

Sparbanken Västra Mälardalen

Full Rating Report

LONG-TERM RATING

BBB+

OUTLOOK

Stable

SHORT-TERM RATING

N-1+

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RATING RATIONALE

Our 'BBB+' long-term issuer rating on Sweden-based Sparbanken Västra Mälardalen (Sparbanken VM) reflects the bank's very strong capital position, low risk appetite and relationship-based funding profile. We view the bank's cooperation arrangement with Swedbank AB as positive, as it provides material diversification of product offerings, shared IT costs and the opportunity to finance retail mortgages. In addition, Sparbanken VM benefits from dividend revenues through its holdings of Swedbank shares, which resumed in 2021.

The rating is constrained by the bank's concentrated exposure to the local economy, which has historically demonstrated volatility associated with being a key region for Sweden's manufacturing industry, and by its regional retail banking customers, SMEs and real-estate collateral. Despite the uncertain economic environment, we expect losses and non-performing loans to remain low, given low interest rates and economic improvements.

STABLE OUTLOOK

The stable outlook on Sparbanken VM reflects our expectation that the bank will maintain strong capital buffers as it grows its loan book. It also reflects projections of below-average population and economic growth in the region and the bank's modest risk appetite. The outlook also takes account of the bank's maintenance of its relationship with Swedbank and expectations of normalised credit losses in our forecast.

POTENTIAL POSITIVE RATING DRIVERS

- Sustainable improvements in core earnings metrics, with core pre-provision income to risk exposure above 2.5%, and improved cost efficiency.
- A material improvement in economic conditions and growth prospects in the bank's local market.

POTENTIAL NEGATIVE RATING DRIVERS

- A sustained reduction in the common equity capital ratio to below 18%.
- A material deterioration in asset quality metrics.
- A long-term economic recession in the bank's operating region, affecting economic activity and employment.

Figure 1. Sparbanken VM key credit metrics, 2017–2023e

%	2017	2018	2019	2020	2021e	2022e	2023e
Net interest margin	1.5	1.4	1.5	1.5	1.4	1.5	1.5
Loan losses/gross loans	-0.08	0.18	0.02	0.14	-0.06	-0.06	0.08
Core pre-provision income/REA	1.4	1.6	1.5	1.8	1.8	2.0	2.1
Return on equity	6.3	5.3	8.5	4.7	8.1	6.7	6.4
Loan growth	9.2	4.4	9.3	5.9	8.0	6.0	6.0
CET1 ratio	23.1	22.3	24.0	23.1	24.7	25.1	25.4

Based on NCR estimates and company data. e–estimate. REA–risk exposure amount. CET1–common equity Tier 1. Core pre-provision income includes only net interest income and net fee and commission income. All metrics adjusted in line with NCR methodology.

ISSUER PROFILE

Sparbanken VM is operated without an owner and focuses on customers in and around Köping Municipality in central Sweden. Like most Swedish savings banks, the bank shares a history and cooperation with Swedbank, which provides product diversification, shared costs on IT solutions, and the opportunity to finance retail mortgages via Swedbank Hypotek, Sweden's largest issuer of covered bonds.

Sparbanken VM is based in Köping, with other core markets in Kungsör and Arboga municipalities in Västmanland County at the western end of Lake Mälaren, which extends to Stockholm to the east. These three communities have a total of 50,000 residents and are located in the Västra Mälardalen region, a geographical triangle comprised of the municipalities of Örebro, Eskilstuna and Västerås that includes nearly 750,000 inhabitants and a strong manufacturing industry.

Figure 2. Sparbanken VM core markets

Municipality	Population, June 2021	Expected population change, 2021–2040	Unemployment, Sept. 2021	Unemployment, Sept. 2020
Köping	26,195	1.1%	9.5%	11.0%
Kungsör	8,805	1.1%	10.2%	11.6%
Arboga	14,101	1.4%	8.3%	10.1%
Sweden	10,327,600	8.9%	7.5%	8.9%

Source: Statistics Sweden, Swedish Public Employment Service.

OPERATING ENVIRONMENT

Operating environment assessment is 'bbb-'

NCR considers a balance of national and regional factors in its assessment of Sparbanken VM's operating environment. The bank operates in a few relatively small municipalities, with a high share of its exposures associated with the local economy, which has higher unemployment and lower population growth than the Swedish average.

Swedish banking has performed well despite COVID threat

National factors score 'a-'

In September this year, NCR raised its assessment of the Swedish banking market to 'a-' from 'bbb+' (see also [Nordic banking assessments raised on reduced COVID threat](#), 9 Sep. 2021). Our assessment is back at the pre-pandemic level to reflect our expectations that new mutations of COVID-19 will not result in decreased economic activity, nor affect the ongoing recovery in cyclical production segments and service industries. We also expect lower unemployment, especially among young adults, who have been disproportionately affected by a loss of service and seasonal work. Sweden's strong public finances and lower-than-projected budget deficit, together with expansionary monetary policies, provide buffers against threats to economic recovery.

The Swedish regulator will increase the countercyclical buffer in June 2022, signalling a more positive outlook for the banking sector. The increased pace of housing price growth during the pandemic has proven to be unsustainable. NCR continues to believe that the pace of housing price growth will align itself with the market's long-term growth rate through 2022, in part due to the continued rollout of COVID-19 vaccines, but also due to the reinstatement of amortisation requirements.

Reduced unemployment improving local operating environment

Regional, sectoral, and cross-border factors score 'bb+'

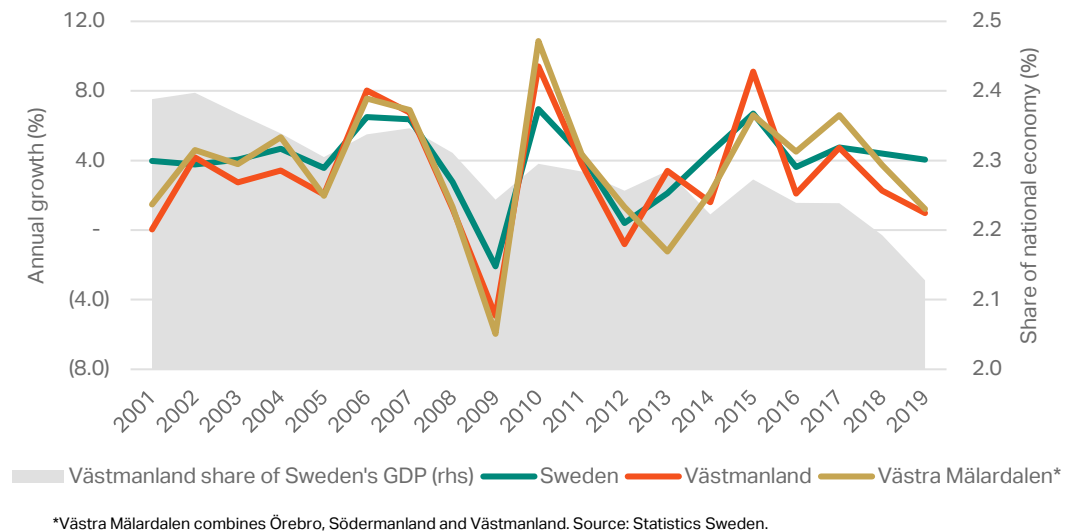
Sparbanken VM's small, core market is Västmanland County, and the bank's customers mainly work and operate in the Västra Mälardalen region, comprising the counties of Södermanland, Örebro and Västmanland. We consider that the bank's three core markets include about 50,000 of the 750,000 inhabitants of the Västra Mälardalen region. Furthermore, our view of the impact and weighting of regional factors in the bank's operating environment assessment reflects projections of low population growth, relatively high unemployment and a relatively high share of manufacturing.

The Västra Mälardalen region is an important part of Sweden's manufacturing industry. Manufacturing represents 20–30% of employment in Sparbanken VM's three primary markets, compared with 12% at national level. This has been a vulnerability during periods of economic

turbulence, and has led to heightened unemployment levels and higher volatility in the regional economy.

The bank's core markets have higher unemployment levels and are expected to have slower population growth than the Swedish average (see Figure 2). The near-term outlook for the bank's markets are improving, however, with local employers expecting growth in 2022 and increased recruitment needs as global supply chain issues recede. In addition, the counties of Kungsör and Köping are planning to construct about 1,000 new apartments over the next five years and the local real-estate market has performed well, as an increase in working from home has made it easier to work for employers based further away.

Figure 3. Västmanland's and Västra Mälardalen's annual economic growth and regional share of Sweden's GDP, 2001–2019



RISK APPETITE

Risk appetite assessment is 'a'

Sparbanken VM's low risk profile is supported by the bank's strong capital ratios, high share of relationship-based retail deposits, access to market funding and the ability to transfer loans to Swedbank Hypotek. The high share of secured lending is offset to some degree by the concentration in its local real-estate market.

Risk governance proportional to complexity and size

Risk governance scores 'bbb+'

Sparbanken VM's risk governance, risk appetite and limit structure are proportional to its complexity and size, although less developed than those of larger Nordic banks. The bank maintains its own risk resources for anti-money laundering and know-your-customer measures and is increasing its cooperation with other savings banks on these issues, while maintaining its ability to access risk resources from Swedbank. The bank's second-line risk management function is outsourced to Svealands Risk & Compliance AB, which employs former bank employees and other personnel with savings bank experience. Svealands Risk & Compliance has direct contact with the bank's board of directors by participating in regular risk reporting and board meetings.

Sparbanken VM proactively manages its modest environmental, social and governance (ESG) risks and has incorporated sustainability into its business operations. The bank has a strong sense of social responsibility in its local communities and has contributed over SEK 100m to youth sports, education, integration and cultural projects since 2000. In addition, the bank also operates a customer bonus scheme, in which funds are distributed to customers for use at local retailers. Sparbanken VM's environmental focus has been on using local, renewable energy, which powers all of the bank's branches. In addition, the bank also incentivises its industrial customers to invest in local and renewable power and supports projects aimed at developing a circular economy.

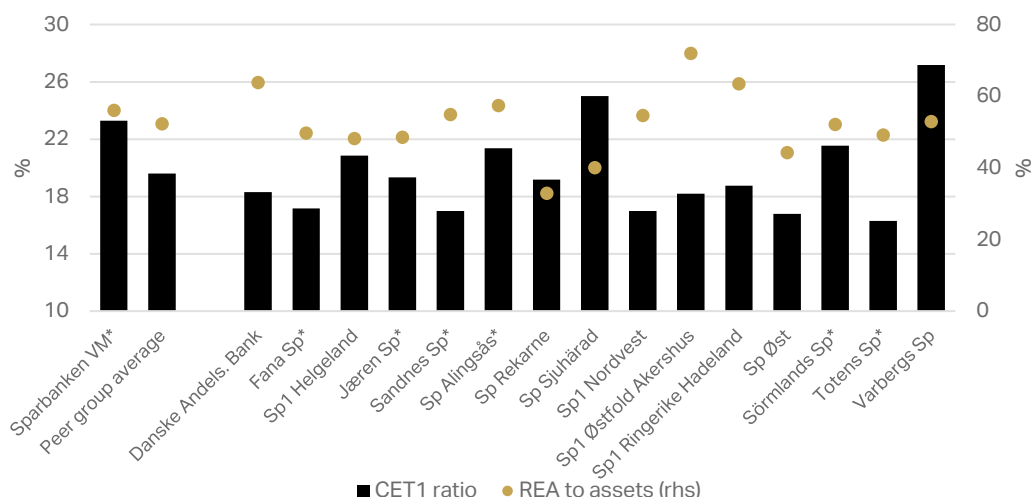
Capital scores 'aa'

Strong capital buffers

Sparbanken VM's common equity Tier 1 (CET1) capital ratio was 23.2% as of 30 Sep. 2021 (24.9% including year-to-date profit), more than 15% above its regulatory CET1 requirements. Our capital projections reflect loan growth of 6% in 2022 and 2023 and an increase in cost efficiency, resulting in a CET1 ratio projection of over 25% by year-end 2022, which is very strong, even within the peer group. Total equity accounts for 16.1% of total assets, which is strong even among well-capitalised Nordic savings banks, but includes holdings in Swedbank, which are deducted from regulatory capital.

As of 30 Jun. 2021, Sparbanken VM's regulatory capital base excluded SEK 221m for its holdings of Swedbank shares that exceed 10% of its own CET1. We note that Swedbank's share price has risen further since the end of the second quarter, effectively improving Sparbanken VM's capital buffers.

Figure 4. Sparbanken VM REA/assets and CET1 ratios vs savings bank peers, 2021H1



Source: bank reports. Sp-Sparbank (Sweden)/Sparebank (Norway). REA-Risk exposure amount. CET1-common equity Tier 1. * CET1 ratio excludes mid-year net profits in regulatory capital ratios.

Increase in customer savings has supported lending growth

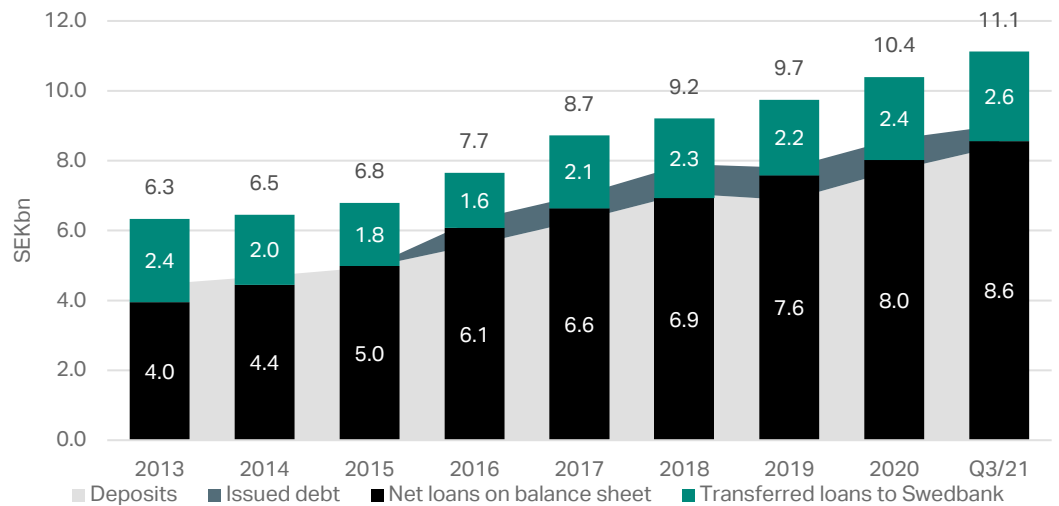
We regard Sparbank's funding and liquidity position as relative strengths. Existing liquidity buffers are strong given the bank's relationship-based retail deposits and the ability to transfer mortgage loans to Swedbank Hypotek. As of 30 Sep. 2021, the bank's net stable funding ratio was a robust 144% and the liquidity coverage ratio is regularly above 200%, well above regulatory and internal limits. In addition, the loan-to-deposit ratio was 103% as of 30 Sep. 2021, even as the loan book grows. The bank has historically maintained a strong liquidity buffer of over 30% of customer deposits, though this has decreased in 2021 due to the repayment of a SEK 300m bond in March.

In addition, the bank's senior funding consists of two SEK 300m bonds maturing in August 2022 and March 2023, and a SEK 200m loan from Swedbank maturing in 2025. We anticipate that the bank will refinance outstanding senior unsecured bonds when they mature and maintain its liquidity buffers to manage volatility in the capital markets.

Sparbanken VM's cooperation with Swedbank allows it to transfer residential mortgages to Swedbank Hypotek, in return for a commission. The volume of transferred loans has been stable since 2017, with most of the bank's new lending growth on its own balance sheet. We note that a majority of Sparbanken VM's transferred loan volumes consist of residential mortgages and that the bank has a relatively low proportion of loans held at Swedbank, increasing its flexibility during weak market conditions.

Funding and liquidity scores 'a'

Figure 5. Sparbanken VM share of total loans transferred to Swedbank, 2013–30 Sep. 2021



Source: company.

Credit risk concentrated in regional real-estate lending

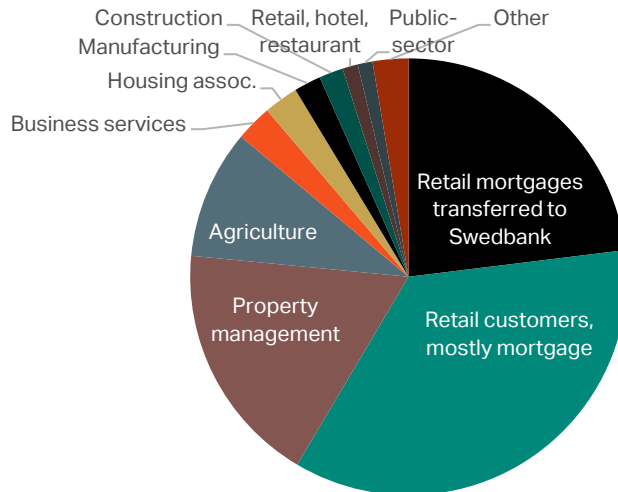
Credit risk scores 'bbb'

Given that at least 80% of Sparbanken VM's customers are based in its three core markets, there is a material concentration of regional real-estate collateral. Over half of the bank's credit exposures (see Figure 6) are residential mortgages and loans to housing associations (including SEK 2.6bn transferred to Swedbank), and its largest corporate exposures are to property management and agriculture. As a result, about 85% of on-balance sheet lending is associated with regional property. Housing prices and real-estate values in the region have increased in line with the Swedish market, supporting the bank's collateral, and lending to the agricultural sector is diverse, with a material proportion extended to family-owned farms and forest owners.

Sparbanken VM's lending is focused on private individuals and SMEs within its own core markets, which leads to geographical concentration. This is partly offset by its retail and corporate customers' access to larger markets in Eskilstuna, Västerås and Örebro. Lending directly to the manufacturing sector is modest, although many of the bank's exposures may be affected by the volatility of the region's largest manufacturers. The bank has relatively low exposure to high-risk industries, with modest exposures to construction, retail, and hotels and restaurants.

Sparbanken VM's mortgage loans transferred to Swedbank provide income via commission fees. The volume of transferred residential mortgage loans has increased in 2021 and total transferred volumes are SEK2.6bn as of 30 Sep. 2021. While on-balance-sheet residential mortgage lending has remained flat, the majority of the bank's growth over the past year has been related to corporate, agriculture and real-estate loans. Sparbanken VM has a first-loss risk associated with the transferred loans, which results in a reduction in paid commission in the event of write-downs of transferred loans. The maximum risk on transferred loans is SEK 18–20m per year, or the amount of reported loan commission income.

Figure 6. Sparbanken VM net loans by segment, 30 Sep. 2021



Source: company

Reduced risk in the investment portfolio

Other risks score 'bbb+'

Sparbanken VM has further reduced spread risk and credit risk associated with its fixed-income investment portfolio. As a result, the rated investment grade share of the portfolio is now over 90%, compared with nearly 50% at the end of 2019. The risk reduction has improved our view of the bank's market-related risk, which is now more in line with its peers' liquidity portfolios.

Interest rate risk in the banking book is another material risk, which is moderated by variable interest rates on a large portion of the bank's loans and the use of interest rate hedges. The bank started using hedge accounting for interest rate derivatives in 2021, reducing the impact of changes in value on the bank's financial results. Sparbanken VM has low limits on interest rate risk and currency risk.

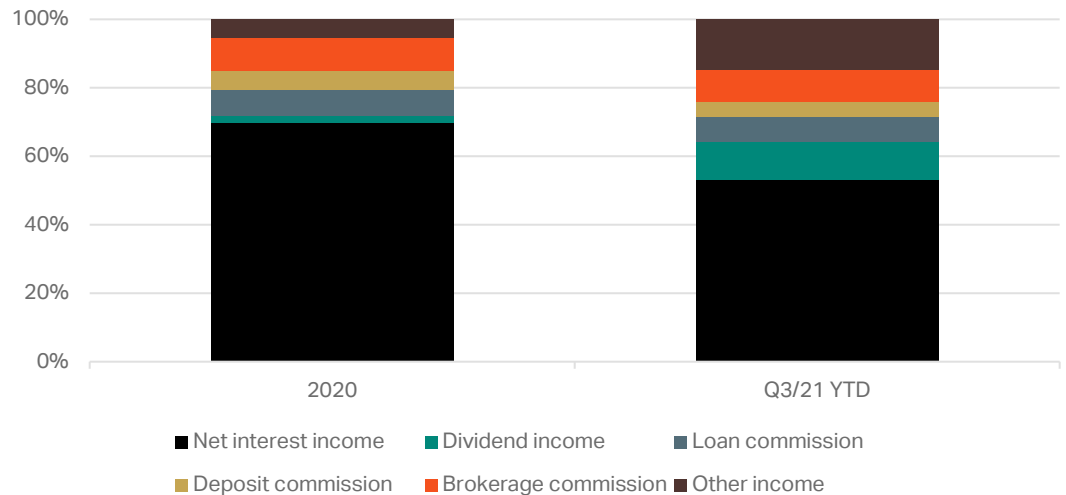
Sparbanken VM's ownership of 2.3m Swedbank shares ensures it has a meaningful voice alongside other savings banks that own shares either directly or via their owner foundations. We consider the importance of Swedbank dividends in our assessment of the bank's earnings performance. In addition, Sparbanken VM has strategic ownership in Indecap Holding AB (jointly owned with over 35 other savings banks), Svealands Risk & Compliance (jointly owned with six other savings banks), and holds 20% of the shares in Portfolio Försäkra AB (jointly owned with five other savings banks).

COMPETITIVE POSITION

Competitive position assessment is 'bb+'

Sparbanken VM has a strong position in its core markets and among local individuals and SMEs, reporting 40,000 retail and 4,000 corporate customers. The bank's primary local competition comes from Handelsbanken, Nordea, and Länsförsäkringar Bank, while larger corporations in the region are serviced by the larger banks. Increased competition from challenger mortgage institutions and savings banks based nearby is affecting the bank's local margins, but has not materially impacted its ability to attract and retain customers. Collectively, savings banks have maintained the highest customer satisfaction score among Sweden's banks, with Sparbanken VM scoring above the average for savings banks. The bank's support of its local community increases customer loyalty. At national level, the bank has a very small presence, with about 0.2% of total deposits and 0.1% of total loans, including loans transferred to Swedbank.

Figure 7. Sparbanken VM income composition, 2020 and 2021Q3 year-to-date



PERFORMANCE INDICATORS

Performance indicators assessment is 'a'

Sparbanken VM is steadily improving its core earnings metrics and is in line with similar savings banks. Loss performance has continued to be strong since the onset of the pandemic and we expect it to remain so as the economy improves.

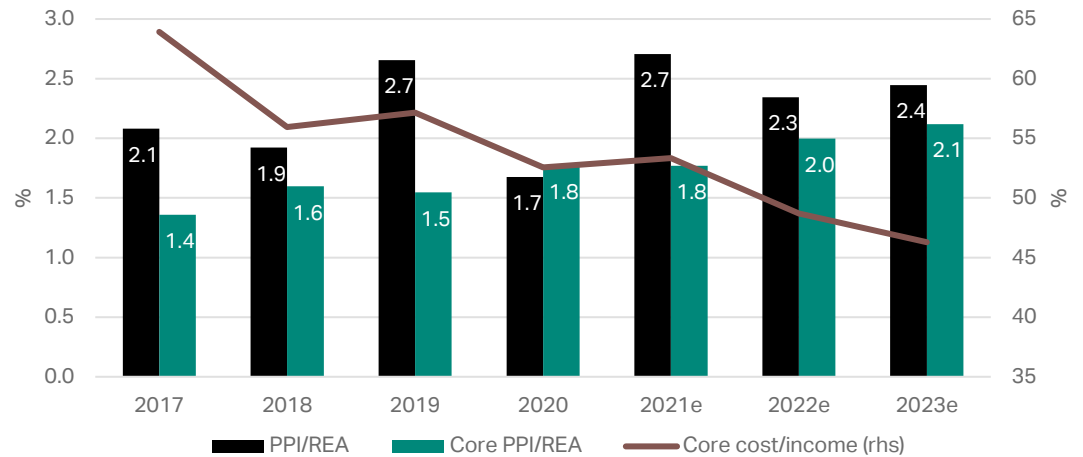
Earnings in line with peers and showing steady improvement

Earnings scores 'bbb+'

The bank's core earnings metrics are in line with those of similar savings bank peers. We expect the bank's core earnings metrics and cost efficiency to continue to improve through scale-driven improvements in core cost efficiency. The bank targets a 50% cost-to-income ratio and we estimate that its core cost-to-income ratio will be below 50% by year-end 2022, down from 64% in 2017. Efficiency gains are also reflected in expected improvements in core pre-provision income to risk exposure amounts. We expect net interest margins to remain stable at 1.4–1.5%, given current policy rate forecasts and high margin pressure for residential mortgage loans and other attractive borrowers across the country's banking market. We expect fee income to grow by about 8% per year, but this depends on the growth of customers' savings with Swedbank, as well as the volume of mortgage loans transferred to Swedbank Hypotek.

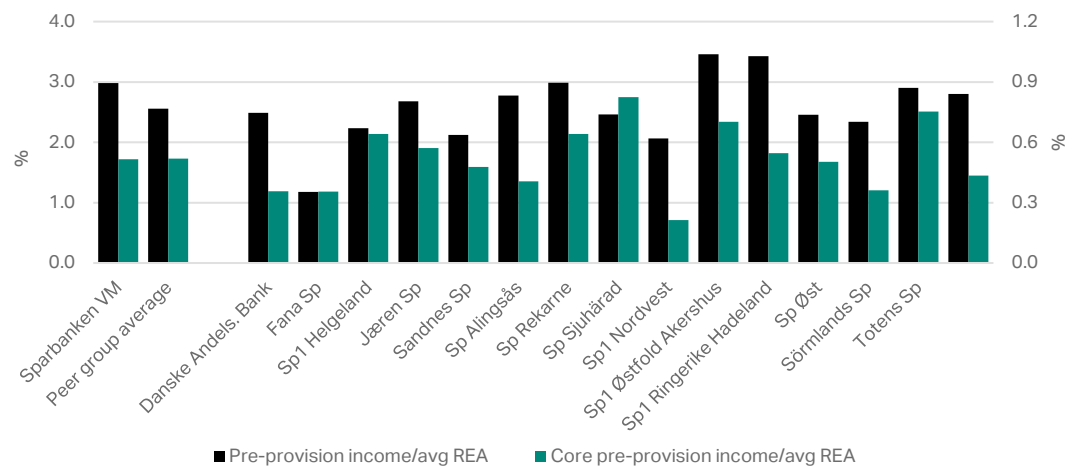
Sparbanken VM has lower reliance on Swedbank dividends than many other Swedish savings banks that have a much higher share of dividend income. Sparbanken VM's earnings have improved in 2021 due to dividends from Swedbank, reflecting 2019 and 2020 profits, totalling in excess of SEK 30m. We expect Swedbank to pay out 50% of profits from 2022 onward. Our forecast includes about SEK 16m being paid out in 2022 and 2023. See [Swedish savings banks get dividend boost after solid 2020](#), 21 Jun. 2021 for further details of the impact of Swedbank's dividends and [Q&A: Swedbank judgement and share price impacts on Swedish savings banks](#), 23 Mar. 2020, for details of how movements in the Swedbank share price affect Sparbanken VM and other Swedish savings banks.

Figure 8. Sparbanken VM earnings metrics, 2017–2023e



Source: company. Core incl. only net interest, net fee & commiss. income. e–estimate. PPI–pre-provision income. REA–risk exposure amount.

Figure 9. Nordic savings banks' risk-adjusted earnings, 2021H1 annualised



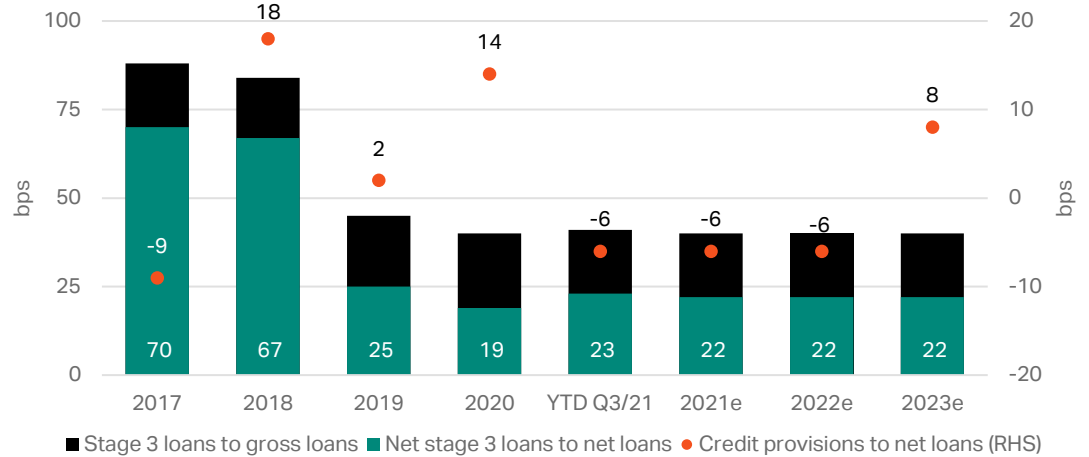
Source: Bank reports. Spb-Sparbank(en). Core pre-provision income considers only net interest income and net fee & commission income.

Non-performing loans and credit losses expected to remain low

Sparbanken VM's loss performance has remained strong since the onset of the pandemic. We expect the bank to reverse its pandemic-related general loss provisions in 2021 and 2022, before returning to normalised losses of 8bps of net loans in 2023. The bank has a strong history of low credit losses, reporting an average of loss provision of 4bps of net loans since 2011 and has maintained low Stage 3 non-performing loans, even compared with its savings bank peer group, since finally resolving a legacy provision in 2019. We believe the bank will continue to show strong loss performance going forward, given the ongoing improvements in the national and regional economy.

Loss performance scores 'a'

Figure 10. Sparbanken VM asset quality metrics, 2017–2023e



Source: company, e-estimate

ADJUSTMENT FACTORS

Peer comparison

Peer comparison is neutral

We believe that Sparbanken VM's relative strengths and weaknesses are accurately reflected in our 'bbb+' initial credit assessment. NCR has confidential credit assessments (not full credit ratings) on nearly 300 Nordic banks. The average assessment is 'bbb+', reflecting a high level of savings banks in the sample.

Support analysis

Support analysis is neutral

Sparbanken VM has no owners. Instead, it has 48 principals who act in the interests of depositors. Half of the principals are appointed by the municipalities of Köping, Arboga and Kungsör, and the other half by the principals themselves. The principals essentially take on the owner's role by appointing a board and allocating the bank's profit. Given the bank's status, there is no additional owner capital held in a foundation or within Swedbank, which is the case at a number of other Swedish savings banks. Consequently, we do not notch the rating up to reflect ownership support.

ISSUE RATINGS

Our rating on Sparbanken VM's unsecured senior debt is in line with the issuer rating, i.e. 'BBB+'. We rate senior unsecured bonds issued under the bank's medium-term note programme 'BBB+', an indication of our ratings on future issuance from the programme.

Figure 11. Sparbanken VM key financial data, 2016–Q3 2021 YTD

Key credit metrics (%)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Q3 2021 YTD
INCOME COMPOSITION						
Net interest income/op. revenue	54,2	54,1	59,1	51,8	70,0	53,1
Net fee income/op. revenue	29,9	29,8	32,7	24,7	32,6	27,3
Net trading income/op. revenue	4,6	1,8	-8,7	10,2	-5,1	8,0
Net other income/op. revenue	11,2	14,3	16,9	13,3	2,5	11,6
EARNINGS						
Net interest margin	1,5	1,5	1,4	1,5	1,5	1,4
Pre-provision income/REA	2,0	2,1	1,9	2,7	1,7	2,7
Return on ordinary equity	5,6	6,4	5,4	8,3	4,6	8,5
Return on assets	1,0	1,1	0,9	1,3	0,7	1,3
Cost-to-income ratio	55,9	53,6	51,3	43,7	53,9	42,4
Cost-to-income ratio, ex. trading	58,6	54,6	47,2	48,7	51,3	46,1
CAPITAL						
CET1 ratio	23,4	23,1	22,3	24,0	23,1	23,2
Tier 1 ratio	23,4	23,1	22,3	24,0	23,1	23,2
Capital ratio	23,4	23,1	22,3	24,0	23,1	23,2
REA/assets	58,8	59,2	59,1	60,2	57,8	55,1
Dividend payout ratio						
Leverage ratio	13,4	13,7	13,0	14,0	13,0	12,6
GROWTH						
Asset growth	19,6	9,3	9,9	-0,6	11,1	3,9
Loan growth	21,9	9,2	4,4	9,3	5,9	6,7
Deposit growth	13,0	12,4	12,2	-2,6	12,3	7,5
LOSS PERFORMANCE						
Credit provisions to net loans	-0,01	-0,08	0,18	0,02	0,14	-0,06
Impaired loans to gross loans	0,71	0,39	0,84	0,45	0,40	0,41
Net impaired loans to gross loans	0,42	0,20	0,53	0,15	0,02	0,07
Net problem loans to equity	1,85	0,92	2,45	0,73	0,10	0,34
Non-performing loan coverage ratio	40,95	49,57	36,43	67,10	95,15	83,10
Stage 3 loans/gross loans		0,88	0,84	0,45	0,40	0,41
Net stage 3 loans/net loans		0,70	0,67	0,25	0,19	0,23
FUNDING & LIQUIDITY						
Loan/deposit ratio	108,7	105,6	98,3	110,2	103,9	103,2
Net stable funding ratio	0,0	147,0	147,0	145,0	149,0	144,0
Liquidity coverage ratio	159,7	211,5	159,4	212,1	270,3	237,5

Key financials (SEKm)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Q3 2021 YTD
BALANCE SHEET						
Total assets	7,961	8,699	9,563	9,510	10,564	10,973
Total tangible assets	7,961	8,699	9,563	9,510	10,564	10,973
Total financial assets	7,844	8,532	9,364	9,412	10,455	10,852
Net loans and advances to customers	6,081	6,639	6,932	7,578	8,021	8,561
Total securities	1,301	1,401	1,670	1,220	1,563	1,445
Customer deposits	5,594	6,286	7,054	6,873	7,719	8,297
Issued securities	725	725	844	925	900	600
of which covered bonds						
of which other senior debt	725	725	844	925	900	600
of which subordinated debt						
Total equity	1,384	1,427	1,512	1,520	1,596	1,775
Total ordinary equity	1,384	1,427	1,512	1,520	1,596	1,775
CAPITAL						
Common equity tier 1	1,097	1,191	1,261	1,372	1,409	1,406
Tier 1	1,097	1,191	1,261	1,372	1,409	1,406
Total capital	1,097	1,191	1,261	1,372	1,409	1,406
REA	4,679	5,147	5,649	5,729	6,107	6,049
INCOME STATEMENT						
Operating revenues	200	220	213	268	215	214
Pre-provision operating profit	88	102	104	151	99	123
Impairments	-1	-5	12	2	11	-4
Net Income	73	90	80	125	71	107

Source: company. FY–full year. YTD–year to date.

Figure 12. Sparbanken VM rating scorecard

Subfactors	Impact	Score
National factors	5,0%	a-
Regional, cross border, sector	15,0%	bb+
Operating environment	20,0%	bbb-
Capital	17,5%	aa
Funding and liquidity	15,0%	a
Risk governance	5,0%	bbb+
Credit risk	10,0%	bbb
Market risk	-	-
Other risks	2,5%	bbb+
Risk appetite	50,0%	a
Market position	15,0%	bb+
Earnings	7,5%	bbb+
Loss performance	7,5%	a
Performance indicators	15,0%	a-
Indicative credit assessment		bbb+
Transitions		Neutral
Peer comparisons		Neutral
Borderline assessments		Neutral
Stand-alone credit assessment		bbb+
Material credit enhancement		Neutral
Rating caps		Neutral
Support analysis		Neutral
Issuer rating		BBB+
Outlook		Stable
Short-term rating		N-1+

Figure 13. Capital structure ratings

Seniority	Rating
Senior unsecured	BBB+

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