P.S. Krøyer's dog, "Rap". Study. 1898. Detail. By Peder Severin Krøyer, one of the Skagen Painters. This image belongs to the Art Museums of Skagen.

SKAGEN Focus

Status Report January 2017

The art of common sense

SKAGEN

Summary – January 2017

- The fund is a highly concentrated equity fund with a broad all-global mandate. The overall objective is to invest in a few select investments with an exceptional risk/reward profile from an absolute return perspective.

- The target number of positions is 30-35 and the top ten positions should constitute 40-50% of the portfolio. At the end of the month, the fund holds 33 positions, and the top ten positions account for 44.5% of the portfolio. The cash position is 6.2%.

- SKAGEN Focus* was up 0.4% in the month (EUR), in line with global equity markets (measured as MSCI AC World) .

- SK Hynix, E-MART and Softbank were the strongest contributors to the fund's performance in January measured as absolute contribution in NOK. Aryzta, Teva and Tesoro were the main detractors during the month.

- After a solid 2016, the fund has continued to receive votes of confidence, in terms of strong inflow. We continued to build up newly initiated position Adient, a US based automotive supplier, during the month. We also increased our position in Carlsberg as we see signs of improved operational conditions for the company going forward.

- The fund has a broad mandate to invest in all geographies and sectors. The fund is also market capitalisation-agnostic, and currently small-cap** positions constitute 15% of the fund, while mid-cap and large-cap positions account for 37% and 48%, respectively. These figures may vary meaningfully over time.

** Unless otherwise stated, all performance data in this report relates to class A units and is net of fees.*
*** Small-cap defined as market cap below USD 2bn, large-cap more than USD 10bn.*

Results as of 31 January 2017

EUR, net of fees

	January	QTD	2016	Since inception*
SKAGEN Focus A	0,4%	0,4%	18,3%	0,3%
World Index*	0,4%	0,4%	11,1%	2,1%
Excess return	0,1%	0,1%	7,1%	-1,8%

Note: All returns beyond 12 months are annualised (geometric return)

** Inception date: 26 May 2015*

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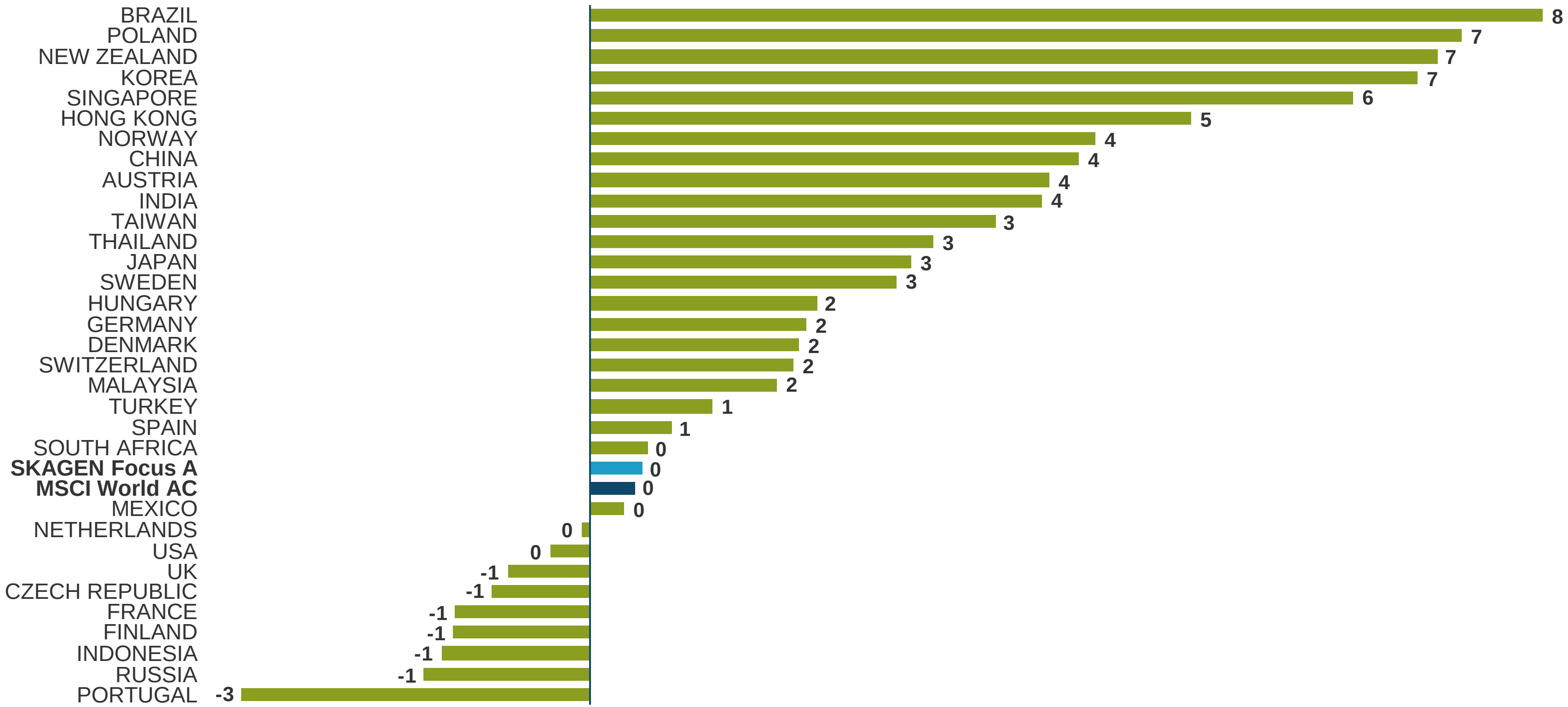
Markets in January 2017 in EUR (%)



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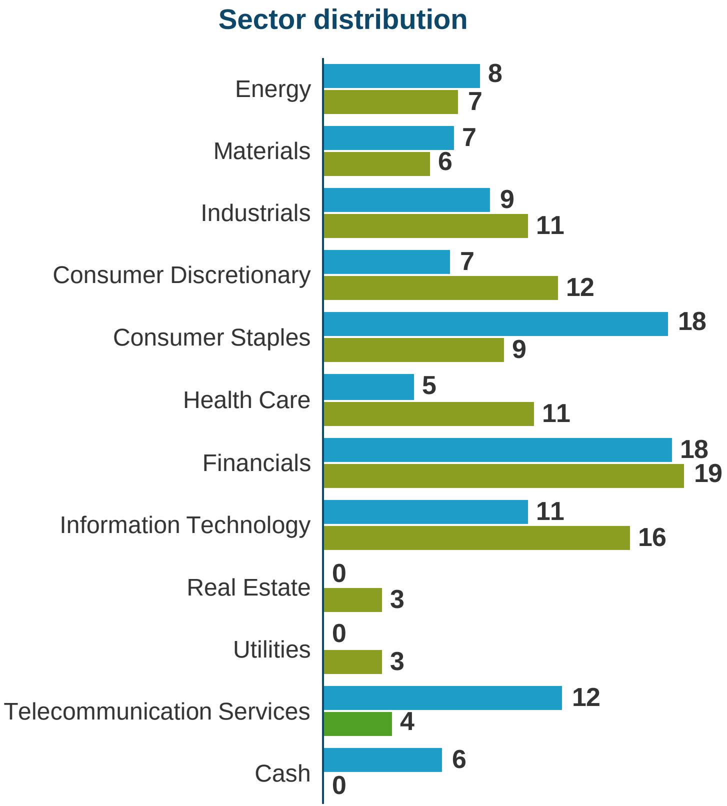
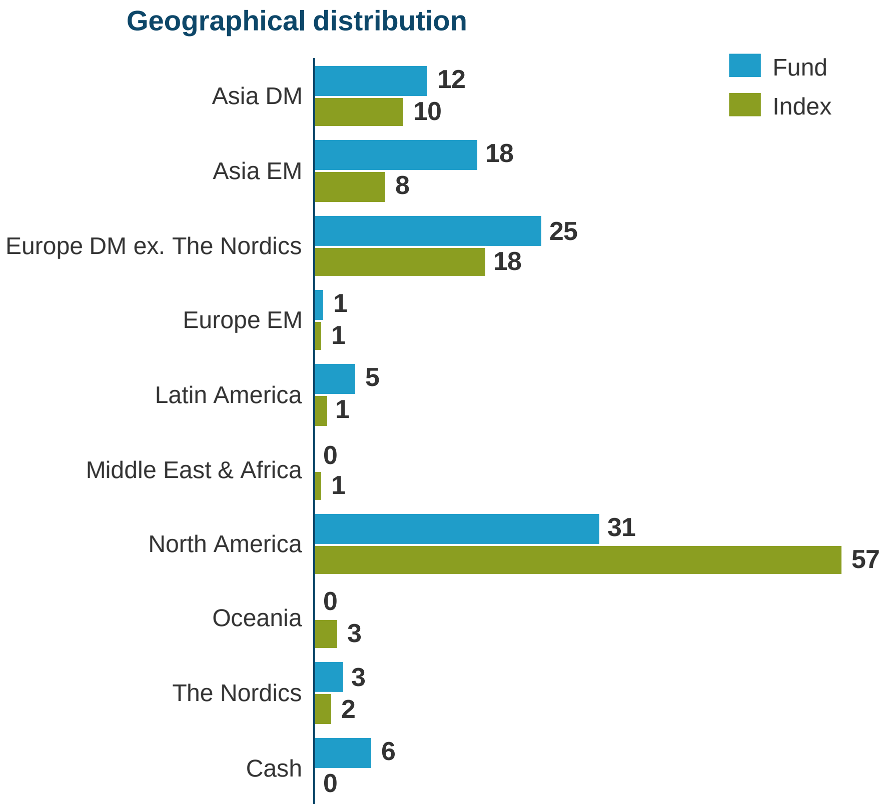
Sector and geographical distribution vs index (Jan. 2017)





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Holdings increased and decreased during January 2017

Key buys

- **Adient –** We continued to increase our position in Adient, a US-based auto-parts supplier, which entered the portfolio last month.

- **Carlsberg –** We increased our position in Carlsberg as we see signs of improved operational conditions for the company going forward.

Key sells

- **Aryzta** – Position was reduced following an unscheduled trading update indicating downward pressure on earnings and poor management execution. See company updates further on for more information.

Largest holdings in SKAGEN Focus

	Price	P/E 2016e	P/E 2017e	P/BV last	Price target	Upside to target %	Holding size, %
American International Group Inc	64,26	20,1	12,0	0,8	90,0	40 %	7,6%
E-MART Inc	203 000,00	14,4	12,8	0,7	270000,0	33 %	4,6%
Jbs SA	11,90	69,2	7,9	1,3	22,0	85 %	4,6%
Telecom Italia Spa	0,80	10,2	11,5	0,8	1,2	51 %	4,4%
Softbank Group Corp	8 701,00	10,6	14,2	4,1	9600,0	10 %	4,2%
SBI Holdings Inc	1 564,00	14,0	14,1	0,9	3000,0	92 %	4,0%
Tesoro Corp	80,85	19,8	12,8	1,7	120,0	48 %	4,0%
Taiheiyo Cement Corp	395,00	9,3	12,6	1,4	495,0	25 %	3,9%
China Telecom Corp Ltd	3,69	15,8	14,0	1,0	8,0	117 %	3,7%
Philips Lighting NV	23,83	10,1	9,7	1,3	30,0	26 %	3,5%
Top 10 positions		**17,8**	**12,5**	**1,0**		**71,5%**	**44,5%**
Total Equity (33 positions)							**93,8 %**
Cash							**6,2 %**
Total Portfolio							**100,0%**

As of 31/01/2017

**JBS is the main owner of Pilgrim's Pride, which is a 0.9% position in the fund. These two positions should be viewed as one, with a total weight of 5.5%.*

Main contributors YTD 2017

Largest positive contributors

Company	NOK (000)
SK Hynix	9 052
E-MART	8 497
Softbank Group	7 901
Taiheiyo Cement	4 073
Schaeffler	3 328

Largest negative contributors

Company	NOK (000)
Aryzta	-20 975
Teva Pharmaceutical Industries	-9 612
Tesoro	-8 578
AIG	-8 337
Whiting Petroleum	-7 611

Value Creation MTD (NOK MM): -34

NB: Contribution to absolute return

Most important changes Q1 2017

Q1 Holdings increased

Carlsberg
China Telecom
Tesoro
AIG
Telecom Italia Spa
Samsung SDI
Philips Lighting
Fila Korea
Taiheiyo Cement
Whiting Petroleum
Synchrony Financial
Schaeffler
Softbank Group
SBI Holdings
E-MART
CIT Group

Q1 Holdings reduced

Aryzta

Key earnings releases and corporate news, January 2017

Schaeffler (3.2% weight)

Investment case update

Schaeffler is a Germany-based automotive/industrial company which is mainly active in engine and transmission systems (75%, auto) as well as bearings (25%, industrial). The company executed an IPO with exceptionally poor timing only days after the Volkswagen emission scandal was announced. In 2016, revenue growth exceeded 3% over last year and EBIT came in at EUR 1.7bn with a solid overall margin of 12.7%. Free cash flow generation was substantial at EUR 730m. The main positive development came from the automotive division while the company is currently undergoing a restructuring process in the industrial division. In 2017, the company sees revenue growth of 4-5% and a continued margin in the same range as 2016. Importantly, there was a statement that “several” orders within electric mobility in autos have been received. The company’s high exposure to traditional combustion engines has been a concern for investors. The stock is still trading at a meaningful discount to absolute fair value (EUR 19 in our opinion) and other high quality operators at mid-term EV/EBITDA of 5x and free cash flow yield at 8-9%.

FFP (1.2% weight)

Investment case update

FFP is a French investment company with a diversified portfolio of assets where approximately 90% of the assets are listed. The company is 80% controlled by the Peugeot family and the largest part of the company NAV is the legacy ownership stake in French automaker Peugeot (45% of NAV and 10% total ownership). French aircraft-engine maker Safran is offering EUR 10bn in cash and a potential share swap, at a 25% premium, for Zodiac Aerospace which will unite two of the country’s biggest aerospace groups. Zodiac Aerospace, which has been undergoing a multi-year turnaround, is a substantial part of the FFP NAV at an approximate 13% weight in latest reports. Even before this positive development, we believe the stock was trading at an unwarranted discount to fair value. The discount may be a result of the scarce coverage of the stock, lower liquidity/free float or general scepticism around the company’s core position in auto-maker Peugeot. We think at least a few of these factors have the potential to change for the better in the mid-term.

Key earnings releases and corporate news, January 2017 (cont.)

Teva
(3.3% weight)

Investment case update

Negative, but in line with expectations for this deep value case. After losing Copaxone lawsuits on patents #1-3 in 2016, we (and the market) largely expected the judge to invalidate patent #4 as well. However, the litigation saga is not yet over as Teva may appeal this verdict and thus prevent competitors from launching generic products for another 12+ months. Additionally, Teva has patents #5 and #6 that have not yet been ruled on by a court of law, so any generic competitor which chooses to take the risk of selling a generic copy of Copaxone at this point may face material damage claims if patents #5 and #6 were to be upheld. Note that patent #5 was issued as recently as Aug 2016. It is also unclear how many generic competitors would and could enter the market (they still need FDA approval for the generic version). From a financial point of view, losing exclusivity on the high margin Copaxone drug (>80% GM vs. generics c.50%) would obviously impact group margins and earnings negatively. In early January, Teva guided that the launch of two generic Copaxone 40mg products would reduce the group's USD 4bn Copaxone revenues by USD 1bn and EPS by c.15%. While this sounds and is negative, we note that the share has priced in significantly negative news and the Teva share has actually already recouped the loss (-3%) it suffered on the day of the court verdict.

Fact

A US court has invalidated Teva's #4 patent on 40mg Copaxone, potentially allowing generic competitors to launch at risk. Teva will appeal the decision.

SBI Holdings
(4.0% weight)

Investment case update

Minor positive. Financial Services Business showed a growth of 7% despite a 20% drop in transactions in Tokyo and Nagoya (though only 10% for SBI). The rise in revenue came from FX, banking and insurance and thereby mitigated the fall in profit to only 0.8% YoY. The volatility in markets and FX is positive for the transaction-based business and they highlight the continued political unrest in the West as providing good potential for better earnings. The Asset Management Business (confusingly named SBI Savings Bank), showed positive signs and recorded a rise in of 270% stemming mainly from better performing loans (re-valuation of book and incorporation of Kora banking). Biotech continued to lose money due to more clinical trials – on the positive side they have manage to recoup some cash on milestone payments and licensing agreements.

Key earnings releases and corporate news, January 2017 (cont.)

Synchrony Financial (2.5% weight)

Investment case update

The company is the leading US provider of private label credit cards (42% market share in the US), and also offers solutions in consumer financing/healthcare. Synchrony was fully separated from GE in November 2015 after being part of GE Capital for over 80 years. The company operates through three main platforms; Retail Card, Payment Solutions and CareCredit. In Q416, net interest income increased by 13% YoY, driven by growth in receivables. Total purchase volume was up 9% YoY, driven by an 8% YoY increase in retail card purchase volume. Payment solutions volume increased 15% YoY while Care Credit volume increased 10%. Total operating expenses increased 6% YoY, driven by higher marketing expenses. Net income rose by 5% YoY. The company continued its share buyback during the quarter, buying back USD 238m in common stock during Q4. Management's 2017 guidance was strong and calls for 7-9% loan growth, a net interest margin of 15.75%-16.00% and credit losses only modestly higher than 2016. Investors may still be overlooking the fact that Synchrony is vastly overcapitalised relative to regulatory requirements and to its peer group which we think will bring outsized opportunities to return capital to shareholders in the mid-term.

Fact

The company reported Q416 net interest income of USD 3.9bn, up 12% YoY. Net earnings of USD 576m, up 5% YoY. Deposit growth was 8% and comprised 72% of the total funding, up from 64% last year.

Aryzta (1.3% weight)

Investment case update

Swiss bakery company Aryzta released an unscheduled trading update, flagging that EPS will come in 20% below the previous year's level leading to a sharp decline in the share price. The key issue has been the loss of co-pack volumes in North America (43% of sales). In essence, the company's efforts to market its cookie brand Otis Spunkmeyer in the snack category have been noticed by Aryzta's bakery competitors. These competitors have responded by no longer outsourcing their own production to Aryzta. The magnitude of this impact and the timing, following confirmed guidance 2 weeks ago and their CMD during end of October where they confirmed US stabilisation, make the shock worse. In addition to the volume decline, the company experienced negative operating leverage and wage pressure, meaning that operating margins in North America look to fall 500-600bps to 6-7%.

Prior to this event, management had low credibility in the market following several years of mismanagement and poor communication. This last stunt obviously destroyed any credibility that was left. On the positive side this could speed up the ongoing strategy review being carried out by the group's new chairman, former Smurfit Kappa CEO Gary McGann. We believe the exit of Aryzta's CEO would be a positive catalyst for the share price. As leverage is high, we think an exit from Aryzta's 49% stake in French frozen food retailer Picard (purchased for EUR 450m), would be regarded as positive and help to strengthen the balance sheet.

Fact

The company released an unscheduled trading update where they see full year EPS coming in 20% below the prior year (vs. earlier guidance of +2% growth).

Key earnings releases and corporate news, January 2017 (cont.)

CIT Group (2.7% weight)

Investment case update

The US specialty finance conglomerate CIT reported a Q416 with several non-recurring items mainly related to the divestment of commercial air and goodwill impairment, which resulted in an overall loss. However, below the surface, rental and finance income were fairly flat over last year while the net finance margin decreased marginally to 3.6%. Core return on equity remains depressed at low single digits. Tangible book value decreased to USD 46/share. Credit quality was a positive as non-performing loans and charge-offs fell, which has been a concern for investors. Capital ratios remain high with common tier one at 13.8%. The sale of commercial air announced last year will free up as much as USD 3.3bn (40% of market cap) and will be distributed to shareholders during 2017, possibly through a tender offer. The core regional bank, the old One West franchise, is currently under-earning compared to other similar regional banks and fundamentally should be able to reach peer group profitability in the mid-term. The equity is trading below book value and with further simplification of the corporate structure combined with peer group profitability in the bank there is substantial upside to the current equity price.

Fact

CIT announced a Q416 net loss of USD 424m from continuing operations (excl. commercial air). Adjusted for non-recurring items, net income was USD 196m (USD 0.97/share).

Philips Lighting (3.5% weight)

Investment case update

Philips Lighting is a spin-off from Royal Philips and a leader in the global lighting industry. Failing a private sale of the company, the company was IPOd in mid-2016 at what we believe to be highly attractive multiples. Royal Philips retains a 70% stake in the company. The company is in the midst of a technology transition in which LED replaces conventional light bulbs and the market is unconvinced that the company will be able to execute this transition successfully.

The company reported a very strong Q416 of EBITA of EUR 188m due to a margin pickup of 180 bps despite a negative 3% sales growth; in addition this was consistent with previous quarters margin expansion, confirming the higher margin level. Furthermore, the company guided for an additional 50-100 bps margin increase in 2017 which we believe is conservative especially if there is growth in organic sales. Surprisingly, due to the 12% high and growing Free Cash Flow, the company announced a cash return to shareholders of 15% of market cap in 2017, via a 7% yield and EUR 300m in share buyback from Royal Philips, amongst others. This will a) lower the share overhang and b) potentially increase free float enough to lead to index inclusion. Meanwhile, the equity is trading at a 30-40% discount to peers.

Fact

The company reported a very strong Q416 of EBITA of EUR 188m due to a margin pickup of 180 bps despite a negative 3% sales growth.

Key earnings releases and corporate news, January 2017 (cont.)

Alphabet
(2.69% weight)

Investment case update

While Alphabet's results continued to show strong progress, both margins and CAPEX have now normalised from “depressed” levels and valuation has increased. The key question is how long the company can sustain its growth. The attractiveness of its business model is easily illustrated by looking at the key highlights in Q4: Revenue 20%+, positive operating leverage, and close to 100% cash conversion. At 21x 2018 earnings and 5% FCF/EV yield (adjusted for stock based compensation) the stock is not expensive given the high growth rate combined with high cash conversion. However, we have started to reduce the position as margin of safety has clearly reduced.

Fact

Alphabet reported strong Q4 2016 results. Overall revenues grew 22% YoY (24% on an FX neutral basis) with continued strong growth in the core sites business (mainly Search but increasingly also YouTube) and “other bets”. Despite worse mix (fastest growing areas like YouTube and “other bets” have lower margins) operating income was up 24% YoY as operating costs continue to grow slower than revenues. Capital intensity has normalised with CAPEX to sales at 13% (down from 20%+ in 2014). The company generated USD 6bn in FCF in Q4 (annualised FCF/EV yield of 4%). While the company is buying back shares, the number of shares outstanding is still increasing modestly (up 1% YoY) due to stock-based compensation.

SK Hynix
(2.8% weight)

Investment case update

Positive. Q4 revenue increased by 26% sequentially and 21% YoY to a historically high level on the back of a strong memory price hike driven by robust demand for bigger storage in mobile devices and computers and supported by a shortage of supply and a weak domestic currency. Operating profit increased substantially QoQ, 112%(!), due to both price increases as well as cost reductions. The chipmaker also benefited from rising NAND memory prices, as demand for 3D chips rose and supply remains limited. As inventory levels are low and the industry remains disciplined on supply additions, a strong pricing environment could continue going forward. Increased supply from China remains a risk but is unlikely to impact pricing until late 2018. An increased proportion of production from their new 21nm plant (the company’s most recent investment) and improving yields, should benefit profitability from here. The stock has been strong so far this year, up almost 20% following a good 2016. We have decreased the position.

Fact

The company reported Q4 2016 sales of KRW 5358bn with an operating profit of KRW 1536bn and EBITDA of KRW 2677bn.

The 10 largest companies in SKAGEN Focus

AIG is an international insurance company serving commercial, institutional and individual customers. The company provides property-casualty insurance, life insurance and retirement services. AIG was at the very centre of the financial crisis as the central bank for mortgage insurance – it was bailed out in a USD 180bn bail out. The company has two core insurance holdings: Sun America and Chartis that it intends to keep.

E-MART Inc. operates E-Mart discount stores. The company retails food, clothing, household goods, electronics, and other items through several branch stores. Revenue breakdown: E-mart offline 70%, Traders 6% (wholesale), E-Mart mall/online 5%, Hotel 16%, With Me (convenience format/CVS) 3%. Market share 48% in core discount format in South Korea.

Brazil-based JBS has transformed itself from a mid-sized local beef producer to the world's largest animal protein processor in just a few years since its IPO in 2007. It is now the world's #1 beef, #2 poultry and #3 pork producer by sales. The company operates in six main segments: JBS USA Beef (40% of sales, US beef processing), Moy Park (14%, UK-based chicken and foodservice provider), Pilgrim's Pride (14%, 2nd largest chicken producer globally; separately listed in the US; PPC US, JBS ownership 75%), JBS Mercosul (13%, Brazil-based beef processing), JBS USA Pork (10%), JBS Foods (9%, prepared foods and poultry processing).

Through subsidiaries, Telecom Italia S.p.A. offers fixed line and mobile telephone and data transmission services in Italy and abroad. Telecom Italia is a former state telecommunications monopoly. The company has two main operations: Domestic telecom (75% of revenues) and a majority stake in TIM Participacoes (25% of revenues, 67% owned), Brazil's second largest mobile operator.

Japan-based Softbank is a telecom and internet conglomerate. The company's main assets are 1) the Chinese online giant Alibaba Group (32% holding). Alibaba is the leading online commerce platform in China, active both in retail and wholesale; 2) US-based telecom operator Sprint (80% ownership) which provides wireless services in the US and is the third largest wireless network operator after Verizon and AT&T; and 3) domestic telecoms (mainly Softbank Mobile, third largest telco in Japan after KDDI and NTT Docomo).

The 10 largest companies in SKAGEN Focus (cont.)

Japanese company established in 1999 as an online financial services company and incubation arm of Softbank. Acquired E*Trade Securities in 2003, Softbank sold out in 2006. Three main businesses: i) Financial services; ii) Asset management, iii) Biotech Financial services. Building an ecosystem to offer a full range of financial services: SBI Securities: Dominant provider of online securities services in Japan, #3 in new tax-saving NISA behind Nomura and Daiwa. SBI Sumishin Net Bank: pure-play internet bank. Also active within insurance (Life & Non-life), Mortgages (through securitisation), trading system and FX trading.

Tesoro Corporation refines and markets petroleum products and provides transporting services. The company operates refineries, as well as a network of retail and refueling stations in the western United States. Tesoro also markets gasoline and diesel fuel to independent marketers and commercial end users.

Largest cement company in Japan and 13th largest globally with approximately 40m tons total capacity (about 60% in Japan). Japanese cement market is an oligopoly with three players following consolidation. Geographic revenue mix: Japan 80%, US 15%, Other 5% (Singapore, Vietnam, HK, Philippines, Australia). Segment revenue mix: Cement 65%, Mineral resources 10%, Environmental business 8%, Construction materials 10%, Other 7%); private/public 50/50. Integrated with minerals business providing large part of internal raw material needs.

China Telecom is a full services integrated information service operator in China. The company, along with its subsidiaries, is engaged in the provision of basic communications services, including wireline telecommunications services, mobile telecommunications services, value-added services, such as Internet access services, integrated information services and other related services. China Mobile, China Telecom and Unicom are the largest and dominant service providers in the country. China Telecom is the growing 2nd player behind China Mobile in a maturing industry, yet with massive growth in data downloads.

Philips Lighting was spun off from Royal Philips and is the global market leader in the c. EUR 70bn lighting industry. Total sales of EUR 7.5bn roughly split between 43% LED/57% Conventional lighting (2015). Industry in the midst of a technological transition in which traditional bulbs are being replaced by LED. As a result LED share of sales will be more than 50% in 2016. Business model is also changing from in-house production selling to distributors (old lamps) to outsourced production and direct solution selling which includes professional services and long-term contracts.

For more information please visit:

Our latest Market report
Information on SKAGEN Focus A on our web pages

Unless otherwise stated, performance data relates to class A units and is net of fees.

Historical returns are no guarantee for future returns. Future returns will depend, inter alia, on market developments, the fund manager's skill, the fund's risk profile and subscription and management fees. The return may become negative as a result of negative price developments. KIIDs and Prospectuses for all funds can be found on our website.