

NorgesGruppen

Solid food

- Norway's leading food retail and wholesale player
- Mid-range leverage due to real estate strategy
- Handelsbanken has a mandate to issue bonds for NorgesGruppen

The undisputed market leader

As the clear leader in the Norwegian food retail and wholesale markets, NorgesGruppen has a very solid market position. A strong store footprint and generally high barriers to entry support NorgesGruppen's attractive position, in our view.

Mid-range leverage adjusted for operating leases

NorgesGruppen has good liquidity and modest amounts of on-balance-sheet debt; however, adjusted for operating leases, the company's leverage is mid-range. The need to obtain and hold attractive retail locations is the primary driving force behind NorgesGruppen's adjusted credit metrics. The situation is similar for peers, we note, as controlling attractive store locations is an important success factor for a food retailer.

Bonds are fair value

NorgesGruppen's NOK bonds are priced nearly 20bp inside our generic NOK corporate curve in the five-year segment. Considering the company's credit profile, spreads are fair value, in our view, and we maintain our Market Perform recommendation.

Johan Sahlström, +46 8 701 1174, josa23@handelsbanken.se

Key figures

NOKm	2013	2014	2015	2016	2017	2018 H1 LTM*
Sales	64,592	68,508	72,746	76,868	82,308	86,643
Adj. EBITDA	5,488	5,982	6,344	6,761	7,086	7,052
Adj. EBITDA margin (%)	8.5	8.7	8.7	8.8	8.6	8.1
EBIT adj.	2,914	3,091	3,284	3,501	3,108	3,566
EBIT margin adj. (%)	4.5	4.5	4.5	4.6	3.8	4.1
Adj. FFO	4,509	5,175	5,529	5,989	6,283	5,850
Capex	-2,598	-2,844	-3,435	-3,117	-2,892	-3,114
Discretionary cash flow	-196	153	-294	878	1,642	604
Gross adjusted debt	18,347	19,388	20,632	20,053	18,711	19,195
Cash and mkt securities	403	400	505	707	1,090	666
Net adj debt	17,944	18,988	20,127	19,345	17,621	18,529
Adj. FFO/net debt (%)	25	27	27	31	36	32
Net adj debt/ EBITDA (x)	3.3	3.2	3.2	2.9	2.5	2.6
EBITDA/net interest adj (x)	9.1	13.5	13.8	15.6	17.8	17.2
Capex to sales (%)	4.0	4.2	4.7	4.1	3.5	3.6

Source: Company reports and Handelsbanken Capital Markets *LTM includes HCM estimates



Underperform



Market Perform



Outperform

Public ratings

No public ratings

Company data

Web address: <http://www.norgesgruppen.no>

CEO: Runar Hollevik

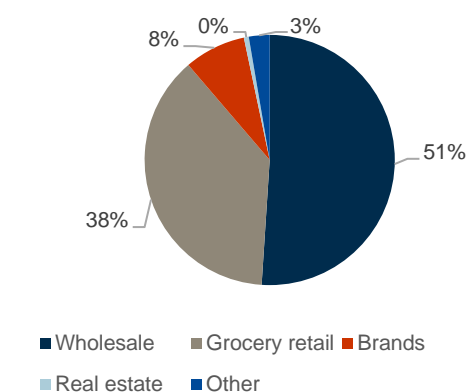
CFO: Mette Lier

Treasurer: Annichen Fladager

Company profile

NorgesGruppen is Norway's largest food retailer and wholesaler with 1,835 associated stores and a 43.1% grocery market share. Total revenues were NOK 83bn in 2017. The company is majority owned by the Johannson family.

Revenue distribution (NOKm), 2018 H1



Source: Company reports

Company description

NorgesGruppen is Norway's largest food retail and wholesale group with dominant market positions in what we see as a fairly attractive market.

Established in its present form in 2000

Overview and brief background

NorgesGruppen was established in 2000 when the wholesale operations of Joh. Johansson were merged with several regional and local retail chains to create a vertically-integrated player more similar to its key competitors. Many associated chain and store owners then became shareholders in the new group, which resulted in a large number of shareholders. To date, the Johansson family continues to own the majority of NorgesGruppen via the company Joh. Johansson Handel I AS.

Since 2000, the group has continued to grow through smaller acquisitions, streamlined brands and concepts and established its own private label operations.

A combination of own stores and franchise

As with many peers, NorgesGruppen uses a mix of own stores and franchise stores. The majority of the group's associated stores are retailer-owned (1,021 of 1,835) as of year-end 2017.

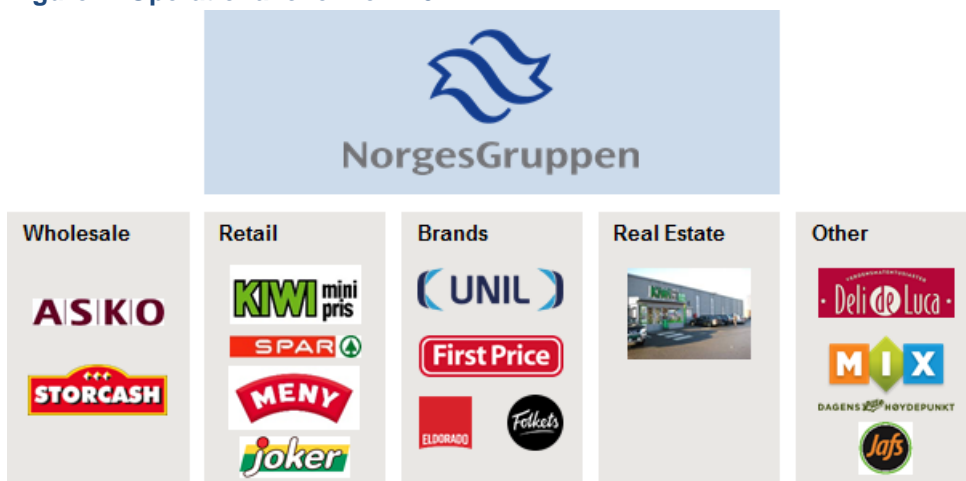
The group has several store concepts with different profiles. The soft discount chain KIWI and the MENY supermarkets mainly include wholly owned stores, whereas the majority of SPAR and Joker are franchise-operated stores. The latter two concepts are typically smaller, neighbourhood stores and local supermarkets.

Five business segments:

NorgesGruppen has five business segments:

- **Food retail:** consists of the group's own stores and management of the retail concepts, i.e. the four main chains: MENY (supermarkets), KIWI (soft discount), SPAR (local supermarkets), and Joker (local stores).
- **Food wholesale:** the group's wholesale arm ASKO, which supplies both consolidated stores and associated stores.
- **Brands:** includes private label goods and own production of bread, ready meals and coffee.
- **Real estate:** real estate when owned by separate companies.
- **Other:** convenience stores and administration.

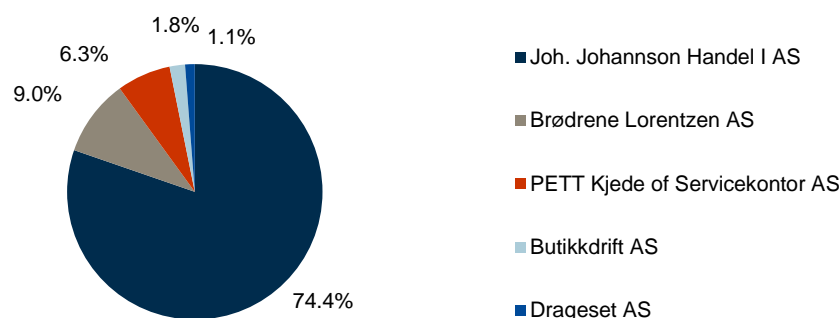
Figure 1: Operational overview 2017



Source: Company report, HCM

Figure 2: Largest owners

The Johansson family owns the majority of NorgesGruppen via Joh. Johansson Handel I AS



Source: Company webpage

NorgesGruppen holds 43.2% of the Norwegian food retail market

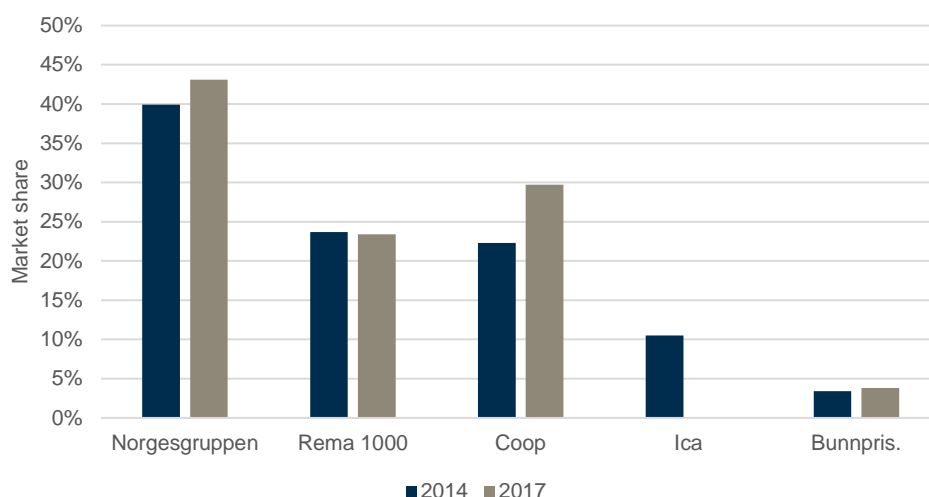
Clear market leader in a consolidated food retail market

NorgesGruppen is the clear market leader (Figure 3) with 43.2% of the well-consolidated Norwegian food retail market that was worth NOK 171bn in 2017, according to the market research company Nielsen. Following ICA's exit through a divestment to Coop in 2015¹, there are only three major players left in the Norwegian food retail and wholesale markets: NorgesGruppen, Rema 1000 (part of the Reitan Group) and Coop. The distant number four, Bunnpris, has sourced from NorgesGruppen since the beginning of 2017.

Comparing market share between 2014 and 2017 shows Coop has gained the most (due to the ICA transaction) and that NorgesGruppen has continued to gain market share. However, it should be noted that some former ICA stores were divested to NorgesGruppen and Bunnpris.

Figure 3: Market share, 2014 vs. 2017

Only three major players in the Norwegian food retail market



Source: Nielsen

An even stronger position in food wholesale

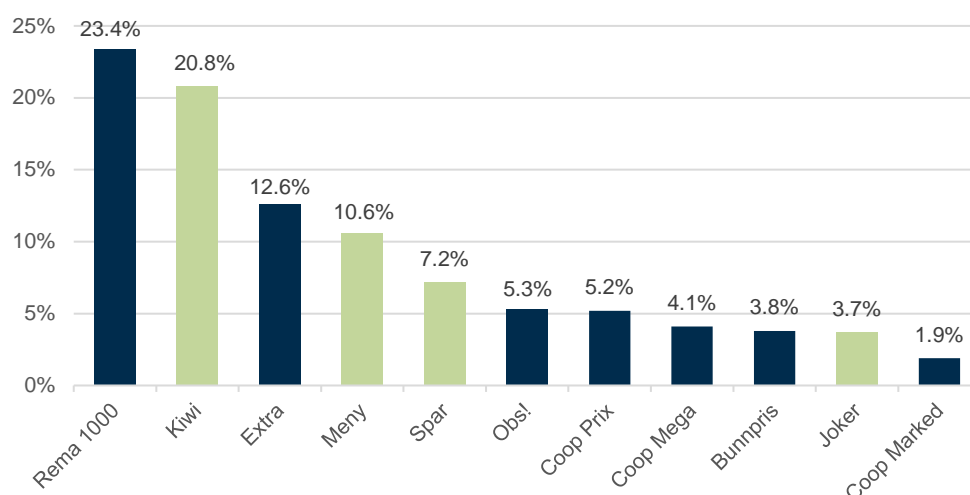
An even stronger position within food wholesale

NorgesGruppen's food wholesale operation is called ASKO and serves both food retail (consolidated and franchise) stores, which accounts for around 80% of sales, and catering customers, at around 20% of its sales. NorgesGruppen says it held around 36% of the catering market in 2017. In addition to associated chains, ASKO also supplies Bunnpris, the fourth largest retail chain.

¹ The transaction was agreed in 2014 but received anti-trust clearance in 2015.

NorgesGruppen has
four major chains

Figure 4: Market share, 2017, by chain (NorgesGruppen in green)



Source: Nielsen

In our view, NorgesGruppen has an even stronger position in food wholesale than in food retail. When the European Commission cleared the acquisition of border retail chain Eurocash by Swedish Axfood and NorgesGruppen (which ended up owning 51% and 49%, respectively) in 2017, it estimated NorgesGruppen's market share in the Norwegian wholesale market to be between 45 and 50%².

Substantial
economies of scale

High barriers to entry and large economies of scale

The Norwegian food retail and wholesale markets exhibit a high degree of consolidation and high barriers to entry. There have only been a few attempts to establish "greenfield" food retail operations in Norway. In 2008, the German hard-discounter Lidl withdrew from the Norwegian market. In 2018, the UK frozen food specialist Iceland (a niche player, in our view) opened two stores in Norway and says it is looking to open additional stores.

A 2017 report written on behalf of the Norwegian Ministry of Trade, Industry and Fisheries about barriers to entry in the Norwegian food retail market³ pointed to the relationship between large purchasing volumes and lower prices, which appears to be unusually strong in Norway.

In addition, the Norwegian food retail and wholesale market is characterised by:

- Highly concentrated food production, with food retailers having significant ownership interests in the sector.
- Norwegian agricultural policy means that important areas of food production are subject to price and quota regulation (e.g. dairy products) and domestic production is protected by import duties.
- Higher distribution costs than in other countries, largely due to geography.
- High store density. Zoning and planning restrictions limit new store openings (not unique to Norway), making it difficult to enter the market for a new player and reach meaningful scale.
- High prices and a growing dominance of discount chains (discount stores held 65.7% of the Norwegian market in 2017, according to Nielsen). Note,

² European Commission; Case M.8464, NorgesGruppen / Axfood / Eurocash

³ Etableringshindringer i dagligvaresektoren / 2017-46 Oslo Economics

though, that the segment is dominated by so-called soft discounters, not hard discounters like Lidl, which are strong in some markets.

- Significant cross-border shopping of groceries (estimated to be worth about NOK 11bn); probably a reflection of the high prices.
- On-line sales were only NOK 2bn in 2017, but grew 30%, according to Nielsen.

Real estate

Large real estate portfolio

Controlling attractive store locations is an important success factor for a food retailer. NorgesGruppen both owns and leases stores and other premises. The company owns more than 800,000 m² of property (a mix of retail, wholesale and logistics property) and leases over 1,000,000 m². The book value of land and property was NOK 8.8bn as of year-end 2017. However, not all premises are used by the group and external rental revenues were NOK 306m in 2017.

A 42% stake in Norway's fourth-largest shopping-centre owner

In addition to consolidated property, NorgesGruppen owns 42% of Scala Retail Property, Norway's fourth largest shopping centre owner that owns 20 shopping centres (around 250,000m²) with rental income of around NOK 425m.

We calculate the net present value of NorgesGruppen's operating leases to be NOK 12.2bn, which represents the bulk of adjusted debt in the company. Thanks to new accounting rules, IFRS 16, leased assets will be booked on the company's balance sheet in 2019, which will change the reported figures notably.

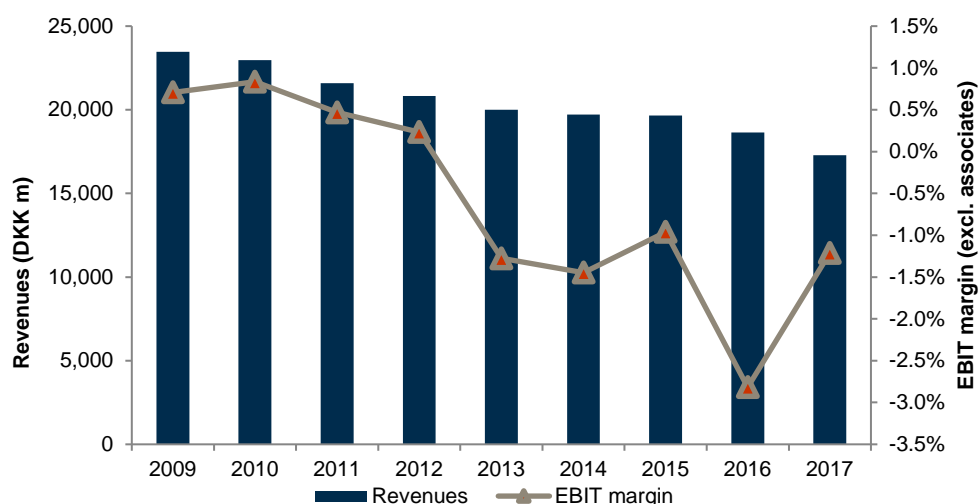
Associated companies

Dagrofa has performed poorly; BAMA has been profitable

NorgesGruppen has several unconsolidated associated companies. In addition to the real estate company Scala Retail Property, NorgesGruppen owns 48.9% in the Danish food retailer Dagrofa, which is reported as an associated company. Dagrofa has performed poorly for some years (declining sales and loss-making since 2013; Figure 5) and is undergoing restructuring. In 2017, Dagrofa closed down the Kiwi chain in Denmark. By our estimates (including adjustments for operating leases) Dagrofa is highly leveraged.

On a more positive note, NorgesGruppen owns 45.55% of the profitable fruit and vegetable company BAMA Gruppen (the other key shareholder is Reitan with around 20% and the Nergaard family via an investment company).

Figure 5: Dagrofa, revenues and EBIT margin



Source: Dagrofa's financial reporting

Dagrofa has been loss making in recent years

Credit view

With its very strong domestic market position, solid cash flow generation and mid-range leverage, NorgesGruppen has a strong and defensive credit profile, in our view. Weaknesses include the loss making Danish Dagrofa operations and significant operating lease commitments.

Key credit considerations

Supportive factors for NorgesGruppen's credit profile include:

- Very strong market positions as Norway's leading food retailer and wholesaler.
- High barriers to entry to the Norwegian food retail and wholesale markets.
- Good control over store locations.
- Stable operating margins.
- Low on-balance sheet leverage and strong liquidity.

Restrictive factors for NorgesGruppen's credit profile include:

- Danish associated company Dagrofa is loss-making and faces structural challenges.
- Large capex hampers cash-flow generation.
- Substantial operating lease commitments.
- Disclosure lagging publicly listed companies.

Business profile

Business profile
supports very stable
cash flows

The combination of a very strong market position in a relatively attractive market means that we see NorgesGruppen as having a business profile that supports very stable cash-flow generation with quite good operating margins. The group's market position is underpinned by its real estate strategy, which is a competitive advantage.

We see a risk that the Norwegian food retail market may become somewhat less attractive over the medium term due to slowing growth and price pressure. Specifically we note that there is a debate about possible changes to agricultural policy that could lead to stiffer competition and accelerating price pressure. However, in our view, the likelihood of such a scenario having a meaningful impact on NorgesGruppen's credit profile over the next few year is modest.

Financial performance

Comparison with
ICA Gruppen

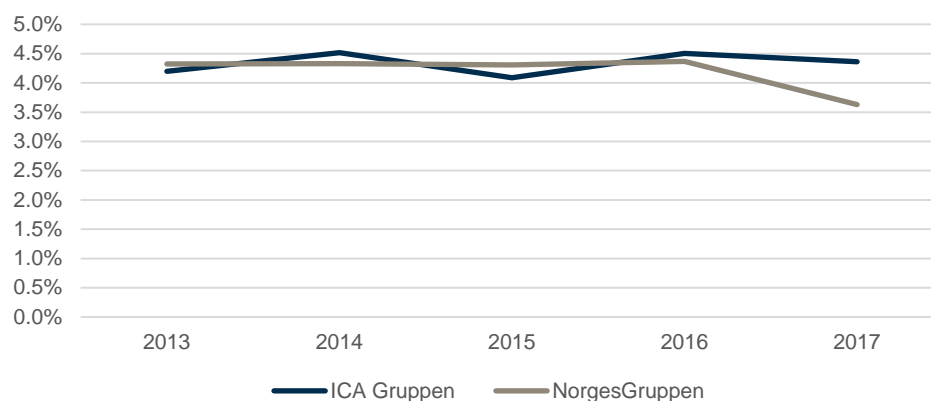
In order to put NorgesGruppen's financial performance into context, we compare it to ICA Gruppen (ICA), the Swedish peer with a similarly strong market position on the Swedish market. The two companies have comparable footprints in so far as both have roots in wholesale, have a mix of owned and franchise stores and an active real estate strategy. However, the companies differ in that NorgesGruppen has a higher share of consolidated stores than ICA and, consequently, a lower share of wholesale revenues.

Both companies exhibit strong and stable EBIT margins (Figure 6). The "blip" for NorgesGruppen in 2017 relates largely to the restructuring of Dagrofa.

Figure 6: NorgesGruppen and ICA Gruppen, adjusted EBIT margin

Both NorgesGruppen and ICA Gruppen show strong and stable EBIT margins

EBIT margin adjusted for one-time items



Source: HCM

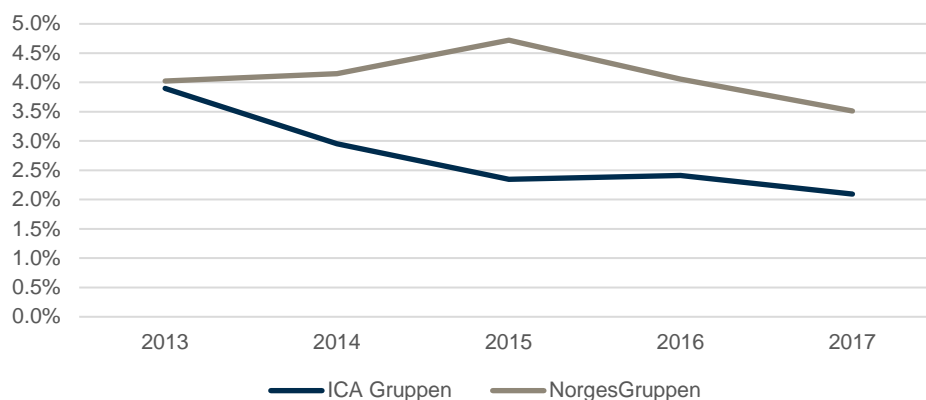
A difference between NorgesGruppen and ICA Gruppen is the capex level (Figure 7). NorgesGruppen invests around 1-1.5% more of its revenues than ICA Gruppen. Part of the explanation is that NorgesGruppen invests more in consolidated real estate, probably related to its larger network of consolidated stores. Because of its greater capex, NorgesGruppen also has higher depreciation than ICA. Looking at EBITDA margins rather than EBIT puts NorgesGruppen well ahead.

We note that ICA Gruppen recently (December 13, 2018) guided for SEK 4bn in capex in 2019, which represents a substantial increase and which we estimate will put ICA Gruppen's capex-to-sales close to that posted by NorgesGruppen in 2017.

Figure 7: NorgesGruppen and ICA Gruppen, capex-to-sales

NorgesGruppen has higher capex-to-sales than ICA Gruppen

Capex to sales



Source: HCM

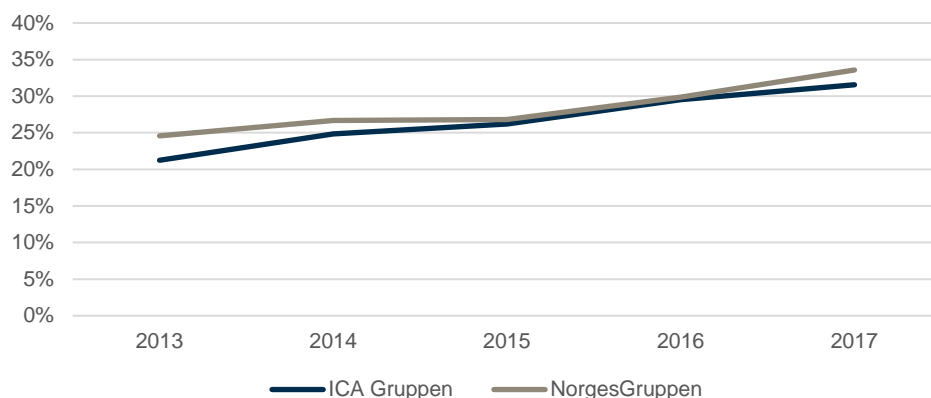
Financial policy and leverage

Leases account for the bulk of adjusted debt

NorgesGruppen has fairly modest, and declining, levels of debt on its balance sheet. At year-end 2017, total debt was NOK 6.1bn and net debt was NOK 5.0bn. Note that the company defines net debt differently, as it includes derivatives but subtracts interest-bearing receivables, which results in a net debt figure of NOK 4.2bn.

Figure 8: NorgesGruppen and ICA Gruppen, FFO-to-adjusted debt

FFO to adjusted debt



Source: HCM

Strong cash flow-to-debt ratios even on a fully lease-adjusted basis

Adjustment for operating leases adds NOK 12.2bn to debt

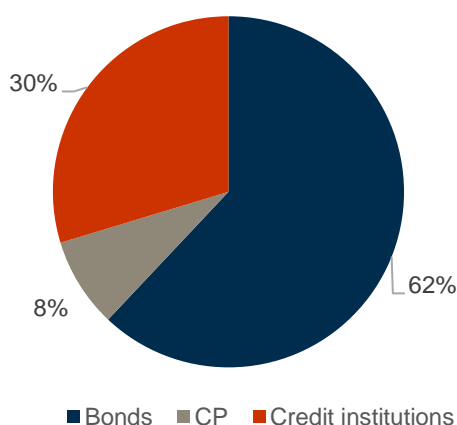
More significant is that our adjustment for operating leases adds NOK 12.2bn to debt, all of which relates to property leases. Because of IFRS 16, which puts lease commitments on the balance sheet, reported numbers will look different as of January 1, 2019. In our view, the impact on adjusted credit metrics from the new accounting standards is unclear.

Nonetheless, on a fully lease-adjusted basis, cash-flow-to-debt metrics have improved notably over recent years. As of year-end 2017, NorgesGruppen's FFO-to-adjusted debt was 33.6%, slightly stronger than ICA Gruppen.

NorgesGruppen and ICA Gruppen are large, complex groups with a lot of leases and debt held in partially owned companies. For instance, NorgesGruppen has lease commitments also in its associated company, Dagrofa.

Funding

NorgesGruppen has a diversified funding profile, in our view. At the end of 2017, the bulk was bonds, NOK 3.7bn, followed by credit institutions and commercial paper. The funding is mainly centralised to the mother company. Some funding is subject to covenants that seem unchallenging, in our view. There is very little asset encumbrance. NorgesGruppen's liquidity is strong. As of year-end 2017, cash reserves were NOK 1.1bn and unused, committed long-term facilities were NOK 5.5bn.

Figure 9: Funding sources, year-end 2017

Source: HCM

Diversified funding and strong liquidity

An uncomplicated and diversified funding profile

Transparency and disclosure

NorgesGruppen reports according to IFRS and publishes annual and semi-annual reports. The financial reporting is generally adequate, in our view, with fairly extensive full-year reports, but somewhat condensed semi-annual reports. The non-financial information and the overall disclosure lags publicly-listed peers, in our view, but it compares fairly well to many non-publicly owned bond issuers.

Relative value

NorgesGruppen's NOK bonds are priced nearly 20bp inside our generic NOK corporate curve in the five-year segment. Considering the company's credit profile, spreads are fair value, in our view, and we maintain our Market Perform recommendation.

A NOK corporate curve excluding real estate and government-related issuers

NOK corporate curve

To evaluate spreads for NorgesGruppen, we use an estimated NOK corporate curve based on bonds issued by A.P. Møller-Mærsk, Borregaard (Market Perform), NorgesGruppen, Norsk Hydro, Nortura, Orkla, Scania, Schibsted (Outperform), Tine (Market Perform) and Yara. We have excluded property issuers because these are priced with a spread premium. We have also excluded government-related issuers, which tend to be priced based partly on implicit ownership support.

NorgesGruppen's interpolated five-year point is indicated nearly 20bp inside our generic curve. Considering the company's credit profile, spreads are fair value across the curve, in our view, and we reiterate our Market Perform recommendation.

Two domestic peers: Tine and Orkla...

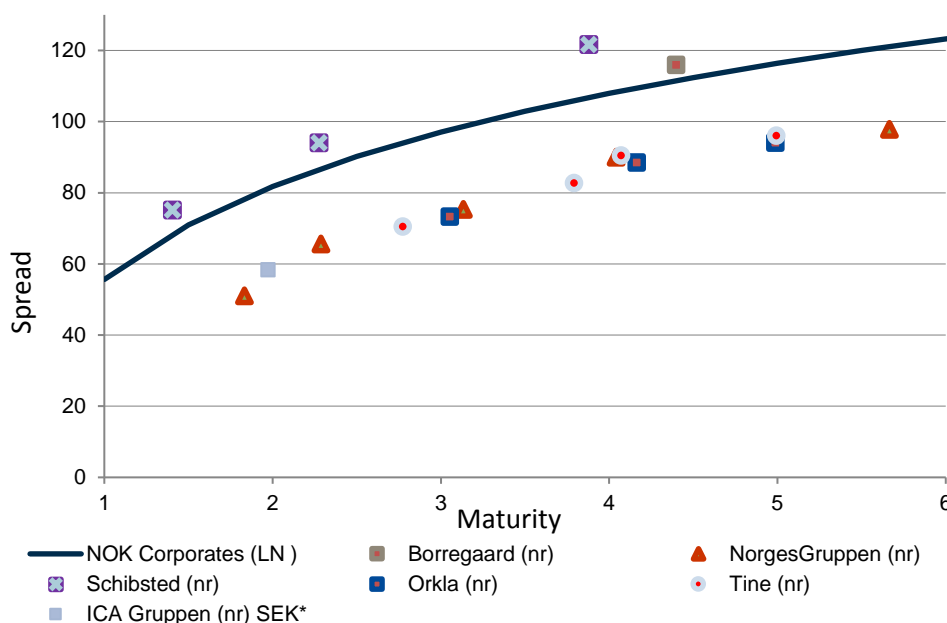
Peers

None of the NOK corporates we cover are really close peers to NorgesGruppen. The closest peers in the NOK market are Tine and Orkla, which are both food-related, non-cyclicals with relatively low leverage. Spreads for NorgesGruppen are very close to these two peers. In our view, NorgesGruppen's indicated spreads offer fair value relative to Tine, for which we also have a Market Perform recommendation.

...and ICA Gruppen in SEK

In order to find an operationally close peer, we show SEK bonds issued by ICA Gruppen (nr) adjusted for cross-currency basis swaps (Figure 10). In the two-year segment, NorgesGruppen is priced in line with ICA Gruppen, despite NorgesGruppen being a stronger credit, in our view. We view ICA Gruppen's SEK bonds as expensive and have an Underperform recommendation for those.

Figure 10: Spreads for NorgesGruppen and selected peers



Source: Bloomberg, HCM, *Cross-currency adjusted spreads

NorgesGruppen is indicated nearly 20bp inside the NOK corporate curve

Key figures

Key metrics, annual data

NOKm	2013	2014	2015	2016	2017
P&L accounts					
Revenues	67,396	71,391	76,224	80,162	85,632
Total op expenses	-63,497	-67,034	-71,495	-75,316	-80,393
EBITDA	3,899	4,357	4,729	4,846	5,238
EBITDA adj	5,488	5,982	6,344	6,761	7,086
Depreciation and impairment	-1,625	-1,678	-1,847	-1,825	-2,116
EBIT	2,746	3,038	3,353	3,325	3,150
Associated income	362	266	289	245	-69
Interest income	53	53	72	68	54
Interest expense	-309	-294	-236	-205	-180
Other financial items	10	-94	8	49	-154
EBT	2,515	2,709	3,183	3,224	2,875
Paid tax	-546	-590	-677	-683	-704
Minorities	-24	-24	-28	-25	-41
Net income	1,880	2,000	2,516	2,499	2,146
Balance sheet					
Financial assets	3,355	3,729	4,376	4,041	3,916
Total tangible assets	12,669	13,756	14,587	15,778	16,102
Total intangible assets	4,813	4,760	4,905	4,895	4,832
Other long-term assets	5,146	5,131	5,172	5,220	5,173
Other current assets	9	64	66	7	23
Cash and equivalents	403	400	505	707	1,090
Total assets	30,914	33,515	35,104	36,382	37,678
Equity	11,455	13,007	14,820	16,728	18,135
Minorities	235	244	245	252	260
LT interest-bearing debt	4,914	5,610	6,163	6,002	4,650
Other long term liabilities	114	219	228	134	100
ST interest bearing debt	3,644	2,838	2,497	1,176	1,462
Other current liabilities	4,645	4,710	4,802	4,731	5,106
Total equity and liabilities	30,914	33,515	35,104	36,382	37,678
Total equity and liabilities adj	40,428	44,140	46,756	48,896	49,882
Total debt	8,559	8,448	8,660	7,178	6,111
Total debt adj	18,347	19,388	20,632	20,053	18,711
Cash flow					
Funds from operations (FFO)	3,198	3,696	4,028	4,309	4,492
FFO adj	4,509	5,175	5,529	5,989	6,283
Change in working capital	-346	-448	-363	291	690
Operating cash flow (OCF)	2,852	3,248	3,665	4,600	5,182
Cash flow from investments	-3,267	-2,983	-3,212	-2,669	-2,507
Capex	-2,598	-2,844	-3,435	-3,117	-2,892
Dividends paid	-451	-251	-524	-605	-648
Discretionary cash flow	-196	153	-294	878	1,642
Net change in debt	820	31	193	-1,116	-1,589
Cash flow from financing	283	-268	-347	-1,729	-2,293
Net cash flow	-131	-3	105	202	382
Key credit metrics (%)					
EBITDA adj margin	8.1	8.4	8.3	8.4	8.3
EBIT adj margin	4.5	4.5	4.5	4.4	3.7
Equity ratio	37.1	38.8	42.2	46.0	48.1
Equity ratio adj	28.3	29.5	31.7	34.2	36.4
Net debt/equity (x)	0.71	0.62	0.55	0.39	0.28
Net debt/EBITDA (x)	2.1	1.8	1.7	1.3	0.96
Net debt/EBITDA adj (x)	3.3	3.2	3.2	2.9	2.5
Debt/EBITDA (x)	2.2	1.9	1.8	1.5	1.2
Debt/EBITDA adj (x)	3.3	3.2	3.3	3.0	2.6
EBITDA/Net interest adj (x)	9.1	13.5	13.8	15.6	17.8
EBIT/interest (x)	5	6	7	7	7
FFO/net debt	39.2	45.9	49.4	66.6	89.4
FFO/total debt adj	24.6	26.7	26.8	29.9	33.6
FFO/net debt adj	25.1	27.3	27.5	31.0	35.7
FOCF/debt	3.0	4.8	2.7	20.7	37.5

Source: Company reports and Handelsbanken Capital Markets

Credit research disclaimer

Recommendation structure and allocations

Handelsbanken Capital Markets Credit Research (HCM) employs a three-graded recommendation scale. The recommendations reflect the analyst's assessment of the bond's total return on a 12-month time horizon in relation to a relevant benchmark. The recommendations amongst companies under coverage and amongst companies under coverage for which Handelsbanken has provided investment banking services in the past 12 months are listed below:

Recommendations: definitions and allocations

HCM recommendation ¹	HCM universe unsecured ²	HCM universe secured ²	IB services ³
Underperform	12%	17%	0%
Market Perform	58%	50%	39%
Outperform	30%	33%	41%

¹ Recommendation definitions:

Outperform: Over the next 12 months, the bond's total return is expected to exceed the total return of the relevant benchmark

Market Perform: Over the next 12 months, the bond's total return is expected to be in line with the total return of the relevant benchmark

Underperform: Over the next 12 months, the bond's total return is expected to be below the total return of the relevant benchmark

² Percentage of companies under coverage within each recommendation

³ Percentage of companies within each recommendation (unsecured) for which investment banking services have been provided in the past 12 months

Source: Handelsbanken Capital Markets, as per 27/1 2019

Recommendations are continuously reviewed by the analyst and monitored by the Research Management and will be updated and/or refreshed regularly. The rationale behind a change in recommendation will be explained in such a refresher/update.

A list of all recommendations made by investment research during the preceding 12-month period is available here: <https://www.researchonline.se/desc/creditchist>.

Unless otherwise specified, prices and spreads mentioned in this report refer to the closing price of the previous day.

Risk warning

All investments involve risks and investors are encouraged to make their own decision as to the appropriateness of an investment in any securities referred to in this report, based on their specific investment objectives, financial status and risk tolerance. The historical return of a financial instrument is not a guarantee of future return. The value of financial instruments can rise or fall, and it is not certain that you will get back all the capital you have invested. At times, the expected total returns may fall outside of the above stated expectation because of price movement and/or volatility. Such interim deviations from specified expectations will be permitted but will become subject to review by Research Management.

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Jan 26. 2019:

The recommendation (unsecured) Market Perform was set on 2016-08-30 as the first recommendation for the company.

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Equity & Credit Research

Acting Head of Research

Ann Öberg +46 8 701 2837

Consumer Discretionary & Staples

Consumer Goods

Rasmus Engberg +46 8 701 5116
 Marcela Klang +46 8 701 5118
 Karri Rinta +46 8 701 3636
 Magnus Råman +46 8 701 1727
 Nicklas Skogman +46 8 701 3128
 Kjetil Lye +47 22 39 7299
 Annette Lykke +45 46 79 1295
 Mika Karppinen +358 10 444 2752

Media & Services

Rasmus Engberg +46 8 701 5116

Energy

Oil and Gas

Johannes Grunselius +46 8 701 3892
 Anne Gjøen +47 22 39 7022
 Mathias Lange Dokkan +47 22 39 7105

Oil Services

Anne Gjøen +47 22 39 7022
 Mathias Lange Dokkan +47 22 39 7105

Utilities

Karri Rinta +46 8 701 3636
 Anne Gjøen +47 22 39 7022
 Mathias Lange Dokkan +47 22 39 7105

Strategy

Pierre Mellström +46 8 701 5114

Credit Research

Johan Sahlström +46 8 701 1174
 Ola Eriksson +46 8 701 2218
 Erik Salomonsson +46 8 701 1231
 Peter Wallin +46 8 701 2534
 Jussi Nikkanen +358 10 444 2408

Healthcare

Medtech

Annette Lykke +45 46 79 1295

Pharmaceuticals

Peter Sehested +45 46 79 1618

Telecom & IT

Telecom Operators

Kristoffer Carleskär +46 8 701 5334

Telecom Equipment

Daniel Djurberg +46 8 701 5575

IT

Daniel Djurberg +46 8 701 5575
 Erik Elander +46 8 701 3141

Small Caps

Erik Elander +46 8 701 3141
 Marcela Klang +46 8 701 5118
 Daniel Lindkvist +46 8 701 2819

Branch Network

Sweden

Peter Engstedt +46 8 701 3104
 Kristoffer Eriksson +46 8 701 1804
 Lars Westberg +46 8 701 4113

Denmark

Jon Abakka +45 46 79 1621
 Michelle Nørgaard +45 46 79 1504

Industrials

Capital Goods

Hampus Engellau +46 8 701 3576
 Erik Elander +46 8 701 3141
 Marcela Klang +46 8 701 5118
 Daniel Lindkvist +46 8 701 2819
 Timo Heinonen +358 10 444 2483
 Mika Karppinen +358 10 444 2752

Construction

Johan Edberg +46 8 701 4351
 Marcela Klang +46 8 701 5118

Commercial Services

Carina Elmgren +46 8 701 2977

Transportation

Frans Høyer +45 46 79 1246

Materials

Steel and Metal

Johannes Grunselius +46 8 701 3892
 Anne Gjøen +47 22 39 7022

Paper

Markku Järvinen +358 40 531 5836

Chemicals

Carina Elmgren +46 8 701 2977

Financials

Banking

Thomas Eskildsen +45 46 79 1587
 Maths Liljedahl +47 8 701 1392

Insurance

Kimmo Rämä +358 10 444 2454

Investment Companies

Magnus Råman +46 8 701 1727

Real Estate

Johan Edberg +46 8 701 4351
 David Flemmich +46 8 701 1354
 Marcela Klang +46 8 701 5118

Equity Sales

Peter Karlsson, Global +46 8 701 2151
 peka15@handelsbanken.se

Lars Hallström, Nordic +46 8 463 2561
 laha08@handelsbanken.se

Micaela Grimm, US +1 212 326 5153
 migr07@handelsbanken.se

Joe Tracy, Continental Europe +46 8 463 3601
 jotr03@handelsbanken.se

Credit Sales

Henrik Franzén, Head of Global FICC Sales
 +46 8 701 114; hefr11@handelsbanken.se

Thomas Grandin, Head of Syndication
 +46 8 463 4583; thgr03@handelsbanken.se

Robert Øvrebø, Head of Bond Sales
 +46 22 82 3012; roov02@handelsbanken.no

Lars Walvig, Norway +47 22 82 3072
 lawa08@handelsbanken.no

Morten Ihler, Norway +47 22 82 3059
 moih01@handelsbanken.no

Lotte Marie Andersen +47 22 82 3003
 loan09@handelsbanken.no

Marko Kassinen, Finland +358 10444 6243
 maka45@handelsbanken.fi

Svenska Handelsbanken AB (publ)

Stockholm

Blasieholmstorg 11
 SE-106 70 Stockholm
 Tel. +46 8 701 10 00
 Fax. +46 8 611 11 80

Copenhagen

Havneholmen 29
 DK-1561 Copenhagen V
 Tel. +45 46 79 12 00
 Fax. +45 46 79 15 52

Helsinki

Itämerenkatu 11-13
 00180 Helsinki
 Tel. +358 10 444 11
 Fax. +358 10 444 2578

Oslo

Tjuvholmen allé 11
 Postboks 1249 Vika
 NO-0110 Oslo
 Tel. +47 22 39 70 00
 Fax. +47 22 39 71 60

London

3 Thomas More Square
 London GB-E1W 1WY
 Tel. +44 207 578 8668
 Fax. +44 207 578 8090

New York

Handelsbanken Markets
 Securities, Inc.
 875 Third Avenue, 4th Floor
 New York, NY 10022-7218
 Tel. +1 212 326 5153
 Fax. +1 212 326 2730
 FINRA, SIPC