Annual Report 2000

THIS IS THE SIXTH SWEDISH NATIONAL PENSION FUND

The Sixth Swedish National Pension Fund is one of the five funds that manage the national pension funds in the Swedish AP Fund System. The Fund plays a special role within the AP Fund System, since it provides the opportunity to act as an active owner for both listed and unlisted companies. Parts of the resources are focused specifically on creating ownership in unlisted companies (private equity). In this way, one can take advantage of the opportunities for high returns that are presented within the fastest growing sectors of the economy. At the same time, the Fund contributes capital, expertise, and contacts that in turn contribute to the growth potential of Swedish companies with sound business ideas.

The Fund today is a successful actor in the Swedish private equity market and works long-term to strengthen and develop this position. The strategic goals reflect our striving for stability, long-term vision, and deepened expertise within a number of clearly defined investment areas. In the longer perspective, the development of a strategic international network is a prioritised goal.

The Sixth Swedish National Pension Fund AP Fund currently administers over SEK 18.4 billion of the Swedish national pension funds, of which approximately SEK 3.7 billion consists of direct and indirect (via funds) investments in unlisted companies. In total, the Fund currently has shares in more than 300 companies.

THE YEAR IN BRIEF

The year saw strong fluctuations and it is therefore very satisfying to note that the Fund, in its fourth year of operation, was able to achieve a return that considerably exceeded the index. Total returns for the year exceeded the comparative index by 10.6% and since its start in 1996, the Fund's management capital has grown from SEK 10.4 billion to SEK 18.4 billion.

The year 2000 was the Fund's fourth year of operations. Both Investment Operations and Asset Management reported good results and the Fund's objectives were reached with good margin.

The loss for the year totalled SEK 428 million and is the equivalent of a return of -1.3%, compared with the Fund's comparative index, SIX Returns Index, whose return amounted to -11.9%.

The unlisted portfolio, Investment Operations, reported a profit of SEK 624 million, the equivalent of a 17.0% return. The comparative index yielded -11.9%.

The listed portfolio, Asset Management, reported a loss of SEK -870 million, which is equivalent to a return of -6.3%. The comparative index showed -11.9%.

The Fund is one of the largest investors in unlisted companies in the Swedish market. At the end of 2000, the Investment Operations portfolio had a value of SEK 3.7 billion, invested in 300 unlisted companies.

Since its start in 1996, the fund capital has grown by SEK 8 billion. This is the equivalent of an increase in value of 80.7%.

THE FUND'S OBJECTIVES

The Sixth Swedish National Pension Fund shall, within the framework of its investment regulations, manage Swedish pension funds so that the return on fund capital is maximised in a 5-year perspective.

The Fund's board has raised the Fund's returns target during the year, meaning that the Fund's return shall surpass the SIX Returns Index instead of its previously stated goal of ”equalling Findata's Returns Index”. The Fund's comparative index, the SIX Returns Index, is adjusted in accordance with the Fund's regulations, which do not allow investments in certain foreign companies that are part of the index.

PORTFOLIO ALLOCATIONS

In order to meet the requirements on maximum returns within a 5-year perspective, the Fund has maintained its strategy of investing in unlisted shares during 2000. The

Fund has reallocated SEK 1.1 billion from the listed portfolio to investments in unlisted shares. The Fund's capital is split among listed shares (79.7%) and unlisted shares (20.3%), (see illustration on next page).

EARNINGS TREND

The total market value of the capital has risen from SEK 10.4 billion to SEK 18.4 billion since the start in 1996 and the year's loss of SEK 428 million is the equivalent of a return of -1.3%, compared with the year's return for the SIX Returns Index of -11.9%.

From the beginning of 1999, the Fund has been fully invested in shares, which is the reason for the comparison with the SIX Returns Index as presented below. The Fund's return, estimated since the start of 1999, exceeded the comparative index for the first time during the third quarter of the year 2000 and the operating year ended with a positive difference for the Fund of 6.3% (see illustration below).

The Fund's portfolio with unlisted shares, Investment Operations, reported a profit of SEK 624 million, the equivalent of a return of 17.0%. The return for Investment Operations was 28.9% better than the SIX Returns Index.

The Fund's portfolio with listed shares, Asset Management, reported a loss of SEK 870 million, the equivalent of a return of -6.3%. The return for Asset Management was 5.6% better than the SIX Returns Index.

Since its inception, the Fund's profit has totalled SEK 8,040 million. The change in value has contributed SEK 3,025 million, while the total costs amounted to SEK 422 million.

The Fund's total increase in value of invested capital, before administrative costs, amounts to 80.7% since its inception in 1996.

A GOOD RESULT AND VALUABLE EXPERIENCES

During the year 2000, we have continued our offensive strategy within unlisted operations. Capital, invested in unlisted companies, increased by SEK 1.1 billion, partly due to value being made visible and partly through investments in 20 indirectly owned companies and 7 investment funds.

Since the beginning of 1996, the Fund's management capital has grown from SEK 10.4 to SEK 18.4 million. In 1999 we changed our strategy and became fully invested in shares. Since then, the goal has been to attain an increase in value equivalent to the comparative index exceeded by 6.3%.

Our organisation has been strengthened during the year with additional expertise within a number of well-defined areas. The knowledge base we are now building has been carefully balanced against our strategic goals and comprises a highly prioritised area of operations. The portfolio companies have also been given additional expertise via our co-workers and via external consultants and management in partially owned investment funds. Our own experiences and developments in the world around us have resulted in a number of changes. The organisation has been refined and our strategy goals have been made even more concrete.

NET PROFIT/LOSS FOR THE YEAR

The capital market has been characterised by strong fluctuations during the year. It is therefore very satisfying to note that the Fund, in its fourth year of operation, was able to achieve a return that exceeded the index by 10.6%.

The Fund's work methods, policies, and system support have all worked well during the powerful market fluctuations. The backlash that affected some of our investments has been balanced by the increases in value in other segments of our holdings.

THE FINANCIAL MARKET IN GENERAL

The market year got off to a promising start – that is, with a powerful upward trend for technology shares and positive prognoses for both private consumption and industrial growth. The reaction was dramatic, therefore, when several of those companies that had stood as symbols for value development and strong growth did not live up to expectations.

As far as private equity is concerned, development within the market's various sectors has been strongly differentiated. These types of investments increasingly demand a deeper level of branch expertise on the part of the investors. This is reflected in the organisation that we are now cultivating within the Fund.

Even if the end of the year was characterised by wariness on the part of the market's players, most analysts have expressed positive expectations when it comes to the Swedish private equity market's long-term development. The bankruptcies that affected a number of e-commerce companies have drawn attention from the fact that the majority of the unlisted market has nonetheless developed positively in our country.

ASSET MANAGEMENT – THE FUND'S CAPITAL MANAGEMENT

Asset Management comprises approximately 80% of the Fund's funds and provides a stabile capital base. This is a prerequisite for the relatively high risks that accompany our investments in unlisted companies. In the Fund's portfolio there are some 70 listed companies, five of which the Fund has a significant holding in.

During the past year, the results exceeded our comparative index by 5.6%. From March until the end of the year, the SIX Returns Index lost more than 25% of its worth. The Fund's portfolio outperformed that figure by 7 percentage points. This can be explained by the fact that we managed to combine active portfolio management with a number of active holdings – of which Castellum, Bure Equity, Capio, and Svolder have been especially noteworthy.

PRIVATE EQUITY – THE FUND'S UNLISTED INVESTMENTS

During the year the Fund has strengthened its position in the Swedish private equity market, which when measured in number of investments per capita, is currently third among all the world's countries – outdone only by the USA and Great Britain.

Thanks to the breadth of the portfolio and quick decisions concerning disposals, a total return of 17% was reported. This result is satisfactory and should be viewed in light of the fact that the Fund was affected by tangible losses during the year due to a number of bankruptcies and necessary depreciation.

The strongly differentiated development within the unlisted market's various segments illustrates the importance of correct prioritisation between the different sectors and intensive follow-up within each and every one of them. This approach is also reflected in the Fund's organisation for investments in unlisted companies.

Experiences from the previous year are now being put to use when refining our business models.

We are striving, for example, to achieve a better ownership balance between the Fund and other owners and to complement and deepen our branch expertise. At the same time, we shall maintain our high level of returns in our operations.

With a work model that survived the trials and tribulations of the previous year, with a strengthened organisation, and with involvement in approximately 300 companies, the Fund is well equipped for a market that is characterised by increasing competition for the most attractive investment objects.

PRIVATE EQUITY – AN IMMATURE MARKET UNDERGOING DRASTIC CHANGES

Compared with the USA, the Swedish venture capital market is still young and relatively immature. Investors abroad do not as a rule accept private equity funds that cannot show a long-term and rational foundation plan for their business dealings. In Sweden, one is forced to a large degree to deal with unproven constellations of market players, a fact that naturally increases the risks. At the same time, however, several of these constellations demonstrate an attractive potential for growth.

In principle, there are two types of players in the market: Partly funds that invest in companies' various development phases, and partly investors who buy their way into funds in order to indirectly become owners in unlisted companies.

The Fund has interests in four buy-out funds and in some 20 venture capital funds – but has also made a substantial number of direct investments. We are in this way, intensively active on both levels, a fact that gives us a unique position in the Swedish market.

The number of newly established funds within venture capital will most likely decrease in the coming years. It is reasonable to predict a development similar to that witnessed in the USA. There the market is dominated within every branch by a small number of actively involved, branch savvy, and capital heavy owners who have the strength to ride out any economic swings. Development in this direction would most likely benefit the Fund.

PRIOR TO THE YEAR 2001

The Fund has a good "track record" and the work towards optimising the investment process is now entering a very intensive phase. The experience gained during the initial years is now the object of very detailed evaluations. The ongoing competency development of our co-workers – which has so far been an important success factor – will be further developed and refined towards particularly vital areas. Monitoring of the world around us will be intensified and will be, to a greater extent, conducted through our own network.

In all likelihood, the changes in the Fund's investment regulations – including the right to invest in foreign companies – will widen the perspective and further increase the possibilities for attractive investments and risk diversification. The establishment of a strategic international network will be accentuated.

In order to keep step with the changes in the world around us and to take practical benefit from the experiences that the Fund has acquired so far, the foundation has been lain for a strategic refinement resulting in five investment portfolios – Asset Management, Buy-out, Industrial Ventures, Technology Ventures, and Life Science Ventures.

The new work method shall lead to a strengthened focus and clearly defined strategic goals. We have has strengthened our opportunities to meet our goals with a satisfactory margin in the future – in other words, to reach a level of return that surpasses the comparative index.

In summary, the Fund is well prepared and equipped to consolidate and develop its position in the Swedish capital market, and I am looking forward to 2001, which promises to be an exciting and dynamic year.

GOTHENBURG, SWEDEN, 22 FEBRUARY 2001

Erling Gustafsson
Managing Director

ATP and the reformed retirement pension system

The Sixth Swedish National Pension Fund is one of the five public funds that manages the national retirement pension funds within the Swedish AP Fund System. The system was introduced as early as 1960, but was reformed in accordance with a parliamentary decision in 1998. Today's system is linked to the country's income development to a greater degree than was previously the case. Below we provide a basic guide to the system's load-bearing segments.

ATP

The system of national supplementary pensions (ATP, *allmän tilläggspension*) was introduced in 1960. This system is built on the idea that pension payments shall be financed through obligatory employers' contributions, based on the active population's income level. The Swedish parliament voted in June of 1998 to reform the ATP system. The new system has been designed so as to better follow society's economic development – in other words, that pensions will follow income development to a greater degree.

THE REFORMED RETIREMENT PENSION SYSTEM

The Swedish Parliament's decision to change the ATP system entails a comprehensive reformation of the national retirement pension system. The change entails a gradual transition to the new rules that govern the calculation of retirement pensions. The system changes from being benefit determined to being fee determined.

The new national pension consists of three parts:

- The income pension is an allocation system. Those fees that come in are channelled directly, in the form of pensions, to current pensioners. In return for moneys paid, one receives individual pension rights. These show that the system owes the person money – which is repaid when that person in turn takes out a pension.
- The premium pension is a so-called premium reserve system. The money placed in the premium pension is not paid out to today's pensioners, but is saved for use when the person paying them takes out a pension. The money is placed in securities funds that the person chooses himself. Those who wish can have their funds managed by the Seventh AP Fund. This fund offers two choices of funds.
- The guaranteed pension is a supplement for persons with low or non-existent incomes. The guaranteed pension is financed with taxes.

In the reformed system, an annual pension right is fixed annually, equivalent to

18.5% of the pension determining income. The lion's share of the pension right – an amount equivalent to 16.0% of the base salary – is supplied to the allocation part and 2.5% is supplied to the premium pension.

The new rules are to be introduced gradually. Persons born before 1937 continue to receive the national basic pension and ATP. Those born between 1938 and 1953 are being phased in by having a part of the pension come from the new and a part from the old system. The younger one is, the greater the share of one's pension that is determined by the new system. Persons born after 1954 receive their pension entirely according to the new system.

For information on the new general pension, turn to Riksförsäkringsverket, Försäkringskassan, and Premiepensionsmyndigheten. Feel free to visit their common Web address: www.pension.nu

THE NATIONAL PENSION INSURANCE FUND

The National Pension Insurance Fund was created when the ATP system was founded – in part to counteract a feared reduction in societal saving patterns, and in part to function as a buffer during periods when pension payments exceeded fee incomes.

Until the reform of 2000/2001, the National Pension Insurance Fund's funds have been managed by six different funds boards with different placement strategies:

The 1–3 fund boards have managed the largest portion of the National Pension Insurance Fund's capital. They have focused on interest bearing investments and a smaller share of property investments.

Fund boards 4 and 5 have primarily focused on listed Swedish shares.

Fund board 6 has focused on the unlisted venture capital market with a larger portion of investments in small and medium companies as a complement to traditional capital management with listed shares.

Fund boards 1–5 were reorganised on 1 May 2000 into four AP Funds (1–4). On 1 January 2001, the investment capital was equally divided between these funds and they were given a common investment mandate.

The Sixth Fund Board has, until further notice, retained the unchanged investment rules and has merely changed its official name to the Sixth Swedish National Pension Fund.

The Seventh AP Fund is not affected by the reorganisation.

THE SIXTH SWEDISH NATIONAL PENSION FUND'S INVESTMENT RULES

As mentioned above, the Sixth Swedish National Pension Fund has unchanged investment rules. These are more flexible than the First - Fourth AP Funds' investment rules – with the exception that the Sixth Swedish National Pension Fund does not have a mandate to invest abroad. The breadth of the investment regulations gives the Sixth Swedish National Pension Fund a special position within the AP Fund system.

The Sixth Swedish National Pension Fund has a mandate to invest in:

• Listed Swedish shares with an ownership share smaller than 30% of the capital and voting rights.

• Unlisted Swedish shares

• Interest bearing instruments

• Recognised derivative instruments

There are no restrictions with regard to allocation between the various asset types.

THE SIXTH SWEDISH NATIONAL PENSION FUND'S TASKS AND OBJECTIVES

The Sixth Swedish National Pension Fund shall, within the framework of its investment regulations, manage Swedish pension funds in such as way that the demands for good returns, long-term investment, and effective risk diversification are met.

The Fund's board has established the goal of having the return on the Fund's investments, within a 5-year period, surpass the SIX Returns Index. The comparative index is adjusted in accordance with the Fund's regulations, which do not allow investments in certain foreign companies that are part of the index.

THE 1ST–4TH AP FUNDS' NEW INVESTMENT RULES

In order to secure the financing for the retirement pension system, it is even more important than previously that the AP Funds provide a long-term, high return. The investment rules for the First–Fourth AP Funds will therefore be characterised by greater flexibility and enable investments in several different asset types. The most important investment rules – identical for the First–Fourth AP Funds – are as follows:

• Investments shall be possible in all existing capital market instruments that are listed and tradable.

• A smaller percentage– five% maximum of every fund's assets – may be placed in unlisted securities. Investments in unlisted shares may only occur indirectly via shares in securities funds or venture capital companies.

• At least 30% of every fund's assets shall be placed in interest bearing securities with low credit and liquidity risks.

• Each fund may own a maximum of ten% of the voting rights in a single listed company.

• A maximum of 40% of a fund's assets may be exposed to exchange risks.

• A maximum of ten% of a fund's assets may be exposed to an issuer or group of issuers.

•At least 10 % of each fund's assets shall be managed by an independent fund manager.

THE FINANCIAL MARKET

The year began with a great amount of optimism with regard to the quickly growing technology sector and the general development of the world economy. A number of factors later contributed to dampening this feeling of confidence – such as a substantial increase in the price of raw goods, the weakening of the market rise and subsequent substantial losses, tightening of financial policies, and a time consuming vote tabulation in the American presidential election.

MACRO-ECONOMIC DEVELOPMENTS

The world economy grew substantially, as expected, during 2000. Consumption increased strongly in both Europe and the USA, and those countries in South America and Asia that had been hit hardest by the crisis of 1997-98 recovered. The Japanese economy, however, continued to have problems escaping its long recession.

Due to strong demand and a production capacity that did not increase at the same speed, the price of raw materials increased during the year. Especially noteworthy in this regard were oil prices, which despite the fact that OPEC increased its rate of production somewhat, continued to rise. This was partially explained by a lack of tanker capacity and by continued unrest in the Middle East.

The end of the year saw several signs of a weakening market trend. Opinions as to its scope and duration, however, were quite varied.

Some indicators of a weakening trend were a weak stock market with the negative business effect that this can have, a dampened optimism on the part of companies and consumers, a very strong dollar that made things difficult for American export companies and high raw material prices and wage increases – which created a risk of cost driven inflation and a press on profitability.

In the USA, the deficit in the trade balance increased to record high levels due to the strong dollar boosting imports and simultaneously depressing American exports.

While production costs increased, inflation – measured as the consumer price index – was relatively low in the USA and Europe. Discounting energy, food, and indirect taxes, the so-called core inflation rate stopped at even lower levels.

THE INTEREST AND FOREIGN CURRENCY MARKET

In February, the Riksbanken raised the repo rate by one half a per cent, but has subsequently classified the risk of inflation as limited. The Federal Reserve and the European Central Bank (ECB) have, on the other hand, tightened their financial policies considerably. This is referenced to strong growth and – in the latter's case – a weak exchange rate.

The dollar strengthened substantially during the year, at the same time that the Euro weakened considerably. The Swedish krona weakened in step with the Euro – with the result that the dollar rate rose during the autumn to exceed the SEK 10 level. In November, the ECB began purchasing the Euro, which contributed to this currency gradually strengthening again.

The interest rate on government bonds sank somewhat during the year, due to expectations of a somewhat slower rate of growth and slowed long-term inflation tendencies. The interest differential on higher risk corporate bonds, however, increased, which can be seen as an indication that profit scenarios for many companies will be worsened in the future.

THE STOCK MARKET

After a very strong year in 1999, there followed a year of down swings for the broad share price indexes. This was primarily concentrated to the tech sector, while more defensive sectors – such as pharmaceutical funds and property, for example – developed strongly. The S&P 500 (the USA) dropped by 10%, the DAX (Germany) dropped by 8%, and the FTSE 100 (UK) dropped by 10%. The Stockholm Exchange (AFGX) dropped by 12%.

BACKLASH FOR THE IT INDEX

The tech sector rose due to a strong level of faith in ”the new economy”, quite substantially up until March. Several factors contributed however, to this sector's weak development during the rest of the year. The strong upswing had led to extremely high valuation levels, e-commerce towards the consumer – and later on between companies – developed more weakly than expected and a number of companies found themselves in an unsteady state.

In addition, the semi-conductor sector was hit by low sales curve combined with depressed prices. Microsoft risked a break up when the company was judged to have taken advantage of its monopoly position with regard to PC operating systems. IT consultants were hit by a gap in demand after the millennium project and wavering demand from e-commerce companies in combination with high recruitment costs and salaries. The business world's IT index – which at its peak during the spring had risen by 40% – dropped by 58% for year as a whole.

LEVELLING OUT WITHIN TELECOMMUNICATIONS

Telecommunications companies Ericsson and Nokia had continued strong progress on the systems side. While Nokia took market shares in mobile phones and retained its high level of profitability, Ericsson indicated that their loss for the year in the consumer products sector would increase to SEK 16 billion. Ericsson, therefore, turned the strong boom of the year's first months into a downswing of 21%, while Nokia rose during the year by 8%.

The stock market began quite early to discount a slowing down of the industrial business trend – despite good profit development during the year for manufacturing and forestry companies. Share prices recovered substantially, however, during the latter part of the year. The AV Skogsindex dropped by 14% and the Enskilda Engineering Index by 9%.

The Trade Index dropped by 46%. Hennes & Mauritz, which dominates this index, suffered from weaker than expected sales and the concurrent high costs associated with establishing a position in the American market. The company dropped considerably, therefore, during the year.

WEAK ”PEOPLE’S STOCK”

Telia was listed on the market in June, and became one of the most widespread shares
in Sweden. Share development over the year, however – as for other telecommunications operators – was disappointing. The primary reason for this was that many European telecommunications operators were forced to pay large sums for 3G licenses and to also build infrastructure networks – at the same time that revenues from 3G per customer were estimated to be lower than previously calculated. Netcom also acquired the loss generating SEC, which was not appreciated by the stock market. Europolitan went down by 44%, Netcom 34%, and Telia 43% from the initial listing price.

DEFENSIVE ALTERNATIVES

Pharmaceutical shares were used by many as a defensive alternative to the rejected tech shares. They rose 30% during the year (SX Kemi and Läkemedel).

Nordea (previously MeritaNordbanken) continued to acquire companies. During the year, they built a position as the largest and most geographically comprehensive Scandinavian bank. The OM group made a bid on the London exchange during the year, which did not get approved however. Banks profited from the stock market thanks to their defensive nature and increased profits as a result of interest development and cost saving measures. The AV Bank and Finance Index rose by 32%.

The trend within property and the construction industry was quite positive during the year, even if a certain weakening could be detected during the latter part of the year. Office and retail rents reached new peak levels. In addition, the sector was well served – as were banks and pharmaceuticals – from its defensive nature. The AV Construction and Property Index rose by 24% during the year.

THE PRIVATE EQUITY MARKET

Private Equity is responsible for investments in unlisted companies. The Swedish private equity market has existed since the 1970s, but first experienced strong growth beginning in 1994.

The Swedish private equity market has had very strong growth during recent years. Many new players have entered the market, which is still immature and will be transformed in the coming years. Development within the different sectors of the market has been strongly differentiated, but overall value development during the year 2000 has been good.

GROWTH AND CHANGE

Sweden is currently third in the world with regard to private equity investment per capita. Only the USA and Great Britain precede Sweden on this list (source: EVCA, see illustration of next page). In total, there are currently about 200 players in the market and disposable funds of SEK 150–200 billion (source: Förvärv & Fusioner).

The illustration at the bottom of the page shows the stages of a company's development – from seed investment to market listing or industrial sales. Compared with the rest of Europe, Sweden has a larger share of invested capital in companies' early stages.

IRREGULAR DEVELOPMENT

The Swedish private equity market has existed since the latter part of the 1970s. Growth has occurred irregularly, in leaps and bounds. During the beginning of the 1980s, the first upswing occurred in connection with a positive market climate and the establishment of the OTC list. When the market development turned and property investments gained dominance, this upswing levelled out.

Up until 1994 the number of players increased slowly, and then subsequently gained considerable speed. This is due to several contributory factors: Institutional investment has allocated more capital to private equity, Sweden has had a strong market upswing, disposal possibilities have improved with new stock market lists, and foreign purchasers have stimulated development. In addition, a number of companies have taken to outsourcing their research and development, which has created many new companies – primarily within the tech sector.

DEVELOPMENT IN SWEDEN DURING THE YEAR 2000

Development in Sweden has been strongly differentiated during the year between the different sections of the private equity market. This illustrates the importance of following up on each and every section. The spectacular losses that struck the e-commerce companies have obscured the fact, for example, that the majority of the Swedish private equity market has developed well during the year.

The trends within the different segments of the private equity market are described below. The buy-out market is primarily focused on mature operations and the venture capital market in the early stages of development. Compare the figure at the bottom of the next page, which describes company's development phases.

BUY-OUT

Within the buy-out market, the trend for the year has been good. The market has only a few established players in the larger segments – Nordic Capital, EQT, and Industri Kapital. No new establishments have occurred or been rejected. Along with the fact that players are starting funds with more capital, there is a tendency to look for larger deals.

VENTURE CAPITAL – THE TECH MARKET

Tee Swedish market for unlisted tech companies has been turbulent during the year. The market is still very young. Most of the players have only been in operation for a few years. In the USA, many successful venture capital funds have built up their operations over a period of decades. In such a mature market it is hard for funds to attract major capital without being able to demonstrate a successful track record. In Sweden, however, investors have been relegated to investing in completely new constellations, which entails a considerably greater risk.

The turbulence that has characterised the market has primarily occurred within the tech sector. Many new establishments that are given a very high initial value are subsequently de-valued due to poor or non-occurring cash flow and the elimination of, among others, e-commerce companies.

VENTURE CAPITAL – THE LIFE SCIENCES MARKET

During the first quarter of 2000, this segment developed very strongly – especially in the field of small and medium companies. Development during the second, third, and especially the fourth quarter was weaker than in the beginning of the year, but all in all the market shows a positive result.

The increased access to venture capital in Sweden has led to a higher value being placed on available objects within the biotech sector.

Only a few new funds have been established during the year within life science. The market's largest players are Investor Growth Capital, HealthCap, and the Sixth Swedish National Pension Fund. Within life science, an increasing degree of internationalisation can be detected. Among other signs, we see the major venture capital company 3i established in Stockholm.

VENTURE CAPITAL – TRADITIONAL SECTORS

There are only a few players – such as Industrifonden, Atle, and Skandia – within the traditional sectors in Sweden. No new establishment has occurred during 2000.

The valuation of companies in traditional sectors has risen somewhat during the year, with expectations being increased by the development within other sectors.

TRENDS

A number of trends can be seen in the Swedish market. It is primarily characterised by consolidation and internationalisation. As the market matures the players become more and more specialised. Simultaneously, development is towards fewer and larger players. In order to contribute to the portfolio companies' development, resources and networks are required.

Specialisation entails in part a focus on various branches, and in part on the separate phases of companies' development. The international trend for players from mature sectors to be attracted to investments in early phases has ceased. Venture capital funds are now seeking to regain their normal position in companies' financing chains. This development is closely connected to the considerably decreased ability to introduce very young companies onto the world's stock markets. The private equity market is global and the importance of a strategic international network is estimated to increase further. Swedish private equity companies need good relations with foreign players – in order to help companies to develop internationally and to find opportunities for the disposal of portfolio companies.

What is private equity?

Private equity stands for investments in unlisted companies. The words risk capital, which are sometimes used synonymously, actually mean investments in a company's own capital. The word ”risk” here refers to the larger risk that the owner takes in relation to other financiers in the company, such as banks or suppliers. (source: Venture capita – concept and definitions, by Professor Anders Isaksson).

The illustration above shows how the different terms fit together. The private equity market can be divided into

• **the buy-out market,** which deals with strategic and financially directed buy-outs and mergers of major companies or parts of major companies, and

• **the venture capital market,** which deals with investments in smaller and often quickly growing companies. The term venture capital, which like most terms is not yet translated into Swedish, refers to limited time investments in unlisted companies where the investor often practices active ownership.

THE FUND'S ALLOCATION PROFILE

The Sixth Swedish National Pension Fund's capital consists primarily of investments in listed and unlisted shares. The portion of unlisted shares grows in tact with the development of the organisation and investments are made. The unlisted portfolio is well diversified – both with respect to branches and companies' stages of development.

PORTFOLIO ALLOCATIONS

At the end of 1996, the Fund had a basic capital of SEK 10.4 billion in total. Capital has been reallocated since the beginning, when the Fund's capital was solely invested in interest bearing objects. Since the beginning of 1999, capital has primarily consisted of share investments in listed and unlisted companies.

The unlisted portfolio has grown steadily, reaching SEK 3.7 billion at the end of the year 2000. As the figure below illustrates, it comprised 20% of the Fund's capital at the end of the year.

Part of the Fund's mission is – in addition to the overall goal of generating a good return with suitable risk diversification – to invest in small and medium companies. This gives the Fund a special position within the AP Fund system. The Fund intends therefore to continue to invest considerable amounts in direct and indirect (via funds) ownership in unlisted companies, in order to attain a long-term return on investment greater than that generated by the listed shares. The unlisted portfolio grows as the Fund finds investment opportunities and builds its organisation and network.

The illustration on the next page shows the branch weighting to the Fund's total portfolio, compared with the weighting in the Affärsvärlden index. The differences are primarily due to Asset Management's holdings in Industrivärden and to the fact that the unlisted portfolio has another weighting, with larger portions of IT and healthcare. For a further description of the allocation within the listed portfolio, see Asset Management on pages 14-15.

A PART OF THE AP FUND SYSTEM

The First to the Sixth Swedish National Pension Funds together manage approximately SEK 540 billion. The new investment rules for the First to Fourth AP Funds state that at least approximately 30% of the entire system's assets must be invested in interest bearing instruments. The Sixth Swedish National Pension Fund's allocation profile should be viewed against the background of the design of the system as a whole. The Fund's investments of SEK 18.4 billion in shares are a part of the total system's share investments. The relatively high percentage of unlisted shares in the Fund's portfolio is due to the fact that the Fund, as a part of the system, has been given the task of investing in small and medium companies.

THE FUND'S ORGANISATION

The Fund's organisation and portfolio are divided into five areas.

Asset Management works with listed shares and derivatives. Read more on pages 14-15.

Buy-out works within the buy-out market. Read more on pages 16-17.

Technology Ventures works with venture capital within the tech sector. Read more on pages 18-19.

Life Science Ventures works with venture capital within the healthcare sector. Read more on pages 20-21.

Industrial Ventures works with venture capital within traditional sectors. Read more on pages 22-23.

Definitions of buy-out, venture capital, and more are provided on page 10.

MANAGING THE UNLISTED PORTFOLIO

Management of the unlisted portfolio rests on a number of cornerstones:

- A diversified portfolio – in other words, spread among various branches or sectors
- Balanced distribution between the various phases of companies' development
- Determined investment criteria
- Local presence – global network
- Careful decision-making process
- Well developed investment process
- Both direct and indirect investments

The image to the right on the next page shows the unlisted portfolio's distribution between different sectors in comparison with the weighting in Affärsvärlden's index. The fund has a surplus within IT and healthcare – areas that the Fund has chosen to focus on because of the good prospects for growth.

The Fund has a satisfactory division of investments between companies in different development phases. In an international comparison, the Fund has – as does the Swedish market in general – more capital invested in early phases. As a result of the restriction that only allows the Fund to invest in Sweden, it is difficult to attain a portfolio with a higher percentage of mature companies. The range of funds that implement this type of investment is limited in Sweden.

When working with unlisted companies, it is important to remain close to the operations, but competition is also international today. A strategic network is decisive in succeeding as an investor. Working actively on a local plane with the company is as necessary as gaining information about global trends and changes via networks when managing investment risks.

The Fund's investment process (which is described on page 24) comprises the basis for managing the unlisted portfolio. All stages of the process – from analysis and agreement drafting to board work and disposal – must be continually developed through personal experience and knowledge gained through our network.

DIRECT AND INDIRECT INVESTMENTS

As the percentage of unlisted shares has increased, so has the percentage of indirect investments via venture capital and buy-out funds grown. Aside from good risk diversification, this indirect involvement provides a deepening of our knowledge about important investment areas. They also provide access to external analysis and management capacity. The percentage of indirect investments has grown during 2000 from 50% to 54%.

By allowing teams with good sector knowledge and well-defined investment directions to implement the investments, the unlisted investments are managed in a professional manner. The Fund's direct investments also become more focused on a smaller number of areas where expertise exists within the organisation or its network. By combining the Fund's direct investments with a number of carefully selected fund portfolios, we create a well-balanced portfolio with unlisted holdings.

MANY HOLDINGS A DECIDING PARAMETER

The most decisive parameter for good risk diversification in the unlisted portfolio is to have a large number of holdings. Today, the Fund has direct and indirect holdings in almost 300 unlisted companies. The large number of holdings within different sectors and development phases means that the Fund can partake of the attractive value growth of fast growing companies while the overall risk level is kept relatively low. It is primarily in the early phases of the companies' development that the risk is often high. It is therefore quite natural that a number of companies do not succeed and are forced to close down – while some companies succeed very well, creating great value.

The image below shows the value development of the Fund's holdings. Here both direct holdings and holdings in funds are seen as investments. Most holdings today, in accordance with the accepted principle, are valued at

the acquisition value and do not therefore affect the Fund's result. All investments that have affected the result positively or negatively since the Fund's establishment are included in the diagram – that is, whether the effects comprise realised or unrealised results. Individual bankruptcies or successful sales become interesting only against the background of the complete portfolio's development.

ASSET MANAGEMENT

After a turbulent stock market year, total returns exceed the SIX Returns Index by 5.6 percentage points – primarily through positive developments for the active holdings Bure, Svolder, Capio, and Castellum and through the investment in Industrivärden. In order to take advantage of the great swings in the stock market, the Fund has worked systematically with strategies for the selection of shares and alterations in liquidity.

Within Asset Management, the Fund works with listed shares and interest-bearing instruments, as well as with accepted types of derivative instruments in the stock and interest markets. In addition to traditional capital management, the Fund has an active ownership in a small number of companies. During 2000, Asset Management exceeded the SIX Returns Index by 5.6 percentage points.

INVESTMENT FOCUS

Since the Fund's establishment at the end of 1996, the capital has been successively reallocated from the interest market to the stock market. Since the end of 1998/beginning of 1999, Asset Management has been fully invested in shares. The large investments that were implemented during the weak stock market climate during the autumn of 1998 have provided very good returns. Through reallocation, Asset Management has also shifted its objective to exceed the SIX Returns Index (see the definition on page 7).

BASIC PORTFOLIO

Investment management comprises to the largest extent the basic portfolio, which is primarily comprised of liquid shares in larger companies on the Stockholm Exchange. The portfolio's division between different sectors is shown in the diagram on the next page.

At the beginning of the year, the Fund implemented a large investment in Industrivärden, and therewith became the company's majority shareholder with 5% of the capital. The primary reason was that the substantive discount in the company was historically high – despite a high-quality portfolio comprising, among other shares, Ericsson, SHB, Skandia, and Skanska. In order to obtain these holdings at a discount, the Fund exchanged a portion of its shares in return for the holding in Industrivärden. So far, the transaction has provided good returns, as the substantive discount was greatly reduced during the year.

The portfolio has, as a result of the investment in Industrivärden, attained a substantial surplus in investment companies – which is shown in the diagram on the next page – while other sectors have either a neutral weighting or a shortfall. Including Industrivärden's underlying holdings, however, the sector weighting during the year was to a large extent neutral. Instead, the Fund has – in order to take advantage of the great swings in the stock market – primarily worked with strategies for the selection of shares and alterations in liquidity. Within the workshop sector, the Fund has reduced its exposure by, among other things, realising its good profits in SKF and by reducing the overexposure in Volvo.

Within the construction and property sector, the Fund has, among other things, exchanged its NCC shares for Skanska shares.

Within the retail sector, the Fund has taken advantage of the weather and collection-related drop in H&M to accumulate shares in the company – and has thereby moved from under- to overexposure.

Within the bank sector, the Fund’s greatest exposure has been SEB. During the latter part of the autumn, the Fund reduced its holdings within the sector.

Within the pharmaceutical sector, the Fund has continued to exchange Astra-Zeneca for Pharmacia, and today has a surplus in the latter company.

Among telephony operators, the greatest exposure has long been Netcom. During the year, Telia was added as a large holding in conjunction with the stock market introduction.

Within the IT sector, the Fund has had neutral exposure with a focus on TietoEnator and the business system companies IBS and IFS. During the year, exposure has been concentrated on the larger and more stabile companies within the sector.

Nokia, in accordance with the Fund’s investment regulations, may not be included in Asset Management’s portfolio. Exposure within telecommunications has been focused on Ericsson and the sub-contractors Nolato and Segerström & Svensson.

ACTIVE HOLDINGS

In addition to the basic portfolio, the Fund has five active holdings, that is, holdings where the Fund participates in the companies’ development in order to obtain better long-term returns. These holdings are Bure Equity, Capio, Castellum, Hexagon, and Svolder.

During the year, Bure changed name to Bure Equity. Operations have been focused on the TIME sector by providing dividends in Capio and selling holdings in, among others, Gunnebo and Nobel Biocare. During 2001, one expects Observer to be provide the shareholders dividends and Dimension to be listed on the stock exchange. During the year, Bure has – including dividends calculated from Capio’s closing-day rate – generated returns of 56%.

Capio – previously Bure Hälsa & Sjukvård (Bure Health & Healthcare) – provided dividends through Bure. The company runs operations covering different forms of healthcare and is assessed to have a very large market potential. Since Capio was first listed, it has grown by 43%.

Castellum has, as a result of a redemption/buy-back programme and strong development in its property holdings, increased by 31% including dividends during the year.

During the year, Hexagon acquired the measuring technique company Brown & Sharpe and made public a new strategy that entails a focus on considerably fewer companies and aggressive growth and profitability targets. The share price, however, dropped by 7% including dividends during the year.

Svolder is an investment company aimed at small companies listed on the Stockholm Exchange, and comprises a large part of the Fund's small company exposure. The company's substantive discount has decreased considerably during the year, which has provided better returns (12%) than the Carnegie Small Companies Index (-7%).

RESULTS AND RETURNS

Capital management's total returns for 2000 amounted to -6.3% and therewith exceeded the SIX Returns Index, which provided -11.9%. The primary reason was very good development of the active holdings Bure, Capio, Castellum, and Svolder.

The basic portfolio returned -13.5%, which was worse than the SIX Returns Index.

The most important event that affected the basic portfolio returns negatively was Volvo's offer for Scania not receiving approval from the EU Commission, at which point the Fund wrote off the claim on Volvo that arose when the company bought the Fund's Scania shares in 1999. Another factor was Industri Kapital's offer for Perstorp, which was retracted due to financing difficulties. Returns have also suffered as a result of shortfalls in Nordea, SHB, and Investor. Factors that have helped the basic portfolio's returns are primarily a successful allocation between shares and liquidity, a reduced substantive discount in Industrivärden, good positioning within, for example, the construction and retail sectors, and good performance for Segerström & Svensson, Pandox, and Wallenstam.

BUY-OUT

The year 2000 saw many events, with both successful sales and a larger loss in conjunction with Netsys announcing bankruptcy. During 2001, the conditions for a good result ought to be good – among other things through the co-operation that has been established with a number of large buy-out funds.

DIRECTION AND CHARACTER

Buy-out's operations are aimed at financially and structurally oriented larger involvement in both growth companies and mature operations. Business possibilities and existing holdings are valued all the more according to business type rather than sector affiliation.

Examples of interesting business situations are buy-outs, private investments, and parallel investments with the specialised buy-out funds that the Sixth Swedish National Pension Fund co-operates with. Buy-out makes both direct investments in companies and indirect investments via funds. As the Fund is perceived within the market as a stabile and long-term owner and as the investment area Buy-out has extensive experience of financial organisation, interesting value is added to business situations.

The broad network that the Sixth Swedish National Pension Fund has access to entails possibilities to provide the companies with necessary expertise, not least within board work.

Buy-out has a broad portfolio and during the year, much work has been invested in existing holdings while approximately SEK 400 million has been invested in new holdings. During 2000, refinement of the portfolio was initiated in accordance with the current strategy, primarily through the selection of new investments. Examples of deals that were implemented include the buy-out from the stock market of Norrporten, which was led by the Sixth Swedish National Pension Fund via NS Holding. Among other activities, the Fund has also participated in the buy-out of Findus from Nestlé, which was led by EQT, and the buy-out of Nybron International Flooring from Skanska, which was led by Nordic Capital, and a parallel investment together with Innovationskapital in Kreatel Communications.

PORTFOLIO AND RESULTS

In February 2000, a partial sale of Tradex, a sub-contractor to the telecommunications sector, was made. In 1997, Buy-out invested in the company and the deal that took place in Q1 2000 means that the ownership structure was altered and the buy-out fund EQT came in as the new majority shareholder. In the agreement, the initial deal was realised, while the participating interest in the new buy-out company was the same as the former shareholding in Tradex. This provided substantial capital gains and the opportunity to partake in Tradex's future value development.

The strategy to make indirect investments via specialised funds has resulted in a number of deals with good results. The sale of the holding in MTS Europe, a supplier of after sales services within the mobile telephony sector, provided capital gains of SEK 16 million and the sale of the system supplier Essex to American Sanmina generated capital gains of SEK 237 million. The investment in Essex comprised both an indirect investment and a larger parallel investment, which provided good leverage.

During the year, a larger loss in Netsys was also realised. Netsys was acquired by the Fund in 1998 and the reasoning behind the acquisition was that the company was assessed to have great potential with its product portfolio at the time. The intention was to search for other technologies for commercialisation. Later during 1998, Netsys bought out Verimation AB from the stock exchange and took upon itself a great financial risk. During 1999, Netsys encountered contractual problems with the license provider for its products and the company lost market shares and a larger customer in its home market. Netsys also encountered management problems. The Fund’s involvement ended during 2000 and a loss of approximately SEK 320 million was realised.

In addition to this, during the year considerable resources were invested in a comprehensive analysis and evaluation of several larger deals that have not been implemented, although a few of the deals are still under consideration. A potential transaction for which discussions were entered during 2000 concerns a deal between the stock market company Beijer Alma AB and Elimag Industri AB, a company in which the Fund has been a shareholder since 1998 and which has successfully implemented a restructuring programme towards the telecommunications and pharmaceutical industries.

PROSPECTS FOR THE YEAR 2001

During the coming operational year, Buy-out intends to implement further investments, both directly and indirectly via funds. The good co-operation that has been built up with the large buy-out funds shall be further developed. The organisation shall be reinforced and further developed so that Buy-out shall obtain more opportunities to identify, push, and implement more and larger deals. In the current market situation, the identification of many interesting business opportunities has been judged likely. Buy-out intends to take an active role within its market segment and larger financial and structural involvement in growth companies and mature operations.

TECHNOLOGY VENTURES

The venture capital market for technology intensive companies experienced great fluctuations during the year. The strong price rises of the spring were followed by a powerful backlash in the autumn, which caused a number of IT companies with weak cash flows to announce bankruptcy. Despite the negative development seen among some of the companies in Technology Ventures' portfolio, the year's returns of 43% are very satisfactory. The focus on innovative companies in early maturity phases will be further enhanced.

DIRECTION

Technology Ventures' business idea is to invest in the sectors IT (hard and software), telecommunications, and media/entertainment, primarily via specialised venture capital funds – which in turn invests in portfolio companies in early phases. The objective is to create high returns with good risk diversification. The strategy also includes, parallel to venture capital funds, investing in individual portfolio companies, primarily in expansion and internationalisation phases.

A DYNAMIC YEAR

The Swedish venture capital market for technology investments has seen a very eventful year. The exceptional IT development last spring generated many successful sales and paved the way for very good returns for the Swedish venture capital companies. The positive development within IT even resulted in several new strong and long-sighted players establishing themselves in the market, but also attracted a number of gold diggers with more short-sighted ambitions.

During the autumn, the market swung considerably, which resulted in companies with weak cash flows encountering great difficulties in attracting new capital. As a result, many companies went bankrupt.

SWEDEN – A FOCUSED MARKET

Despite the market fall, the interest in Sweden shown by international players is still strong. Sweden has developed into an important test market for new technology – due, among other reasons, to Sweden's high Internet penetration and extensive mobile usage. For a few years now, Sweden and Finland – together with the USA and Israel – are among the most innovative areas in the world. Sweden has a world-leading position within research and technical developments in interesting areas such as mobile communications and fibre optics – due to a large extent to Ericsson's and Nokia's special positions within the area.

As confirmation of Sweden's leading position, during recent years several multinational companies, such as Microsoft, Intel, Motorola, and IBM, have established parts of their research in Sweden.

PORTFOLIO AND RESULTS

Technology Ventures, as of 31 December 2000, had committed capital in funds totalling SEK 1,376 million. Technology Ventures have, during the year, invested in the following venture capital funds: BrainHeart Capital, V2 Internet Fund, IT Provider Fund 2000, Slottsbacken Fund II, and Swedestart Tech.

The year 2000, in terms of results, was positive for Technology Ventures. The for the year 2000 was SEK 324 million, which is equivalent to a return of 42.6%. Technology Ventures has made a number of large sales during the year that have contributed to the positive result. These include: Altitun, which was sold to ADC Telecommunications; Cocom A/S, which was sold to Cisco; and LGP Telecom, which was sold to Arkivator.

Technology Ventures was also involved, as was the sector in general, with a number of companies with negative developments. Losses have been realised for Dressmart, Jahaya, Linq, which was sold during the year, and Simpleworld, which just before the end of the year entered corporate reconstruction. These companies have been hit hard by the altered conditions in the capital market.

PROSPECTS 2001

In general, the weak development seen among IT companies during the latter half of 2000 is expected to continue, at least for the first half of 2001. A certain amount of consolidation is to be expected among the Swedish venture capital funds within the IT sector. In the first instance, we believe that the smaller venture capital players with weak capital bases and limited histories will find it difficult to defend their market positions. The result ought to be fewer newly established venture capital funds in the Swedish market during 2001.

During the coming years, the market looks good from Scandinavian and Swedish perspectives. During the past six months, we have seen increased interest among American venture capital players to invest in Swedish technology companies.

Technology Ventures will focus on building up an international network with expansion capital in order to make possible the expansion of portfolio companies and sales. Here the emphasis will be placed on co-operation with both financial and industrial players. During 200, we plan to intensify our co-operation with universities and research institutes with the aim of initiating investment co-operation in very early phases.

LIFE SCIENCE VENTURES

The year 2000 was a turbulent year for the Swedish and international life science markets. An increase in value during the first half of the year was followed by a powerful backlash beginning in the third quarter. With a well balanced portfolio, Life Science Ventures could attain good a return, while a number of interesting investments in new companies were implemented and co-operation with the research sector was deepened.

The life sciences include pharmaceuticals, biotechnology, and medical technology. This area is dynamic, research intensive, and demands capital. The dialogue between the capital market players and the research side has, during recent years, attained more established forms.

DIRECTION AND CHARACTER

The Fund's investment area Life Science Ventures invests in both new operations and more mature companies within pharmaceuticals, biotechnology, and medical technology. Investments within the life science area are naturally long-term. It often takes 3–5 years before the value can be made visible or sales considered. The area is characterised by high risks – primarily within technology and project development. From a historical perspective, the returns on investments within life sciences are usually more profitable than within the market as a whole.

THE PORTFOLIO

2000 was a very turbulent year for the Swedish and international life science markets. During the first quarter – and in part also during the second quarter – biotech and pharmaceutical companies showed very strong development. A number of companies were successfully listed on the stock exchanges and the values of those already listed climbed dramatically in many cases. The value of, for example, KaroBio, of which the Fund owns 5.5%, increased five-fold in the space of a couple of months.

During the third quarter – and primarily during the fourth quarter – a powerful backlash was encountered. In Sweden, this backlash was strengthened by the difficulties faced by Maxim and Medivir. Of the Fund's holdings, Biora was hit hardest, and its value dropped by more than half in comparison to the end of 1999.

Life Science Ventures portfolio – which at the end of the year had a market value of SEK 1,438 million – is comprised of 18 direct investments and 7 funds. The portfolio has a good balance between holdings within pharmaceuticals, biotechnology, and medical technology respectively. All active investments – with the exception of the listed companies Biora and KaroBio – are in early phases and can each be considered risk investments. Overall, however, the risk is well balanced, as the investments have been made in both different technologies and different types of project.

CO-OPERATION WITH THE RESEARCH SECTOR

The venture to create funds and companies together or in close concert with the universities in Uppsala, Gothenburg, Stockholm, Malmö, Lund, and Copenhagen has continued. During the year, discussions have also been entered concerning co-operation with other Scandinavian universities.

Swedish and Scandinavian research has traditionally been very successful with regard to the development of pharmaceuticals and biotech products. Also in the future, many exciting projects are expected to take form, and which can develop into profitable sales to large pharmaceutical or biotech companies. Through its proximity to the universities, the Fund can take advantage of this development potential.

INVESTMENTS IN CUTTING-EDGE KNOWLEDGE

During 2000, Life Science Ventures invested in eight new companies – of which three are pharmaceutical companies, three are medical technology companies, and two are biotech companies.

Life Science Ventures has invested in A Carlsson Research AB, a company grounded by its majority shareholder, Professor Arvid Carlsson. Later during the year, Professor Carlsson received the Nobel Prize for Medicine for his breakthrough discoveries within the dopamine field. The company has a number of interesting pharmaceutical projects within the field of central nervous system afflictions. They have also developed a sophisticated technique for the rapid evaluation of new pharmaceutical candidates.

Life Science Ventures has – together with, among others, Investor Growth Capital and Karolinska Investment Fund – invested in Gyros AB. This company is a spin-off from Amersham Pharmacia Biotech and develops a unique and patented technology within the field of microflows. This technology is expected to be able to be applied commercially within a number of diagnostic and analysis areas.

Life Science Ventures has also invested in Camurus AB, Carmel Pharma AB, Demetech AB, Melacure Therapeutics AB, NeuroNova AB, and Pharmacure AB during the year.

During 1999, the Fund began the acquisition of holdings in Biora AB and Doxa Certex AB, a venture within the dental care sector. Biora's price development during the latter part of the year was dramatically negative. The trend for Doxa Certex has been more promising. The company launched its first product – the tooth filling material DoxaDent™ with unique characteristics – at the National Swedish Dental Congress in 2000. The reception was most promising. At the end of the year, a new share issue amounting to SEK 126 million was implemented, at which point the English venture capital company 3i, among others, invested SEK 29 million.

Overall, the year 2000 was a very successful year with a good return and a number of promising investments.

PROSPECTS FOR THE YEAR 2001

During 2001, we anticipate the good proposal flow to continue.

We do believe, however, that a weaker market situation will reduce access to investment capital within the life sciences. This will lead to an increased risk within the existing portfolio, as syndicating partners may lack capital. New share issues may, therefore, prove difficult to implement. We shall therefore place a strong focus on available capital and cash flow within our portfolio companies in order to be able to take any necessary measures in good time.

More limited access to investment capital will also provide more opportunities for good investments at a profitable level, as competition will be slightly reduced.

During 2001, we shall continue to invest within the areas pharmaceuticals, biotechnology, and medical technology. In addition to the direct active investments – preferably of the size SEK 25–50 million – we also plan, together with capital heavy partners, to create one or two funds in Scandinavia.

INDUSTRIAL VENTURES

High investment rates, active involvement in ownership roles, and intensive expansion of expertise centres and local networks characterise operations for the year. A return of 17% was attained despite the realisation losses and negative development of the market value of several companies.

DIRECTION AND CHARACTER

Industrial Ventures' business idea is to build up expertise centres and take advantage of local networks for investments in smaller and medium growth companies or mature operations. As a venture capital actor, Industrial Ventures plays an active and time-limited ownership role. A focus is placed on companies that have completed the start-up phase and which manufacture and sell attractive products and services from an established market position.

CLOSE TO THE MARKET

Within Industrial Ventures, we find the Sixth Swedish National Pension Fund's active directly owned investments outside the sector-specific business areas Life Science Ventures and Technology Ventures. Industrial Ventures bases its operations on expertise centres in five locations: Gothenburg, Malmö, Kalmar, Umeå, and Stockholm. Through local presence and well-developed local and national networks, Industrial Ventures can define and benefit from interesting investment opportunities and find profitable structural deals.

HIGH ACTIVITY

The organisation has been strengthened in terms of expertise during the year through new recruitment. The investment portfolio currently has a broad spectrum with a surplus in industry. The second largest sector is IT, which in Industrial Ventures case primarily entails software applied in industrial environments.

During the year 2000, a number of new investments have been implemented and certain holdings sold. Industrial Ventures result for the entire year was SEK 94 million, equal to a return of 16.8%. A satisfactory result despite several of the investments being disposed of at a loss and the market value of a few other holdings developing negatively. A contribution to the year's result was the value of a number of holdings being appraised at higher values.

Via the Malmö office, investments have been implemented in, among others, Sörman Information AB in Växjö and Malmö Bildetaljer Invest AB in Malmö.

The office in Umeå has invested in Ekström Management Investment AB in Umeå, SQS Security Qube System AB in Skellefteå, and Norr Sådd Holding AB. Ownership in Nord 2000 Intressenter AB and Adrasoft AB has been wound down.

Fylkinvest AB and Småföretagsinvest AB, in partnership with Nordea/Merita Nordbanken and Swedish Handelsbanken respectively, have both sold holdings and made a number of new investments during the year.

During the year, Rekonstruktionsfunden (the Corporate Reconstruction Fund), established together with Ackordscentralen, has, through the management company Amplico, implemented its first corporate reconstruction and sale with a positive result.

By continually taking advantage of experience of profitable and less profitable investments, Industrial Ventures' investment process is continually developed. A few of the most important factors to be a successful owner are as follows:

- Knowledge about the company, the sector, and the surrounding factors that affect the company's development.
- Continually defining and measuring every company's critical success factors.
- A focus on the ownership plan, which shall define exit opportunities and what is required to reach them.
- Internal and external networks must be maintained and further developed.
- An active ownership role in close collaboration with company management and other owners, which in turn requires influence and a certain holding.

PROSPECTS FOR THE YEAR 2001

While the investment rate shall continue to be high, the ownership process shall receive high priority. Work to profile Industrial Ventures as a knowledge-based organisation for small and medium companies in terms of expertise, networks, and capital continues. Resources, involvement, and knowledge will be concentrated on a number of selected sectors. This is in order to better be able to contribute to companies' development.

BUSINESS SUPPORT FUNCTIONS

The Fund's central functions – adapted to the complex business flow – are summarised under the name Business Support. Below we describe the individual functions and their respective roles in operations.

Control and Risk Management is to be seen as the Fund's quality assurance, as its task is to provide continual follow-ups of risks taken.

Finance is responsible for internal and external accounting.

Back-office check transaction notes, follow up transactions, and are responsible for daily contacts with banks and the Fund's business associates.

The IT environment within the Fund is well developed and characterised by speed and complexity. Simple interfaces ease the use of advanced portfolio management systems.

Legal supports the Fund's Investment Managers with advice during all investment process phases.

Business development co-ordinates the Fund's strategy work and contributes with surrounding factors analyses of the private equity market.

Business Support is also responsible for the functions personnel and office administration.

The investment process

Investments in unlisted companies comprise a work-intensive and time-consuming process, which can be divided into four phases, as shown in the illustration below.

The Business Flow Process

In the first phase, contact is made with the companies showing interesting potential. This is done via the Fund's network and via evaluations of proposals from the companies.

The Negotiation Process

Once the company's potential has been evaluated, a suitable price level is decided and negotiations are entered. Before a final decision concerning investment, consensus with the other owners concerning, for example, management culture and strategic goals, is ensured.

The Ownership Process

Activity and expertise in the role as owner are cornerstones of the Fund's work method. The Fund works actively – among other methods, via the company's board of directors – in order to create long-term value development. Via its network, the Fund can often provide external expertise and contribute to the creation of new alliances.

The Disposal Process

In the final phase, the Fund disposes its holding. This is achieved by selling to another long-term owner or via a stock market introduction. In the latter case, the Fund can remain an owner of the listed holding.

RISK MANAGEMENT OF ASSET MANAGEMENT

Risk management of Asset Management is performed on a daily basis by following up different risk measurements. Below are descriptions of Tracking Error and the Sharpe Ratio, which are two of the measurements used. How financial risks are to be managed is decided by the Fund's financial policy.

The financial policy specifies frameworks for operations and concrete guidelines for managing financial risks. In order to keep the financial policy in phase with developments in the finance market, it is revised on an annual basis.

RISK CONTROL OF ASSET MANAGEMENT

Risk management is based on information from the Fund's portfolio management system. All business deals are registered in the system. Every week, the MD receives a risk report, which provides a recurrent point during board meetings. Risk reporting is concentrated on the share price risk, that is, the most important market risk for the Fund. Other risks, however, are also reported – for example, interest, liquidity, and credit risks.

MANAGING SHARE PRICE RISKS

Asset Management's portfolio is comprised to a large extent of shares. The focus is therefore on the share price risk. This is measured in relation to a comparative index, the SIX Returns Index.

Active risks occur when the portfolio deviates from the comparative index – that is, when an active position is created. The active risk is managed by limiting the room for active positions. The room is specified in the finance policy by defining the allowed deviations. The share that each sector represents in the Fund's total portfolio is compared with the relative weighting that each sector has in the comparative index.

As mentioned previously, the Fund uses the SIX Returns Index as a comparative index. The sector weightings are related to the sector weightings specified in Affärsvärlden's General Index. As of 1st February 2001, Affärsvärlden is to change the sector weightings in order to better meet today's sector demands. In the table below, the Fund's weighting is shown in comparison to Affärsvärlden in accordance with the old and new sector divisions respectively.

During the year 2000, the Fund has to an all the more greater extent begun to measure the active risk with the aid of Tracking Errors. Tracking Errors show how the difference between the return from the portfolio and the selected comparative index vary over time. A small variation indicates a low risk in relation to the comparative index, while larger variations indicate a higher risk in relation to the same index. The Fund's strategy is to take active risks, that is, to position itself so as to deviate from the comparative index. The Sharpe Ratio is another measurement that is followed up. This ratio measures the risk adjusted absolute return. The ratio is measured as the portfolio's return reduced by risk-free interest in relation to the portfolio's risk. The measurement is used to follow risk taking and to study whether a higher risk provides a better return.

RESULT 2000

The recorded profit for the year of SEK 2,332 million (1,398) refers to the result realised during the year. The market value result for the year amounts to SEK -428 million (6,672). This result is calculated in order to be able to compare the Fund's return with market development in general and other capital management institutes' results.

The Fund's market value result is comprised of returns in the form of interest, coupons, dividends, and option premiums together with changes in value – realised and unrealised – in the Fund's assets.

The market value loss for the year, before costs, is divided into SEK 870 million (6,283) from the operational area Asset Management and SEK 624 million (504) from the area Investment Operations. Share dividends amounted to SEK 405 million (351). The Fund's administration costs for the year amounted to SEK 122 million (78). A breakdown of the more important cost items can be found under note 3. During 2000, the Fund's results have been charged with fees for external investment managers amounting to SEK 60 million (37), which have been paid to investment companies as remuneration for administrating the investment funds.

RETURNS

The total returns before administration costs for all investments during 2000 amounted to -1.3% (55.8), of which the change in value comprises -14.6 percentage points. The returns for the operational area Asset Management amount to -6.3% (60.4) and for investment operations 17.0% (33.3).

LIQUIDITY

The Fund's readiness to pay is specified in the Finance Policy. It shall normally be equal to, at every specified point in time, the liquid fund needs that the Fund has for the coming quarter.

PERSONNEL

The number of employees within the Fund at the end of the year was 40 (32) persons. Additional personnel information can be found under note 3.

ACCOUNTING PRINCIPLES

The Fund follows the rules contained in the Swedish Law with Regulations for the National Pension Insurance Fund (Lag med Reglemente för Allmänna Pensionsfunden (SFS 1983:1092 with later approved alterations)). The annual report has been produced in accordance with generally accepted auditing standards in Sweden. As of 1 January 2001, the Swedish Law Governing the Sixth Swedish National Pension Fund (Lag (2000:193) om Sjätte AP-fonden) is effective.

ACCOUNTING FOR AND VALUING INVESTMENTS IN LISTED SECURITIES

In the annual accounts, both book values and market values are included for holdings in securities. Interest-bearing securities are valued at acquisition value with accrual accounting of premiums and discounts.

The portfolio method is applied when valuing listed securities, that is, the book value for individual entries is not adjusted, even if the market value for a period drops below the acquisition value, as long as the surplus value of other entries in the portfolio motivate this view.

The acquisition value of shares and other securities includes commissions and other costs.
When calculating capital gains and losses, the average value method has been applied.

The market value is primarily set to the final buying-rate during the final trading day, secondarily to the final selling-rate.

Purchases and sales of all securities are accounted for on the trading day.

The positions of derivative instruments are valued according to the same principles as those applied to the investments for which the market risk is protected or altered.

ACCOUNTING FOR AND VALUING INVESTMENTS IN UNLISTED SECURITIES

Unlisted securities are accounted for at acquisition value. When setting the market value for unlisted securities, the EVCA principle (European Venture Capital Association) is applied, which normally entails using the acquisition value. Exceptions may, according to the principle, be made when the acquisition value is obviously unreasonable.

The Group Accounts have not been prepared as the subsidiaries are of little importance with regard to the demand on a correct representation.

Receivables are accounted for at the value that they are expected to bring in.

The depreciation period for inventories and other tangible assets is 3–5 years.

The Fund is exempt from income tax for investments within Sweden.

The Fund's capital is comprised of the basic capital and book result. The basic capital is comprised of a transfer from the 1st-3rd fund boards and SEK 366 million remaining from the closing down board for Fund 92-94. There are no demands on the Fund transferring the returns to any of the other AP Funds.