG factors assessed as adequate

Vacse's environmental, social and governance (ESG) policies support our view of the company's overall business risk and competitive position. The company has demonstrated a commitment to environmental issues with certification targets for its new and existing property portfolio, which we view as increasingly important for its government-related tenants.

In 2018, Vacse developed a green bond framework aligned with the UN's sustainable development goals and has been accorded "Medium Green" status in a second opinion from CICERO, the Centre for International Climate Research. Within this framework, Vacse has issued debt of SEK 2.5bn. The company's focus on certification could provide further debt diversification opportunities and strengthens the likelihood that its properties will retain their asset values over time, thereby facilitating renegotiation of contracts at maturity. We see this as a positive factor for the portfolio assessment.

Most of Vacse's properties are associated with social stability. In this respect, the company caters to major global trends such as demographic shifts and population growth. Continued population growth in Sweden coupled with increased immigration could result in a need for greater judicial strength and access to judicial services. To promote social responsibility, Vacse runs a programme supporting

foreign post-graduate students. In our understanding, the company places an emphasis on its reputation as a good employer and landlord. We see little risk of change, conflicts or other governance-related issues in connection with the current management, board or owners.

The main ESG issues that could affect our overall assessment of Vacse's creditworthiness are factors that might contribute to loss of revenues, increased costs, higher capital spending, or reduced financing possibilities (see Figure 17). Vacse has demonstrated its commitment in resolving various ESG issues and, in our view, the company is unlikely to face major ESG problems in the near term.

Figure 17. Vacse ESG considerations

Issue	Risk	Mitigating efforts	Result
CO ₂ emissions	Increased costs due to regulatory and/or taxation changes	Efforts to reduce CO ₂ emissions and certify all properties under BREEAM In-Use or LEED standards	CO ₂ emissions (electricity, heating and cooling) down by 20% in 2020
Impact of climate change on operations	Loss of revenues or increased capital spending	Environmental certification of properties	As of Dec. 2020, 85% of all properties were certified
Increased environmental focus on financial markets	Adverse effect on financing possibilities or higher financing costs due to slow transitioning to lower CO ₂ dependence	Efforts to increase energy efficiency and reduce CO ₂ emissions	Detailed ESG reporting on energy usage, CO ₂ emissions, water usage and environmental certification of properties. Energy usage down by 8.7% in 2020

Source: company.

OWNERSHIP ANALYSIS

Ownership assessed as neutral

We view Vacse's ownership structure (see Figure 18), as supportive of the company's low-risk strategy and solid financial position, which we factor into our assessment via the financial risk profile and overall rating on the company. Vacse's owners are pension foundations associated with a number of well-known Swedish blue-chip companies. Supporting factors include the following:

- Vacse's owners are financially strong and, we believe, committed for the long term.
- Vacse is integral to the owners' long-term investment policy.
- A change-of-control clause stipulates that the company's bonds must be repaid in full if the current group of owners were to have less than 50% ownership.
- Committed equity capital of SEK 2.8bn in funding, of which 1.1bn is unutilised.
- A history of the owners injecting funds into the company.

Figure 18. Vacse ownership structure, 30 Jun. 2021

Owner	Share of capital/votes
Ericsson Pensionsstiftelse	21.4%
Skanska Trean Allmän Pensionsstiftelse	21.4%
Apoteket AB:s Pensionsstiftelse	14.3%
AB Volvo Pensionsstiftelse	14.3%
Atlas Copco-Group Gemensamma Pensionsstiftelse	10.7%
Stora Enso Svenska Gemensamma Pensionsstiftelse	10.7%
Sandvik Pensionsstiftelse i Sverige	7.1%

Source: company.

ISSUE RATINGS

As of 30 Jun. 2021, Vacse's secured debt as a proportion of total debt was 30%. Accordingly, the rating on the company's senior unsecured obligations is commensurate with the 'A-' issuer rating.

Figure 19. Vacse key financial data, 2017–Q2 2021

SEKm	FY	FY	FY	FY	LTM
Period-end	31 Dec. 2017	31 Dec. 2018	31 Dec. 2019	31 Dec. 2020	30 Jun. 2021
INCOME STATEMENT					
Rental income	334	340	369	384	422
Other income	–	–	–	–	–
Total costs from operations	-49	-54	-63	-63	-68
Net operating income	285	286	306	321	353
Administrative expenses	-21	-23	-24	-25	-25
Administrative expenses, project portfolio	–	–	–	–	–
EBITDA	264	263	282	296	328
Share of profit in associated companies and joint ventures	–	–	–	–	–
Interest expenses	-68	-64	-55	-53	-58
Interest income	0	0	0	0	0
Interest expenses, shareholder loans	-88	-81	–	–	–
Financial costs from leasing	–	–	–	–	–
Other financial costs	–	–	–	–	–
Changes in investment property	116	267	179	318	717
Gain (loss) on financial assets held at fair value	–	–	–	–	–
Depreciation and amortisation	–	–	–	–	–
Restructuring activities	–	–	–	–	–
Pre-tax profit	284	384	395	535	1,043
Current taxes	-3	-1	0	-1	–
Deferred taxes	-56	-66	-92	-110	-217
Net profit	224	318	303	423	825
BALANCE SHEET					
Investment property	5,228	5,943	6,522	7,167	8,386
Other non-current assets	31	3	7	5	33
Total non-current assets	5,259	5,946	6,529	7,172	8,419
Cash and cash equivalents	92	188	120	210	132
Other current assets	39	32	54	49	79
Total current assets	130	220	173	259	212
Total assets	5,389	6,166	6,702	7,431	8,631
Total equity	1,324	3,096	3,330	3,683	4,154
Non-current borrowings	2,130	1,824	2,416	2,974	3,060
Non-current borrowings, shareholder loans	1,454	–	–	–	–
Deferred tax liabilities	249	314	406	516	667
Other non-current liabilities	99	10	23	48	2
Total non-current liabilities	3,932	2,148	2,845	3,539	3,728
Total current liabilities	132	922	527	210	749
Total equity and liabilities	5,389	6,166	6,702	7,431	8,631
CASH FLOW STATEMENT					
Pre-tax profit	284	384	395	535	1,043
... of which changes in investment property	116	267	179	318	717
Depreciation and amortisation	0	0	2	2	–
Tax paid	-11	10	-1	2	9
Adjustment for items not in cash flow	-175	-265	-169	-292	-770
Cash flow from operating activities before changes in working capital	98	130	228	247	281
Changes in working capital	-23	7	1	6	2
Cash flow from operating activities	75	137	229	253	283
Cash flow from investment activities	218	-415	-395	-320	-898
Cash flow from financing activities	-308	375	98	157	591
Cash and cash equivalents at beginning of period	106	92	188	120	157
Cash flow for period	-15	96	-68	90	-25
Cash and cash equivalents at end of period	92	188	120	210	132

Source: company. FY–full year. LTM–last 12 months.

Figure 20. Vacse rating scorecard

Subfactors	Impact	Score
Operating environment	20.0%	a
Market position, size and diversification	12.5%	bb-
Portfolio assessment	12.5%	a+
Operating efficiency	5.0%	aa
Business risk assessment	50.0%	a-
Ratio analysis		a-
Risk appetite		a-
Financial risk assessment	50.0%	a-
Indicative credit assessment		a-
Liquidity		Adequate
ESG		Adequate
Peer comparisons		Neutral
Stand-alone credit assessment		a-
Support analysis		Neutral
Issuer rating		A-
Outlook		Stable
Short-term rating		N-1+

Figure 21. Capital structure ratings

Seniority	Rating
Senior unsecured	A-

DISCLAIMER

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