

An illuminated quarter

SKAGEN Focus was meaningfully ahead of global equity markets in the second quarter. We could observe a more positive investment climate in European equities following several political events with market friendly outcomes. Despite an environment where central banks around the world are introducing a tighter monetary policy, most global equity markets ended at near record high levels in the quarter. As a highly concentrated equity fund, company specific events continue to drive fund performance. Our top contributors in the quarter, measured as absolute contribution in NOK, were Philips Lighting, Tesoro and Unicredit. Our largest negative contributors were JBS, Whiting Petroleum and Schaeffler.

Light reaching the end of the tunnel in one year

In our market report one year ago we highlighted our participation in the highly unpopular IPO of Philips Lighting at EUR 20/share in June 2016. When we initiated the position, the shares offered a remarkably high free cash flow yield of about 15-20%. Now, one year on, the equity has re-rated about 60% and the stock was the top performer in the quarter. The re-rating has been driven by solid earnings reports and a successful sell-down in shares by the former sole owner Royal Philips which has increased the free float of the shares and availability for the average investor. Management has consistently confirmed a faster than anticipated transformation from conventional lighting to LED-based lighting solutions which has surprised the previously rather sceptical investor base. At the same time, the conventional lighting segment is producing a very attractive free cash flow in this contracting environment. We exited the position during the quarter as it reached our target price.

Oil turbulence and political uncertainty

During the second quarter there was a substantial decline in the oil price driven by an increase in supply primarily by the US shale operators. On this occasion our two positions in the energy sector, US shale exploration company Whiting Petroleum and US refiner Tesoro moved in opposite directions. Whiting Petroleum was the main detractor while Tesoro was one of the better performers, which also highlights their reverse exposure to the oil price.

The highly depressed environment uncovered another opportunity and we have accumulated shares in US-based contract driller Helmerich & Payne. The contract driller currently operates 384 land rigs in the US, 50 international land oil rigs and 9 offshore platform rigs. The company is the market leader in a new emerging segment within drilling which is the "super spec" category and has the highest active number of these highly advanced rigs. The company has a robust balance sheet with a net cash position and currently delivers a 5% dividend yield which is unheard of in the current US energy sector environment.



One year on from initiating a position in Philips Lighting, the stock has re-rated about 60 percent and was the top performer in the quarter. Photo: Bloomberg

The Brazilian equity market was once again thrown into huge political turmoil and our position in JBS was one of the main detractors. J&F, the controlling shareholder of the company entered into a plea bargain with Brazilian prosecutors to settle a myriad of different claims. This in turn created excess volatility in the stock price. Importantly, none of these allegations or settlements were directed at JBS but focused on the holding company. We did exit the closely related listed subsidiary Pilgrim's Pride in the quarter as the equity rallied sharply during the quarter despite the turbulence in the main owner's shares.

Moving higher in Japan

The fund has notably increased its exposure to the Japanese equity market. At the end of the quarter the fund has about 15% in Japanese equities, although the exposure is quite diversified. Japan has long been associated with cash-rich companies that are run ineffectively with regard to capital efficiency. The current Abe administration has taken several measures in recent years to stimulate economic growth, promote improved corporate governance and emphasise the importance of effective capital allocation. We think this may gradually rub off on the Japanese equity market, following a surge of activity in for instance Korea, where the presence of active shareholders could increase from virtually zero presence. Recent tax-reforms in Japan are also pushing in this direction, whereby for instance spin-offs will be tax free encouraging companies to engage in value-enhancing structural actions.

We entered a position in Bank of Kyoto, the largest regional bank in the Kyoto which accounts for 16% of the Japanese population. The bank has capital ratios well above requirements and peers, while domestic consolidation and a steady loan growth offer substantial opportunities to increase core bank return on equity. The company has a vast securities portfolio and among its strategic shareholdings, the company has stakes in major Kyoto companies such as Nintendo, the game and console maker and others such as Nidec, Murata and Kyocera. While the stock is looking artificially expensive on traditional earnings multiples, the equity trades at less than 50% of the net asset value of the company. Expressed differently, we believe the market has put a fair price on the current core banking operations while failing to price the securities portfolio correctly.

At the end of the quarter, SKAGEN Focus consists of 35 stocks with a wide range of market cap sizes, whereby 15% are small cap stocks and 41% mid-cap stocks. They all have the common denominator of being substantially undervalued with company-specific potential to re-rate over a 2 to 3 year horizon.



We entered a position in Bank of Kyoto in the quarter. The company has stakes in major Kyoto companies including Nintendo (pictured). Photo: Bloomberg.

The fund is a concentrated global equity fund with a mandate to invest in all cap-sizes, geographies and sectors globally. With our concentrated portfolio of 30-35 core positions, we aim to generate absolute returns at a controlled level of absolute risk.

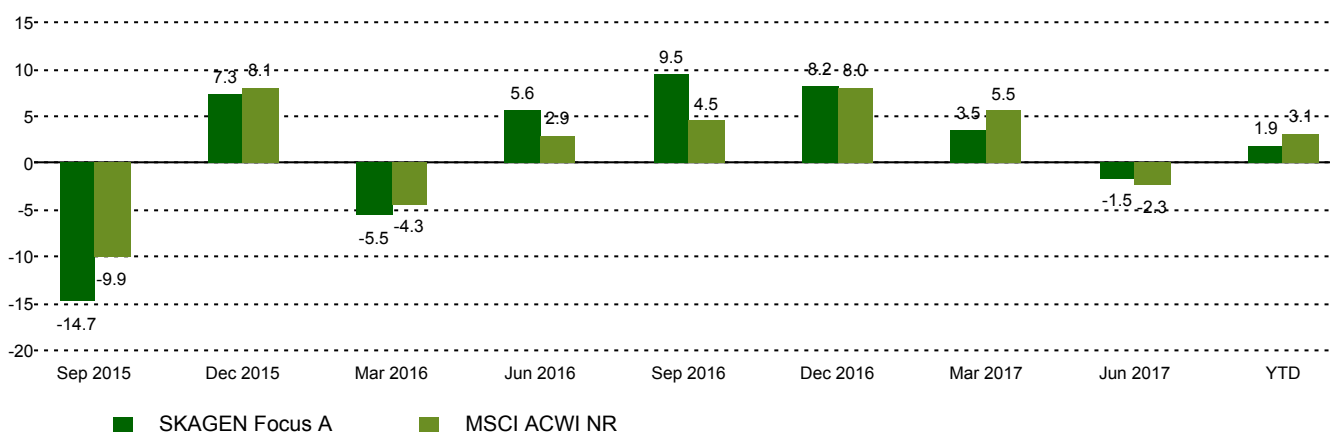
Historical performance (net of fees)

Period	SKAGEN Focus A	Benchmark index
Quarter to date	-1.5%	-2.3%
Year to date	1.9%	3.1%
Last year	20.7%	16.4%
Last 3 years	n/a	n/a
Last 5 years	n/a	n/a
Last 10 years	n/a	n/a
Since start	0.9%	3.0%

Fund Facts

Type	Equity
Domicile	Norway
Launch date	26.05.2015
Morningstar category	Global Flex-Cap Equity
ISIN	NO0010735129
NAV	12.09 EUR
Fixed management fee	1.60%
Total expense ratio (2016)	2.24%
Benchmark index	MSCI ACWI NR
AUM (mill.)	233.17 EUR
Number of holdings	35
Lead manager	Filip Weintraub

Quarterly Performance



Contributors in the quarter



Largest contributors

Holding	Weight (%)	Contribution (%)
Philips Lighting	1.95	0.84
Tesoro	4.72	0.61
UniCredit	3.06	0.56
E-MART	3.23	0.55
Magforce	2.11	0.50



Largest detractors

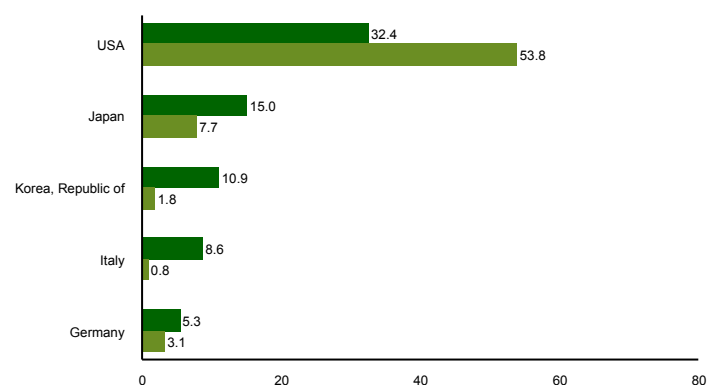
Holding	Weight (%)	Contribution (%)
Jbs	3.21	-1.62
Whiting Petroleum	2.09	-0.96
Schaeffler	3.03	-0.54
GCL-Poly Energy Holdings	0.70	-0.29
TerraVia Holdings	0.20	-0.27

Absolute contribution based on NOK returns at fund level

Top ten investments

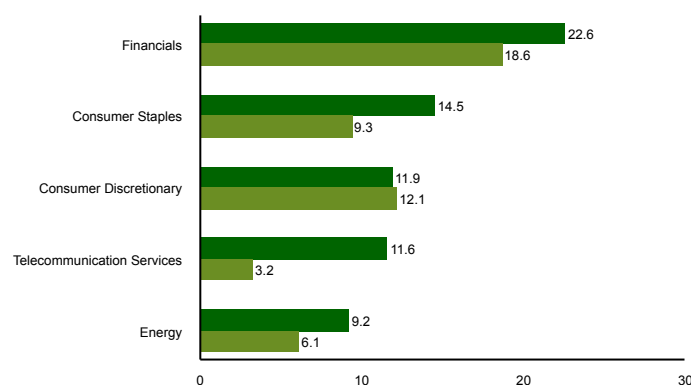
Holding	Sector	Country	%
AIG	Financials	USA	6.89
Tesoro	Energy	USA	5.01
Taiheiyō Cement	Materials	Japan	4.75
Telecom Italia Spa	Telecommunication Services	Italy	4.46
Teva Pharmaceutical	Health Care	USA	3.74
Softbank Group	Telecommunication Services	Japan	3.64
China Telecom	Telecommunication Services	China	3.46
Bank of Kyoto	Financials	Japan	3.27
UniCredit	Financials	Italy	3.25
Carlsberg	Consumer Staples	Denmark	3.22
Combined weight of top 10 holdings			41.69

Country exposure (top five)



■ SKAGEN Focus A ■ MSCI ACWI NR

Sector exposure (top five)



■ SKAGEN Focus A ■ MSCI ACWI NR

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