

Thorough risk management creates freedom to act

A number of factors affect, or could affect, Pandox's operations – either directly or indirectly. Pandox works continuously and in a structured way to identify business risks, in order to manage these as conscientiously and effectively as possible. Good risk management creates the freedom to act and strengthens confidence in the Company among the communities around us.



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Pandox's risk work

Pandox's business activities are associated with risk and the Company works in a structured and proactive way to map, analyse and manage this. As part of Pandox's operating activities the executive management, treasury and Board – including through the Audit Committee and Finance Committee – worked actively during the year to manage risk, taking into account the extraordinary circumstances that Covid-19 continued to bring about and with a particular focus on risk associated with property valuation, the tenants' financial status, refinancing of loans and meeting the conditions of the loans. Risks were also analysed, assessed and managed within the framework of the Company's strategy work.

Pandox assesses each risk based on the expected impact (from insignificant to very significant) if the event that triggers the risk should occur, and the likelihood (from very low to very high) of the risk then being realised. This assessment subsequently forms the basis of an evaluation of how the risk should be prioritised, whether it requires specific action or if it can be managed as part of Pandox's normal administration. The effectiveness of existing measures to mitigate risk is assessed on a scale ranging from low to high control.

Identified risks are mapped in a risk matrix based on expected impact and likelihood. By taking active steps the potential effects of risks on the business can be reduced. The Covid-19 pandemic and restrictions that in various ways limit the ability to conduct hotel operations remain a substantial risk.

FINANCIAL EFFECTS OF CHANGES IN CERTAIN KEY PARAMETERS, AS OF 31 DECEMBER 2021 ³⁾:

Investment properties, effect on fair value	Change	Effect on value, MSEK
Valuation yield 2 5	+/-0.50pp	-4,395 /+5,284
Change in exchange rates 2 5	+/-1%	+/-374
Net operating income ¹⁾ 2 4 5 6	+/-1%	+/-395 (535)

Investment properties, effect on revenues ¹⁾	Change	Revenue effect, MSEK
RevPAR (assuming a 50/50 split between occupancy and rate) 2 4 5	+/-1%	+/-5 (26)

Operating properties, effect on revenues ¹⁾	Change	Revenue effect, MSEK
RevPAR (assuming a 50/50 split between occupancy and rate) 2 4 5	+/-1%	+/-7 (22)

Financial sensitivity analysis, effect on earnings	Change	Effect on earnings before changes in value, MSEK
Current fixed interest, change in interest rates, with derivatives ²⁾ 2 5	+/-1%	+6/-171
Current fixed interest, change in interest rates, without derivatives ²⁾ 2 5	+/-1%	-215/+31
Remeasurement of interest rate derivatives following shift in yield curves 2 5	+/-1%	+/-988

¹⁾ The value is the level at the end of 2021 based on 32 fully variable agreements and 16 agreements (of a total 96) where the rent is variable above a minimum level. In leases with a minimum rent level, variable rent is generated only when cumulative rent exceeds the minimum level. The value in brackets is for 2019, which was unaffected by the Covid-19 pandemic and is an approximation of a normal business year.

²⁾ The effect on earnings is asymmetrical because Pandox has limited opportunities to fully benefit from negative market interest rates.

³⁾ The effects are described in detail in the respective note.

Financial sensitivity analysis

The sensitivity analysis above describes the financial effects of changes in certain key parameters linked to risk. The figures indicate which risk area is most relevant to each parameter. In terms of financial reporting of both income and financial position, changes in

valuation yields currently have the greatest impact overall. If the market value of the hotel properties falls, this will have a negative impact on Pandox's income statement and balance sheet.

Reflections on two years with Covid-19

The past two years have been unique from a risk perspective. Pandox's strategy, business model, organisation and employees, as well as its income statement and balance sheet, have been very much put to the test. The particular feature of Covid-19 has been the many restrictions imposed by the authorities that limited the ability to operate hotels in many markets at the same time, leading to a dramatic decrease in demand.

As vaccination programmes have been successfully implemented and the spread of infection has developed differently between countries, a certain positive effect of Pandox's geographical diversification has been noted. Pandox's exposure to mainly domestic demand has also been positive.

Although the capital market is open, financially squeezed operators that may not be able to pay their rent remain the weakest link in the chain of risk. This is in turn linked to the (discounted) cash flows that make up the value of Pandox's hotel properties, which for their part materially affect Pandox's key financial ratios such as interest coverage ratio and loan-to-value ratio – and by extension also Pandox's refinancing risk. During the pandemic, as a consequence of agreements and legal requirements, Pandox has adjusted its rent payment terms in order to support its tenants. This has given rise to deferred rent receivables in the balance sheet that are secured by various kinds of collateral.

Pandox's financial protection consists mainly of contractual minimum rent and fixed rent, which cover all of Pandox's costs and ensure a satisfactory interest coverage ratio at Group level. Pandox also has a strong financial position with cash and cash equivalents and unutilised credit facilities of MSEK 3,576 as at 31 December 2021. In addition, the fact that Pandox is able to take over operations at hotel properties owned by the Company offers significant operational and financial protection. However, taking over operations on a large scale may reduce earnings in the short term.

PANDOX'S RISKS AND THE COMPANY'S MANAGEMENT OF SUCH RISKS ARE DESCRIBED IN MORE DETAIL BELOW.
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Risk	Description	Risk management
1. EXTERNAL RISK		
Economic downturn	Economic activity is a primary driver of both business and leisure travel, and a weakened economy can therefore have a negative effect on demand.	<ul style="list-style-type: none"> The portfolio consists of a large number of sizeable hotel properties with a good spread as regards geography, location, brand, operating model and type of demand (international, domestic and regional) The hotel properties are predominantly full-service hotels in the upper-mid segment, which has historically been more stable in earnings than, for example, the high price segment
Disruptive business models	Pandox's business model may be challenged by the emergence of new business models, such as online travel agencies (OTAs) and home sharing services. If Pandox is not able to keep up with the competition, this could have a negative impact on revenues and earnings.	<ul style="list-style-type: none"> Pandox works with around 30 different hotel operators and hotel brands; this gives the Company a unique position as regards information and knowledge of market changes and also helps to diversify commercial risk Pandox's working methods are based on optimising revenues taking into account the distribution landscape and its impact on revenue and costs, including through the support of a Group-wide Revenue Management Centre Long leases with external hotel operators which stipulate a contractual minimum rent; general deductions for commission are not usually permitted
Geopolitical events	Security and geopolitical events can have significant effects on travel patterns and demand in the hotel market.	<ul style="list-style-type: none"> A well thought-out strategy and business plan exists for each individual hotel property and geographical area; the ability to continually monitor economic conditions for each individual hotel property creates a readiness to make quick business decisions when needed
Overexpansion of hotel rooms	New capacity in the form of new hotels and hotel rooms could have a significant adverse impact on RevPAR in individual markets.	<ul style="list-style-type: none"> Ongoing market analysis is carried out for each geographical area of operations and hotel property, which means that changes in the market are detected early on and measures can be initiated without delay
Pandemics	Global spread of infectious diseases resulting in extraordinary social measures in many countries simultaneously, such as travel restrictions, limits on meetings and public gatherings, and restricting the ability to run hotel operations.	<ul style="list-style-type: none"> Geographically diversified hotel property portfolio Exposure to mainly domestic demand Significant proportion of leases have contractual minimum rent and fixed rent
Terrorist attacks	Disruptive events that affect Pandox-owned hotel properties and hotels directly, or indirectly through a significant impact on infrastructure that is critical to society.	<ul style="list-style-type: none"> Ongoing security efforts Contingency plans Insurance cover Geographical diversification
2. STRATEGIC RISK		
Growth through acquisitions	Risk attributable to acquisitions is mainly the risk of paying too much for assets, the risk of incorrect assumptions as regards future earnings of the acquired asset/business, the risk of taking over leases or other agreements that are unfavourable, and the risk of management time and other resources being spent on acquisitions that are not completed.	<ul style="list-style-type: none"> Pandox's long-term focus on hotel properties as a class of asset has generated extensive specialist expertise An active Board of Directors and active principal shareholders, experienced management and a sound basis for decisions Pandox has a well thought-out strategy in which the country, city, type of hotel, brand, type of agreement, form of operation and yield are continually and consistently evaluated Tried and tested due diligence processes supported by internal and external specialists reduce the risk of incorrect acquisitions Pandox's way of working (the Pandox Method) increases cash flow and limits risk for the hotel in question
Major investments in the existing portfolio	There is a risk that the costs of investments may be higher than expected and that the return is therefore lower than expected because of inaccurate costings, unprofessional procurement or inefficient project implementation.	<ul style="list-style-type: none"> Extensive specialist knowledge of the identification, evaluation and implementation of investments in the existing hotel property portfolio Long-term investment management of measures implemented in the property portfolio Monthly review of all investment projects Follow-up and calculation of actual costs and outcomes for completed investment projects
Impact of digitalisation	Digitalisation is bringing about major changes in society and is changing people's behaviour. This affects Pandox's organisation and ways of working, and opens up opportunities for new actors with different business models to become established.	<ul style="list-style-type: none"> Pandox works proactively at an operational level to gather know-how on strategic digitalisation matters Work on targeted initiatives is in progress within various parts of the Company and Pandox continually reviews its ways of working and processes in order to increase its digital readiness

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2. STRATEGIC RISK, cont.		
Major lease renegotiations	The risk of disadvantageous changes in rent levels and/or the division of responsibilities when making investments and/or taking over operations.	<ul style="list-style-type: none"> • Attractive hotel products and close dialogue with tenants • Internal project team with good expertise and clear authority
Concentration on a few tenants	Being highly dependent on a small number of tenants could increase operational and financial risk.	<ul style="list-style-type: none"> • Competitive and operationally strong tenants • Clear division of responsibilities and risk in the lease • Various kinds of guarantees as security for rent payments
3. OPERATIONAL RISK		
Dependence on key individuals	High dependence on individuals in key positions can pose a risk of daily duties not being able to be performed with adequate efficiency and quality.	<ul style="list-style-type: none"> • Plan for long-term talent supply • Good knowledge of external individuals in senior roles for recruitment • Strong external network with supporting specialist expertise • Remuneration Committee that ensures competitive levels of remuneration • Clear personal incentives and long contract terms • Procedures and process descriptions for key functions to reduce dependence on individual personnel
Competency of employees	The risk that Pandox is unable to find the right competencies in new markets or to replace lost competencies in existing markets, or is unable to do so sufficiently quickly.	<ul style="list-style-type: none"> • As part of operational HR work, recruitment needs are reviewed regularly at both the central and local level • Strong external network with supporting specialist expertise • Attractive workplace with great personal freedom in professional roles and good opportunities to develop
Tenants' business and financial status	The risk that tenants underperform and/or are unable to pay their rent.	<ul style="list-style-type: none"> • Individual business plans for each hotel property • Each tenant's results are followed up monthly, as are ongoing investment projects • Various guarantees that in certain circumstances may be called on to cover unpaid rent
Integration of acquisitions	Commercial, technical and accounting risks that arise ahead of, during and after an acquisition or business takeover.	<ul style="list-style-type: none"> • Many years of experience of integrating acquisitions in numerous geographical markets • Clear project organisation and allocation of roles • Internal specialist expertise in property, finance, tax, valuation, law and communication • Clear work methods and processes • Extensive external network with specialist expertise
Own operating activities at hotels	Pandox is exposed to certain risks that commonly occur within hotel operations, such as increased operating costs that cannot be fully offset by increased room rates or increased prices for other hotel services, the costs of compliance with laws and regulations, the ability to forecast occupancy and average room rates and to plan staffing, the quality and reputation of hotel brands used, an inability to keep pace with technological development, faults in or damage to IT systems, as well as risks and costs associated with protecting the privacy of guests' personal data and providing for their physical safety.	<ul style="list-style-type: none"> • Strategic and operational work to ensure each hotel is optimally positioned in each market • Strong local management and an effective organisation • A Group-wide Revenue Management Centre for distribution of hotel products • Modern systems for revenue forecasts, staffing and productivity • Ongoing benchmarking and analysis of each hotel's performance in relation to its immediate competitors
IT security	As digitalisation has increased, so too has the risk of IT incidents that could result in the loss, manipulation or locking of data and systems.	<ul style="list-style-type: none"> • Each year the Board of Directors adopts an IT Policy • Well-separated system environments with few users at Group level • Regular risk analysis and continual maintenance of IT security supported by external expertise
Tax risk	Pandox could be affected by changes in tax legislation or practice. Pandox's tax situation may worsen if the Company's past or current management and assessment of tax matters is successfully questioned.	<ul style="list-style-type: none"> • Pandox has internal tax expertise and works with reputable external tax advisors on acquisitions, divestments and ongoing evaluation of changes in tax legislation and its interpretation in each country of operation • Planning of measures based on proposed changes to tax legislation is initiated at an early stage • In the event of inquiries from local tax authorities, reputable external tax advisors are consulted • Pandox has a Tax Policy adopted by the Board of Directors which, among other things, expressly stipulates that Pandox is to comply with all laws and rules in force where the Group's companies operate, and that tax is to be managed on a sound business basis and in an ethical way that is prudent and transparent; aggressive or advanced tax planning is not allowed

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3. OPERATIONAL RISK, cont.		
Disputes	Disputes can arise in various areas and can have negative financial consequences and reduce confidence.	<ul style="list-style-type: none"> A generally cautious approach Strong network of advisors in each individual market and for each type of issue
Inflation	Shortages and disruption in the economy that result in cost inflation for investments and/or the operation of hotel properties and hotels.	<ul style="list-style-type: none"> Planned purchasing in large volumes Increased input prices can be offset by raising room rates and prices of other hotel services in Operator Activities
4. FINANCIAL RISK		
Fluctuations in interest rates	Interest expense is, and has historically been, Pandox's largest item of expenditure. Interest expense is affected by market interest rates and by credit institutions' margins, as well as by Pandox's strategy as regards fixed interest. The majority of Pandox's credit facilities have a variable rate of interest. There is a risk that Pandox's interest expense will increase if market interest rates rise, or that Pandox will fix its interest rates at a level that is higher than the market interest rate.	<ul style="list-style-type: none"> Interest rate derivatives are used – mainly interest rate swaps – in order to manage interest rate risk and increase the predictability of Pandox's earnings Variable interest rates are partially swapped through interest rate swaps, giving Pandox fixed interest rates Pandox has a Financial Policy that regulates risk mandates and is approved annually by the Board of Directors Internal specialist expertise in treasury and risk Close cooperation with external financial expertise
Refinancing and liquidity risk	Refinancing risk is the risk that financing cannot be obtained or renewed upon maturing, or only at significantly higher costs. Liquidity risk refers to the risk that Pandox will be unable to meet its payment commitments due to a lack of liquidity.	<ul style="list-style-type: none"> Pandox has access to long-term financing Pandox's Financial Policy specifies minimum levels of unutilised credit and loan-to-value ratio Pandox has a liquidity reserve to ensure that the Company is able to meet ongoing payment obligations at all times Pandox has good access to long-term credit facilities Pandox has a diversified portfolio of lenders consisting of 11 Nordic and international banking partners Pandox has established a separate Finance Committee consisting of members of Pandox's Board of Directors and executive management in order to manage key practical and strategic matters relating to the Company's financing
Breach of terms and covenants in credit agreements	Considering the extraordinary situation created by Covid-19, it cannot be ruled out that a situation might arise where, for example, commitments and covenants in the Company's credit agreements are not met.	<ul style="list-style-type: none"> Ongoing monitoring and control of the credit portfolio and its terms and covenants Proactive and close dialogue with lenders concerning adapting the terms and covenants in existing credit agreements Specific actions that can be taken, if needed, to remedy any non-compliance, such as payment of interest into an escrow account, adjustment of covenants, covenant holidays or certain repayments In 2021 lenders provided waivers in individual credit agreements
Currency risk	Currency risk is defined as the risk of the consolidated income statement and consolidated statement of financial position being negatively impacted by exchange rate fluctuations. This risk can be divided up into transaction exposure, i.e. the net amount of operating and financial (interest/principal repayment) flows, and translation exposure associated with net investments in foreign Group companies.	<ul style="list-style-type: none"> Foreign operations generally report both income and expenses in local currency, which means that currency exposure resulting from current flows, i.e. transaction exposure, is limited; in view of the limited risk, Pandox does not currency-hedge these flows unless there is a particular reason to do so Equity is currency-hedged ahead of acquisitions, investments and divestments to avoid changes in the value of equity Pandox reduces its currency exposure associated with net investments in foreign Group companies by taking out loans in local currencies
Certification and authorisation	Authority to take decisions, approval matrix and payment processes.	<ul style="list-style-type: none"> An approval matrix established by the Board of Directors Well-defined levels of authority in internal systems Special verification for payments and orders above a certain level in the approval matrix
Financial statements	Errors in or inconsistent quality of both internal and external reporting, such as errors in rent accounting and property valuation. Risks also include late reporting or reporting not being in compliance with the Group's accounting principles.	<ul style="list-style-type: none"> Pandox aims to have uniform procedures and checks for financial reporting that are adapted to and support its operations across the Group Manuals, instructions, schedules and reviews with the subsidiaries in the Group to ensure consistent and timely reporting An Audit Committee appointed by the Board of Directors reviews the Group's financial reporting and risk management

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4. FINANCIAL RISK, cont.		
Property valuation	Individual and systematic errors in the valuation process, such as incorrect assumptions regarding growth, profitability and valuation yield.	<ul style="list-style-type: none"> Pandox has a robust valuation process and a consistent valuation approach; the valuation model consists of an accepted and proven cash flow model, where the future cash flows that the hotel properties are expected to generate are discounted by the market yield requirements The valuation is based on the business plan for the hotel concerned, which is updated at least twice a year and takes into consideration, among other things, developments in underlying operator activities, market developments, the contract situation, operating and maintenance issues and investments aimed at maximising the hotel property's cash flow and yield in the long term External valuations of all properties are normally carried out annually by independent property appraisers; the external valuations provide an important reference point for Pandox's internal valuations, to the extent that differences compared with internal valuations are analysed to challenge the internal valuation The external appraisers complete a more in-depth inspection at least every three years or in conjunction with major changes to the properties Quarterly review of valuations by Pandox's management, Audit Committee, Finance Committee and Board of Directors before publication of each financial report For further information on property valuation, see pages 143–146
Insurance errors	Particularly the risk of properties being underinsured and that adequate insurance compensation cannot be obtained in the event of a loss.	<ul style="list-style-type: none"> Insurance policies are reviewed at least annually Ongoing advice on premiums and insurance levels
Counterparty risk related to bank derivatives	The risk that a bank which issues OTC derivatives is unable to meet its contractual obligations.	<ul style="list-style-type: none"> Banks with a good rating Risk tolerance managed in Financial Policy Continuous monitoring by treasury
Rent reporting	Under- or overestimation of rental income.	<ul style="list-style-type: none"> Continuous monitoring and reconciliation with tenant Periodic review of rent reporting internally and, where relevant, externally with tenant

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5. SUSTAINABILITY RISK		
Environment	Pandox impacts the environment through the use of energy, water, chemicals and materials, and generates emissions and waste. A deterioration in the physical environment may negatively impact people in and around our hotels, as well as the properties, which could result in increased costs and a need for investments.	<ul style="list-style-type: none"> Environmental Policy Collaboration with tenants and business partners on investments for environmental improvements Measures to improve resource efficiency through Pandox's green investment programmes Environmental certification of hotel operations and properties
Climate change	Extreme weather and floods could damage the properties. Higher temperatures and more heatwaves could result in water shortages. Scarcity of natural resources could result in increased costs for materials and energy. The transformation of society could result in reduced international travel but greater regional travel, thereby creating new business opportunities.	<ul style="list-style-type: none"> Environmental Policy Measures to reduce energy and water consumption and to lower emissions of greenhouse gases and volumes of waste Environmental certification of hotel operations and properties Increased use of renewable energy and photovoltaics
Human rights	Failures in the supply chain and in the operations could result in infringement of human rights. In the property sector there is a risk of illegal labour and wage dumping; in the hotel industry, the main risk is of trafficking and prostitution in and around the hotels.	<ul style="list-style-type: none"> Human Rights Policy Code of Conduct for employees and business partners Risk analysis and supplier monitoring process Training in human rights for employees Whistleblower system and process for following-up on incidents Modern Slavery Act statement
Employees' confidence	The risk that Pandox may be seen as an unattractive employer and find it difficult to retain existing staff and to recruit new employees. Dissatisfied employees could have a negative effect on the Company, hotel guests and business partners, which is an operational risk.	<ul style="list-style-type: none"> Code of Conduct for employees Healthcare and wellbeing initiatives Performance and career development reviews and annual pay revision Opportunities for specialisation and further training Varied work with great opportunities to have an influence
Health and safety	In the hotel industry there are health and safety risks due to heavy lifting as well as slips, trips and falls, a risk of suffering burns and cuts, and risks relating to threats. Fires are another safety risk. Failures in health and safety procedures could result in injuries and ill-health among staff, guests and suppliers.	<ul style="list-style-type: none"> Preventive healthcare and wellbeing initiatives Regular fire inspections and fire drills Contingency plans and security policies Training in CPR and installation of defibrillators
Anti-corruption	Pandox has zero tolerance for corruption. Nonetheless, there is a risk of corruption in connection with, for example, sourcing of goods and services, bribery and partiality when signing agreements, and a risk of internal irregularities.	<ul style="list-style-type: none"> Anti-corruption Policy Code of Conduct for employees and business partners Anti-corruption training External whistleblower service for reporting irregularities Internal control procedures
Data security	The risk that failures in data security and data processing could breach customers' privacy. The risk of falling victim to cybercrime is also increasing in society in general.	<ul style="list-style-type: none"> Each year the Board of Directors adopts an IT Policy that covers data security Code of Conduct for employees Technical and organisational protective measures, such as firewalls and password-protected systems Training of employees Annual review of risks and vulnerabilities