

# SKAGEN Vekst

**Morningstar Category Benchmark**  
MSCI World Small Cap NR USD

## Morningstar Qualitative Rating™



Elite  
Superior  
▶ **Standard**  
Inferior  
Impaired

**Thomas Furusetth**

Morningstar Analyst

## Executive Summary

**People:** Beate Bredesen is the natural successor to Kristian Falnes, who now runs SKAGEN Global.

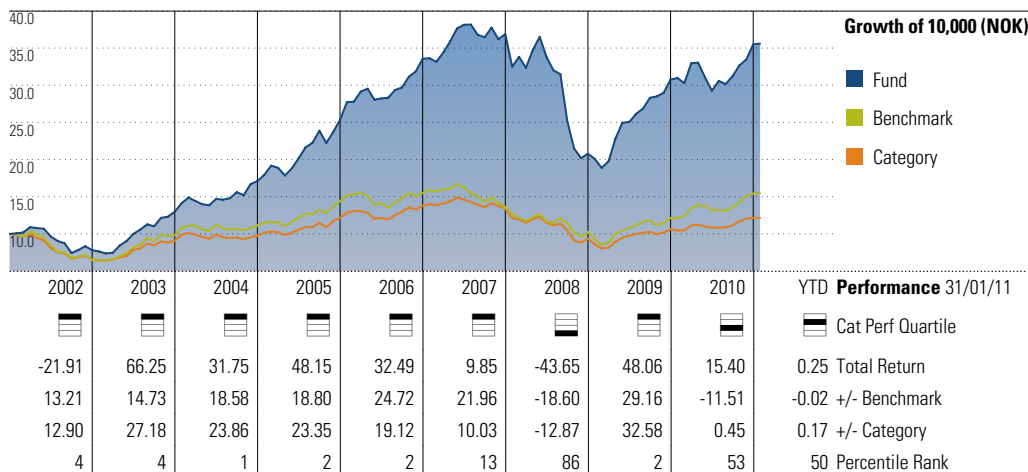
**Parent:** SKAGEN focuses on its core competencies and hasn't launched any equity funds since 2002. Its growth mainly has come from offering its funds in additional markets.

**Process:** The process is bottom-up and value-oriented. Unlike most category funds, this offering has emerging-markets exposure and a large Norwegian equity stake.

**Performance:** The performance has historically been good, compared to relevant benchmark. After Bredesen took the helm, the performance has been fair.

**Price:** We find the structure of the performance fee inappropriate. The hurdle rate of 6% sets the bar too low given this fund's mandate.

**Role in Portfolio:** This fund is best suited as a supporting player for most investors, but it can be used as a core holding by Norway-based investors.



## Morningstar Opinion

21 Jan 2011 | Beate Bredesen is the natural choice to lead SKAGEN Vekst.

This fund's former lead manager, Kristian Falnes, moved over to the much larger SKAGEN Global fund following Filip Weintraub's departure. Beate Bredesen joined SKAGEN in 2004; she has 13 years' total investing experience. Bredesen selected Ross Porter as comanager as she believes they complement each other. Porter came to SKAGEN in 2000 to manage SKAGEN Avkastning, a bond offering, which he ran for eight years until he was replaced in 2008. We are eager to see what Porter and Bredesen can achieve going forward. Their cooperation with other equity teams at SKAGEN is also a key positive feature here.

This fund has a significant bias to Norwegian equities, which may be natural for many Norway-based investors, but not for other investors. Managers allocate roughly half of the portfolio to Norwegian stocks, compared with just 3% for the typical Global SMID category fund. That impacts the fund's risk profile since the Norwegian equity market is small and skewed toward energy. To illustrate the risks, after the bear market ended in 2003, the OSEBX index gained an amazing 400% through mid-2007, before it plunged 57% from June 2007 to Nov. 2008 (all figures in non-annualized NOK terms). Except for the allocation to Norwegian equity, SKAGEN continues its tradition of not paying too much attention to country allocation and employing the firm's contrarian strategy that looks for unpopular, under-researched and, in their opinion, cheap stocks.

The process led the managers to emerging markets and their EM stake has historically ranged between 6% and 14%. More recently, they bought US-based companies such as Winn-Dixie Stores and Seagate. SKAGEN typically adds positions over time and reduces positions in the same manner, thus aggregate changes to the portfolio since March 2010 have been modest. Bredesen and Porter have made active steps to lower the number of positions in the fund by selling the tiny stakes. The managers' performance record is too short to make a meaningful assessment, but over their tenure through Dec. 2010 they have underperformed the 50/50 Norwegian/global equities benchmark by roughly 3%.

The fund charges a reasonable management fee of 1%; however, we think its performance fee structure is inappropriate: The fund charges a performance fee of 10% on returns in excess of a rate of 6%. As a result, the fund is rewarded not only for manager skill but also when its market segments are in favour. In the 2009 bull market the TER reached an excessive level of 4.5%. Furthermore, the performance fee should incorporate a high-water mark to avoid performance fees on recovery of past periods of underperformance.

This fund's good parent and process are key strengths, but we would like to see more from the new managers. Add a faulty performance fee structure and we assign Standard rating.

Morningstar® Category	Global Small/Mid-Cap Equity
Manager's Benchmark	50% MSCI AC World NR USD, 50% OSE OBX Indeks
Inception Date	01/12/1993
12 Month Yield %	0.00

ISIN	N00008000445
Domicile	Norway
Legal Status/UCITS	Open Ended Investment Company
Currency	NOK
Total Net Assets	NOK 9427.32 Mil

# SKAGEN Vekst

## Morningstar Category Benchmark

MSCI World Small Cap NR USD

Manager	Beate Bredesen, Ross Porter
Manager Start Date	31/05/04
Average Tenure	3.83
Avg Yrs Experience	12.5
Longest Tenure	6.71
Number of Analysts	6 other PMs

## People

Beate Bredesen became the lead manager in March 2010 and is the natural successor to Kristian Falnes. Falnes steered SKAGEN Vekst from Nov. 1997 to March 2010 when he replaced Filip Weintraub at the much larger SKAGEN Global fund. SKAGEN hired Beate Bredesen in May 2004 to assist Falnes with the management of this fund. Previously, Bredesen worked as an analyst at the investment division of Orkla; her experience there dates back to 1997. Beate Bredesen brought on Ross Porter to comanage the fund. He was formerly lead manager of SKAGEN Avkastning, a bond mandate, from 2000 to 2008. He stepped down in the midst of weak performance during the financial crisis. Prior to SKAGEN he holds experience from Norwegian Bank Investment Management.

Bredesen selected Porter because she thinks they complement each other. Bredesen and Porter also leverage the knowledge of the other equity managers at SKAGEN. We look forward to seeing more of the duo, and we appreciate Bredesen's tenure here.

Management Company  
SKAGEN AS

Total Assets Under Mgt	NOK 107.5 Bil
Total Assets in Strategy	NOK 9.4 Bil

## Parent

The company is currently owned by its founders and key personnel. This structure can lead to skewed incentives to grow assets, which can run counter to fund shareholders' interests. However, this worry is mitigated by the owners' investments in their own funds. We also see the transparent and fair disclosure of information as a key strength at SKAGEN. Managers are compensated by a fixed salary plus a bonus based on one-year performance. We'd like to see compensation based on longer track records; it discourages excessive risk-taking and helps align managers' interests with shareholders' long-term investment horizons. The firm has grown assets primarily by expanding distribution to new countries, not by launching trendy products. It has stuck to its core

competencies, but it has still broadened its fund lineup—recently in the bond and money market space. SKAGEN's equity funds have three different performance fee structures, and not all of them are ideal; for example, SKAGEN Vekst has a flat hurdle rate of 6% that we think is inappropriate given the fund's mandate.

Max Position Size	10%
Regional Constraints	Min 50% Norway
Tactical Use of Cash	No
Hedging Policy	Unhedged
Manager's Benchmark	50% MSCI AC World NR USD, 50% OSE OBX Indeks

## Process: Investment Approach

By mandate the fund must allocate 50% of assets to Norwegian equity, which is atypical for a fund in the Global Small/Mid-Cap Equity peer group. The high exposure to Norwegian equities makes it best suited for Norway-based investors. Except for this constraint, Bredesen continues SKAGEN's contrarian house strategy, which emphasizes securities that are undervalued, under-analyzed, or unpopular, or combinations of the three. In addition, the managers also look for triggers for price appreciation. The approach leads to distinctive portfolios that are very different from typical benchmarks. The

managers try to limit sector concentrations, although they typically pay less attention to country of domicile. The managers maintain a long-term horizon, resulting in relatively stable portfolios and low turnover, which is attractive. SKAGEN's equity managers leverage each other's ideas, so there is some overlap among all three of the firm's equity funds. Investment ideas are generated from a variety of sources. For example, the managers may get ideas when they analyze the competitors and suppliers of current portfolio constituents. The managers add holdings to their portfolios carefully and gradually, and they reduce their stakes in the same manner.

# SKAGEN Vekst

## Morningstar Category Benchmark

MSCI World Small Cap NR USD

Value Measures	Fund	Rel Cat
Price/Prospective	11.07	0.86
Earnings		
Price/Sales	0.56	0.74
Price/Book	0.97	0.65
Price/Cash Flow	4.84	0.98
Dividend Yield	1.51	0.52

Growth Measures	Fund	Rel Cat
Long-Term Earnings	10.98	1.04
Historical Earnings	-7.80	0.37
Sales	-27.95	0.86
Cash Flow	-25.62	-1.09
Book Value	-15.08	0.82

Average Market Cap	NOK 11595.80 Mil
--------------------	------------------

Top 5 Regions	% Equity
Europe - ex Euro	56.07
United States	10.68
Eurozone	8.31
Asia - Developed	6.78
Latin America	5.23

Top 5 Countries	% Equity
Norway	52.81
United States	10.68
Korea, Republic Of	6.78
Brazil	4.53
United Kingdom	3.15

Market Maturity	% Equity
Developed Country	88.33
Emerging Markets	11.67
Not Classified	0.00

## Process: Portfolio Positioning

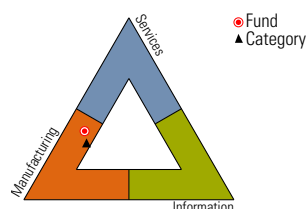
In light of the fund's mandate that 50% of the portfolio is invested in Norwegian equities and the rest is invested globally, the fund looks a lot different from the typical fund in the Morningstar Global Small/Mid-Cap Equity category. The fund's significant bias toward Norway also impacts its sector composition because the Norwegian market is heavy on energy exposure. As a result, this fund has a permanent bias toward the energy sector compared with other global small/mid-cap funds. Besides the Norwegian exposure and its subsequent influence on the energy stake, Bredesen continues the tradition of looking for opportunities wherever they arise rather than looking at domicile. The duo has started to reduce the number of holdings by selling off the smaller stakes in order to

Asset Allocation	% Assets	long %	short %	net %
Stocks	93.93	93.93	0.00	93.93
Bonds	0.95	0.00	0.00	0.95
Cash	1.66	0.01	0.01	1.65
Other	3.47	0.00	0.00	3.47

Top Holdings	% Assets
31-01-11	
Kongsberg Gruppen ASA	4.13
DOF ASA	2.54
Solstad Offshore ASA	2.43
Norsk Hydro ASA	2.37
Samsung Electronics Co., Ltd.	2.26
Bonheur ASA	2.24
Wilh. Wilhelmsen ASA Shares - A	2.17
Ganger Rolf ASA	2.13
Gjensidige Forsikring ASA	2.06
Petroleo Brasileiro SA Petrobras ADR	2.04
Carnival Corporation	2.03
Centrais Ele. Brasileira S.A. Elet...	2.02
Pride International, Inc.	2.02
Teva Pharmaceutical Industries Ltd...	2.01
Norwegian Air Shuttle ASA	1.72
Dockwise Ltd.	1.65
Stolt-Nielsen Ltd.	1.63
Olav Thon Eiendomsselskap ASA	1.59
Transocean Ltd.	1.55
Cermaq ASA	1.52
Total Equity/Bond Holdings	166/5
Assets in Top 10 Holdings %	24.38

streamline the portfolio and adjust the number of names to a more manageable figure. The fund holds a significant stake in emerging-markets stocks; it used to be 3 times category norm. Now the average exposure in the category has increased, while Bredesen (and Falnes before her) has kept the exposure at the same level. Hence the EM stake doesn't stand out as much now as it did previously. Because of its quirky regional makeup, this fund should be used as a supporting player for most Europe-based investors.

### Sector Delta



Sector Weightings	% Equity	Rel Cat
<b>Information</b>	<b>10.04</b>	<b>0.71</b>
Software	0.56	0.26
Hardware	4.95	1.06
Media	0.00	0.00
Telecommunication	4.53	0.79
<b>Service</b>	<b>37.71</b>	<b>1.21</b>
Healthcare	6.48	0.98
Consumer Services	6.14	0.85
Business Services	15.32	2.61
Financial Services	9.77	0.85
<b>Manufacturing</b>	<b>52.26</b>	<b>0.96</b>
Consumer Goods	13.15	0.99
Energy	14.27	0.52
Energy	22.37	3.24
Utilities	2.47	0.36

# SKAGEN Vekst

## Morningstar Category Benchmark

MSCI World Small Cap NR USD

Trailing (NOK)	Total Rtn %	+/- % Bmark	+/- % Cat	%Rnk in Cat
3 Mo	8.98	0.18	4.83	7
6 Mo	16.44	-0.23	4.12	24
1 Yr	14.95	-12.85	-1.99	62
3 Yr Annualised	3.09	-4.03	2.27	37
5 Yr Annualised	5.12	4.81	5.34	4
10 Yr Annualised	12.72	8.40	11.99	1

MPT Stats	3 Yr	Rel Cat	5 Yr	Rel Cat
R-Squared	85.31	1.00	81.84	1.00
Beta	1.17	1.29	1.15	1.25
Alpha	-2.80	0.52	5.90	-65.56

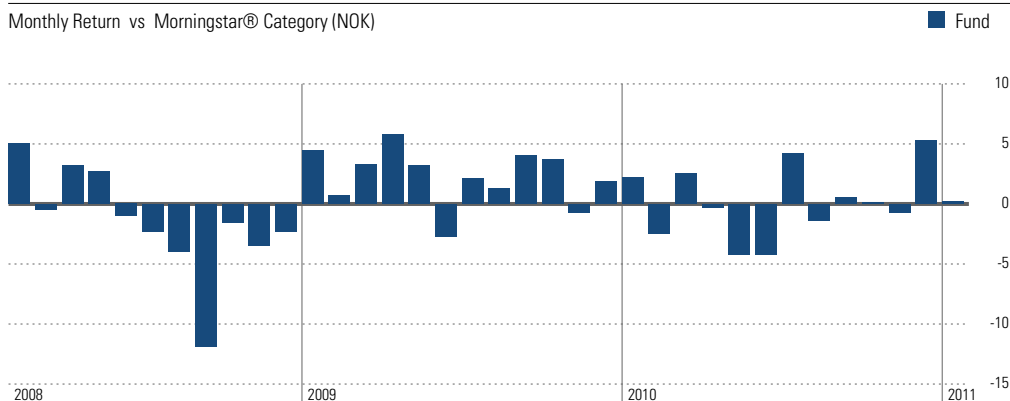
Volatility & Risk Adj Returns	3 Yr	Rel Cat	5 Yr	Rel Cat
Std Deviation	23.43	1.28	19.98	1.19
Mean	0.48	2.40	0.59	5.90
Sharpe Ratio	0.10	-1.67	0.16	-1.00
Information Ratio	-0.28	0.48	0.39	-6.50
Treynor Ratio	0.46	-0.22	5.14	12.85

## Performance Analysis

Bredesen has contributed to the strong historical track record and the duo now has to continue that path. They could have gotten off to a better start: The fund's return from March through Dec. 2010 was 7.8%, while a 50/50 Norwegian/global benchmark achieved 11.7%. Of course the time period is too short to make a meaningful assessment of the results. Bredesen comanaged the offering for a number of years and hence contributed to its strong historical track record. Comparing it to the same benchmark, it outperformed in three of five years during Bredesen's tenure. Falnes did have a material impact, of course, but he's still on the equity team and ideas flow

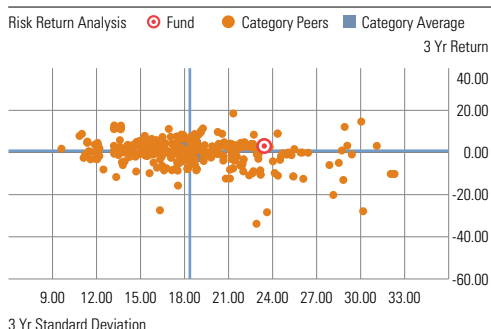
from one team to the other. Investors need to take note of the fund's unique composition; it will lead the fund to behave much differently than its peers both in the Morningstar Global Small/Mid-Cap Equity and Norway Equity categories. The strategy does not come without risk: In 2008, the fund lost 43.6%. The managers achieved decent results during 2010, but the return was just in line with their stated benchmark. Investors here should be prepared for some ups and downs, as the fund has experienced more volatility than the typical global small/mid-cap fund and the 50/50 benchmark.

Monthly Return vs Morningstar® Category (NOK)



## Risk & Return

Investors need to be prepared for a bumpy ride compared with typical peers, as the fund holds a significant portion in Norwegian equities. Norwegian equities tend to be more volatile and more concentrated on energy issues than global category funds. That said, investors have historically been properly rewarded for taking on this risk.



Morningstar Rating™ (Rel Cat)	Morningstar Return	Morningstar Risk	Morningstar Rating™
3 Year	Abv avg	High	★★★
5 Year	High	High	★★★★
10 Year	High	High	★★★★★
Overall	High	High	★★★★

## Price

We find the structure of the performance fee inappropriate. The hurdle rate of 6% sets the bar too low given this fund's mandate.

Max. Initial Sales Charge %	-
Annual Management Fee %	1.00
Total Expense Ratio %	4.50