

# SpareBank 1 Østfold Akershus

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 credit rating on SpareBank 1 Østfold Akershus (SB1 Østfold Akershus) reflects the bank's strong profitability and capitalisation, as well as its exposure to a growth region of Norway which has been less affected by the COVID-19 pandemic than most of the rest of the country. The bank is part of the SpareBank 1 Alliance, which Nordic Credit Rating (NCR) views as supportive of business diversity, operating efficiency and liquidity. The bank has very strong pre-provision profitability, driven by higher net interest margins and a higher share of fee income in revenues than its peers, as well as strong cost efficiency. SB1 Østfold Akershus is predominantly a mortgage retail bank but also has exposure to commercial real estate lending.

Unlike most Norwegian savings banks, SB1 Østfold Akershus' equity belongs almost entirely to the owners of the bank's equity capital certificates (ECCs) and the bank is utilising the equity market to finance growth. Two foundations control approximately two-thirds of the ECCs. We view the ownership structure as supportive of our standalone credit assessment, but do not notch explicitly to reflect potential support.

## STABLE OUTLOOK

The outlook is stable, reflecting our expectations of a flatter U-shaped recovery rather than the sharp V- or, in the worst case, W-shaped rebound that we anticipated previously. There are remaining risk factors, including the longer-term impact of changing market dynamics on commercial property prices. However, we believe that the bank's strong capitalisation and earnings make it resilient to a possible new economic downturn.

## POTENTIAL POSITIVE RATING DRIVERS

- An upgrade is unlikely at this time given the current state of the regional economy and uncertain timeline for a return to normal operating conditions.

## POTENTIAL NEGATIVE RATING DRIVERS

- An economic downturn leading to deteriorating credit quality.
- Growth significantly outpacing capital generation.
- Increased competition leading to lower profitability.

Figure 1. SB1 Østfold Akershus key credit metrics, 2016-2022e

(%)	2016	2017	2018	2019	2020e	2021e	2022e
Net interest margin	1.94	1.84	1.76	1.84	1.75	1.70	1.75
Loan losses/net loans	0.01	0.00	0.04	(0.09)	0.20	0.17	0.14
Pre-provision income/REA	3.7	3.5	3.4	3.8	3.2	3.2	3.3
Return on ordinary equity	14.1	12.3	11.7	12.3	9.5	9.7	10.0
Loan growth	5.1	5.7	11.3	1.3	8.5	5.0	5.0
CET1 ratio	16.3	17.6	16.1	17.8	17.7	18.0	17.8

Based on NCR estimates and company data. e-estimate. REA-risk exposure amount. CET1-common equity Tier 1. All metrics adjusted in line with NCR methodology.

**ISSUER PROFILE**

SB1 Østfold Akershus is a medium-sized Norwegian regional savings bank with origins dating back to 1835. The bank has operations in the southeastern part of Viken county (formerly Østfold county and the southern part of the former Akershus county) in southeastern Norway. The region has a population of 450,000 and is within commuting distance of Oslo. The bank has seven branch offices and 213 employees (full-time equivalents).

SB1 Østfold Akershus is a member of the SpareBank 1 Alliance (the Alliance), Norway's second largest finance group in terms of assets. The Alliance consists of 14 independent savings banks, which cooperate on branding and provide a joint platform. Importantly, the Alliance allows individual banks to offer competitive products and achieve economies of scale in development projects and compliance.

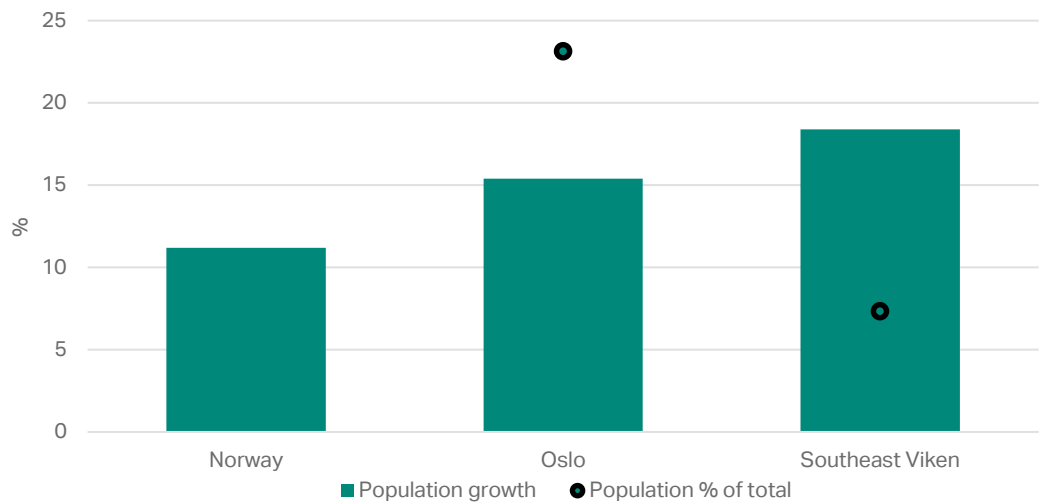
The bank has ECCs listed on the Oslo Stock Exchange. The owners of the ECCs control 93.6% of the bank's equity, but under Norwegian law they control no more than 40% of the vote in the assembly of representatives. The two largest owners are the foundations which exist for the purpose of owning the bank and supporting the community.

**OPERATING ENVIRONMENT IS MODERATILY AFFECTED BY COVID-19**

Operating environment assessment is 'a-'

NCR expects that Norwegian banks will continue to weather the COVID-19 crisis well. We see low interest rates as a greater challenge than credit risk for savings banks, with their focus on mortgage loans. SB1 Østfold Akershus operates in a region with a diverse industrial base and low reliance of the oil sector. Statistics Norway's regional growth projection for 2020 indicates strong long-term growth prospects due to its proximity to the Oslo region on the main transport routes to the rest of Europe.

**Figure 2. Southeast Viken population projection 2020-50 and share of total domestic population, 2020**



Source: Statistics Norway (Southeast Viken is defined as the municipalities in the former Østfold and southeastern Akershus counties.)

**National factors affected by COVID-19**

National factors score 'a-'

In our view, Norway is well prepared for any renewed upsurge in COVID-19, and localised outbreaks should prove easier to manage than national shutdowns. Better understanding of the virus has led to improved treatments, and we note that the Norwegian government's finances remain in good shape thanks to higher tax income and lower support payments than we previously anticipated. Weakening international growth prospects represent a risk factor but are counterbalanced by robust government finances and a weak currency. NCR notched national factors down to 'a-' from 'a' in April 2020.

During the COVID-19 pandemic, Norwegian banks have outperformed our earlier expectations. An initial fall in income due to capital market tightening had been mostly corrected in the second quarter, while net interest margins in Norway have fallen due to lower policy rates. The country's banks have recorded loan losses based on economic projections and their own exceptional loss reserves, increasing buffers against future actual losses. They have also cancelled or reduced dividends for 2019,

Regional, sectoral, and cross-border factors score 'a'

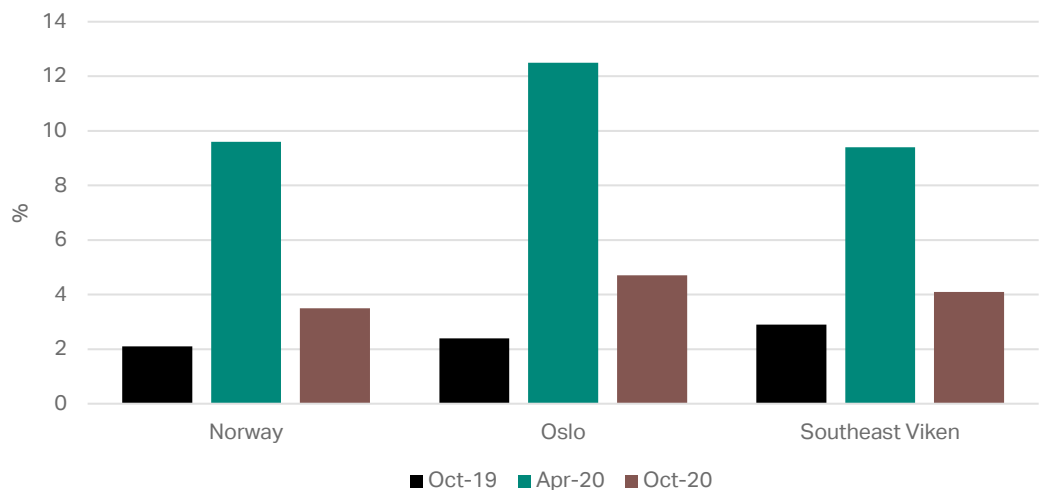
further improving their buffers. A sharp increase in customer deposits has supported liquidity. Property prices remain relatively stable and property lending remains the primary form of exposure within the wider Nordic banking market.

**Operating in a growth region**

About 87% of SB1 Østfold Akershus' lending is extended to borrowers located in the southeastern part of Viken county, a region close to Oslo. Main roads and railway lines to Sweden and the rest of Europe run through the region and significant investment is currently underway to modernise railway systems and reduce commuting times. High real estate prices in Oslo have led to significant housing and commercial real estate development projects in the region. Population growth in the region has been in line with the Norwegian average over the past 10 years at 1.1% per annum, but is most likely to be higher over the next few years.

Unemployment in the region has for many years been higher than the Norwegian average owing to the decline of old manufacturing industries. The number of jobs is now increasing as a result of growth in building and construction, technology-driven industries, logistics and warehousing, and organic agriculture. Accordingly, while COVID-19 has led to increased unemployment in the region, the impact has been less severe than elsewhere. The impact has also been counteracted by reduced trade leakage to Sweden. Grocery stores in the former Østfold county reportedly increased revenues by close to 50% in the second quarter of 2020.

**Figure 3. Unemployment by region, October 2020**



Source: Norwegian Labour and Welfare Administration (Southeast Viken is defined as the municipalities in the former Østfold and southeastern Akershus counties.)

**WELL CAPITALISED BANK WITH FOCUS ON MORTGAGE LENDING**

Risk appetite assessment is 'a'

SB1 Østfold Akershus has a medium to low risk profile. The bank has sufficient capital and liquidity buffers and a moderate credit risk profile. Its risk governance and internal risk reporting are adequate considering the bank's risk profile and complexity.

**Risk governance and ESG summary**

Risk governance scores 'a'

SB1 Østfold Akershus is a medium-sized local bank and, as such, has an adequate risk appetite framework and internal risk and compliance tools. It also has access to resources and tools developed by the Alliance.

Norwegian savings banks use parts of their surplus funds to give gifts for socially beneficial purposes. SB1 Østfold Akershus takes care of this through the two foundations that own a total of 65.9% of the bank's ECCs. The foundations receive dividends which are used to sponsor sports, cultural events, education and research in the bank's operating region. We already incorporate this activity into our assessment of SB1 Østfold Akershus' environmental, social and corporate governance (ESG) efforts, and note that the bank is making good progress in applying ethical considerations to the credit process.

The bank, for example, does not extend loans to oil service companies and is developing a green framework for loans. SB1 Østfold Akershus has adequate resources allocated to money laundering, customer surveillance and compliance. There is also a central function in the SpareBank 1 Alliance which supports member banks in compliance issues.

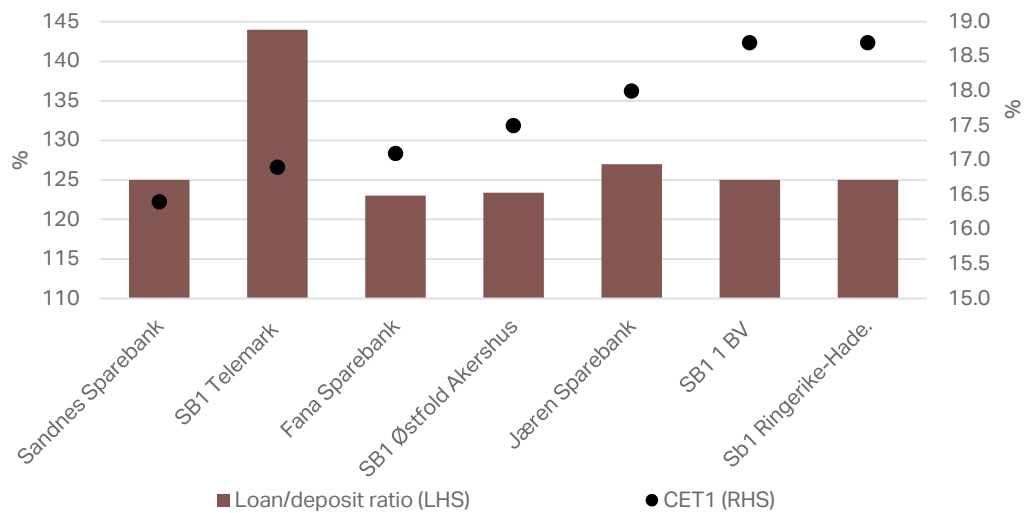
**Capital is a strength for Norwegian savings banks**

Capital scores 'a+'

Our capital assessment takes into account NOK 150m in hybrid capital and strong profitability, as well as the bank's ability to reduce its dividend from the 50% target level during a time of stress. SB1 Østfold Akershus has a Basel Pillar I CET1 requirement of 11% plus a provisional Pillar II requirement of 1.7% and a management buffer of 0.8%. The bank's target CET1 ratio is a minimum of 15%, well below its most recently reported CET1 ratio of 17.5% (proportionally consolidated) at 30 Sep. 2020, or 17.8% including 50% of year-to-date profit. The bank uses the standardised capital model, which is generally more conservative than internal ratings-based capital models, particularly for a predominantly residential mortgage bank. The leverage ratio is strong at 8.4%.

Implementation of the EU's Capital Requirements Regulation (CRR)/Capital Requirements Directive (CRD) has strengthened SB1 Østfold Akershus' consolidated CET1 ratio by about 1.8pp. To compensate for this, the systemic risk buffer for all Norwegian banks will be increased by 1.5pp from end-2022 for banks using the standardised capital model. The implementation of CRR II, from end-2022 at the earliest, is likely to increase the bank's CET1 ratio further, due to an extension of the capital discount for SMEs and a new capital discount for infrastructure projects.

**Figure 4. Norwegian savings banks' capitalisation and liquidity as of Q3 2020**



Source: company.

**Satisfactory funding and liquidity**

Funding and liquidity scores 'a'

We view the bank's management of liquidity as satisfactory. As of 30 Sep. 2020, the liquidity coverage ratio was 125%. The ratio measures liquid assets compared with a 30-day net liquidity requirement in a stress situation. SB1 Østfold Akershus' loan-to-deposit ratio was 123% at the end of the third quarter of 2020, down from 124% a year earlier. This is high compared with the corresponding ratios of the bank's international peers, owing mainly to Norway's institutionalised pensions savings. The bank has low financing needs through the first half of 2021.

An important additional source of funding for the bank is its ability to transfer loans to the Alliance's jointly owned covered-bond companies. As of 30 Sep. 2020, SB1 Østfold Akershus had transferred NOK 10bn to the two companies (see below), which represents 33% of total lending including transferred loans. This ratio has increased by 2pp in the past 12 months. The bank also has a significant buffer in loans that can be transferred to the covered-bond companies as a liquidity reserve.

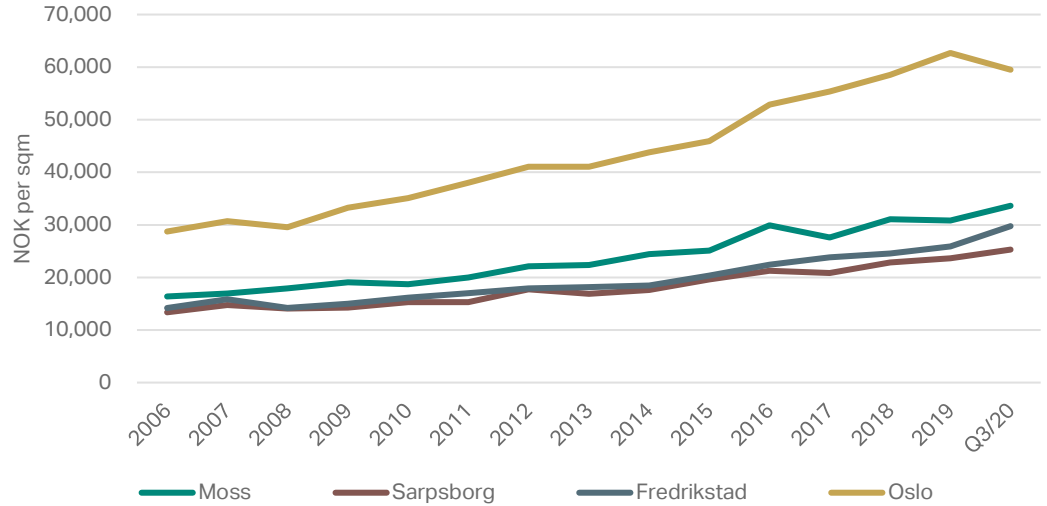
Credit risk scores 'bbb+'

**Predominantly a mortgage bank**

SB1 Østfold Akershus' loan portfolio mainly consists of retail mortgage loans to regional customers (72% excluding loans transferred to covered-bond companies and 80% including such loans). The retail loans predominantly comprise mortgage loans, 99% of which are within 80% of loan to value (LTV). SB1 Østfold Akershus' split between retail and commercial is normal for a savings bank. Some 87% of loans are extended to customers in the bank's primary region.

The bank's loan growth was 6% in the past 12 months (9% including transferred loans), compared with 4.6% growth in total domestic debt. Retail loans grew by 4%, while commercial loans grew by 11%. The bank expects commercial loan growth to outpace retail loan growth over the coming quarters.

**Figure 5. Prices of detached housing in the Southeast Viken region's largest population centres and Oslo, 2006–Q3 2020**

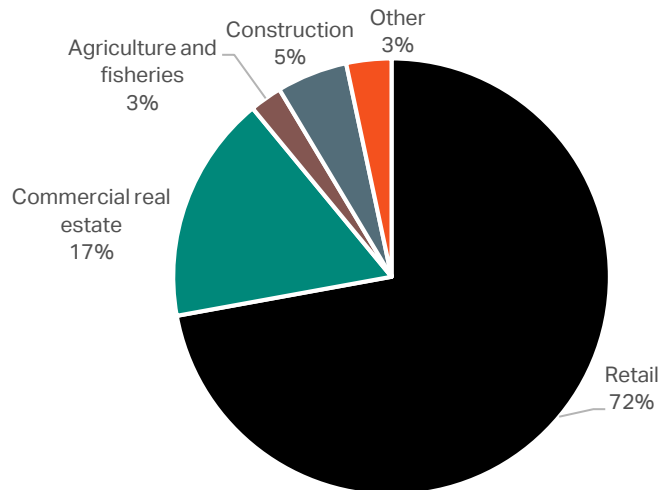


Source: Statistics Norway.

SB1 Østfold Akershus receives commission based on its net return on transferred loans. The bank has minority interests in the Alliance's two covered-bond companies. The loans are therefore not consolidated on SB1 Østfold Akershus' balance sheet but are consolidated in the capital requirement, according to CRD IV. Credit risk is transferred to the covered-bond companies, and the risk that remains with the bank is the ownership risk and a pro-rata 12-month liquidity guarantee (which can be off-loaded to the central bank via the deposit of covered bonds). Both covered-bond companies are rated 'AAA' or equivalent by a rating agency accredited by the European Securities and Markets Authority.

SB1 Østfold Akershus has a diverse commercial loan book. Lending to the sectors most affected by COVID-19, namely hotels and restaurants, accounts for less than 0.1% of lending (0.2% when retail trade is included). As with most Norwegian savings banks, the main exposure by sector is to commercial real estate. This sector has historically been worst hit in a banking crisis, as in Norway in the early 1990s, and our subfactor-score takes into account that about one-third of the commercial real estate portfolio consists of project financing. However, we see limited risk over the next few years due to the low LTV ratios in the portfolio, and low interest rates.

Figure 6. SB1 Østfold Akershus lending by sector as of Q3 2020



Source: company.

**Focus on core banking mitigates other risk factors**

Other risks score 'a'

In our view, market risk is a negligible risk factor for SB1 Østfold Akershus given its strategy of not holding a trading portfolio of financial instruments, and its low limit on interest rate risk and currency risk. The bank operates in a region with good access to skilled labour. Membership of the Alliance gives access to external competence and tools, and we believe that this helps to reduce regulatory and other governance related risk. The Alliance also provides fee-generating products, which reduces the bank's risk associated with, for example, fund management and securities brokerage. However, there is a risk that the contribution from the jointly owned insurance companies could turn sharply negative and that, in the worst case, these companies might require capital support. Real estate brokerage is organised in a separate company and we see limited risk for the bank in this business area.

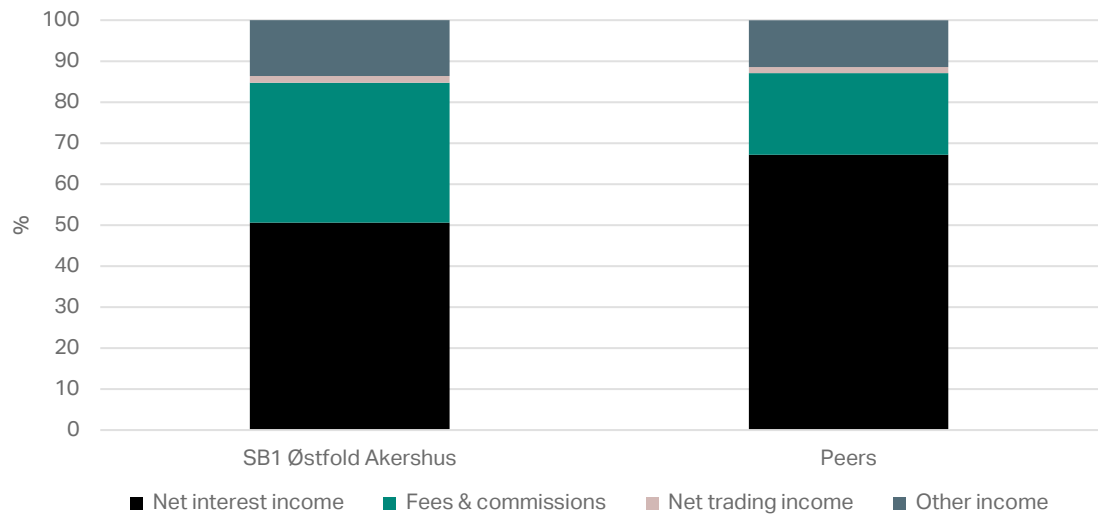
**LARGE NORDIC BANKS ARE MAIN COMPETITORS**

Competitive position assessment is 'bbb+'

SB1 Østfold Akershus has the second-largest market share in the former Østfold county after DNB, with 17% of the retail lending market according to 2018 data. In addition to the large Nordic banks, there are also several small savings banks in the Eika alliance operating in the bank's operating region, particularly in rural areas. In the Moss/Rygge area, which is experiencing high population growth, the bank's market share was as high as 30% in 2018. In commercial lending, market share was 19% in the targeted SME market. We believe that overall, the bank has maintained its market share since 2018; some retail customers have probably been lost while its share of the SME market appears to have increased. SB1 Østfold Akershus' national market share in lending is only 0.6%, however.

Like other banks in the Alliance, SB1 Østfold Akershus is focusing on increasing fees and commissions. The bank has a growing real estate brokerage business. Unlike other banks in the Alliance, SB1 Østfold Akershus has not entered the market for accounting services. Nonetheless, it generates more fee and commission income than similar-sized peers (see Figure 7). Some of the difference is explained by relatively high transfers to covered-bond companies.

Figure 7. SB1 Østfold Akershus breakdown of income against peer group average, 2018–2019



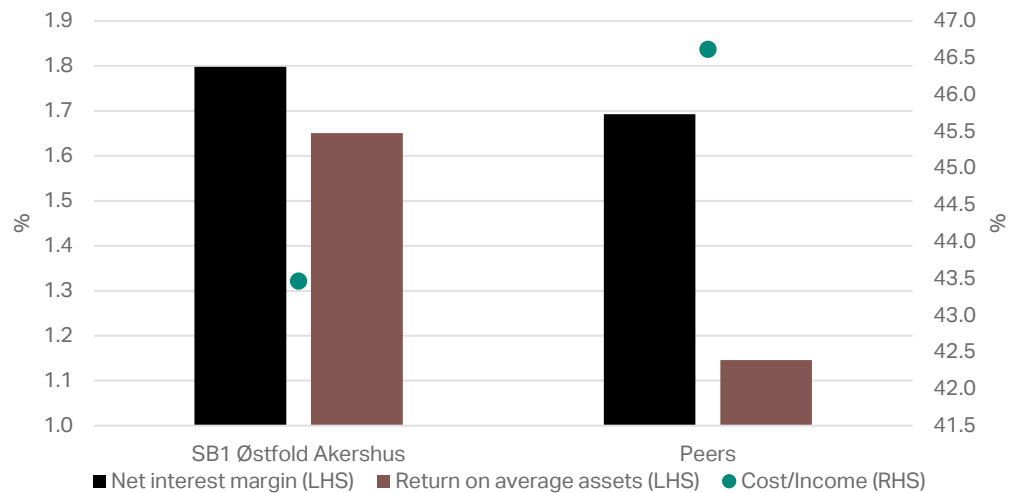
Source: company. Peers: SpareBank 1 BV, SpareBank 1 Ringerike Hadeland, Fana Sparebank, Sparebanken Møre, Jæren Sparebank, SpareBank 1 Telemark.

**STRONG PROFITABILITY**

Performance indicators assessment is 'a+'

SB1 Østfold Akershus has undergone a period of restructuring and has reduced risk since a change of management in 2013. In recent years, the bank has had higher profitability than its peer group average due to stronger performance in all major income and cost elements. Loan losses have also been lower than those of the wider peer group, averaging 1bp of lending in the 2015-19 period.

Figure 8. SB1 Østfold Akershus performance metrics against peer group average, 2018–2019



Source: company. Peers: SpareBank 1 BV, SpareBank 1 Ringerike Hadeland, Fana Sparebank, Sandnes Sparebank, Jæren Sparebank, SpareBank 1 Telemark, Sparebanken Møre.

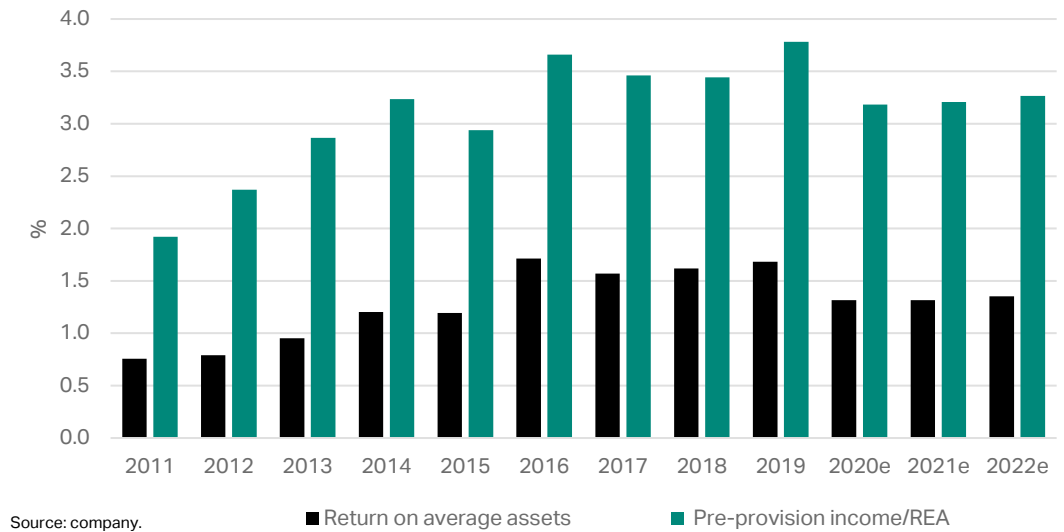
**Earnings above peers'**

Earnings score 'aa'

We expect pre-provision return on REA to remain above 3% over the next three years (Figure 9), despite margin pressure due to low interest rates. Using proportionate consolidation for minority ownership in Alliance product companies, in accordance with CRD IV, reduces this measure to about 2.5%, without changing the economic realities for the bank.

We expect low growth in fee income, which is driven more by increased real estate brokerage fees than traditional banking fees. We expect margin pressure and somewhat higher loan losses to lead to an even stronger focus on operating costs and expect the cost-to-income ratio to fall below 45% from 2021.

Figure 9. SB1 Østfold Akershus return on assets and REA, 2011–2022e

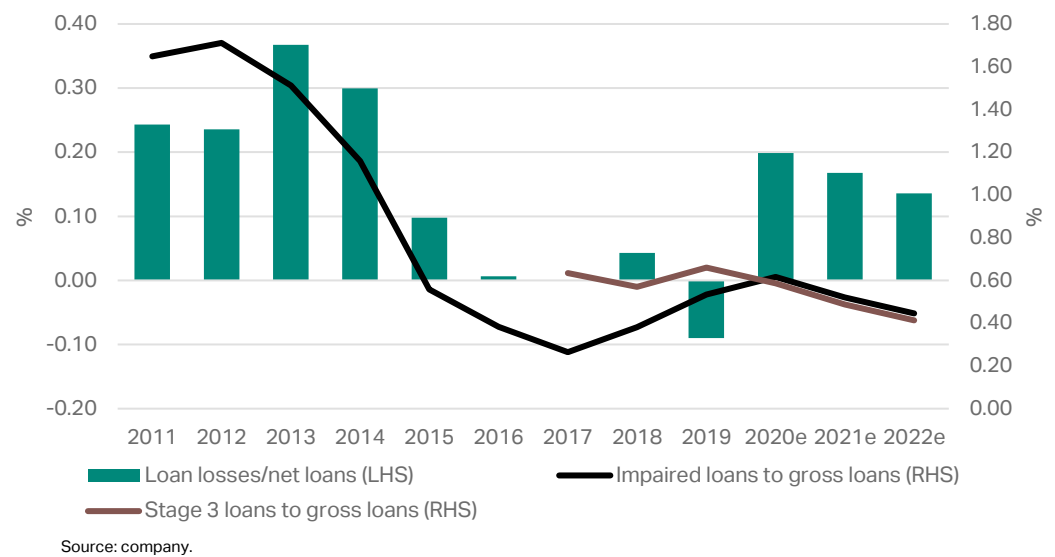


**Moderate COVID-19 effect on loan losses**

SB1 Østfold Akershus reported loan losses of NOK 2m in the third quarter of 2020 and NOK 32m in the year to date (0.14% of lending, annualised). There are no indications of increased risk in the loan book and only 0.6% of the loan book consists of Stage 3 non-performing loans. New model assumptions could allow a NOK 23m reduction in provisions. However, due to economic uncertainty, the bank has not made any such reduction.

Loss performance scores 'a'

Figure 10. SB1 Østfold Akershus loss performance indicators, 2011–2022e



We believe that over our forecast horizon loan losses will be higher than in recent years but that improved credit risk governance will keep them below the levels seen in the aftermath of the 2008 financial crisis.



## ADJUSTMENT FACTORS

### Peer comparison

Peer comparison is neutral

We believe that SB1 Østfold Akershus' relative strengths and the bank's current operating environment are reflected in our 'a' initial credit assessment and do not adjust our initial credit assessment based on a peer assessment or any other factors. NCR has confidential credit assessments (not full credit ratings) on about 300 Nordic banks, including 120 Norwegian banks. Six percent of both sets of assessments have a score of 'a' or higher, down from 12% before the outbreak of COVID-19. The average score is 'bbb+'.

### Support analysis

Support analysis is neutral

We view SB1 Østfold Akershus' ownership as supportive of our standalone credit assessment, but do not provide additional notching as a result of this support. The two foundations which control 65.9% of the bank's ECCs are currently liquid and able to participate in further equity issues, as they have done historically. SpareBank 1 Stiftelsen Halden did not participate in the last ECC issue to reduce its stake, but we believe it has available liquidity to participate if necessary. The foundations have a stated purpose to exercise long-term and stable ownership of SB1 Østfold Akershus and must have an ownership interest constituting 15% or more of the bank's issued equity capital.

**Figure 11. SB1 Østfold Akershus ownership structure**

Owner	Share of ECCs
SpareBank 1 Stiftelsen Østfold Akershus	40.67%
SpareBank 1 Stiftelsen Halden	25.24%
Pareto Invest AS	8.89%
Vpf Eika Egenkapitalbevis	2.72%
Landkreditt Utbytte	1.86%
Arctic Funds Plc	1.63%
Pareto Aksje Norge	1.63%
Wenaasgruppen	0.97%
Bergen Kommunale Pensjonskasse	0.93%
Other	15.46%
Total	100.00%

## ISSUE RATINGS

Our rating on SB1 Østfold Akershus' unsecured senior debt is in line with the issuer rating of 'A'. NCR considers the underlying credit quality of the issuer in its notching of various instruments. The risk of non-payment of capital instruments for highly rated entities is perceived to be very low. We therefore adapt the notching of individual debt instruments depending on the underlying credit quality and the ability of a financial institution to repay its debts.

**Figure 12. SB1 Østfold Akershus key credit metrics, 2015-Q3 2020**

Key credit metrics (%)	2015	2016	2017	2018	2019	Q3 2020 YTD
<b>Income composition</b>						
Net interest income/op. revenue	55.4	51.8	51.9	50.5	50.8	51.3
Net fee income/op. revenue	39.4	32.6	35.8	36.1	32.1	36.4
Net trading income/op. revenue	(3.7)	5.7	1.5	2.7	0.6	(2.9)
Net other income/op. revenue	8.9	9.9	10.7	10.7	16.5	15.2
<b>Earnings</b>						
Net interest margin	1.9	1.9	1.8	1.8	1.8	1.8
Pre-provision income/REA	2.9	3.7	3.5	3.4	3.8	3.6
Return on ordinary equity	10.7	14.1	12.3	11.7	12.3	10.6
Return on assets	1.2	1.7	1.6	1.6	1.7	1.5
Cost-to-income ratio	52.2	44.1	43.9	44.7	42.2	42.5
Cost-to-income ratio, ex. trading	50.3	46.8	44.6	46.0	42.5	41.3
<b>Capital</b>						
CET1 ratio	16.6	16.3	17.6	16.1	17.8	17.5
Tier 1 ratio	17.6	17.9	19.2	17.8	19.1	18.6
Capital ratio	17.6	18.2	19.9	19.2	19.9	19.9
REA/assets	55.3	55.7	55.6	53.7	54.6	54.7
Dividend payout ratio	20.4	27.0	35.9	53.9	39.3	-
Leverage ratio	8.1	8.8	9.8	9.7	10.1	9.7
<b>Growth</b>						
Asset growth	-	5.7	5.4	11.9	2.4	5.2
Loan growth	-	5.1	5.7	11.3	1.3	5.8
Deposit growth	-	4.8	4.6	11.0	7.3	6.3
<b>Loss performance</b>						
Credit provisions to net loans	0.10	0.01	0.00	0.04	(0.09)	0.16
Impaired loans to gross loans	0.56	0.38	0.26	0.38	0.53	0.60
Net impaired loans to gross loans	0.48	0.38	(0.09)	0.01	0.20	0.15
Net problem loans to equity	0.47	(0.12)	(0.52)	0.06	1.07	0.85
NPL coverage ratio	86.6	105.6	135.9	97.1	63.0	74.4
Stage 3 loans/gross loans	-	-	0.63	0.57	0.66	0.60
Net Stage 3 loans/gross loans	-	-	0.52	0.47	0.56	0.48
<b>Funding &amp; liquidity</b>						
Loan/deposit ratio	129.1	129.5	130.9	131.3	123.9	123.4
Net stable funding ratio	124.0	121.0	130.0	121.0	152.0	123.4
Liquidity coverage ratio	115.0	234.0	137.0	209.0	123.0	150.0

Based on NCR estimates and company data. All metrics adjusted in line with NCR methodology. YTD-year to date.

**Figure 13. SB1 Østfold Akershus key financials, 2015-Q3 2020**

Key financials (SEKm)	2015	2016	2017	2018	2019	Q3 2020 YTD
<b>Balance sheet</b>						
Total assets	18,793	19,865	20,946	23,437	24,004	25,252
Total tangible assets	18,779	19,855	20,940	23,435	24,004	25,252
Total financial assets	18,240	19,280	20,381	22,911	23,227	24,362
Net loans and advances to customers	15,246	16,023	16,944	18,857	19,093	20,208
Total securities	1,883	1,853	2,217	2,420	2,906	2,830
Customer deposits	11,806	12,370	12,939	14,359	15,412	16,379
Issued securities	4,339	4,433	4,537	5,358	4,837	4,760
Of which other senior debt	3,874	4,120	4,225	5,047	4,686	4,610
Of which subordinated	465	314	312	311	151	150
Total equity	2,246	2,670	3,096	3,330	3,534	3,640
<b>Capital</b>						
CET1*	1,723	1,804	2,044	2,063	2,206	2,279
Tier 1*	1,829	1,979	2,232	2,289	2,352	2,426
Total capital*	1,829	2,020	2,317	2,431	2,495	2,568
REA	10,387	11,071	11,641	12,580	13,110	13,807
<b>Income statement</b>						
Operating revenues	610	703	701	754	841	626
Pre-provision operating profit	292	393	393	417	486	360
Impairments	14	1	0	6	(3)	32
Net income	221	332	321	358	404	272

Based on NCR estimates and company data. All metrics adjusted in line with NCR methodology. YTD-year to date.

\*Proportionally consolidated from 2018 onwards

**Figure 14. SpareBank 1 Østfold Akershus rating scorecard**

Subfactors	Impact	Score
National factors	10.0%	a-
Regional, cross border, sector	10.0%	a-
Operating environment	20.0%	a-
Capital	17.5%	a+
Funding and liquidity	15.0%	a
Risk governance	5.0%	a-
Credit risk	10.0%	bbb+
Market risk	-	n/a
Other risks	2.5%	a
Risk appetite	50.0%	a
Market position	15.0%	bbb+
Earnings	7.5%	aa
Loss performance	7.5%	a
Performance indicators	15.0%	a+
<b>Indicative credit assessment</b>		<b>a</b>
Peer comparisons		Neutral
Transitions		Neutral
Borderline assessments		Neutral
<b>Stand-alone credit assessment</b>		<b>a</b>
Support analysis		Neutral
Material credit enhancement		Neutral
Rating caps		Neutral
<b>Issuer rating</b>		<b>A</b>
Outlook		Stable
<b>Short-term rating</b>		<b>N-1+</b>

**Figure 15. Capital structure ratings**

Seniority	Rating
Senior unsecured	A
Senior non-preferred	A
Tier 2	A-
Additional Tier 1	BBB

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