SKAGEN Focus

Status Report October 2016

The art of common sense

SKAGEN

Summary – October 2016

- 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 36 positions, and the top ten positions account for 41% of the portfolio. The cash position is 7.2%.

- SKAGEN Focus* was up 1.1% in the month measured in EUR, while the global equity markets (measured as MSCI AC World) were up 1.2%. In 2016, the fund is up 10.4% while the global equity markets are up 4.1%.

- AIG, Citizens Financial and First Quantum were the strongest contributors to the fund's performance in October measured as absolute contribution in NOK. JBS, TerraVia and Fila Korea were the main detractors during the month.

- During the month we increased our positions in US-based Whiting Petroleum and Korean discount retailer E-mart. We continued to reduce our exposure in Australian mining company South32 following a strong re-rating of the shares.

- 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 21% of the fund, while mid-cap and large-cap positions account for 45% and 34%, respectively. These figures may vary meaningfully over time.

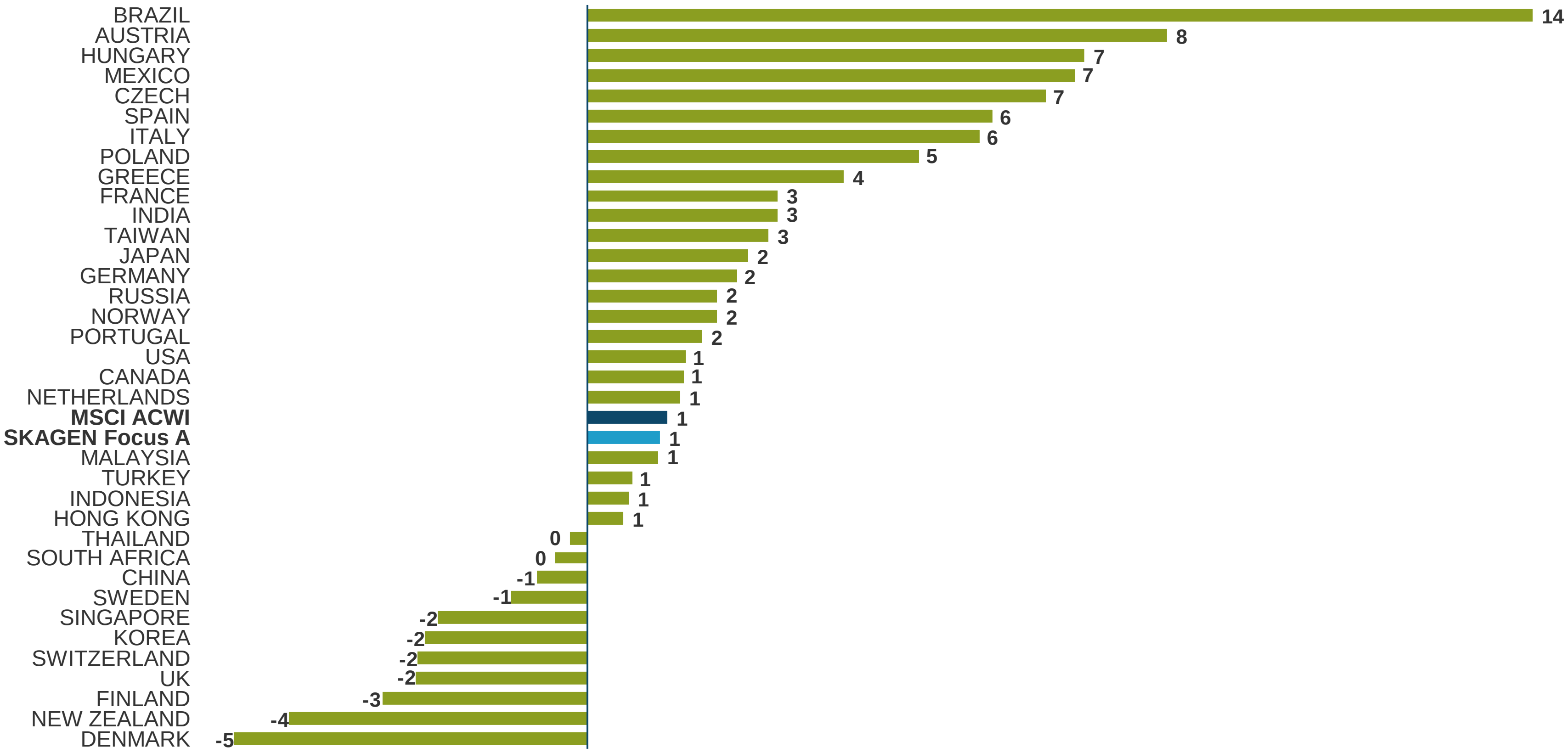
** Unless otherwise stated, all performance data in this report relates to class A units and is net of fees.*
*** Small-cap defined as market cap below USD 2bn, large-cap more than USD 10bn.*

Results, October 2016 in EUR

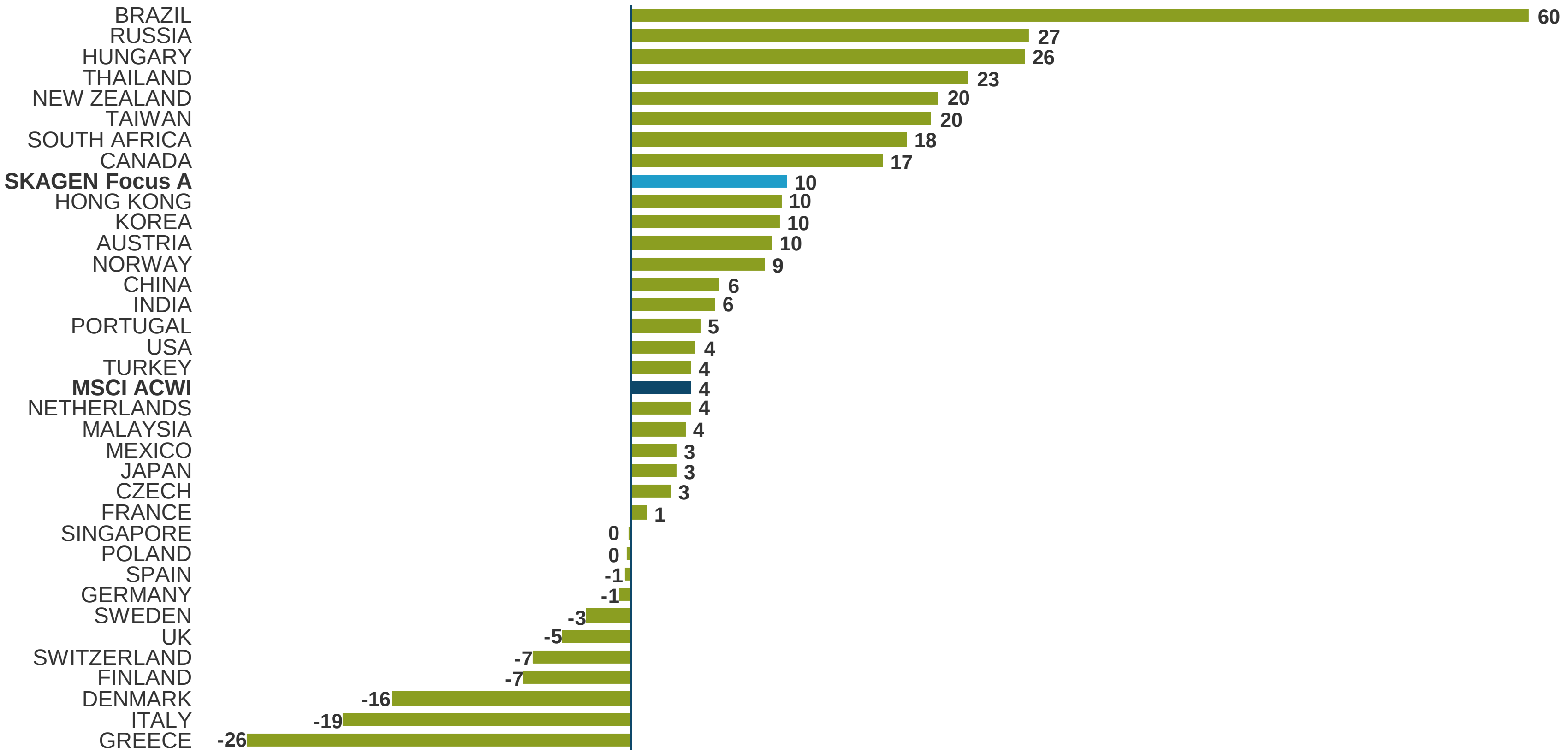
	October	QTD	YTD	Since inception*
SKAGEN Focus A	1,1%	1,1%	10,4%	-4,7%
World Index*	1,2%	1,2%	4,1%	-2,4%
Excess return	-0,1%	-0,1%	6,3%	-2,3%

Note: All returns beyond 12 months are annualised (geometric return)
** Inception date: 26 May 2015*

Markets in October 2016 in EUR (%)



Markets YTD 2016 in EUR (%)



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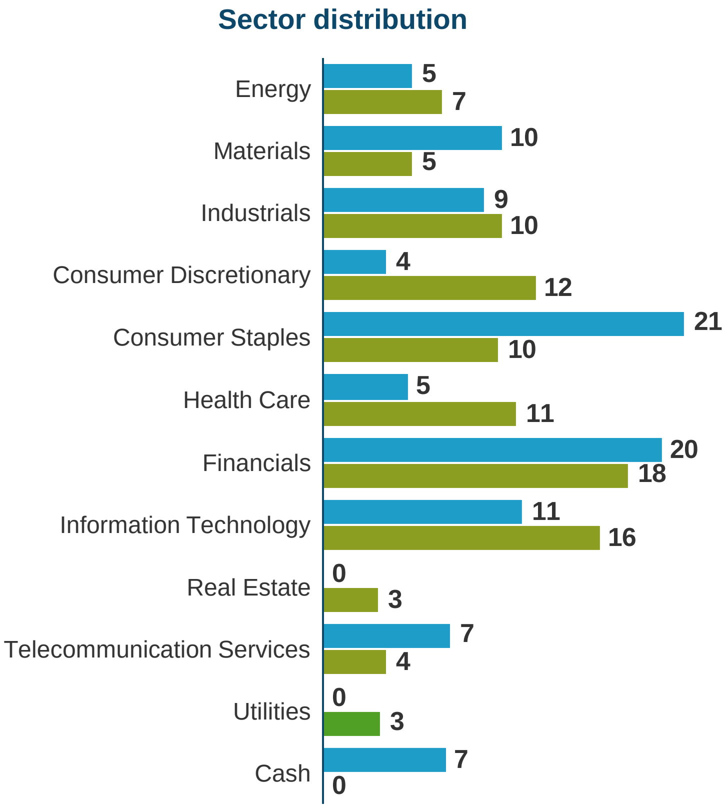
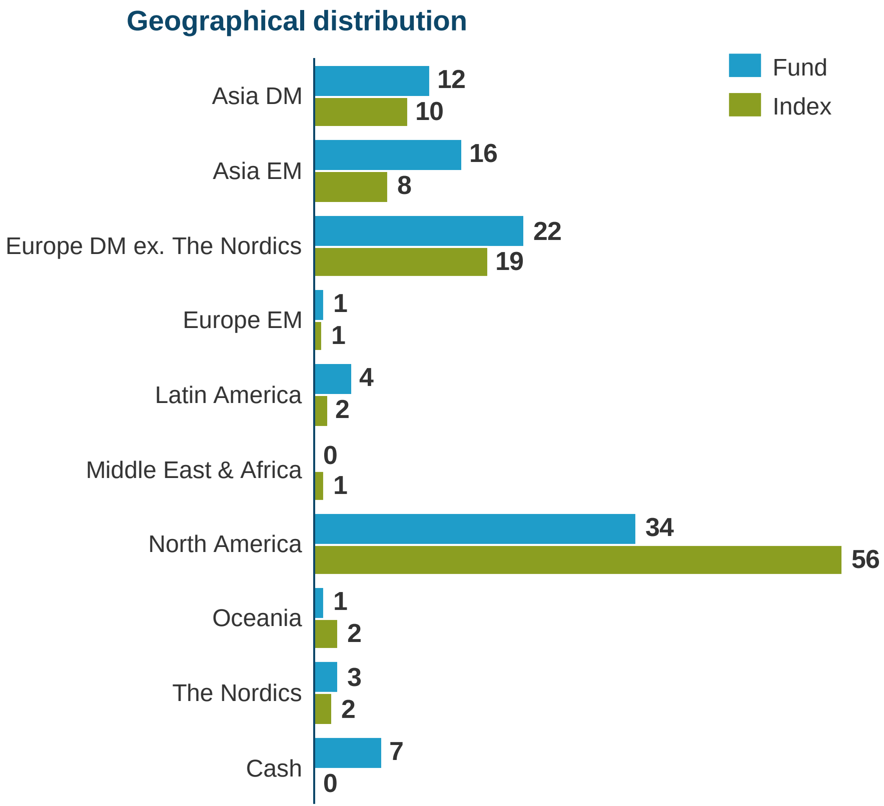
Sector and geographical distribution vs index (Oct. 2016)





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Holdings increased and decreased during October 2016

Key buys

- **Philips Lighting** – increased the position on weakness after the company reported solid earnings numbers in combination with substantial free cash flow.
- **Whiting Petroleum** – increased the position on the back of improved overall business fundamentals and de-risked balance sheet.
- **E-Mart** – increased the position towards target weight as the shares continue to trade at a highly attractive valuation.

Key sells

- **South32:** The stock continues to climb higher following solid FY16 results. These are its first results as a stand-alone entity after being spun-off from BHP. Position size reduced.
- **AerCap:** Although the company still trades at attractive levels in terms of valuation, catalysts for re-valuation are now harder to identify. Position size reduced.
- **SK Hynix** - Following a major re-rating of South Korean semiconductor manufacturer SK Hynix, we continued to reduce the position size. Behind the strong price gain in Hynix is normalisation of DRAM and NAND prices supported by low inventory levels and better demand/supply dynamics.

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	61,70	15,7	11,3	0,7	90	46 %	7,7%
Softbank Group Corp	6 602,00	7,5	10,9	3,1	9600	45 %	4,4%
Infineon Technologies AG	16,36	23,0	20,3	3,8	20	22 %	4,1%
Jbs SA	9,71	46,9	6,5	1,1	22	127 %	4,0%
Taiheiyo Cement Corp	301,00	8,3	9,1	1,2	420	40 %	4,0%
SBI Holdings Inc	1 250,00	11,2	11,2	0,7	3 000	140 %	4,0%
Teva Pharmaceutical-Sp ADR	42,74	8,2	7,3	1,7	90	111 %	3,3%
Schaeffler AG	13,78	9,0	8,4	6,3	19	38 %	3,3%
Philips Lighting NV	21,36	10,7	9,5	1,3	30	40 %	3,2%
Citizens Financial Group Inc	26,34	13,8	12,5	0,7	35	33 %	3,1%
Top 10 positions		**11,9**	**9,9**	**1,2**		**63,1%**	**40,9%**
Total Equity (36 positions)							**92,8 %**
Cash							**7,2 %**
Total Portfolio							**100,0%**

As at 31/10-2016

**JBS is the main owner of Pilgrim's Pride, which is a 2.5% position in the fund. These two positions should be viewed as one, with a total weight of 6,5%.*

Main contributors October 2016

Largest positive contributors

Company	NOK (000)
AIG	8 065
Citizens Financial Group	4 433
First Quantum Minerals	4 408
China Telecom	2 433
Infineon Technologies	2 400

Largest negative contributors

Company	NOK (000)
Jbs	-8 036
TerraVia Holdings	-4 014
Fila Korea	-3 832
Philips Lighting	-3 650
Teva Pharmaceutical Industries	-2 739

Value Creation MTD (NOK MM): 22

NB: Contribution to absolute return

Main contributors YTD 2016

Largest positive contributors

Company	NOK (000)
South32	26 777
Pan American Silver Corp	23 180
AirAsia BHD	20 030
First Quantum Minerals	16 232
Haitai Confectionery & Foods Co Ltd	15 971

Largest negative contributors

Company	NOK (000)
Teva Pharmaceutical Industries	-10 901
Magforce	-6 601
Crown Confectionery	-6 537
Uniqa Insurance Group AG	-6 191
Aercap Holdings	-5 305

Value Creation YTD (NOK MM): 69

NB: Contribution to absolute return

Most important changes Q4 2016

Q4 Holdings increased

Samsung SDI
Whiting Petroleum
Fila Korea
Philips Lighting
Taiheiyo Cement
Jbs
E-MART
Stock Spirits Group
Teva Pharmaceutical Industries
Massimo Zanetti
FFP

Q4 Holdings reduced

South32
AerCap Holdings
Sk Hynix
Pilgrim's Pride

Key earnings releases and corporate news, October 2016

JBS
(4.0% weight)

Investment case update

Brazil-based JBS has transformed itself from a mid-sized local beef producer to one of the largest food companies in the world since its IPO in 2007. Today it has a leading global market share position in beef, poultry (through 76% owned Pilgrim's Pride in the US) and pork. Our position in JBS was initiated at the end of 2015, on the basis of an attractively valued asset at a major discount to its peer group and its economic value with normalisation of beef margins as well as a shift towards prepared food as potential catalysts. Valuation was pressured by a depressed climate for Brazilian assets in general and an excessively sized derivative position in the company to hedge its USD-denominated debt. In an effort to remove the valuation discount in its shares and enjoy lower financing costs, JBS sought to list its international activities in the US (in a new company) while the Brazilian activities would remain listed in in Brazil. This was announced in May 2016 and triggered a positive share price reaction. Now, BNDES, a state development bank and one of the shareholders of JBS, has delivered its veto against the transaction on the basis of a shareholder agreement. It is at this point not entirely clear what the reasons behind the veto from BNDES are, but it was formally stated that "denationalisation" of the company would not be in the interests of the country or shareholders. The shareholder agreement is valid until 2019. While this is unfortunate, we think that JBS has several other avenues to crystallise value, for instance through separate listing of its units (JBS USA, Seara or Moy Park) which does not rely on an approval from BNDES. The investment case remains based upon an operational turnaround, including a partial recovery in beef margins, better capital discipline and a substantial undervaluation of the shares, now back to below 5x EV/EBITDA forward multiples.

Taiheiyo Cement
(4.0% weight)

Investment case update

Taiheiyo Cement is the largest cement company in Japan, which also has a fairly sizable presence in the US (primarily California). Despite a fairly negative consensus and a depressed domestic cement market, the company announced a positive forecast revision for 1H17. The improvement is mainly due to an improved cost base while domestic cement volumes were indicated to come in line with earlier depressed forecasts. Furthermore, the sale of the stake in Korean operator Ssangyong will positively impact net income and strengthen the company's cash position. The company also announced a share buyback and is looking to acquire 35m shares (3% of outstanding) over the next 3 months. The shares, at the current discounted levels of 5x EV/EBITDA or 8x forward earnings multiple, indicate a substantial equity upside at current earnings capacity. However, we believe there is a decent probability that the market might underestimate the opportunities to cut costs and the potential of a more favourable operating environment in the domestic market as well in the US. Taiheiyo is trading at half the multiples of several US-listed peers, where the market already seems to anticipate an increase in infrastructure spending.

Fact

Operating profit 1H17 was revised to JPY 21bn (from 18.5bn) and a share buyback of 35m shares (3% of outstanding shares) was announced.

Key earnings releases and corporate news, October 2016 (cont.)

Citizens Financial (3.1% weight)

Investment case update

The company is the 13th largest regional bank in the US. After suffering from a long period of mismanagement within Royal Bank, the company is now on a quest to reach at least peer group profitability in its core operations from still quite low levels; capital levels are also meaningfully higher than its peers. The company reported third quarter numbers with a solid return on average tangible equity, a key metric for the company's profitability, which increased to a level of 8.0% (6.6% during the same period last year and 7.3% during the previous quarter). The improvement was mainly driven by an increase in the net interest margin despite no help from interest rates, a 7% YoY average loan growth with strength in both commercial and retail, controlled expenses and fee income growth. The company continues to execute its strategy towards better profitability by continuing to grow its loan base, investing in fee-based businesses and controlling the cost base. The stock is trading below tangible book value and the balance sheet is still overcapitalised (well above regulatory requirements and with a CET1 ratio 10% above peer level). Assuming the company manages to improve profitability closer to peer group levels of around 10%; the upside in the equity is towards 1.0x book value or ca. USD 35 per share. This would equal 13x EPS of USD 2.6 in 2017-2018.

Fact

The company reported Q316 total revenue of USD 1.4bn and net income of USD 278m (up from USD 220m in earnings during the same period last year). Return on tangible equity increased to 8% vs 6.6% during the same period last year and 7.3% the previous quarter.

Alphabet (2.6% weight)

Investment thesis update:

Alphabet's results showed progress on all key aspects of our investment thesis. i) Revenues continued growing 20%+ ii) Capital intensity continued to decline, and iii) Headcount growth is slowing down. The combination of high growth, stable margins, and reduced CAPEX intensity resulted in FCF doubling YoY.

Facts

Alphabet reported better than expected 3Q 2016 results. Overall revenues grew 20% YoY (23% on FX neutral basis) with continued strong growth in the core sites business (mainly Search but increasingly also YouTube) and "other bets". Headcount growth continued to grow slower than top-line, leading to stable margins despite mix shift (fastest growing areas like YouTube and "other bets" have lower margins). Capital intensity also continued to drop with CAPEX to sales at 11% (down from 20%+ in 2014). The combination of high growth, stable margins, and reduced CAPEX intensity resulted in FCF generation doubling YoY.

Key earnings releases and corporate news, October 2016 (cont.)

CIT Group (2.1% weight)

Investment case update

The US specialty finance conglomerate CIT announced the sale of its aircraft lease business to Chinese-owned Avalon Holdings for USD 10bn including debt, which equates to a price/book value of 1.2x. On the positive side, the company also received a "non-objection" from the Fed to return up to USD 3.3bn to shareholders (total market cap is currently USD 7.3bn) in conjunction with this transaction. Most of the company's tax loss carry forwards will be used in the transaction. Both the price tag and the capital return exceed most expectations. Since emerging from bankruptcy in 2010, CIT has been an underperforming asset with an odd mix of businesses. The new management team is focused on further streamlining and simplifying and future activities may include a sale of the rail-car leasing business. 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 sharply below book value and, with further simplification of corporate structure combined with peer group profitability in the bank, there is substantial upside to current equity price.

Fact

CIT announced the sale of C2 Aviation to Chinese-owned Avalon Holdings for USD 10bn including debt. The transaction is expected to close in Q117.

Philips Lighting (3.2% weight)

Investment case update

Philips Lighting is a spin-off from Royal Philips and a leader in the global lighting industry. Having failed to sell the company privately, the company was IPO'd in mid-2016 at what we believe were 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 old conventional lamps and the market is unconvinced that the company will be able to execute this transition successfully. In Q316, overall sales declined (comparable basis) 3% over last year, while adjusted EBITA rose 25% at 10% EBITA margin compared to 7.5% last year. Free cash flow was EUR 164m which exceeded most estimates. Lamps fell 13% but EBITA increased 15% driven by rationalisation and procurement savings. LED sales increased 11% which supported a 60% rise in EBITA. There was an overall disappointment in Professional where sales fell 4% on a comparable basis, mainly due to weakness in Middle East and Turkey. LED sales are now more than half of total revenue. The investment case centres around improving margins with higher returns and solid potential for free cash flow generation which was all delivered upon in the quarter. Meanwhile, the equity is trading at EV/sales of 0.6 – 0.7x (30-40% discount to peers) and has the potential to deliver free cash flow yields above 10% in the mid-term.

Fact

In Q316, sales fell to EUR 1.7bn (-3% over last year). EBITA rose 25% to EUR 175m (adjusted margin of 10%). Generated free cash flow was EUR 164m in the quarter.

Key earnings releases and corporate news, October 2016 (cont.)

Stock Spirits
(1.8% weight)

Investment case update

Stock Spirits is a branded spirits (primarily vodka) and liqueurs business focused on Central Europe, mainly Poland, the Czech Republic and Italy. Following deeply disappointing results, primarily from the core Polish operation, the company is in the midst of a turnaround of its operations with cost-cutting initiatives, change of top management and numerous initiatives to win back market share in Poland. These activities have been more or less initiated by activist investor Luis Amaral, who now has a 9.7% stake in the company. The activists have managed to replace the CEO and also secure two board seats in the company. Now, the company has announced the acquisition of three spirits brands from Bohemia for CZK 135m. Although quite small in size, we think this represents a first positive step by the recently appointed management team as the company sits on a substantial cash balance which allowed them to pay an extra dividend this summer. Activist Luis Amaral also recently expressed an intention to increase his stake to be able to increase influence and push for a corporate restructuring, including moving the headquarters/management location from London closer to its home markets in Eastern Europe. Although things are still at an early stage, we see positive signs of change with the activists involved and continued signs of a fundamental business turnaround. The company has a highly discounted valuation (30-40% to peer group) and we see scope for further re-valuation in the mid-term. Our price target is GBP 2.6 (current price is GBP 1.5) which is 12x mid-term EV/EBITDA multiple.

Fact

The company announced an acquisition of three spirits brands from Czech Bohemia for CZK 135m.

Aryzta
(3.0% weight)

Investment case update

Swiss bakery company Aryzta hosted its first capital markets day (CMD) in 6 years recently after reporting full-year results with solid free cash flow generation. Management has particularly low credibility in the market following several years of mismanagement and poor communication. Signs of stabilisation in North America and improved governance through a newly appointed chairman have now turned the investment case back in the right direction after a difficult period. The CMD comes as an attempt to restore investor confidence and took place at the Maidstone Bakery, a 480k square foot facility located in Brantford, Ontario. This is one of the flagship bakeries in Aryzta's North American network. The factory is a highly automated, efficient and well-invested bakery (currently producing 18m donuts a week!). During the CMD, management confirmed its mid-term targets to unlock an additional EUR 1bn of sales, EUR 250m of EBITDA and recurring FCF of at least EUR 225m-275m per year from the current asset base. There were also discussions around the fact that the industry in North America has reached a regulatory inflection point with the forthcoming implementation of the Food Safety Modernisation Act, a move which will enhance the prospects of well-invested operators like Aryzta.

As of 2015, Aryzta owns a 49% stake in French frozen food retailer Picard, an acquisition that has been questioned by investors due to the mismatch of business strategies. Aryzta has a call option to acquire the remaining 51% for an estimated cost of EUR 2.5bn. During the CMD management mentioned, for the first time, that this controversial plan of fully acquiring Picard will be put under review. We believe this to be a major positive as a potential acquisition would severely increase leverage (which is now above 3x ND/EBITDA) and increase risks at this point. Led by the new chairman and supported by the company's confirmed free cash flow ability, we see a renewed basis for potential change around the corner.

Key earnings releases and corporate news, October 2016 (cont.)

MagForce (1.6% weight)

Investment case update

MagForce is a German medical technology company which uses innovative therapy in the treatment of solid tumour cancers with clear advantages compared to traditional treatment methods (see previous fund updates for more information). As expected, the company reported showing some improvement in revenues in 1H2016, while still being loss-making. The share price has suffered due to lack of progress with commercial treatments in Europe, which has been the main concern. Without further progress here it is hard to see the company becoming self-sustaining from a cash perspective. Although they are halfway towards their goal of 100 inquiries per month, progress has been slow. The main issue is logistical rather than clinical, however, i.e. getting funding in place before the disease progresses to a point where the treatment is not worth doing (it just takes months from discovery until it could be too late for treatment). Demand is certainly in place but not always awareness. Costs are adjusted to chemotherapy which does not offer much help against this type of cancer, but for lack of better options, it remains the standard procedure. To cope with this, the company has streamlined the implementation of the cross-border reimbursement process, is re-evaluating strategic locations for treatments for logistical reasons and is continuing its efforts to increase medical awareness of the value of their NanoTherm therapy to enable earlier patient inquiries.

On the other side of the Atlantic, MagForce is pursuing its second opportunity, namely its treatment for prostate cancer. As of today prostate cancer can be cured, but there are objectionable side effects. No other treatment limits those effects as well as the NanoTherm therapy that MagForce has developed. The company filed for an investigational device exemption in late 2015 and updated data continues to be strongly supportive. An answer is expected from the FDA in the coming months which, if positive, would allow for treatment of patients – a potential major catalyst for the share price.

The position in MagForce is not really representative of our portfolio or the way our investment process usually works. This is a case which we have been following for some years because of the impressive medical data. Breakeven is on the horizon, the hurdles in the way of progress are operational and we truly believe the company now has the right group of people in place to deal with the challenges ahead.

We recently met with management and it is worth highlighting their conviction. The company's current CEO and Chairman Dr. Ben Lipps, a legend in the healthcare world (the man behind Fresenius), has a 2% stake in the company. In order to join MagForce, Dr. Lipps, who is 70 years old, had to 1) return from retirement, 2) turn down honourable board seat proposals offered to him within the healthcare industry and 3) convince his wife after a long career that the MagForce opportunity is too good to miss. He has increased his stake in the company over recent months.

Key earnings releases and corporate news, October 2016 (cont.)

Synchrony Financial (2.0% 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 financing solutions in consumer financing/healthcare. It was fully separated from General Electric in November 2015 after being part of GE Capital for over 80 years. In Q316, net income was USD 604m (over USD 570m last year) driven by an increase in net interest income (up 12%) but mitigated by higher loan loss provisions, resulting in an overall generated return on equity of 18%. Loan growth was solid at 11% over last year. The market has been concerned about spiking credit costs, and shares have been pressured accordingly despite solid overall business performance since the separation. In our view, this is mostly about the normalisation of credit quality from extremely low levels. The company repurchased USD 240m of stock during the quarter. Fully phased-in Basel III came in at 17% which is substantially higher than current capital requirements and peers. We believe the company is overcapitalised and this will pave the way for substantial capital returns in the mid-term. It is currently trading at a less than 10x forward earnings multiple and with an unwarranted disconnect between price/tangible book and sustainable return on equity.

Fact

The company announced Q316 results of USD 604m (USD 0.73/share) up 5%/9% respectively over last year. Loan receivables grew 11%. Deposits were up 23% to USD 9bn.

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.

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).

Infineon Technologies AG designs, manufactures and markets semiconductors. The company's products include power semiconductors, microcontrollers, security controllers, radio frequency products and sensors. Infineon markets its products to the automotive, industrial, communications, consumer and security electronics sectors.

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).

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.

The 10 largest companies in SKAGEN Focus (cont.)

Japanese company established in 1999 as an online financial services company, 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 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.

Teva's history can be traced back to Jerusalem in the 1930s. Today Teva is the world's largest producer of drugs that have gone off-patent. HQ in Israel; presence in 60 countries; 45k employees. Teva's strategy is to focus on 1) Central nervous system (CNS) 2) Respiratory and 3) Improved versions of existing drugs (not just Teva drugs) and 4) Production of biosimilar drugs. In July 2016, The US Federal Trade Commission granted Teva approval for the acquisition of Allergan's generics business (Actavis).

Schaeffler AG is an integrated automotive and industrial supplier with more than 12bn sales and 84k employees. Founded and mainly owned by the Schaeffler family (who also holds a majority stake in Continental). Two main operating segments: Automotive (75% of sales) - Production of components such as engine systems, transmission systems and chassis. Broad client list of OEMs, which currently accounts for around 60% of segment revenues, the rest is aftermarket sales. Industrial (25% of sales) – Production of rolling bearings and power transmission solutions. Company recently launched a cost-cutting program to increase margins in this segment. The company was listed on the market on 9 October after cutting the IPO size by 50% due to the VW scandal.

Philips Lightning 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 technology transition in which traditional lamps 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) towards outsourced production and direct solution selling which includes professional services and long-term contracts.

The company is one of the oldest financial firms in the US, with headquarters in Providence, Rhode Island, with its roots going back to 1828. It is today the 13th largest retail bank in the US with a footprint in New England, the Mid West and the Mid Atlantic, with over 1200 branches in 11 states. The company was listed in September 2014 after being spun off from the UK-based bank Royal Bank of Scotland (RBS).

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.

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