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

# SKAGEN Global

## Status Report November 2015

The art of common sense

SKAGEN

# Summary – November 2015

- SKAGEN Global outperformed its benchmark index by 0.6% in November. The fund gained 4.3% while the benchmark MSCI All Country World Index added 3.7% (measured in EUR).* SKAGEN Global has returned 13.5% YTD (measured in EUR) which equates to 0.7 percentage points less than the benchmark at 14.2%.

- In November, Tyson Foods,  GE and NN Group were the three best monthly contributors to absolute performance while Samsung Electronics, Lundin Mining and Sanofi were the three main detractors.

- The team initiated two new positions: ServiceMaster and Xcel Energy. The USD 5bn market cap US company ServiceMaster is a leading provider of residential and commercial services, specialising in pest and termite control. Xcel Energy is a fully regulated US utility operating primarily in Colorado and Minnesota.

- With around 50 holdings in the fund, the risk-reward hurdle that companies must meet to stay in the portfolio remains high. Hence, we sold out of our positions in the steel producer Ternium and the telecom operator Vimpelcom as we see risk-reward deteriorating in both names.

- The fund continued to trim winners and add to losers where we have high conviction. During the month we took profit in HeidelbergCement, GE, Tyson Foods, Unilever, NN Group, and Samsung Electronics after strong performance. We added to G4S, Dollar General, Kingfisher, Sanofi, AIG, Barclays and Credit Suisse on short-term weakness.

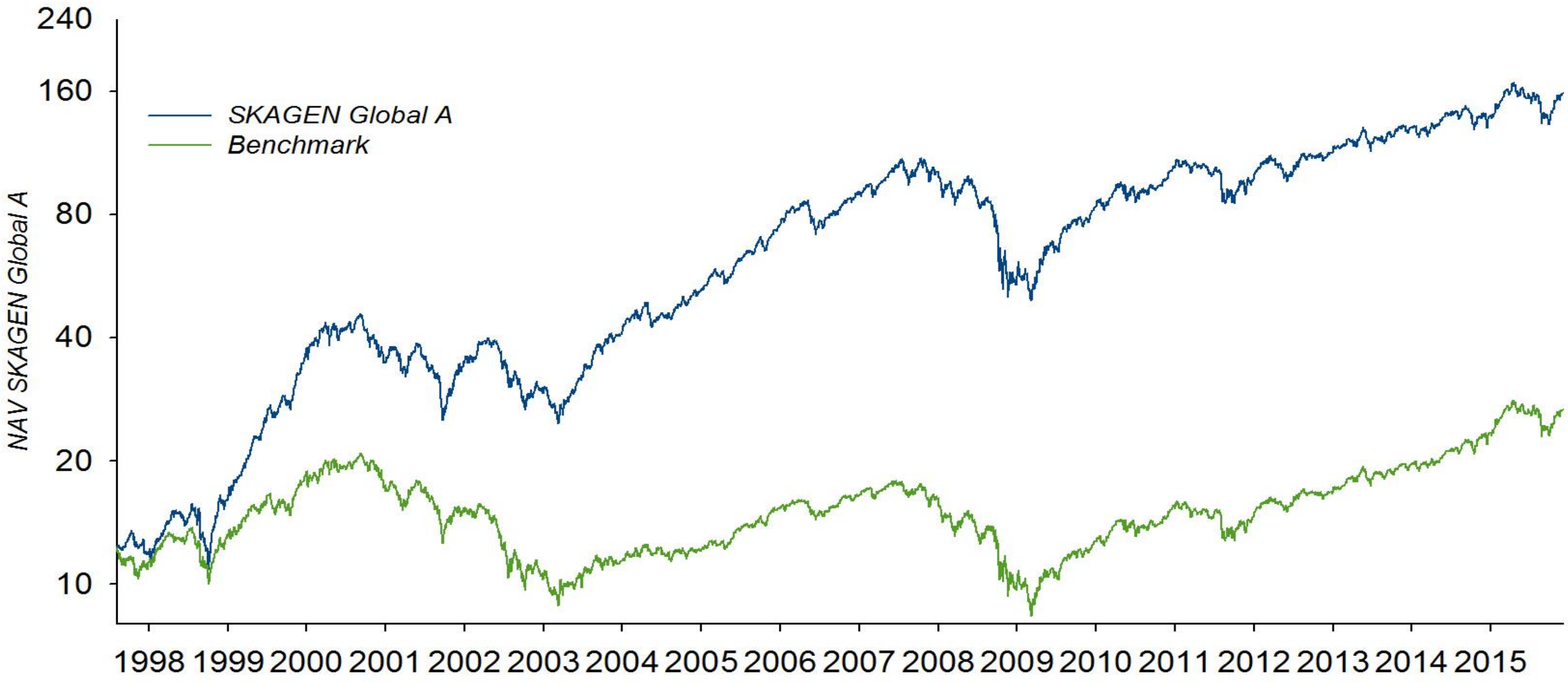
- The portfolio remains attractively valued both on an absolute and a relative basis. The fund's top 35 holdings trade at a weighted Price/Earnings (2015e) of 14.0x and a Price/Book of 1.4x vs. the index at 16.5x and 2.1x, respectively.

- The weighted average upside to our price targets for the fund's top 35 holdings declined marginally month-over-month from 35% in October to 34% in September as equity markets pushed higher.

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

# SKAGEN Global A results, November 2015

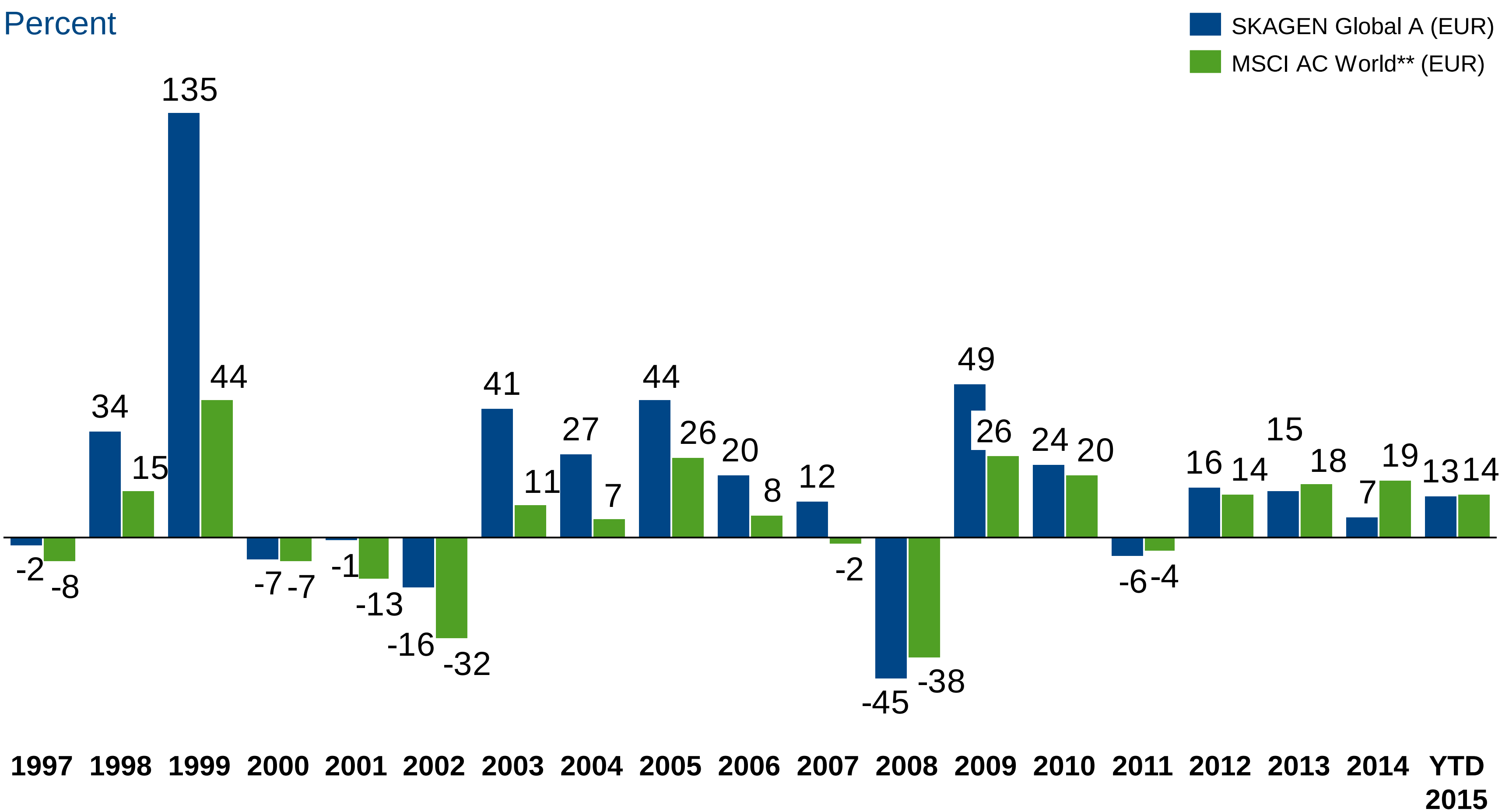
## EUR, net of fees




| | November | QTD | YTD | 1 Year | 3 years | 5 years | 10 Years | Since inception* |
|---|---|---|---|---|---|---|---|---|
| SKAGEN Global A | 4,3% | 16,9% | 13,5% | 13,0% | 12,7% | 10,0% | 8,3% | 15,0% |
| MSCI AC World Index* | 3,7% | 13,5% | 14,2% | 15,1% | 17,1% | 12,6% | 5,9% | 4,3% |
| Excess return | 0,6% | 3,4% | -0,7% | -2,1% | -4,4% | -2,6% | 2,4% | 10,7% |

*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 14 out of 18 years




*Note: All figures in EUR, net of fees*
** Inception date: 7 August 1997*
*** Benchmark index was MSCI World in NOK from 7 August 1997 to 31 December 1997 and MSCI All Country World Index from 1 January 2010 onwards*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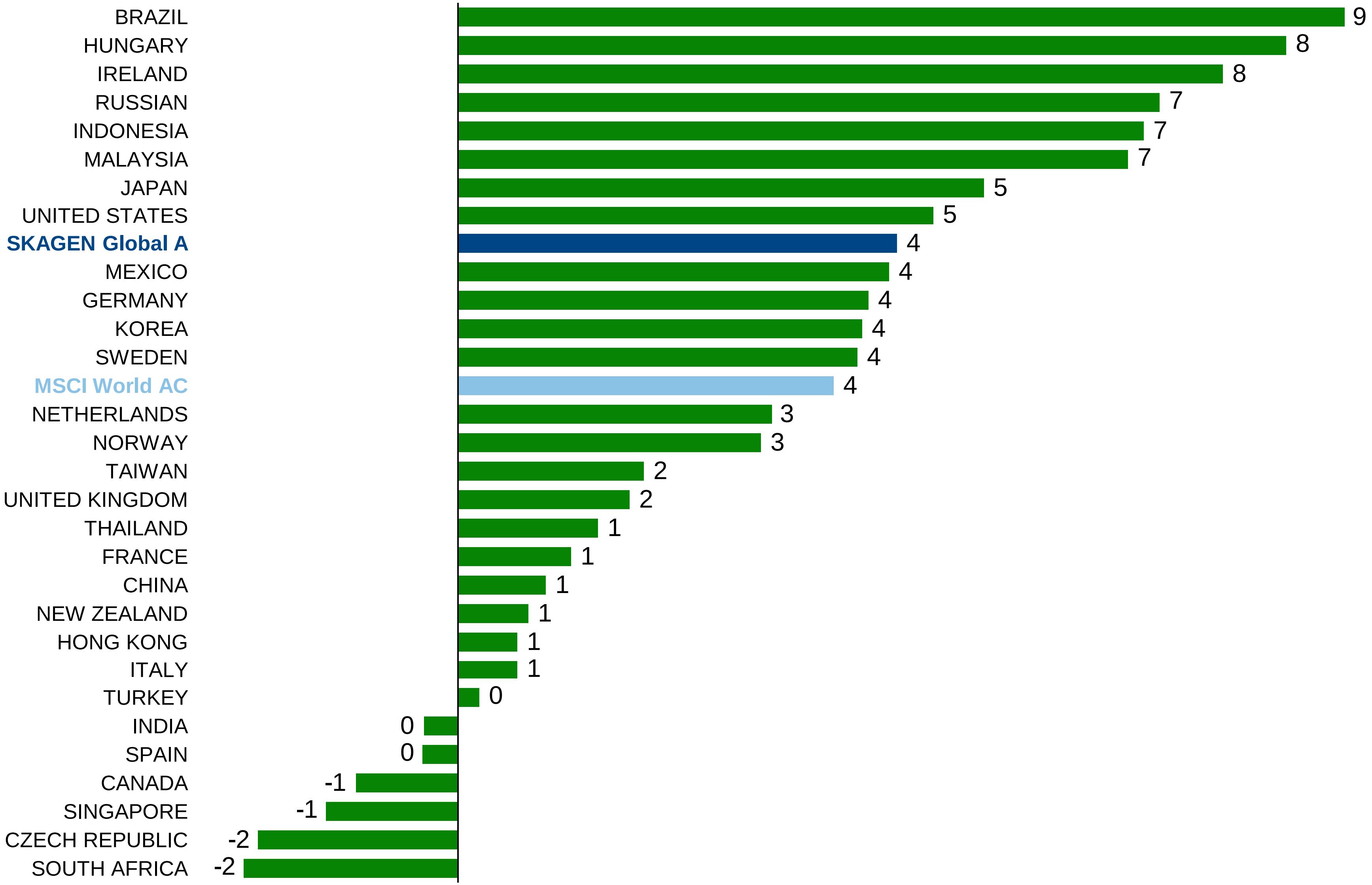
# Markets in November in EUR (%)



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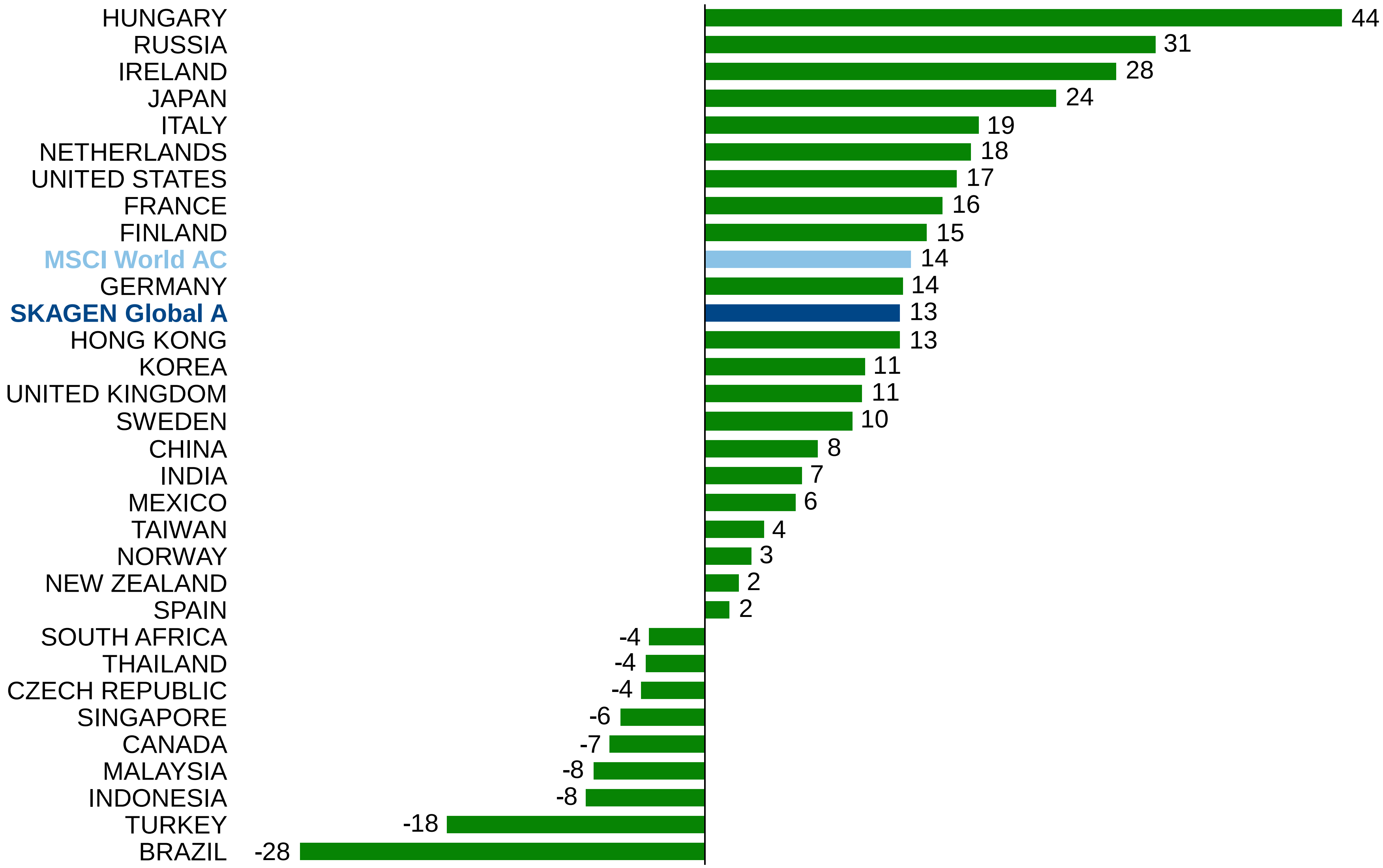
# Markets YTD in EUR (%)



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# Main contributors MTD 2015

## Largest positive contributors

| Company | NOK Millions |
|---|---|
| Tyson Foods Inc | 115 |
| General Electric Co | 94 |
| NN Group NV | 90 |
| Citigroup Inc | 86 |
| American International Group | 74 |
| Lenovo Group Ltd | 71 |
| Tata Motors Ltd | 62 |
| HeidelbergCement AG | 61 |
| Alphabet Inc | 60 |
| Indosat Tbk PT | 60 |

## Largest negative contributors

| Company | NOK Millions |
|---|---|
| Samsung Electronics Co Ltd | -141 |
| Lundin Mining Corp | -99 |
| Sanofi | -65 |
| IRSA | -47 |
| G4S Plc | -46 |
| WM Morrison Supermarkets PLC | -25 |
| Haci Omer Sabanci Holding AS | -22 |
| Cheung Kong Holdings Ltd | -20 |
| Mayr Melnhof Karton AG | -17 |
| Egyptian Financial Group-Hermes | -16 |

**Value Creation MTD (NOK MM): 857**

*NB: Contribution to absolute return*

# Main contributors QTD 2015

## Largest positive contributors

| Company | NOK Millions |
|---|---|
| Samsung Electronics Co Ltd | 452 |
| General Electric Co | 342 |
| American International Group | 287 |
| Microsoft Corp | 232 |
| Citigroup Inc | 227 |
| Alphabet Inc | 207 |
| NN Group NV | 157 |
| Tyson Foods Inc | 129 |
| Tata Motors Ltd | 126 |
| UPM-Kymmene OYJ | 119 |

## Largest negative contributors

| Company | NOK Millions |
|---|---|
| Sanofi | -31 |
| VimpelCom Ltd | -25 |
| WM Morrison Supermarkets PLC | -16 |
| Barclays PLC | -13 |
| Haci Omer Sabanci Holding AS | -5 |
| Gap Inc/The | -4 |
| Mayr Melnhof Karton AG | -4 |
| G4S Plc | -4 |
| Global Mediacom | -4 |
| China Unicom Hong Kong Ltd | -4 |

**Value Creation QTD (NOK MM): 4151**

*NB: Contribution to absolute return*

# Main contributors YTD 2015

## Largest positive contributors

| Company | NOK Millions |
|---|---|
| American International Group | 575 |
| General Electric Co | 502 |
| Alphabet Inc | 444 |
| Citigroup Inc | 395 |
| Microsoft Corp | 324 |
| Samsung Electronics Co Ltd | 297 |
| Renault SA | 289 |
| NN Group NV | 252 |
| Tyson Foods Inc | 239 |
| Nordea Bank AB | 194 |

## Largest negative contributors

| Company | NOK Millions |
|---|---|
| Banrisul | -195 |
| Lundin Mining Corp | -184 |
| KazMunaiGas | -176 |
| Norsk Hydro ASA | -161 |
| Afren PLC | -140 |
| Gap Inc/The | -136 |
| Hyundai Motor Co | -125 |
| Egyptian Financial Group-Hermes | -115 |
| Global Telecom Holding | -114 |
| State Bank of India | -104 |

**Value Creation YTD (NOK MM): 5386**

*NB: Contribution to absolute return*

# Holdings increased and decreased during November 2015

## Key buys in November

- The team initiated two new positions: **ServiceMaster** and **Xcel Energy**. The USD 5bn market cap US company ServiceMaster is a leading provider of residential and commercial services, specialising in pest and termite control. Xcel Energy (USD 18bn market cap) is a fully regulated US utility operating primarily in Colorado and Minnesota. See attached fact sheets later in this report for more detailed information.

- We added to our holdings in **G4S**, **Dollar General**, **Kingfisher**, **Sanofi**, **AIG**, **Barclays** and **Credit Suisse** on short-term weakness.

## Key sells in November

- As we continuously assess the risk-reward profile of our holdings, we strive to allocate capital to the holdings with the most attractive risk-return profile. While the steel producer **Ternium** has a solid balance sheet and good near-term cash flow, we think the company will struggle to overcome challenging fundamentals as the global steel market is heading toward a supply-induced meltdown.

- Severe corporate governance issues have surfaced in the telecom operator **Vimpelcom**, amplifying the downside risk in the investment case. After trimming the name on several occasions throughout the year, we have now decided to exit this position completely.

- Due to strong share price performance we trimmed our positions in **HeidelbergCement**, **GE**, **Tyson Foods**, **Unilever**, **NN Group** and **Samsung Electronics.**

# Most important changes Q1 2015

## Holdings increased

**Q1**

| | |
|---|---|
| General Electric | (New) |
| Lundin Petroleum | (New) |
| Columbia Property Trust | (New) |
| AIG | |

## Holdings reduced

**Q1**

| | |
|---|---|
| Renault | (Out) |
| Baker Hughes | (Out) |
| Gazprom | (Out) |
| Yamaha Motor | (Out) |
| Weatherford | (Out) |
| Petrobras | (Out) |
| Mosaic | (Out) |
| UIE | (Out) |
| Renewable Energy Corp (conv.) | (Out) |
| Afren | (Out) |
| Akzo Nobel | |
| Samsung Electronics | |
| Technip | |
| Toyota Industries | |
| Unilever | |
| Raiffeisen Bank | |
| Gap | |
| Talanx | |

# Most important changes Q2 2015

## Holdings increased

**Q2**

| | |
|---|---|
| Tyson Foods | (New) |
| Sabanci Holding | (New) |
| Cheung Kong Property Hld* | (New) |
| Google | |
| Cheung Kong Hutchison Hld | |
| Hyundai Motor | |

## Holdings reduced

**Q2**

| | |
|---|---|
| Technip | (Out) |
| Talanx | (Out) |
| Raiffeisen Bank | (Out) |
| Cheung Kong Property Hld* | (Out) |
| Citigroup | |
| AIG | |
| Lenovo Group | |
| Volvo | |
| China Unicom | |
| Comcast | |
| Tyco International | |
| Samsung Electronics | |

** Spin-off from Cheung Kong Hutchison Hld*

# Most important changes Q3 2015

## Holdings increased

Q3

| | |
|---|---|
| G4S | (New) |
| China Mobile | (New) |
| Merck | (New) |
| Barclays | (New) |
| Credit Suisse | (New) |
| WM Morrison Supermarkets | (New) |
| Samsung Electronics (Ord) | |
| Carlsberg | |
| Lundin Mining | |
| Tyson Foods | |
| Google | |
| | |

## Holdings reduced

Q3

| | |
|---|---|
| Hyundai Motor | (Out) |
| Storebrand | (Out) |
| Varian Medical Systems | (Out) |
| OCI | (Out) |
| Valmet | (Out) |
| Prosegur | (Out) |
| China Mobile | (Out) |
| China Communication Services | (Out) |
| Samsung Electronics (Pref) | |
| LG Corp | |
| General Motors | |
| Citigroup | |
| Google | |
| Sanofi | |
| Teva Pharmaceutical | |

# Most important changes Q4 2015

## Holdings increased

**Q4**

- Dollar General Corp (New)
- ServiceMaster Global Holding Inc (New)
- Xcel Energy Inc (New)
- American International Group
- Roche Holding AG
- Sanofi
- Kingfisher Plc
- Merck & Co Inc
- Tata Motors Ltd
- Barclays PLC
- Credit Suisse Group AG
- G4S Plc

## Holdings reduced

**Q4**

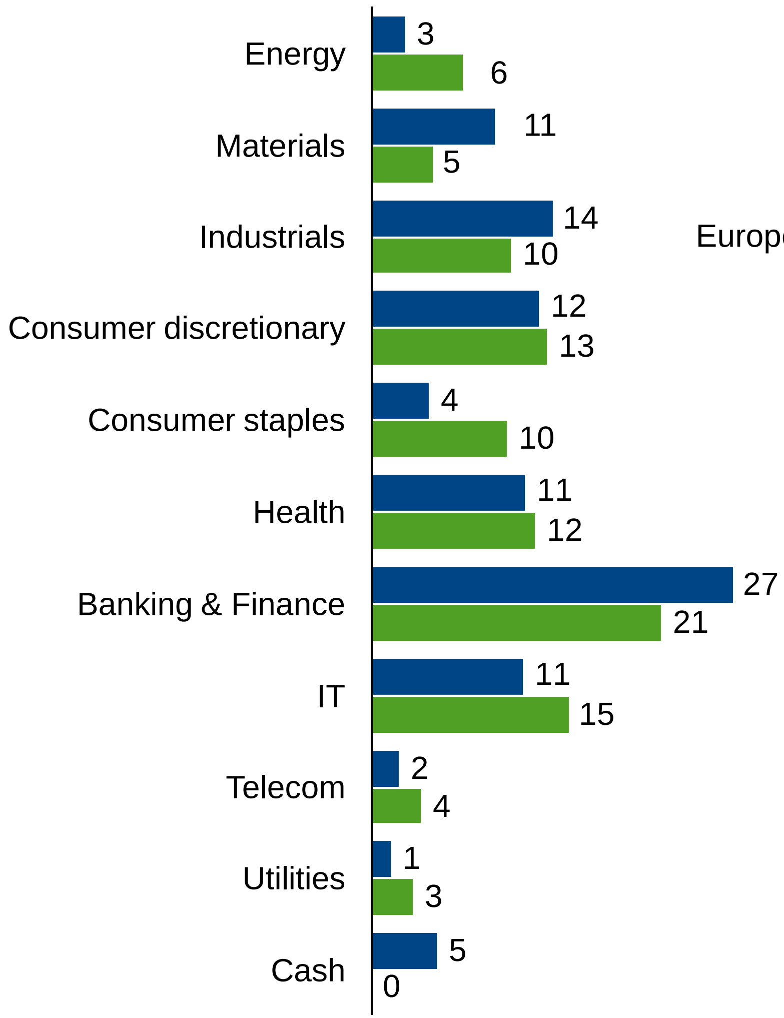
- Norsk Hydro ASA (Out)
- LG Corp (Out)
- Gap Inc/The (Out)
- Ternium SA (Out)
- KazMunaiGas (Out)
- Yazicilar Holding AS (Out)
- VimpelCom Ltd (Out)
- First Pacific Co Ltd/Hong Kong (Out)
- Global Telecom Holding (Out)
- Banrisul (Out)
- General Electric Co
- Samsung Electronics Co Ltd
- Tyson Foods Inc
- Alphabet Inc
- Microsoft Corp
- Goldman Sachs Group Inc/The
- Comcast Corp
- General Motors Co
- HeidelbergCement AG
- Tata Motors Ltd

# Largest holdings in SKAGEN Global as of 30 November 2015

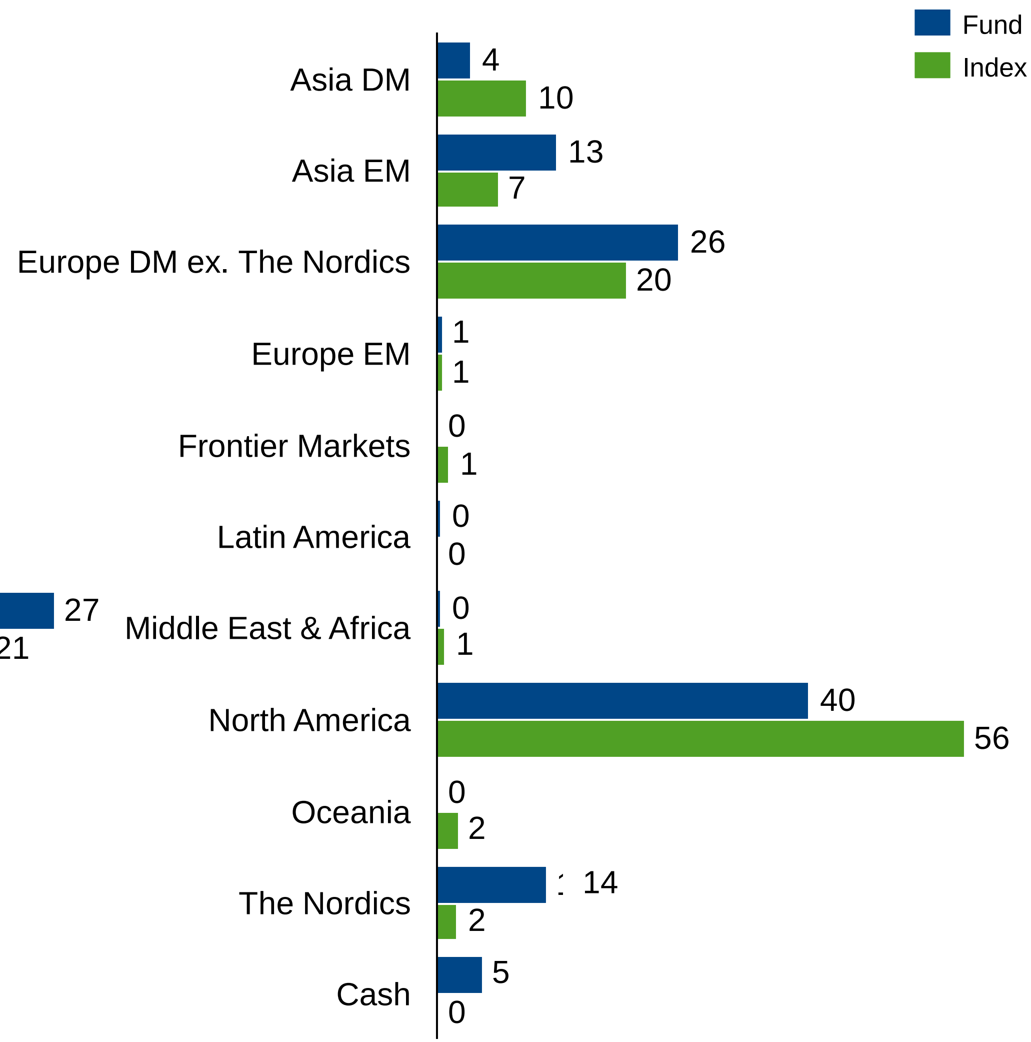
| | Holding size, % | Price | P/E 2015e | P/E 2016e | P/BV last | Price target |
|---|---|---|---|---|---|---|
| AIG | 7.1 | 63.6 | 14.8 | 12.4 | 0.8 | 90 |
| CITIGROUP | 5.9 | 54.1 | 9.8 | 9.3 | 0.8 | 75 |
| SAMSUNG ELECTRONICS | 5.4 | 1 096 000 | 7.8 | 7.7 | 0.9 | 1 500 000 |
| ROCHE | 4.0 | 275.5 | 19.5 | 17.9 | 13.7 | 380 |
| GENERAL ELECTRIC | 3.9 | 29.9 | 23.0 | 19.8 | 2.7 | 34 |
| MERCK | 3.3 | 53.0 | 14.9 | 14.2 | 3.3 | 76 |
| NORDEA | 3.3 | 96.7 | 11.4 | 11.5 | 1.4 | 140 |
| DOLLAR GENERAL | 2.7 | 65.4 | 16.7 | 14.5 | 3.6 | 94 |
| STATE BANK OF INDIA | 2.7 | 250.2 | 9.4 | 7.9 | 1.1 | 400 |
| CK HUTCHISON | 2.5 | 101.7 | 12.3 | 10.7 | 1.0 | 140 |
| **Weighted top 10** | **40.9** | | **12.3** | **11.3** | **1.2** | **39%** |
| **Weighted top 35** | **83.8** | | **14.0** | **12.7** | **1.4** | **34%** |
| **MSCI AC World** | | | **16.5** | **15.1** | **2.1** | |

# Sector and geographical distribution vs index (Nov 2015)

## Sector distribution




## Geographical distribution





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# Key earnings releases and corporate news, November 2015

**DSM**

**(2.0%)**

**CMD confirms focus on profitability and cash flow**

*Summary:* New targets presented at the Capital Market Day (CMD), including 2 overall goals: 3-year target on EBITDA (high single digit growth) and ROCE (80-100bps improvement). Other highlights include annual organic growth of 3-5% in Nutrition, annual cost savings of EUR 250-300m (2015 consensus EBITDA is EUR 1.1bn), 3-year targets vs 5-year targets previously (to give organisation a sense of urgency), R&D spend under review (to drive efficiency, may not necessarily spend less), exit bulk chemicals and pharma JVs (no timing given, exiting associates could bring liquidity of EUR1.5bn or 17% of current market cap) and reducing working capital from 22% to <20%.

*Investment case implications:* The CMD confirmed our investment case. Management is now 100% focused on improving profitability and free cash flow (FCF). Speaking with sell-side analysts, it was also obvious just how sceptical they actually are to the execution of these targets, given the historical one-sided focus on M&A-led growth. After a decade purely focused on growing the nutrition business via M&A, management is now focusing on improving profitability and free cash flow through integration of these assets. While this is well communicated to the market, investors remain sceptical and want to see actual progress before pricing this in.

**Heidelberg-**

**Cement (1.7%)**

**Topline miss, but good cost control leads to in-line EBITDA**

*Summary:* Q315 sales fell 2% like-for-like (LFL) against a weaker macroeconomic backdrop. Weaker demand seen during the quarter is only temporary, and the key markets (US, UK and Indonesia) are already back on track for a strong finish to 2015. EPS of EUR 2.55 up 30% year-on-year (YoY) was 26% above consensus, but mostly driven by lower taxes. Net debt fell from EUR 7.5bn to EUR 5.9bn largely due to the divestment of Building Products. Full year guidance slightly reduced on revenues though earnings guidance unchanged. The acquisition of Italcementi to close in 1H2016. Synergy target significantly increased.

*Investment case implications:* Neutral. Still HeidelbergCement offers the best growth prospects through their exposure to US, UK and a solid outlook for Indonesia. Earnings power to be helped by a smooth integration of Italcementi with synergies raised from EUR 175m this summer to EUR 300m now. There should be potential upside to the synergies estimate. We like the improvements of their operations but were surprised by the acquisition of Italcementi as the message from management was focus on shareholder returns at their Capital Markets Day in the early summer. EPS estimates for 2017 are EUR 6.5 and we think the stock should be able to trade at a 12x multiple giving us a target price of EUR 85 cum-dividends. Dividends to grow as payout ratio improves together with higher earnings. Management credibility has taken a hit after the deal, but with signs of more synergies from the deal they might be able to turn things around.

# Key earnings releases and corporate news, November 2015 (cont.)

**Tyco**

**(1.6%)**

**In-line with expectations due to cost cutting**

*Summary:* Tyco's organic revenue was down 7% YoY mainly due to FX (-1% on an organic basis) which was marginally weaker than expected. Impressive cost control expanded margins enough for the company to grow operating earnings by 6% YoY. Management increased the range for restructuring in 2016 but savings will be reinvested into their products. Total backlog increased 3% YoY. Tyco extended the maturity of its debt last quarter with limited impact on interest costs.

*Investment case implications:* Tyco continues to execute well on its cost cutting program, leading to healthy FCF. However, the continued lack of top-line growth is a concern.

**NN Group**

**(2.2%)**

**NN Group CMD: Dutch. Dividend. Delight.**

*Summary:* NN Group hosted its maiden Capital Markets Day at De Remise in The Hague. A further 15% cost savings (EUR 120m) in the Netherlands by 2018 announced as the EUR 200m IPO-target was reached ahead of schedule. Standard model Solvency II ratio of 214% (end-Q3) disclosed with partial model discussions ongoing with the Dutch regulator. NN Life targeting stable investment margin (100-150 bps) over the medium term with renewed focus on innovation and digitalisation to capture growth in the changing pension market. NN Insurance Europe ROE breakdown by country showed Eastern European countries creating value, while Turkey, Greece and Belgium are generating ROE below cost of capital. NN Bank’s target ROE is 7% (!) by 2018. Management remain tight-lipped on any asset divestments/acquisitions but emphasised the need to stay rational.

*Investment case implications:* Strong positive. SKAGEN Global attended NN Group’s CMD in The Hague, arguably the best CMD of the year which further boosted our conviction in the investment case. Interestingly, SKAGEN Global was one of only a dozen foreign investors who attended in person, a sign that the stock remains out-of-favour with many on the buy side. There were 3 key takeaways. First, the added details on the capital position lead us to believe that the capital return runway is even longer than we had previously assessed. Specifically, we deduce that NN Group has close to another EUR 2bn in capital (19% of market cap) that may be available to shareholders (e.g. EUR 0.5bn in non-qualifying hybrid debt, EUR 1.1bn tied-up in non-available own funds, etc.) and we see the stock generating 8-9% FCF yield with limited downside. Second, the operational results have been mixed this year but we estimate that this is another source of upside not yet in the price (e.g. <97% non-life CoR by 2018 vs. 102% YTD). Third, the bench in NN Group is remarkably strong. The divisional heads were impressive and demonstrated an unwavering commitment to disciplined and sensible capital allocation. In summary, the NN Group management exudes focus, accountability and humility. The near-term stock price is probably up with events, but as long-term investors we will need to adjust our current EUR 35/share price target as the story is developing more in-line with our bull case. Note that the unit-linked litigation risk remains an overhang which could lead to a “buying opportunity” if it were to materialise.

# Key earnings releases and corporate news, November 2015 (cont.)

**Kingfisher**
**(2.5%)**

**UK doing fine while France is poor**

*Summary:* Kingfisher reported retail profit below expectations due to weaker performance in France. UK did well with LFL sales up 4.6% due to better than expected performance from B&Q and continued strength in Screwfix. Total sales grew 1.5% in France but retail profit was down 7.5%. Kingfisher completed the GBP 200m share buyback program during the quarter.

*Investment case implications:* Neutral. Kingfisher has embarked on a journey to turn things around with its "One Kingfisher" plan. These initiatives have just started and we need to be patient. We continue to see Kingfisher as a self-help story that will play out over a number of years. The balance sheet is strong and valuation is not demanding. We get a 3% dividend yield while we wait. A new share buyback program should be announced and might happen at their CMD at the end of January 2016. Stock currently trading at 16x P/E for 2016. When Kingfisher gets their "One Kingfisher" working, there should be plenty of upside. We don't expect France to turn around anytime soon, but perhaps not get any worse as the housing starts are at a 40-year low.

**State Bank of India**
**(2.7%)**

**Buyback program announced**

*Summary:* State Bank of India (SBI) reported net earnings of INR 38.8bn , up 25% YoY on NII at INR 143bn, up 7% YoY and strong non-interest income of INR 62bn, up 36% YoY. Opex of INR 102bn rose 9% YoY on pension provisioning (while salary costs were down 1% YoY). Non-performing assets were INR 568bn (flat QoQ, -6% YoY), at 4.15% which is down from 4.9% YoY. SME and mid-corporate deteriorated while Large corporates and the International division saw improvements. Gross slippages, i.e. loans downgraded to non-performing, were lower than expected at INR 59bn, down from INR73bn in 1Q16. In terms of capital adequacy, they are now at a CAR of 12.2% with tier 1 at 9.9%.

*Investment case implications:* Positive. Our investment case is built on improving credit quality and cost structure, while the market has been more focused on achieving low-mid teen growth in 2015-16. We've started to get a good indication that costs and asset quality (now in the absence of restructuring) are heading in the right direction. The cost to income ratio was down 37bps, gross NPA ratio down 74bps and Net NPA ratio down 59bps. ROE increased to 12.6% (+122bps YoY) with ROA of 0.73%. We see >60% upside to current valuation at 1.1x P/B and 9x FY16 P/E.

# Key earnings releases and corporate news, November 2015 (cont.)

**Tyson Foods**

**(1.7%)**

**UK doing fine while France is poor**

*Summary:* Chicken did well with strong margins. Beef took a hit on mark-to-market inventory adjustments. Pork margin as expected. Prepared foods segment did fine with margins as expected. Dividend increased and the company is buying back more shares. Outlook is encouraging as guidance for chicken margins at 10%+ is higher than previous guidance of 7-9% for 2016, while beef segment will be lower. More synergies to come from the Hillshire acquisition. Excess cash will be used for dividends and more share buybacks.

*Investment case implications:* Our investment thesis is playing out the way we hoped as Tyson has been able to sustain high margins in their chicken segment. The main reasons for this are that they are buying chicken meat (up to 10%) in the market and stamping the Tyson brand on it and secondly they have changed the way they do business by having cost-plus contracts that protect their chicken margin. This is a process that was started 3 years ago and now we see results coming through. Beef segment is depressed and they should think about a spin-off, but not right now. Their prepared foods business should also improve the stability in their margins. Balance sheet is solid and they are buying back more shares and increasing the dividend. EPS expected to grow at 10%+ p.a. Tyson is not yet comparable to prepared foods peers as they still have exposure to the somewhat volatile commodity business. We think they should trade between pure commodity peers (8-9x P/E) and prepared foods peers (20-21x P/E). Re-rating is ongoing and we think a 15x P/E multiple is fair. Price target two years out is USD 60 derived from 15x P/E on USD 4 earnings.

**Carlsberg**

**(1.7%)**

**Setting sail for a more profitable future – self-help case becoming clearer**

*Summary:* Sales DKK 18bn +1%, OP DKK 3.5bn +2%. West Europe sales up 5%, however lower profitability. Eastern Europe/Russia sales down 23%, but much better profitability as 3Q14 was impacted by write-downs. Asia saw 18% sales growth and better profitability due to scale effects. Restructuring/impairment charge of DKK 8.5bn. 97% non-cash. Will improve profitability by DKK 1.5-2.0bn by 2017 (2/3 will be visible in 2016) to fund investment in future profitability. Will reduce debt and increase shareholder remuneration. M&A is off the agenda.

*Investment case implications:* Positive. The Danish brewer Carlsberg's investment case core is that it is a stable earner with sub-par profitability to peers and on route to be improved. The 3Q15 report confirms the path. Organic sales grew 3% and operating profit grew 9% to a 18.9% margin. Carlsberg's annual OP-margin is 14%, while that of the three large peers (InBev, SAB Miller and Heineken) are 32%, 20% and 17% respectively. Geographical mix will not enable Carlsberg to reach more than 17-18%, but the investment thesis requires only 15.5% to reach the target price. No more large M&As is good news because Carlsberg's M&A history is a textbook of how *not* to do it. The new Sail 2022 strategy plan will be communicated in March 2016.

# The 10 largest companies in SKAGEN Global

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.

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.

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.

Founded in 1892 by Thomas Edison et al., General Electric (GE) operates two divisions (GE Industrial and GE Capital) contributing approximately the same portion of group earnings. GE is the world's 10$^{th}$ largest publicly-traded company and boasts the 6$^{th}$ 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.

# The 10 largest companies in SKAGEN Global (cont.)

MERCK

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.

Nordea

Nordea holds pole position in the Nordics with 11.2m retail customers and 625,000 corporate clients. Nordea is the largest Nordic asset manager/wealth manager with EUR 224bn in AuM (EUR 138bn in managed funds). It is the most diversified among its Nordic peers. Total loans are EUR 346bn with the following split: Finland 27%, Sweden 26%, Denmark 24%, Norway 18%, and Baltics/Poland/Russia 5%.

DOLLAR GENERAL

Dollar General (DG) is the largest US dollar store retailer with an estimated 28% market share and 2015e sales of USD 20bn. DG has more than 12,000 stores in 43 states. Most customers live within 3 to 5 miles, or a 10-minute drive, from the store. DG has 12 distribution centres and employs 100,000 people. Items typically cost in the range of USD 1-5 apiece. DG sales are divided into 4 main categories: Consumables (76%), Seasonal (13%), Home Product (6%) and Apparel (5%).

State Bank of India

State Bank of India is the largest bank in India with a 22% market share. It has an unrivalled pan-India branch network and a very strong deposit franchise. The bank also has a sizeable overseas presence (15% of loan book). Aside from its core banking operation, the company is also involved in life insurance, asset management, credit cards, and capital markets.

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 (% of 1H 2015 total EBITDA): Infrastructure (37%), Telecom (20%), Retail (15%), Ports 13%), and Energy (11%).

| Mean reversion | Special situation | Long-term value builder |
|---|---|---|
| 0% | 25% | 75% |

# Xcel Energy (XEL US) USD 35

### History, business model and source of investment idea

- Founded in 1998, Xcel Energy is a fully regulated US electricity and gas utility operating in 8 Midwestern states where its 12,000 employees serve >3m electricity customers. Xcel ranks #255 on the 2015 Fortune 500 list.
- The company's generation mix includes natural gas, nuclear, coal, wind, hydro and solar power assets.
- Overview of regulatory schedule and activity in key jurisdictions:
  - Minnesota (~35% of rate base): Multi-year electricity case (2016-18) filed in Nov 2015 with final ruling 2017 Q1
  - Colorado (~31% of rate base): Multi-year electricity case (2015-2017) done. Final decision on gas in 2016 Q1
  - SPS - Texas/New Mexico (~10% of rate base): Electricity rate case decision by 2015 Q4 (TX) / 2016 H2 (NM)
- Targets: EPS/DPS growth of 4-6%/5-7%, 60-70% PR, 75% of revenue from MYP, ROE gap 50 bps less by 2018
- CEO & Chairman: Ben Fowke (b. 1958), appointed in 2011. Ex-COO. Owns stock worth USD 12m.
- Case identified through SKAGEN Global internal proprietary research.
- ESG – No severe issues identified but carbon emission rates and water usage intensity merit close observation.

### Rationale for investment

Our two-pronged contrarian investment thesis on Xcel is remarkably simple and straightforward:

- First, Xcel is a well-managed, diversified and fully regulated utility offering high earnings visibility, solid EPS/DPS growth (4-7% 3-yr CAGR) and a proven track record of meeting financial targets. Given this transparency, the market's obsession with the stock's purported "limited short-term potential" masks the *long-term* value opportunity created by Xcel's inherently defensive qualities that underpin an appealing double-digit total return story. We deviate from the common market perception in that we find Xcel's risk-reward attractive in the current environment and we predict the market over time will conclude the same and re-rate the stock. Importantly, the market misses the capital return buffer (consensus PR only at 60%) which reduces the stock's downside risk.
- Second, given positive recent regulatory developments combined with future earnings optionality from capitalising on clean energy capex, transmission build-out and/or gas infrastructure projects, we argue Xcel should trade at a distinct premium to the peer group (vs. in-line today). In addition to this upward re-rating potential, the option of single-digit EPS/DPS upgrades in outer years (2018+) does not seem to be priced in at current levels.

### Triggers

- Constructive implementation of new regulations in CO/MN boosting EPS/DPS (short-term).
- Consistent delivery of financial targets in a similar macro environment will support a re-rating (medium-term).
- EPS/DPS growth in outer years significantly above expectations as capex optionality materialises (long-term).

### Risks

- Regulatory risk. Adversary ruling in existing and future rate cases due to deteriorating regulatory climate.
- Interest rate risk. Several interest rate hikes in rapid succession by the Fed may well de-rate the stock's multiple.

### Target price

We value Xcel using P/E and DDM valuation techniques, thus deriving a base case price target of USD 45/share. Annual value creation from approximately 5% EPS growth, 4% dividend yield and 5%+ re-rerating. In a bear case scenario, we see 17% downside while our bull case offers over 50% upside over a 2-year perspective.

Xcel Energy

| Key Figures | |
|---|---|
| Market cap | USD 17.8bn |
| Daily turnover | USD 110m |
| No. of shares | 508m |
| ND/EBITDA | 4.4x |
| ROE 2015e | 10.2% |
| | |
| P/E 2017 | 14.9x |
| P/B 2015 | 1.7x |
| EV/EBITDA 2017 | 8.5x |
| DY 2015 | 3.6% |
| | |
| # of analysts | 18 |
| with Sell/Hold | 72% |

**Largest Owners**

1. Blackrock 7.0%
2. Vanguard 5.9%
3. JP Morgan 5.2%

# 3U acid test

**Unpopular**

- 72% SELL/HOLD recommendations.
- Fear of owning utilities ahead of a potential rate hike by the Fed.
- The Utilities sector is consistently rated as unpopular among investors; for example, Utilities had the highest underweight (>35%) of all sectors in in BAML's Fund Manager Survey published in November 2015.

**Under-researched**

- The business model is not complicated, but the equity story is arguably misunderstood in the sense that Xcel's long-term value is not properly captured by the investment community as the story is not conducive to "making a quick buck".
- More specifically, utility analysts typically spend vast amounts of time trying to nail the next quarter's EPS on the penny rather than sizing up the long-term opportunity.

**Under-valued**

- Yes. The value of solid earnings visibility coupled with several options on higher-than-expected EPS/DPS growth is underappreciated by the market.
- On a risk-adjusted basis, Xcel offers a compelling defensive exposure from a global equity portfolio construction point of view.
- Our base case indicates a fair value of USD 45/share (29% upside) with an attractive risk-reward (17% downside).

# ServiceMaster (SERV US) USD 34.5

| Mean reversion | Special situation | LT value creator: |
|---|---|---|
| 25% | 0% | 75% |

## History, business model and source of investment case

- Founded in 1929, ServiceMaster is a leading provider of residential and commercial services, primarily in the US. The company offers termite and pest control services under its Terminix brand (57% of revenues) and home warranty plans covering the repair or replacement of household systems and appliances under its AHS brand (32%). Additionally, the company provides disaster restoration, janitorial, cleaning, furniture repair, and home inspection services under its Franchise Services Group segment (11%). The company was made private in 2007 and floated again in 2014.
- Our ESG research shows that ServiceMaster complies with SKAGEN's ethical guidelines.

## Investment rationale

- **Strong positions in "recession proof" markets.** Pest control industry is attractive for large-scale players due to the fragmented nature of competition (20,000+ companies, most of which with <100 employees), relatively modest penetration of services, as well as the highly resilient revenue stream as most services are essential; the cost of professional treatment is far outweighed by the cost of inaction or ineffective treatment, and homeowners' insurance policies generally do not cover damage caused by pests. ServiceMaster is the #1 player in Termite with 51% market share; and #2 in Pest with 15% share (local market shares are significantly higher, driving strong network effects and high returns). Within the home warranty segment, AHS has a market share of 43% (>4x the size of the largest competitor). AHS adds value by passing along economies of scale, cutting out middle men and aligning incentives, through its network of contractors and technicians. Customer retention was largely sheltered from the financial crisis across the group's core businesses.
- **Under-appreciated growth potential.** AHS is faced with an un-vended opportunity of ~30 million owner-occupied homes in the US, that better marketing could capture (lack of awareness; strong value proposition). Household penetration is merely 3-4% (but significantly higher in certain areas, e.g. 90% in California). We estimate this will support a medium-term double-digit revenue CAGR opportunity with high incremental margins. Over the longer term, AHS could potentially grow to 5x its current size if it reaches the penetration of e.g. home security systems. Penetration of professional pest control services are also expected to expand from current levels. More specifically, Terminix has the opportunity to expand its presence in the commercial market that enjoys even higher customer stickiness. There is also an untapped cross-selling opportunity as the customer overlap between Pest and AHS is less than 10% (SRV effectively visits 75k homes every day).
- **Asset-light business model.** Bulk of services are contracted on pre-paid basis which is why growth is partly self-funded. The capex requirements are also very low (less than 2% of sales). This translates into high cash conversion of profits.
- **Expanding capital allocation options.** De-levering is progressing as planned and ServiceMaster's target leverage of 3.5-4.0x ND/EBITDA is expected to be reached early 2016. Low operational risk allows the company to run with high financial leverage: ND/EBITDA peaked at ~10x, which was manageable even during the financial crisis. Going forward, cash can be deployed in highly accretive M&A (bolt-ons typically acquired at 2-3x EV/EBITDA once integrated), leveraging the network effect, or returned to shareholders (company has not paid a dividend while de-levering). Ongoing refinancing of high yield debt will fuel a positive spiral effect and free up more cash.
- **Trading at deep discount to peers.** ServiceMaster trades at a 40% discount to peers. We see no fundamental reason why this discount should persist over time, and expect it will perish as confidence in the new management team builds.

## Triggers

- Update on capital allocation policy (short-term).
- Stabilisation of pest control customer count; expected on back of normalisation of weather (medium-term).

## Risks

- Virgin Island case (DoJ investigation into an event caused by use of restricted chemical).
- Competitive disruption driving irrational pricing behaviour (e.g. Rentokil being more aggressive and scaling up in the US).

## Price target

Base case upside of 52% until 2017 driven by profit growth (no re-rating). Blue-sky scenario of c. 90% if valuation gap to peers is closed; and -15% potential downside in adverse scenario (de-rating and material price pressure).

**Key Figures**

| | | |
|---|---|---|
| Market cap | USD | 4.7bn |
| Net debt (adj.) | USD | 2.6bn |
| Enterprise value | USD | 7.3bn |
| Equity | USD | 0.5bn |
| No. of shares o/s | | 135m |
| EV/Sales 2016 | | 2.67x |
| EV/EBITA 2016 | | 11.4x |
| P/E 2016 | | 17.2x |
| FCF yield 2016 | | 6% |
| EPS CAGR (2014-17) | | 23% |
| Daily turnover | USD | 30m |
| No of analysts | | 9 |
| with Sell/Hold | | 22% |

**Owners**

| | |
|---|---|
| Citadel | 5.2% |
| Wells Fargo | 5.1% |
| Vanguard | 5.1% |

# 3U acid test

**Unpopular**

- Fallen out of favour with investors since its Q2'2015 results release: share dropped more than 6% on back of deteriorating customer count within Terminix (see below).
- 22% Sell/Hold – Less popular in the market than on the sell side.

**Under-researched**

- Misdirected focus on customer trends in pest control: customer count has been on a downward trend over the past few years and has recently come into investors' focus. Our analysis indicated this is weather related. The peculiar fact is that good service delivery and mild weather reduce customers' perceived need for contracted services. Hence, a normalisation with warmer summers will support a recovery of customer count.
- Under-appreciated growth potential within AHS: faced with an un-vended market opportunity of ~30 million homes in the US, services are now being successfully pushed to customers for the first time. Overall, household penetration is merely 3-4% but significantly higher in certain areas, e.g. 90% in California. We estimate this will support a medium-term double-digit revenue CAGR opportunity. Over the longer term, AHS could potentially grow to 5x its current size if it reaches the penetration of e.g. home security systems. Notably, incremental margins and returns are very attractive given AHS' size.

**Under-valued**

- ServiceMaster currently trades at 40% discount to peers, which we believe is unwarranted. We expect this to fade over time as confidence in management builds.
- Its highly cash-generative and "recession proof"-business model deserves a premium valuation despite current (manageable) debt load.
- Attractive risk-reward profile with expected base case return of 52% over the next 2-3 years (11x EV/EBITDA). Downside is limited to -15% on back of low operational risks.

# 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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