SKAGEN Global
Status Report January 2017

From the moors north of Skagen, 1885. By P.S. Krøyer, one of the Skagen Painters. This image belongs to the Skagens Museum.

The art of common sense

Summary – January 2017

- SKAGEN Global underperformed its benchmark index by 0.6% in January. The fund had a return of -0.2% while the benchmark MSCI All Country World Index gained 0.4% (measured in EUR).*
- Samsung Electronics, G4S and Comcast were the three best monthly contributors to absolute performance while General Electric, Citigroup and Teva were the three largest detractors.
- The fund initiated a new position in Hyundai Motor.
- We trimmed positions in AIG and Samsung Electronics after favourable share price development.
- The fund's top 35 holdings trade at a weighted Price/Earnings (2017e) of 13.7x and a Price/Book of 1.6x vs. the index at 15.7x and 2.1x, respectively.
- The weighted average upside to our price targets for the fund's top 35 holdings is 30%.

** Unless otherwise stated, all performance data in this report relates to class A units and is net of fees.*

SKAGEN Global A results, January 2017

EUR, net of fees

NAV SKAGEN Global A

SKAGEN Global A
Benchmark

240
160
80
40
20
10

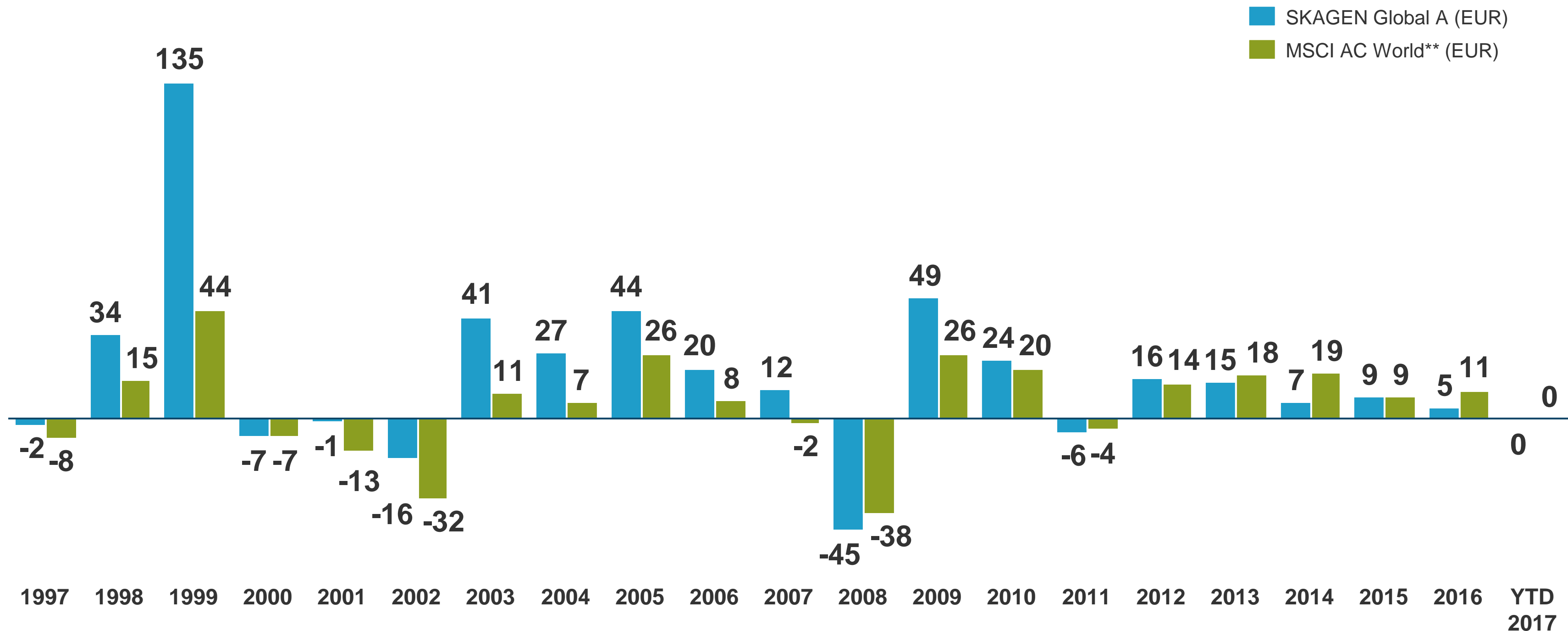
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017

	January	QTD	2016	1 year	3 years	5 years	10 years
SKAGEN Global A	-0,2%	-0,2%	4,8%	12,5%	8,1%	8,9%	5,6%
World Index*	0,4%	0,4%	11,1%	19,4%	13,7%	13,0%	5,3%
Excess return	-0,6%	-0,6%	-6,3%	-6,9%	-5,6%	-4,2%	0,2%

Note: All returns beyond 12 months are annualised (geometric return)
** Inception date: 7 August 1997*
*** Benchmark index was MSCI World in NOK from 7 August 1997 to 31 December 2009 and MSCI All Country World Index from 1 January 2010 onwards*

Annual performance since inception (%)*

SKAGEN Global A has beaten its benchmark 15 out of 20 years



Note: All figures in EUR, net of fees

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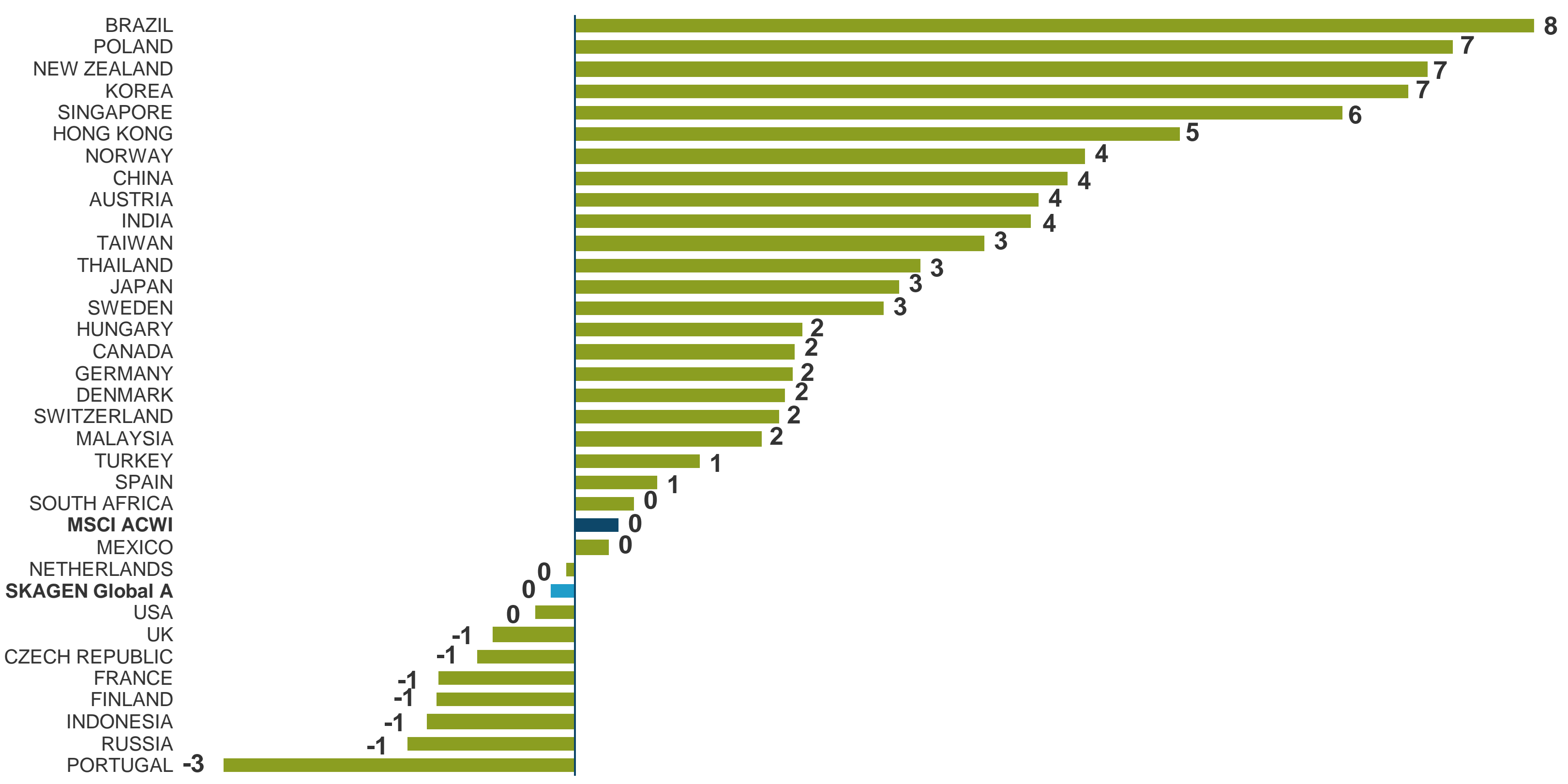
Markets in January 2017, EUR (%)



Main contributors YTD 2017

Largest positive contributors

Company	NOK Millions
Samsung Electronics	114
G4S	49
Comcast	30
China Mobile	29
IRSA	26
CK Hutchison Holdings	24
Akzo Nobel	19
Ageas	13
Sony	13
Medtronic	10

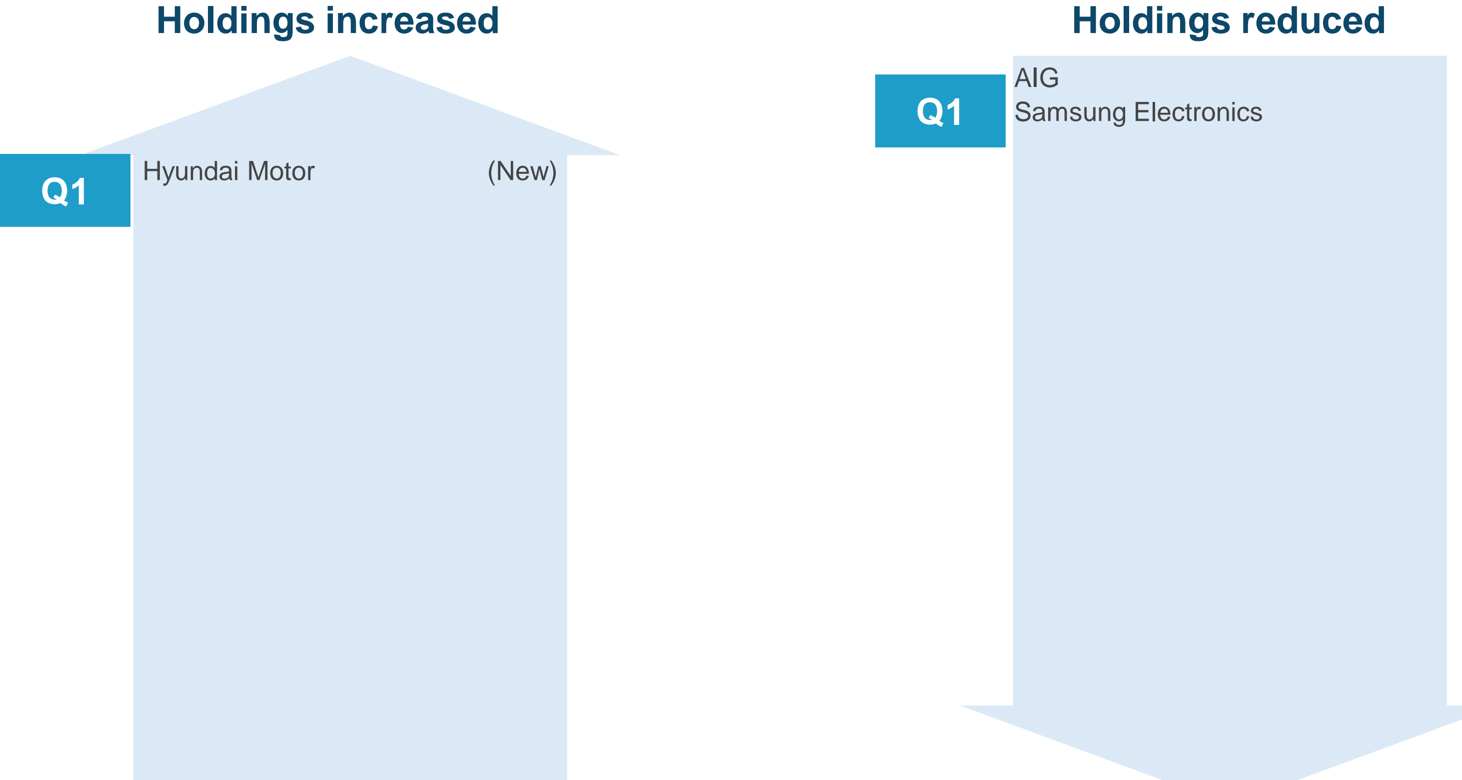
Largest negative contributors

Company	NOK Millions
General Electric	-129
Citigroup	-127
Teva	-118
Unilever	-83
AIG	-80
3M	-66
Cap Gemini	-52
Dollar General	-38
Kingfisher	-24
Philips	-24

Value Creation YTD (NOK MM): -538

NB: Contribution to absolute return

Most important changes Q1 2017



Holdings increased and decreased during January 2017

Key buys

- We initiated a new position in the Korean automotive company **Hyundai Motor**. The depressed valuation of the preference share opens up an investment opportunity driven by an underappreciated sales recovery in emerging markets. This is coupled with an overlooked potential for improved corporate governance to be reflected in a higher dividend payout which would trigger a re-rating of the share.

Key sells

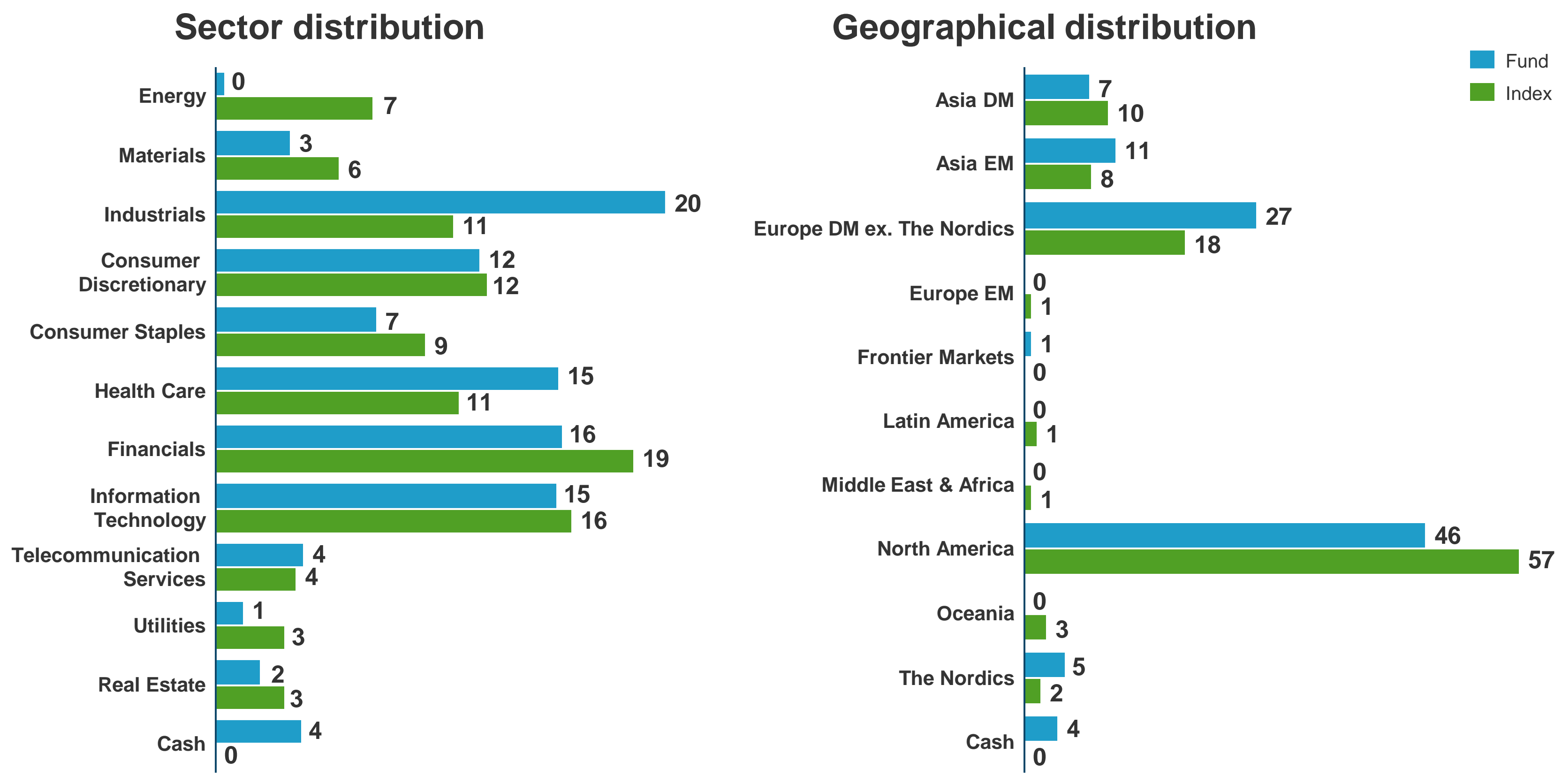
- The fund scaled back positions in the US insurance company **AIG** and the Korean conglomerate **Samsung Electronics** after the higher share price reduced some of the upside to our price targets.

Largest holdings in SKAGEN Global

	Holding size, %	Price	P/E 2016a/e	P/E 2017e	P/BV last	Price target
UNILEVER	5,0	37,4	19,8	18,5	6,5	44
CK HUTCHISON HOLDINGS	4,9	93,5	11,4	10,5	0,9	140
AIG	4,8	64,3	20,1	12,0	0,8	90
SAMSUNG ELECTRONICS	4,5	1 571 000	9,8	7,4	1,1	1 650 000
ROCHE	4,5	233,0	16,0	14,8	10,8	360
GENERAL ELECTRIC	4,3	29,7	19,9	18,1	3,6	36
CITIGROUP	4,3	55,8	11,8	10,7	0,8	70
MICROSOFT	4,2	64,7	23,2	21,9	7,3	68
CHINA MOBILE	3,9	87,9	14,7	13,6	1,7	120
MERCK	3,9	62,0	16,4	16,2	3,9	76
Weighted top 10	**44,4**		**15,2**	**13,0**	**1,6**	**28 %**
Weighted top 35	**90,6**		**15,3**	**13,7**	**1,6**	**30 %**
MSCI AC World			**18,4**	**15,7**	**2,1**	

As of 31 January 2017

SKAGEN Global sector and geographical distribution



Key earnings releases and corporate news, Jan 2017

Unilever

(5.0%)

Soft top-line, strong margins

Summary: The results were somewhat mixed. Q4 organic top-line growth was below expectations (+2.2% YoY), with management blaming weak markets, compounded by further destocking in China and the impact of demonetisation in India. The weak top-line was mainly due to volumes (-0.4%), as pricing (+2.6%) was in-line. At a segment level, personal care (2.5%) and home care (+3.0%) continued to outgrow foods (+1.9%). Similarly, Asia (+3.5%) and Americas (+3.7%) continues to outgrow a week Europe (-2.5). More positively, Unilever continued improving margins (+40bps), leading to 5% EPS growth.

Investment case implications: While only one quarter, theweak top-line growth is something we clearly need to monitor. The other parts of our thesis: margin expansion, FCF growth, and mix change towards the most attractive segments (home care, personal care, and emerging markets) continued to progress according to plan. The stock trades at 17x 2018 earnings and 5% FCF/EV yield with low operational and financial risk (net debt at 1x EBITDA). With renewed market optimism around EM, it is worth remembering that 60% of Unilever's revenues come from these regions. Listed subsidiaries of Unilever in India, Indonesia, and Nigeria trades at close to 40x 2018 expected earnings.

Samsung Electronics

(4.5%)

Rock solid operational outlook and new USD 8bn buy-back program announced

Summary: Final operating profit for 4Q16 of KRW 9.2tr was in line with preliminary numbers and marks a 76% QoQ and 50% YoY increase. Revenues of KRW 53.3tr was flat YoY and +12% QoQ helped by semiconductor and seasonal strength in consumer electronics. Operating margin of 17.3% is an all-time high and would have been 22.0% excluding Note 7 recall costs. Component divisions made up 69% of total profit. Operating profit for semiconductor of KRW 4.95tr rose 77% QoQ for an operating margin of 33% (all-time-high) amid positive mix and tightening market balance through the quarter. Mobile profit of KRW 2.5tr rose markedly QoQ, even adjusted for lower Note 7 recall costs. FY16 mobile profit of KRW 10.8tr was up 7% YoY despite KRW 6.35tr cost of Note 7 recall.

Investment case implications: Positive. Lower contribution from FX strength and apparent lack of non-recurring gains mean that underlying result is even stronger than we thought after preliminary result. Contrary to last year, management was optimistic on 2017 outlook, mainly driven by component divisions but also due to absence of recall costs which hurt 2016 profit by KRW c6tr or a c17% drag. Consensus operating profit for FY17 of KRW 39tr still seems low as 4Q16 excluding Note 7 recall costs were KRW 11.8tr; a quarter which had yet to capture the full benefit of upswing in memory prices. Going through broker updates, a majority is still working with fairly conservative assumptions for FY17 which should ensure a continuous positive revision trend. Announced buy-back exceeded sell-side expectations. We note that net cash position is now above the guided comfort level, which together with expected superior earnings outlook gives room for upside to capital distribution plans.

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

GE

(4.3%)

Cash flow improving, revenue still lagging

Summary: GE's 2016 Q4 results met expectations on USD 0.46 EPS (+14% YoY) but revenue at USD 33.1bn (-2% YoY) came in 2% lighter than expected. Industrial operating margin at 18.7% improved 110 bps YoY and GE targets another 100 bps gain next year. Orders +2% (w/ Alstom) with US orders +23% while growth market orders -9% YoY. With regard to segments, the key negative was Oil & Gas posting a 22% drop in revenue and -43% in operating profit YoY. Operating cash flow of USD 8.2bn was roughly in-line with estimates and +34% YoY. 2017 guidance framework reiterated.

Investment case implications: Neutral. The weaker-than-expected revenue disappointed the market slightly but should not be a big surprise given the sluggish macro environment (and strong USD). We note that service orders rose 20% YoY (equipment orders -7%) and that bodes well long-term as GE increases the stream of recurring service revenue. Another underappreciated data point was the growing backlog, now at an immense USD 321bn (equivalent of 10 quarters of orders). GE remains out-of-favour but could surprise positively in 2017. Recall that the CEO Geoff Immelt (who bought stock on several occasions in 2016) is likely to retire in 2017/2018 and, presumably, many crown princes at GE are eager to deliver top-notch results for their business areas in the coming year. It is also worth recalling that several hundred top and middle managers are heavily financially incentivised for GE to hit USD 2.00 EPS in 2018, a goal the market currently does not believe in. Finally, as GE has lagged in the recent cyclical rally the valuation has come down to 13.3x FY2 P/E (10x FY2 EV/EBITDA), certainly not an unattractive level with many markets trading at all-time-highs.

Citigroup

(4.3%)

Capital build-up continues

Summary: Overall numbers are still impacted by significant reductions in the bad bank, Citi Holdings. Looking at the core Citicorp franchise, Q4 revenues grew 6% YoY (8% in constant dollars) driven by growth across the consumer and institutional business. Importantly, Q4 highlighted a more scalable cost structure as core operating expenses declined 1%. Credit quality remains extremely good across the franchise, with credit costs down 11% YoY. The combination of higher revenues, lower operating and credit costs led to a 25% YoY increase in net income. Tier 1 Capital ratio ended the year at 12.5% vs. 12.1% in December 2015 and tangible book value ended the year at USD 64.5 per share vs. USD 60.6 last year. Thus, Citigroup grew capital ratios and book value despite returning USD 11bn to common shareholders in 2016.

Investment case implications: Q4/2016 showed the developments we were hoping for with i) lower operating costs, ii) continued reduction in Citi holdings, and iii) significant capital generation that is increasingly returned to shareholders. The most interesting aspect of the Q4 result is confirmation of a more scalable cost structure with revenue growing 6% while costs declined 1%. Growth has never been part of our core thesis, but if that were to materialise, it would obviously be very positive. Share price performance in Q4 also clearly highlights our long held thesis that a higher interest rate environment was not priced into the shares. After the strong performance, we have reduced our holding in Citi.

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

Microsoft

(4.2%)

Microsoft's 2017Q2 report shows continued strong cloud growth

Summary: Microsoft reported quarterly revenues of USD 26bn (+3% YoY), operating margin at 31.3% (+50 bps YoY) and EPS USD 0.84 (+6% YoY). Commercial cloud annual revenue run-rate exceeded USD 14bn (+8% QoQ) with Azure +95% YoY. Operating cash flow rose by 12% YoY and Microsoft chose to return USD 6.5bn to shareholders (roughly evenly split between dividends and buybacks). The LinkedIn acquisition closed in December 2016.

Investment case implications: This was a strong quarterly report from Microsoft with incremental improvements in most areas. To quickly re-cap our investment thesis on the stock, we view Microsoft as the big, dormant PC-player which is gradually transforming itself into a leading giant in the cloud era. The commercial cloud annual revenue run-rate is now USD 14bn and has some way to go to hit the USD 20bn target. Microsoft's share generated 15% total return in 2016 and we continue to see that the market (1) fails to account for the long-term opportunity in cloud; (2) underestimates Microsoft's operating leverage and cash flow generation ability; and (3) underprices the capital allocation skills of the (relatively) new management team after suffering a decade with Steve Ballmer & Co at the wheel. Our price target is under review.

Merck

(3.9%)

Early filing for FDA approval of Keytruda+chemo combo for lung cancer treatment

Summary: The FDA has accepted an early filing from Merck on the Keytruda (immuno-oncology drug) + chemotherapy combo treatment for lung cancer (in 1L NSCLC patients) for accelerated review. If approved in May 2017, it could increase the addressable US patient population by 4x to over 70,000.

Investment case implications: Minor positive. Merck has stealthily shifted strategy from buying assets to developing drugs in-house through focused R&D. The key immuno-oncology drug Keytruda is the result of this dedicated effort. As we have stated earlier, we believe the immuno-oncology race will ultimately have more than one winner. The market assumes Keytruda peak sales of USD 3-4bn by 2020, a number we think may carry upside risk. Estimates for the wider immuno-oncology market keep rising – from USD 25bn to as high as USD 100bn – as it could be a total game-changer for cancer treatment over the next decade. Merck has been seen by the market as the dark horse in this race after industry leader Bristol-Myers Squibb; however, this perception may now slowly be shifting. In addition, we see free options in the Merck investment case with two key study read-outs later in 2017 of which the Alzheimer's trial is widely expected to fail but would provide a significant boost if it surprises on the upside (a real possibility, in our view).

The 10 largest companies in SKAGEN Global

Unilever is a manufacturer of branded and packaged consumer goods. Main segments are food (24% of sales), refreshment (19%), personal care (38%), and home care (19%). The company operates in more than 180 countries and emerging markets now account for more than 50% of sales. We think the market underestimates the long-term organic growth in emerging markets and Unilever's ability to increase margins. Due to very high ROIC, growth will be produced with a minimal "growth" CAPEX, enabling the company to grow and maintain a high pay-out ratio.

Founded in 1950 as a plastics manufacturer by its current main shareholder Li Ka Shing, CK Hutchison Holdings is now a multinational conglomerate. The company holds the non-property businesses of the former Cheung Kong and Hutchison group. The group owns assets in (as % of 1H 2015 total EBITDA): Infrastructure (37%), Telecom (20%), Retail (15%), Ports 13%), and Energy (11%).

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 that it intends to keep: Sun America and Chartis.

Samsung Electronics is one of the world's largest producers of consumer electronics. The company is global #1 in mobile phones and smartphones, the world's largest in TV and a global #1 in memory chips. Samsung also produces domestic appliances, cameras, printers, PCs and air conditioners.

Roche is a leading pharmaceuticals and diagnostics company based in Switzerland. Half of group sales and 2/3 of EBIT are derived from the company's Big 3 oncology franchises: HER2 (breast cancer), Avastin (colorectal cancer), and MabThera/Rituxan/Gazyva (blood cancer), each about USD 7bn of revenue. These businesses all come from Genentech, in which Roche has been a majority owner since 1990, and bought the last 46% in 2009.

The 10 largest companies in SKAGEN Global (continued)

Founded in 1892 by Thomas Edison et al., General Electric (GE) operates two divisions (GE Industrial and GE Capital) contributing approximately the same proportion of group earnings. GE is the world's 10th largest publicly-traded company and boasts the 6th most valuable brand. The industrial segment is a play on global infrastructure with a high-margin service business and a large installed base producing a wide variety of capital goods ranging from aircraft engines and power turbines to medical imaging equipment and state-of-the-art locomotives.

Citi is a US financial conglomerate with operations in more than 100 countries worldwide. The bank was bailed out by the US government during the credit crisis and subsequently raised USD 50bn of new capital. Consists of two units: Citi Holdings which is a vehicle for assets that are to be run down and sold and Citi Corp which is the core of the going concern business. In Citicorp 60% of revenues are derived from outside the US - mainly from emerging markets.

Microsoft is the world's largest software company and delivers software to a number of applications from PCs to servers and cell phones – its most famous product is Windows and the affiliated Office Software Suite. In recent years the company has also diversified into video game consoles, ERP systems, internet search and cloud-based computing. Despite a strong push for diversification, 80% of the company's revenues and nearly all its profits come from three main areas: Windows OS, Windows Server and the business division (Office Suite).

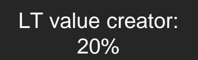
China Mobile is the leading mobile operator in China with more than 800 million subscribers. After losing out in 3G, the company is aggressively rolling out its 4G network.

Founded in 1891, Merck & Co is a US large-cap pharma company (and #7 worldwide by revenue) with a broad pharma portfolio and a solid pipeline (R&D 16-17% of sales). HQ in New Jersey and 70,000 employees. Sales by division (2014, USD 42bn): Diabetes (14%), Infectious Diseases (18%), Vaccines (13%), Animal Health (8%), Oncology (2%), Other (45%). Consensus expects legacy drugs sales to shrink by single-digit percent annually.

Hyundai Motor (005385 KS) KRW 98100

Mean reversion 30%

Special situation 50%



History, business model and source of investment case

- Hyundai Motor Company (HMC) is a full-scale global assembler of passenger cars, trucks and commercial vehicles. The HMC Group is run by one of the Chung family brothers, MK Chung. Its affiliates include auto manufacturers, auto parts manufacturers, steel producers, and financial companies.

ESG

- Ongoing controversies with labour unions in South Korea. Controversial real estate investment in 2014. Sales volume tilted to smaller fuel-efficient vehicles. Industry wide safety risk elements. Improved corporate governance is a core part of our thesis for a higher valuation (higher dividends and lower equity risk premium).

Investment rationale

- Hyundai Motor has ranked among the most unloved stocks (in an unloved sector) in recent years with the ordinary shares down 50% from peak levels. At the current valuation of the pref. shares, we get the core auto operations almost for free. This is particularly interesting as we expect stabilisation/recovery of EM demand combined with a new product line-up (with increased mix towards high margin SUV segment). Operating leverage is significant, so we expect this to have a positive impact on margins.
- While the market has put extensive focus on the restructuring of the Samsung group, the market has forgotten that Hyundai should see a similar transition. We see significant upside to valuation multiples as the dividend yield of Hyundai should go up to fund this exercise (particularly for the pref. shares due higher dividend yield).
- Fundamental downside is well protected from a low valuation (on depressed earnings) and a solid balance sheet

Triggers

- Improved demand from EM and new product line-up helping top-line and improving margins due to operating leverage
- Higher margins from mix change towards SUV segment
- Group restructuring leading to higher dividends/share buybacks which would also reduce pref. discount as we have seen in Samsung Electronics

Risks

- Corporate governance, macro economic deterioration, strikes, FX, Hyundai finance running into trouble (credit quality and resale values), sharing economy leading to significantly lower global auto demand

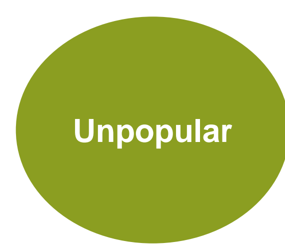
Price target

- Base case: Assuming 50% payout ratio on 2019 earnings, the market pricing is at 6% dividend yield (12% earnings yield) and assuming a 25% pref. discount (36% today) that leaves a target price of KRW 160k – 65% upside (@KRW 160k, dividend yield on pref. shares would be 8% (50% pay-out) with current net cash + JV = KRW 110k per share)
- Bull case: earnings +30% vs. base case, 10% earnings yield (higher payout), 20% pref. discount – 175% upside
- Bear case: Ordinary shares valued at core auto net cash balance and 40% pref. discount - 66% downside

Key Figures		
Market cap	USD	32bn
Net cash core auto	USD	12bn
Daily turnover (all pref. classes)	USD	10m
No. of shares o/s		268m
P/E 2017e		4.3x
P/E 2018e		4.0x
P/BV trailing		0.4x
ROE 2017e		9%
Dividend yield 2017e		4.7%
No. of analysts		42
with Sell/Hold		24%

www.hyundai.com

3U acid test



- Being a Korean blue chip, 10 Hold recommendations (24% of total) is not normal
- After the disastrous real estate transaction in 3Q14 and weak unit sales, HMC has fallen off a lot of investors' radars. The annual strike by already well paid employees has also not helped sentiment
- Korea trades at a discount to the rest of the world due to historically poor corporate governance

- No, not with 32 sell side analysts covering the stock
- Most analysts simply value the shares based on P/E and miss the strong balance sheet. Also, while some talk about the positive impact on sales from EM demand and new products, they fail to see the operating leverage
- Despite positive group restructuring at Samsung Electronics, analysts fail to take into account what a similar exercise would do to payout ratios and thus valuation and the pref. discount at Hyundai Motor

- Yes, at the current valuation of the pref. shares, we get the auto operations almost for free just as earnings should improve
- We see significant upside from revaluation and lower pref. discount as payout ratio goes up to fund group restructuring
- Despite obviously being in a cyclical industry, we think the current equity risk premium is too high as the balance sheet is rock solid and corporate governance should/could improve

For more information please visit:

Our latest Market report
Information on SKAGEN Global 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.

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The art of common sense