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Review of the environment to invest in the Nordic Region

Review of the environment to invest in the Nordic Region, February 2021

Executive summary

- When the Nordics are considered as one economic zone, it's GDP lies somewhere between that of Italy and Canada.

- While the Nordics should remain strong exporters, mainly to the EU, one shouldn't underestimate their strong internal market or overestimate their reliance on global trade.

- Norway is indeed still reliant for 18% of it's GDP and 7% of it's employment on the oil & gas industry and its supply chain. However, the weighting of this is decreasing every year and Norway has plenty of intellectual and monetary capital to reposition itself.

- The private equity market in the Nordics is very well developed with plenty of small and mid-cap opportunities as well as plenty of local exit possibilities (secondaries, trade buyers and a vibrant stock market).

Overview of the Nordic market

In this paper, we will consider the Nordics as one economic region. The Nordics are Scandinavia (Norway, Sweden, Denmark and Iceland) plus Finland. We realise that the Nordic countries have different currencies (DKK, SEK, NOK, EUR) but as all Nordic countries are part of the European Economic Zone and as all (except Finland) speak a rather similar language and all (including Finland) can be said to have a similar culture and of course border each other, they can be considered therefore as a single region such as the Benelux.

Another reason to look at the Nordics as a single region is that once private equity funds go above an assets under management (AUM) of €500m, they typically invest in more than one Nordic country, often with a strategy of turning a national champion into a regional champion. The companies are therefore more exposed to regional than national economic swings.

We will however, single out Norway and the Norwegian relationship with the oil industry as a particular pain point later on in this paper.

The Nordics comprise a population of about 27 million people, which sits somewhere between Australia (25m) and the Benelux (29m). They punch however totally above their weight when it comes to GDP with combined nominal GDP somewhere between Italy and Canada (and 15% higher than the Benelux). Just as important is a very good ranking in the Gini (economic equality) and Human Development Indexes showcasing an egalitarian, well-educated and cohesive society.

Country	GDP total (PPP)	GDP per capita (PPP)	GDP total (nominal)	GDP per capita (nominal)	Gini	HDI
Denmark	325.556	56,412	362.150	62,041	28.1	0.929
Finland	252.753	44,958	282.010	50,879	25.9	0.92
Iceland	26.674	78,452	20.284	79,270	24	0.935
Norway	441.439	80,247	448.460	82,773	22.3	0.953
Sweden	554.659	54,759	563.240	54,135	25.4	0.933
Nordics	**$ 1,601.081**	**62,966**	**$ 1,676.144**	**65,820**	**25.14**	**0.934**

Another highlight of this region is the strong balance sheet and low public debt of all Nordic countries, which should allow them to spend their way out of a crisis if need be.

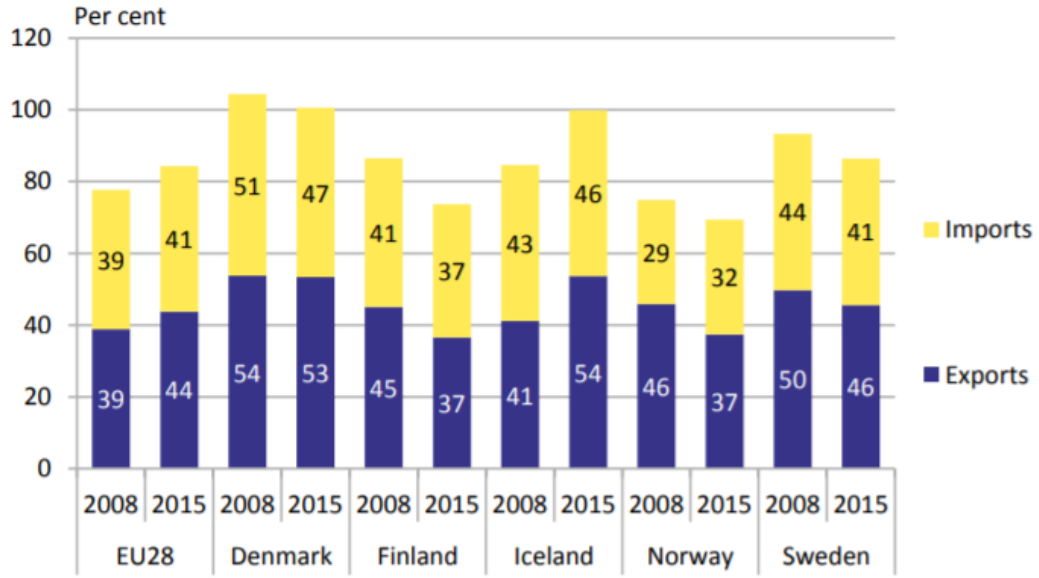
In this research, we thought we have decided to focus on the strength of the of the Nordic economy going forward.

Export and the Nordic internal market.

Historically, the Nordics have performed well as an exporter and are recognised for their export-driven companies such as Nokia, Ikea, Rovio, Maersk, Equinor (Statoil), Yara just to name a few of the biggest.

However, research indicates that in 2015[1], only Denmark (& Iceland) traded more than the EU28 average. Norway traded actually less than the average. Sweden & Finland traded equivalent to the EU average. The overall Nordics proportion of export trade on GDP decreased from 2008 to 2015, indicating a growth in the proportion of internal market trade.

Figure 2: Trade in goods and services as percentage of GDP



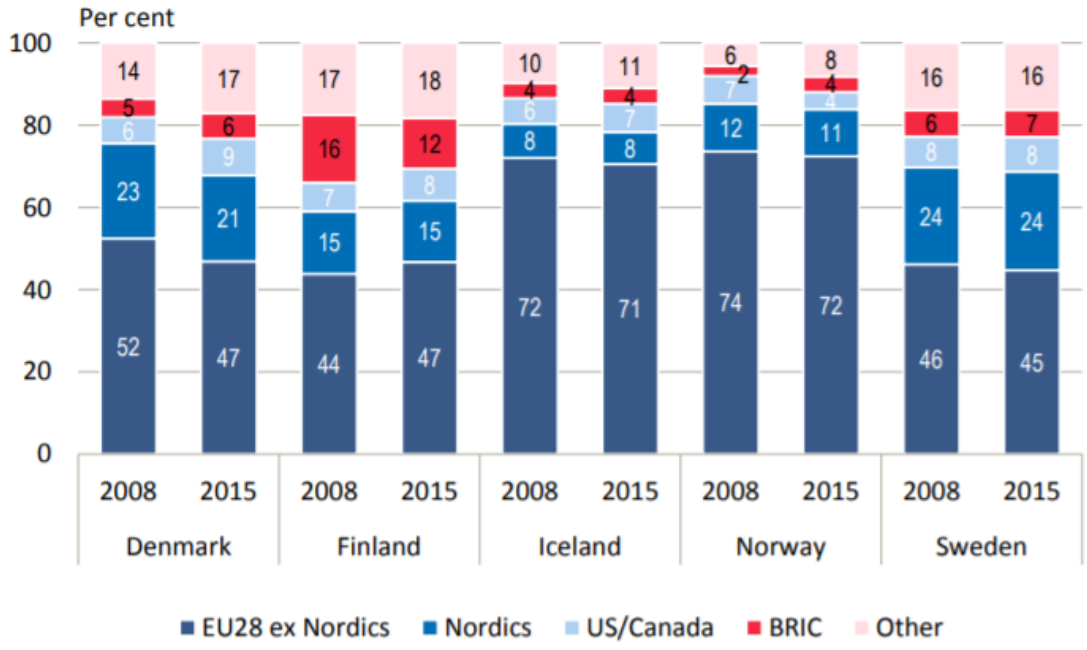
Source: Eurostat (table nama_10_gdp).

Exports in 2015 consisted mainly of goods, with services only making up 33% of total exports (up from 27% in 2015 making the Nordics less dependent on goods).

When looking at goods, the Nordics follow the old rule of thumb that it is far easier to trade with your neighbours (as the Brexiteers have suddenly discovered). The Nordics mainly export to Europe and the other Nordic countries, with Germany, the Benelux and the UK as their main European export destinations.

[1] https://norden.diva-portal.org/smash/get/diva2:1047303/FULLTEXT01.pdf

Figure 8: Share of exports of goods to selected markets



Source: Eurostat EasyComext (table DS-018995 and DS-043227). StatBank Norway (table 08809) for Norwegian 2015 data.

The figures above have to be compared to the EU average of goods exported in 2015[2], where 21% of goods exported went to the US, 10% to China and 8% to Switzerland. This is mainly due to Germany and to a lesser extent France and Italy and probably also distorted by car exports (but that is another story).

To cut a long story short, the Nordics are known for their exports but are maybe less exposed to a reduction in global trade than generally thought. The Nordic's main trading partners being the EU and the other Nordic countries.

That being said, if there were a trade war between the EU (Germany) and the USA, the Nordics would be impacted as Germany is one of their main export destinations. The same reasoning applies to most of the EU economy where Germany plays a very big role. A hard Brexit would also affect the Nordics, just as it would for the Benelux, Germany and France. The UK imports the bulk of its energy from Norway, which is not so easy to replace[3].

[2] https://ec.europa.eu/eurostat/documents/2995521/7224419/6-31032016-BP-EN.pdf
[3]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/857027/UK_Energy_in_Brief_2019.pdf

We recently saw more signs that the Nordics are becoming less reliant on exports than was previously thought.
During the last Covid lockdown, it is generally believed that the Nordic economies suffered a relative limited drop in GDP because of its reliance of the local economy[4] (and because they handled the Covid pandemic perhaps a bit more pragmatic than other countries, but that would bring us into politics).

SWEDEN

Expected peak for unemployment in Q3 2020

9.2%

The Swedish economy is seeing a broad recovery. Households are holding the fort, and housing prices have hit record highs. The labour market situation has stabilised, and we expect unemployment to start declining already in the second half of 2020.
/ page 14

DENMARK

When GDP should return to pre-crisis level

Mid-2022

Household consumption is also driving Denmark's recovery, supported by historically low interest rates, higher housing prices and government aid packages. The Danish pharmaceutical industry has helped underpin exports amid nosediving global demand.
/ page 17

NORWAY

Expected drop in mainland GDP in 2020

-3.5%

Norway's economic recovery has exceeded expectations. Rate cuts and Norwegians on "staycation" have boosted domestic demand. Oil investment will likely be less of a drag than feared, thanks to higher oil prices and a tax relief package.
/ page 20

FINLAND

Expected drop in GDP in 2020

-5.0%

Finland's economy has also fared better than expected. Domestic demand recovered swiftly during the summer, and government support measures for companies and a temporary layoff scheme have helped keep the reins on unemployment.
/ page 23

This stronger than expected internal market may appear counterintuitive but is in a sense similar to the current China narrative that everyone believes to be export driven. While the Chinese internal market is of course a lot larger than the Nordic internal market, there simply is a lot of buying power in the Nordics.

The Nordic companies also display a lot of innovation in the development of their goods and services[5]. Partially, this can be explained by a very well-funded educational system, but also, this can be explained by the very high cost of living and consequent labour costs in the Nordics. The Nordics cannot compete on price so they have to do so with innovation. Their high labour costs also spur investments in business automation, digitalisation and advanced processes giving Nordic countries an edge when expanding to new, less efficient markets.

We do not have a crystal ball but we infer that the Nordic internal market and strong ties to Europe are solid enough to withstand a reduction in global trade. Furthermore, the Nordic countries have strong balance sheets, quite cohesive political systems, a culture of innovation and a well-trained population, all of which should help to shield the economy when things take a turn for the worse.

[4]https://sebgroup.com/siteassets/press_sv/expertrapporter/nordic_outlook/nordic_outlook_september_2020_eng.pdf
[5] https://cor.europa.eu/en/news/Pages/Regional-Innovation-Scoreboard-2019-Nordic-capital-regions-top-the-ranking-while-innovation-divide-remains-a-concern.aspx#:~:text=%E2%80%8BHelsinki%2DUusimaa%20in%20Finland,Scoreboard%202019%20published%20on%20Monday.

Weaknesses of the Nordic economies

Some weaknesses we were able to spot could lie in a slight bubble in residential real estate prices which, when popped could reduce consumer confidence.

Sweden went through an economic slump in the 1990's (partially caused by a real estate crisis but also because of 20 years of very socialist policies), but was able to find its way out of this crisis rather rapidly[6].

The Nordic national banks are quite aware of the residential house price bubble and are trying to mitigate it.[7] In a sense, overregulation in the Nordics has let to under-speculation in real estate, leading to severe shortages in available stock, which contrasts with the sub-prime crisis which was purely speculation driven.

Sweden for instance has very strict rent controls making it difficult for developers to develop buy-to-let. Real estate let by city councils is extremely attractive and also prevents the rise of a commercial buy-to-let industry. Capital gain taxes on real estate are a disincentive for the elderly to sell their large houses to new families. Couple this with very low interest rates and many Swedes feel the only solution is to build their own house and to take up large mortgages. However, there are quite strict regulations on this. The result is a tremendous demand for quite limited supply, not dissimilar to The Netherlands, Canada, UK and Switzerland.

The solution lies in the construction of more affordable housing. The Nordic countries as a whole have strong enough balance sheets to afford this, their main stumbling block is over-regulation.

The Nordic banking sector is extremely large compared to the region's size but the banks in general tend to be quite profitable which make for good balance sheets. Non-performing loans are quite rare in the Nordics which also helps their balance sheet (about 0.5% versus a 3.5% European average, thank you Cyprus...)). [8]

The Nordics, and Sweden in particular, took in some 160 thousand asylum seekers in 2015 who regrettably do not integrate well and have put further strain on their public housing system, which partially explains the surging popularity of more nationalist political parties[9]. Sweden has recently reversed their open-door policy and politicians seem to be aware they need to take action.

When it comes to currencies and currency risk, only Finland is in the eurozone. The Danish Krone is effectively pegged to the EUR and so must stay within a 2.25% range. The SEK is not pegged to the EUR and neither is the NOK. The NOK tends to be more volatile with a correlation to oil price volatility. I guess you can spend a full evening debating whether this is a strength or a weakness of the Nordic economy. It is a weakness because we as investors add currency risk to our portfolio. It is also a strength as you hold the currencies of countries who can set their own fiscal and financial policy while still having access to the EU market. My gut feeling would be that the NOK is actually

[6] https://www.tresor.economie.gouv.fr/Articles/8ff87be3-e406-4db3-b985-6da39ce8dbdc/files/20cf5f07-8478-48e2-8abc-26034abaa9c8
[7] https://www.bofbulletin.fi/en/2020/2/nordic-countries-are-vulnerable-to-housing-market-risks-aggravated-by-the-coronavirus-pandemic/
[8] https://www.ceicdata.com/en/indicator/sweden/non-performing-loans-ratio
[9] https://rmx.news/article/article/no-more-migrants-sweden-changes-its-asylum-policy

rather cheap now, which is not a bad entry point[10]. The SEK is less volatile and I would also consider it as rather cheap[11] at this moment. Given that we invest in EUR, and that our capital call will be called over half a decade, our exposure to Nordic currencies will be built gradually. At this stage, it is unlikely that Sweden will join the EUR and it would be a miracle for Norway to join the EUR.

The private equity funds are to pay us back in EUR, with their performance fee calculated on the EUR amounts. Past performance results of most mid-cap funds are mostly in EUR as well, indicating how well these funds and their underlying companies are able to deal with currency risk.

Is Norway too reliant on oil for it's economy?

Given that some of the funds we are looking at, such as Norvestor, have Norwegian roots, we thought it worth the time to take a deeper look at Norway. While Sweden, Finland and Denmark have exposure to energy & the maritime sector, Norway's links to oil really stand out. Or do they?

We first tried to find an answer as to how long the oil industry in general should be a major economic factor. Nobody knows when we will reach 'peak oil.' Over the last years, the world has continued to consume more oil every year, yet at a slower rate. Some studies we looked at predict 'peak oil' somewhere 10 years from now[12]. Nobody knows whether we will gently plateau down from there or not.

There is a slight chance that CCS technology (Carbon Capture & Storage) will slow down the need to shift to renewables, but for the moment this technology is in the lab phase.

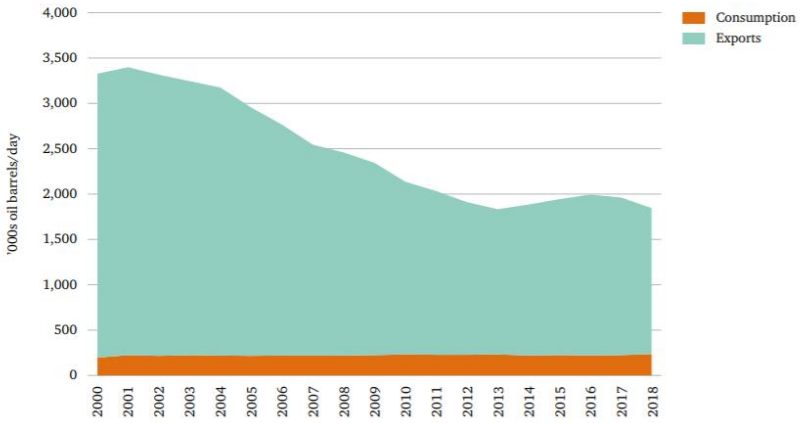
So, let's be ecologists for a day and imagine a world that consumes no more oil, suddenly.

There is an interesting line of thought stating that Norway would simply return to the economic level of Sweden[13]. Until the 60's when oil was first discovered, Norway and Sweden had more or less the same level of prosperity. If you subtract the contribution of oil to the Norwegian GDP per capita, you roughly end up with the GDP per capita of Sweden.

More importantly, Norway is already weaning off oil, as the graph below shows. Please note that this is only in barrels. Were you to include the drop in oil prices, you would see an even steeper drop in oil income for Norway.

[10] https://seekingalpha.com/article/4355631-norwegian-krone-expected-to-strengthen-against-greenback
[11] https://research.sebgroup.com/macro-ficc/reports?reportType=SEK%20Views&language=English&nbrows=20
[12] https://www.chathamhouse.org/2020/06/expert-perspectives-norways-energy-future
[13] https://www.quora.com/Would-Norway-still-be-a-wealthy-nation-without-oil-reserves?q=norway%20oil%20

Figure 2: Norway's oil exports 2000–18 (b/d)

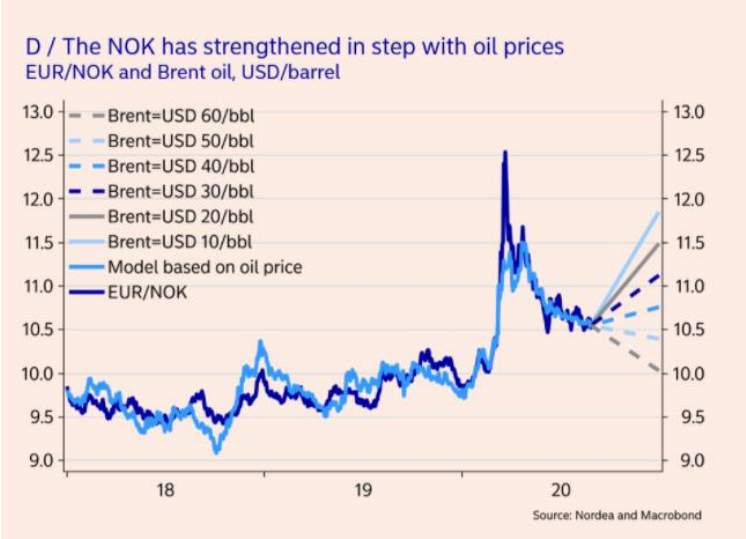


Source: BP, Statistical Review of World Energy, 2019.

Norwegian GDP has however been steadily growing since 2000, with only one minor down-year following the Great Financial Crisis of 2008.

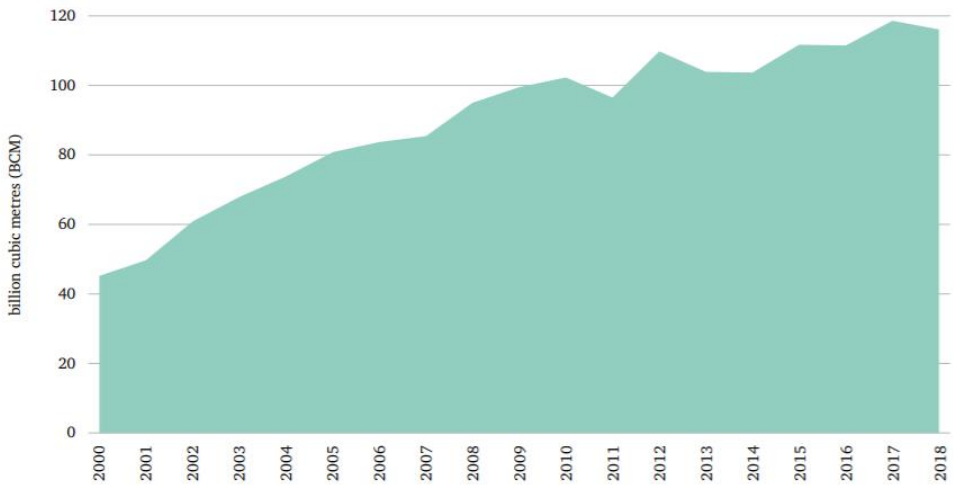
Evolution: Annual GDP Norway		
Date	Annual GDP	GDP Growth (%)
2018	434,167M.$	1.3%
2017	398,394M.$	2.3%
2016	368,827M.$	1.1%
2015	385,802M.$	2.0%
2014	498,410M.$	2.0%
2013	522,762M.$	1.0%
2012	509,506M.$	2.7%
2011	498,283M.$	1.0%
2010	428,757M.$	0.7%
2009	386,188M.$	-1.7%
2008	462,250M.$	0.5%
2007	400,939M.$	3.0%
2006	345,580M.$	2.4%
2005	308,884M.$	2.6%
2004	264,510M.$	4.0%
2003	228,858M.$	0.9%
2002	195,525M.$	1.4%
2001	173,973M.$	2.1%
2000	171,246M.$	3.2%

The decrease in oil exports does not mean Norway is encapsulated from oil. The NOK/EUR for instance however still correlates oil prices.



To an extent, both the continuation in GDP and the lockstep of the NOK and the oil prices, can be explained by the expansion in gas exports from Norway. Gas may have helped the oil & gas industry to stay afloat, while gas prices normally follow oil prices. The papers on the energy transition we read indicate that gas will definitely be needed for a while to pick up the pace until renewables can replace fossil oils, gas being cleaner than oil (but maybe not as clean as nuclear, but I don't want to get political).

Figure 6: Norway's gas exports 2000–18



Source: BP Statistical Review of World Energy, 2019.

When it comes to energy, Norway has not only been blessed with oil & gas but also an abundance of flowing water, which has made Norway into a world leader in hydropower.

This has two important consequences, the first being that the next Norwegian energy export is hydropower.

Table 1: Norwegian electricity interconnectors

Connection to	Size	Status (expected start-up)
Denmark	1.6 GW	Operational
Finland	100 MW	Operational
Netherlands – NorNed	700 MW 450 kv HVDC	Operational
Russia	100 MW	Operational
Sweden	0.6 GW	Operational
Sweden	0.7 GW	Operational
Sweden	0.25 GW	Operational
Sweden	2.15 GW	Operational
Germany – Nordlink	1.4 GW 500 kv HVDC	Under construction (2020)
UK – NSN	1.4 GW 515 kv HVDC	Under construction (2021)
UK – NorthConnect	1.4 GW 500 kv	Pending licence

Source: Global Transmission Report (2019), 'Data & Statistics', https://www.globaltransmission.info/archive.php?id=1424 (accessed 30 Mar. 2020).
Note: HVDC = high voltage direct current.

The second consequence being that Norway is almost fully energy self-reliant just on hydropower. This is already benefitting heavy industry. If and when the 'Energiewende' occurs, Norway will be one of the countries where non-polluting heavy industry would make the most sense.

That being said, it is still a fact that oil & gas make up about 18% of Norwegian GPD and make up a very large share of exports[14], even though the industry employs just 1% of the Norwegian labour force. It is estimated however, that in 2017, about 6% of the Norwegian labour force work in the supply of this industry. This is down though from 9% in 2013. The Norwegian 2020 budget also mentions (but doesn't quantify) the importance of the oil & gas revenue in sustaining public domain employment.

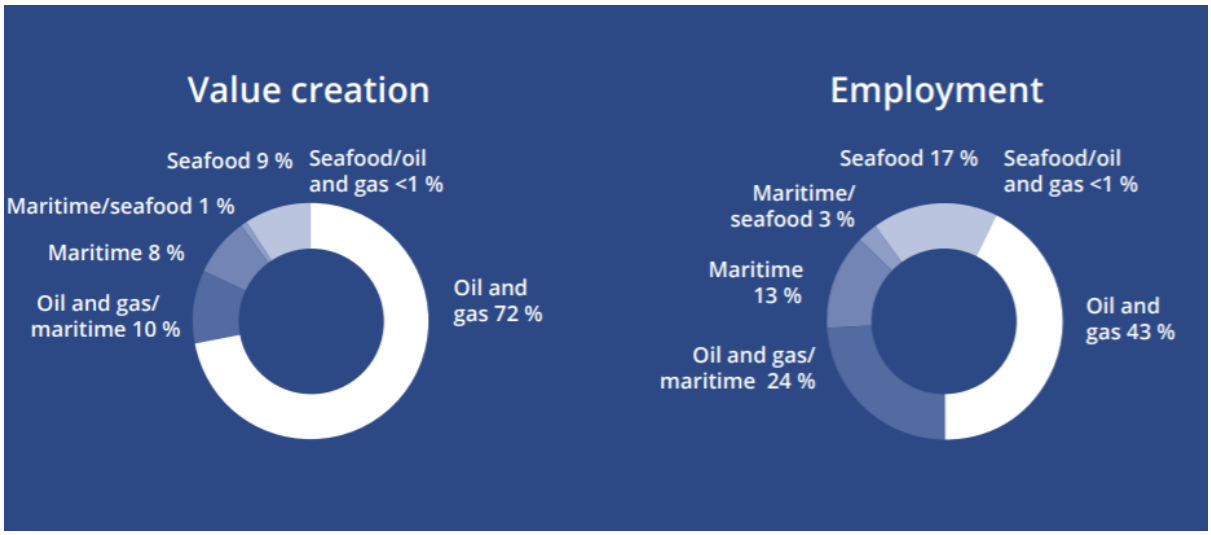
Tabell 1 Key figures for the Norwegian economy The National budget 2020

	Billion NOK[1]				
	2018	2018	2019	2020	2021
Private consumption	1 533,6	1,9	1,8	2,7	2,9
Public consumption	826,8	1,4	1,6	1,7	..
Gross fixed investment	851,5	2,8	6,1	1,2	-0,5
Of which: Petroleum extraction and pipeline transp.	153,4	1,9	17,8	-3,5	-10,4
Business sector Mainland Norway	311,0	6,8	6,2	3,4	2,7
Housing	193,5	-6,2	1,4	2,2	0,8
Public sector	192,7	7,5	1,3	0,3	..
Demand from Mainland Norway[2]	3 057,6	2,0	2,1	2,2	2,2
Exports	1 357,3	-0,2	2,3	7,3	3,5
Of which: Crude oil and natural gas	569,4	-4,8	-2,9	14,0	4,6
Goods except oil and gas	411,0	2,0	5,6	5,0	5,1
Services except oil, gas and shipping	247,2	4,4	5,3	5,0	1,6
Imports	1 152,2	1,9	5,4	1,8	1,3
Gross domestic product	3 530,9	1,3	1,8	3,8	2,3
Of which: Mainland Norway	2 906,9	2,2	2,7	2,5	2,0

Norway is very aware of this and is actively trying to diversify away from oil & gas, by investing in

[14] https://www.regjeringen.no/contentassets/09814fbc520946869d6eaa65099c2983/national_budget_2020.pdf

their maritime & fishing industry (the Blue Opportunities)[15] as well as in technical innovation[16] and start-ups. This is a difficult shift, even if 5 kilos of salmon costs as much as a barrel of oil.



Then again, Norway can afford to invest.

For instance, they spend about 16,600 USD per child in secondary and tertiary education versus an OECD average of 11,000 USD[17]. In the World Education Index, Norway scores a fourth place (just behind Belgium)[18].

Partially, this comes out of the Norwegian Sovereign Wealth Fund, which has about 1 trilion USD AUM and is easily the largest in the world. The Norwegian government can spend about 3 percent of this fund per year (it's estimated yearly return) which makes up about 20% of it's budget. Norway has used part of their allocation in 2020 to give tax relief on investment in oil & gas drilling & exploration, also demonstrating that despite Norway's attempts to diversify away from oil & gas, they will not starve their cash cow.

Size of the Nordic mid-cap market

While the Nordics are known for their iconic international companies such as Maersk, Ikea, Nokia, Rovio, Yara, Salmar, Novo Nordis, Vestas, ABB, Carlsberg and Equinor just to name a few, there is a vibrant mid and small cap market. For instance, there are more than 550 listed 'small caps' with an average value of 500 million EUR (or between 300 and 5 billion) in the Nordics[19]. This is roughly the same size of listed mid-caps as France or Germany[20], mid-caps being defined here as having a value between 200 million and 2 billion EUR.

[15] https://www.regjeringen.no/globalassets/departementene/nfd/dokumenter/strategier/w-0026-e-blue-opportunities_uu.pdf
[16] https://www.innovationpolicyplatform.org/www.innovationpolicyplatform.org/content/norway/index.html
[17] https://gpseducation.oecd.org/CountryProfile?primaryCountry=NOR&treshold=10&topic=EO
[18] https://en.wikipedia.org/wiki/Education_Index
[19] https://docfinder.is.bnpparibas-ip.com/api/files/8F49807F-D3ED-4FEC-8068-FC9D2EA9B2DB
[20] http://www.idmidcaps.co.uk/commun/pdf_vitrine/IDMidCapsAMSite.pdf

Our friends from Finfactor were kind enough to perform some Bloomberg magic for us confirming the large amount of small caps in the Nordics. About 300 of these companies are Swedish, indicating that you can't afford not to be in Sweden when looking at private equity.

What do Swedes do to pass away these long Arctic nights? Yes, they count small caps. (Small caps here were defined as companies with an enterprise value (EV) below 50 million, lower mid-cap in the 50-100 million, upper mid-cap as an EV between 100 and 500 million and large cap as everything above 500 million.)

I'm probably as shocked as you are by the relatively close results for the total amount of listed companies on France, Germany, Benelux and Italy combined. It is really special.

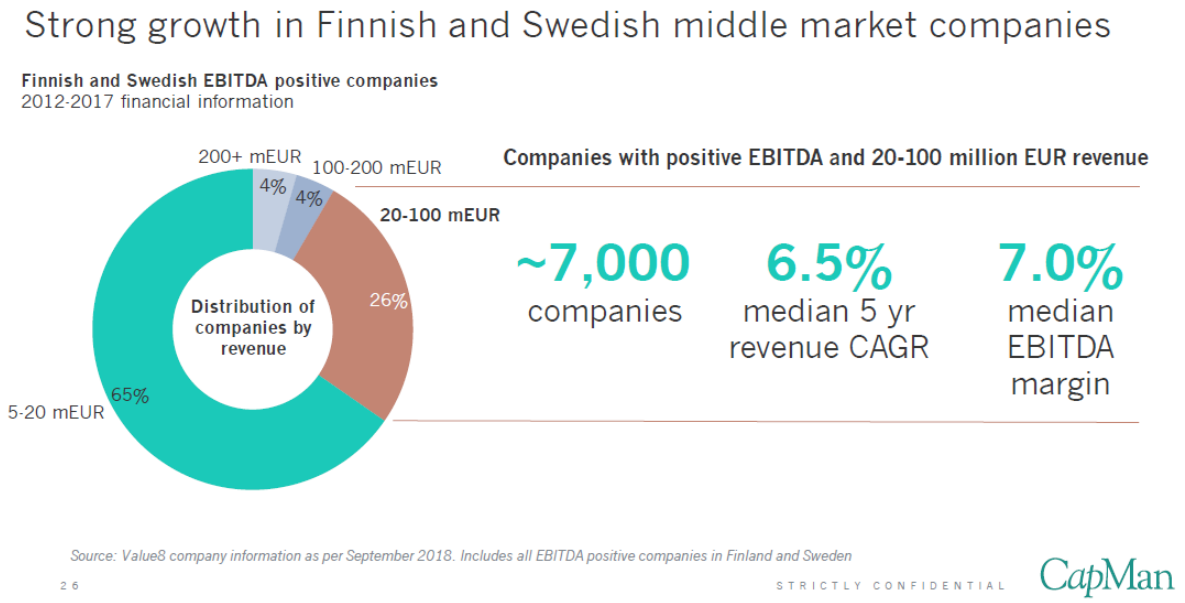
Nordics:

Row Labels	Count of Market Cap
Large cap	364,00
Lower Midcap	143,00
Small Cap	505,00
Upper Midcap	237,00
Grand Total	**1.249,00**

Frankrijk, Duitsland, Benelux, Italie:

Row Labels	Count of Market Cap
Large cap	607,00
Lower Midcap	179,00
Small Cap	618,00
Upper Midcap	434,00
Grand Total	**1.838,00**

When it comes to non-listed Nordic companies, we relied upon this research found in the documentation of CapMan, a leading Nordic private asset management and equity investor.



Based on these figures, and making some crude extrapolations based on GDP, we arrive at more than 4,000 investable companies in the Nordics for a mid-cap strategy, with over 13,000 potential companies for buy and build. Assumptions here being that a company with over USD100 million revenue and an EBITDA margin of 7 should be interesting to a mid-cap and all companies with revenue below 100 million should be interesting for either small-cap or add-on.

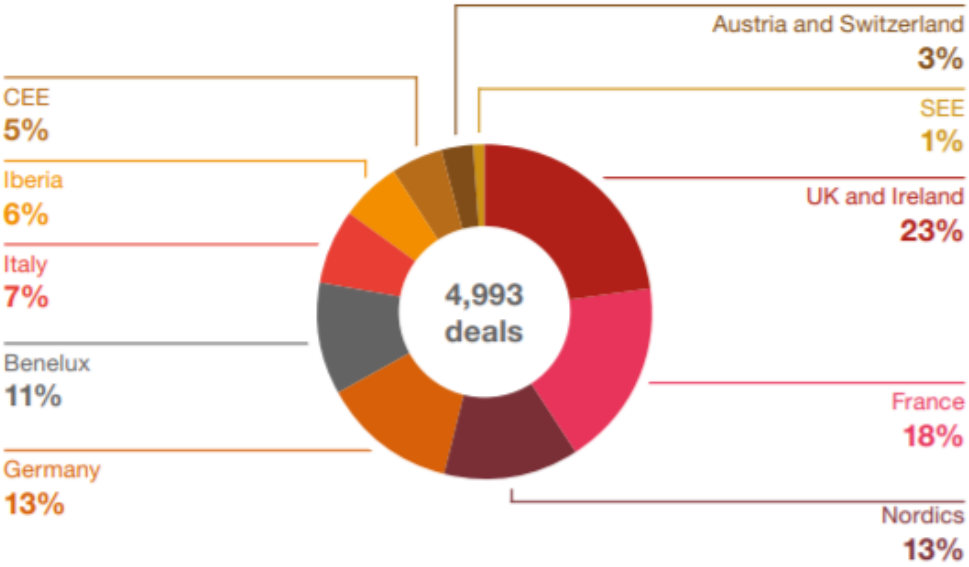
	26	4	4			
Country	**20-100 mio rev**	**100-200 Mio rev**	**Over 200 Mio rev**	**GDP total (nominal)**		
Denmark	2999	461	461	362.150	43%	
Iceland	168	26	26	20.284	2%	
Norway	3714	571	571	448.460	53%	
Sweden + Finland	7000	1,077	1,077	845.250		
Nordics	**13,881**	**2,136**	**2,136**	**$ 1,676.144**		
Median Ebitda margin of 7%						

The Nordics together are a very important private equity market in size, making up about 13-14% of total volume, almost on par with Germany (Germany may be a vastly larger market, yet companies remain much more in family ownership) or 7 percent of total deals done[21].

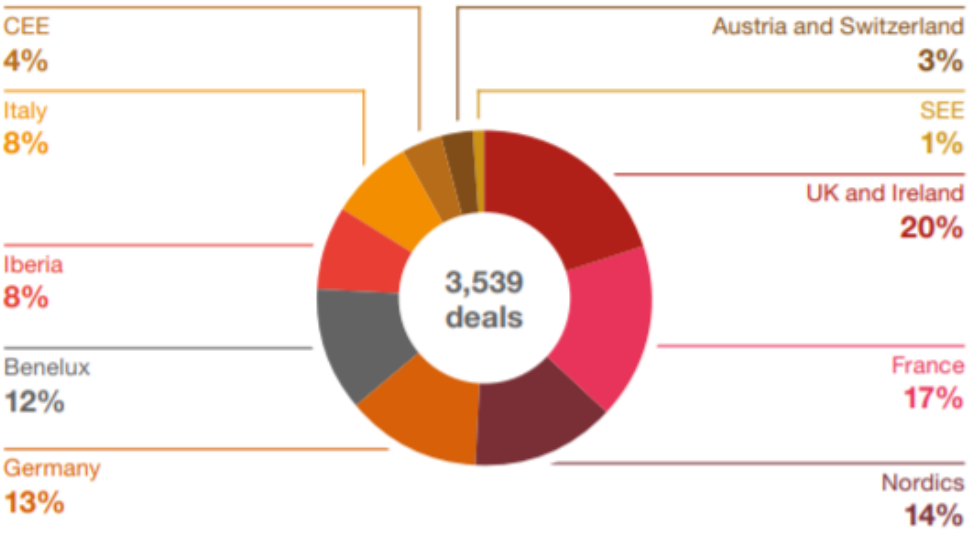
[21] https://www.investeurope.eu/media/3052/20200512_invest-europe-investing-in-europe_-private-equity-activity-2019-final.pdf

Fig. 5 European buyout volume, split by region

2014–2017



2018–2019



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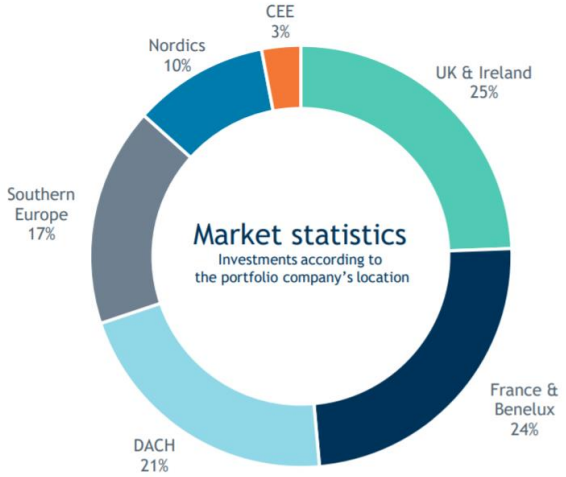
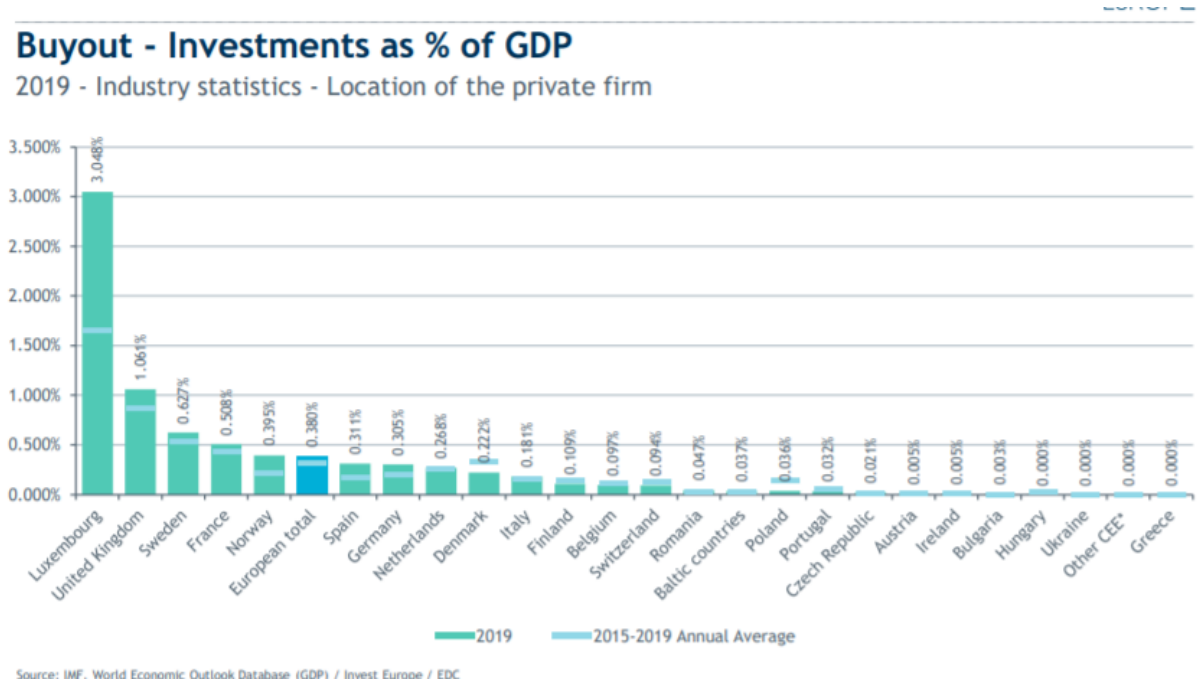


This is largely explained by Sweden and Norway being culturally very open to private equity investment. To an extent, we can also see this in their very buoyant stock market.



Conclusion

The Nordics really punch above their weight. For a region of their size, there is an amazingly high GDP and amount of listed and privately held small companies. It is true that they are export driven countries which could make them vulnerable to trade shocks. However, as their main trading partners are the other Nordics countries and Northern Europe, we should not overestimate this exposure either. It's also true that Norway is quite exposed to the oil & gas industry, but even if these industries would (unexpectedly) stop tomorrow, Norway's economy would shrink to Swedish levels with a sovereign wealth war chest to weather just about any crisis. The main weaknesses we could identify are the quite high residential real estate prices and currency risks. On the other hand, we think few countries in the world have this amount of innovation and civic cohesion combined, which should allow the Nordics to weather quite some storms. We recommend picking a regional fund here with strong exposure to the biggest market, being Sweden.

Appendices: interesting graphs and data

Key trade and foreign direct investment statistics (2018) 1

	Denmark	Finland	Iceland	Norway	Sweden
Population (in million)	5.8	5.5	0.3	5.3	10.2
GDP (USDb)	350.9	275.3	25.9	434.9	551.1
GDP per capita (USD)	60,692.4	49,845	74,278.2	81,692.6	53,873.4
Real GDP Growth (%)	1.7	2.4	4.6	1.4	2.3

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Investor perspectives on the Nordic market

Attractions

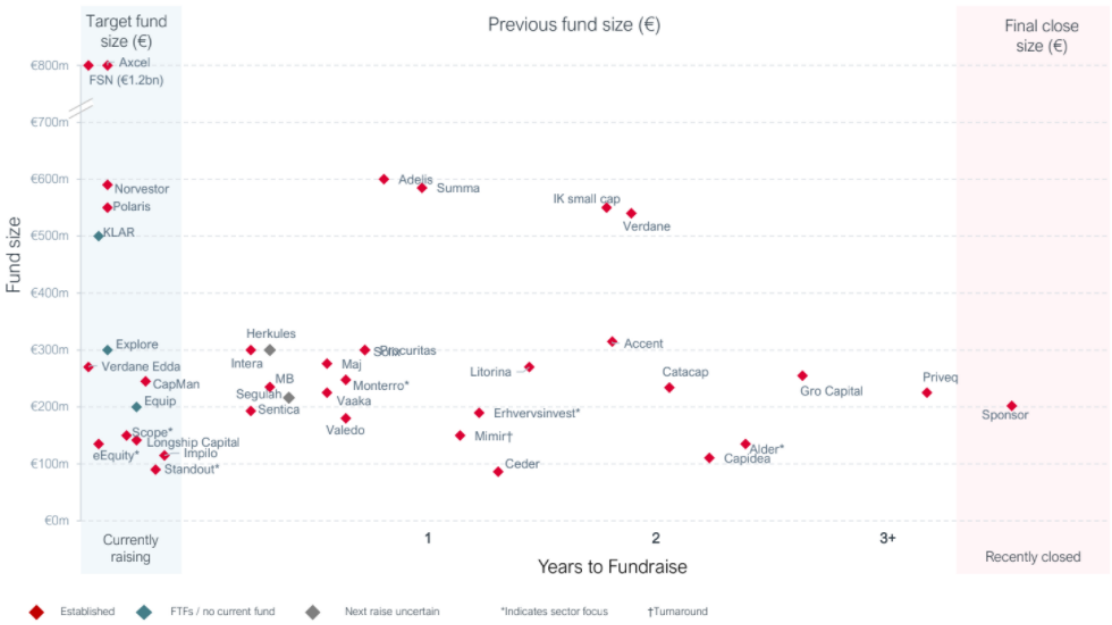
- Strong performing economic region
- Robust domestic demand supplemented with strong exports
- Abundance of SME's with a high acceptance of private equity in the region
- Strong GP performance over cycles

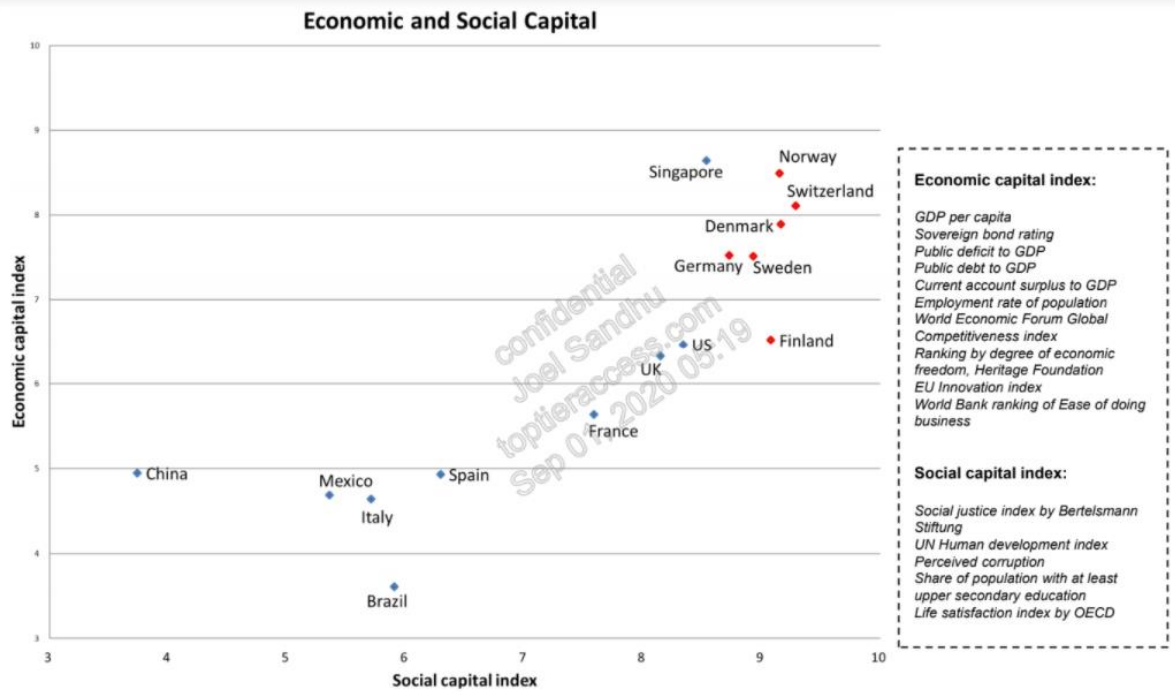
Concerns

- Concerns that the market has raised too much private equity capital over the last few years
- Abundance of secondary buyouts; sharp reduction in proprietary situations
- Crowded market - companies are expensive and valuations are high
- Ongoing debate between a country vs regional approach

LANDSCAPES

Nordic mid-market fundraising landscape





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Countries that were unable to control their outbreaks have tended to suffer the most economic pain