

# Interview: Svein Høgset: - Incentive Active Value Fund

Stockholm (HedgeNordic.com) - July saw a new hedge fund come to the market out of Norway. Svein Høgset, Niklas Antman and Mikael Berglund launched the Incentive Active Value Fund under the umbrella of Sector Asset Management. Incentive is a directional long / short equity fund with a European focus looking to profit from under-analysed equities, typically within the mid cap segment. We had the opportunity to interview Svein Høgset, the portfolio manager on the new fund, and here is what he had to say:

**HedgeNordic:** Can you give us, in a nutshell, an understanding of Incentive Active Value Funds trading approach?

**Svein Høgset:** We are launching the Incentive Active Value Fund to exploit what we believe is a multi year opportunity in European mid caps. In a world where most investors are flocking to the most liquid securities out there, for example those companies that are part of the largest benchmark indices such as the FTSE 100 or the MSCI Europe, we believe that there is an opportunity for those who are willing and able to do the work on mid caps to find exceptionally attractive investment opportunities in areas of the market that fall outside of say the largest 10-15% of the listed company universe in Europe. The typical company in our portfolio will have a market cap somewhere between EUR500m and EUR5bn and it will be covered properly by only a few, if any sell side research houses. Our portfolio will be concentrated, with only 10-20 investments at any given point in time and we are looking for companies that we think will perform well for us over multi year periods. We will stay close to the management teams of the companies we invest in and from time to time, we may engage actively if there are areas where we can contribute positively to the value creation process.

**HedgeNordic:** What is universe of companies you are looking at?

**Svein Høgset:** Our universe is big. In Europe, there are more than 2000 companies with a market capitalisation in excess of EUR200 million. Only 10-20% of these are covered properly by the sell side, which leaves a large number of companies that receives little or no attention by research analysts. We believe that we are well equipped to find great investments within this universe, whether the companies are based in the Nordic region or elsewhere. Within industries that we know well and where companies compete head to head with each other, irrespective of where they are listed, we may even opportunistically invest outside of Europe, for example in companies within capital goods, energy or transportation. We are typically not fond of situations where one binary event can kill the entire investment thesis so we will typically shy away from companies where one bad event can cause a large permanent loss. We are not likely to invest, therefore, in early stage E&P or biotech for example, where the outcome of one risky exploration well or one uncertain FDA approval process can cause a big drop in a company's stock price. We are simply not that good at analysing such situations and prefer to invest in businesses with somewhat more resilient business models.

**HedgeNordic:** You do single out the Nordic region as target for allocations. Where do you see the advantages and opportunities in the regional markets?

**Svein Høgset:** Relative to many investors, we have a particular edge when it comes to finding good investments in the Nordic region. Whereas Mikael, Niklas and I have been based in London for most

of our careers where we have invested on a European and even on a global basis, Scandinavia has always been our home turf. This is a particular strength I believe, considering how attractive the Nordic markets are as a hunting ground for equity investors. That doesn't mean that we will exclusively focus on Nordic opportunities.

First and foremost, we are value investors and one of the great advantages we have, relative to many investors, is the fact that we aren't restricted to any particular region, a particular industry or a particular benchmark in our search for attractively priced investments. This puts us in a position where we can own an outsized position in a company that we find attractive, irrespective of whether the company is Swedish or Greek, or whether or not it is part of a reference index. Our ability to focus our research and our capital on a particular segment of the market where something, perhaps controversy or complexity, causes companies to trade at deep discounts to their fair value is something that we intend to exploit, irrespective of whether the opportunity is Nordic, or listed somewhere else.

With that said, we only want to invest in situations where we believe that we have particular edge, relative to most other investors. That obviously restricts our comfort zone to industries, geographies and situations that we know well.

**HedgeNordic:** You say you will have „active involvement“ and „engage actively with portfolio companies“. What exactly do you mean by that and how will you execute it?

**Svein Høgset:** We are investors, not traders and we will hold only a limited number of investments at any point in time. A long term perspective and a concentrated portfolio approach gives us the luxury of being able to spend a lot of time on each of our portfolio companies. We do a lot of research before we make investments, research that includes in depth discussions with the management teams of the companies we invest in. This dialogue continues as we become shareholders and to the extent that we have views on what companies can do to improve their operating performance, how they finance themselves or how they communicate with investors for example, we will of course express these views and if need be, encourage our portfolio companies to take the right steps. Sometimes, this engagement will involve discussions with other relevant constituents – for example board members– and sometimes, we could even sit on nomination committees or other relevant corporate bodies. In our experience, the vast majority of companies we talk to want actively engaged shareholders and we hope to be a positive contributor in most companies we commit the fund's capital to in the years ahead.

**HedgeNordic:** Can you tell us more on what you consider to be „deep value“ companies and how you find and identify them?

**Svein Høgset:** Our research process is for the most part bottom up although we also periodically screen markets on various value metrics to get a sense for whether there are certain areas of the market that could be of particular interest for us, be it specific sectors or specific countries. If a screen tells us that real estate companies in Germany trade at low cash flow multiples for example, we may decide to go to Germany to meet with all of those companies, with the hope that we come across a particularly attractive opportunity. The more stones we turn, the more likely we are to find great opportunities, so we spend our days learning about as many companies as we possibly can. Our research process involves reviewing a lot of financial reports, whether from the companies themselves or external analysts covering them and also a lot of our own financial modelling. Ultimately, the value of a company is a function of its ability to generate free cash flow for its shareholders and in order to have a strong view on this, one needs to understand broader industry dynamics as well as company specific factors extremely well.

**HedgeNordic:** You made a strong case for Norwegian investment company “Aker”. What is the opportunity you see in Aker? Will Aker be one of the first positions in Incentives portfolio?

**Svein Høgset:** In its current form, Aker has been listed for 10 years. As an investment company, Aker has been exceptionally successful – it’s Net Asset Value per share has compounded at around 29 per cent annually if you include dividends paid during this period. This is world class investment performance and I cannot think of many companies who comes close to a record like this – and I think that the market fails to recognise this history of value creation. Of course, this analysis is backward looking, so the real question is obviously whether Aker will be as successful in creating value for its shareholders in the next ten years as it has been in the last decade.

Aker’s recipe of success has been to be an active, long term, controlling shareholder in sectors that it knows well, yet pragmatic enough to exploit the fact that sometimes, there are bargains to be had and sometimes, companies can be sold at valuations that perhaps exceed fair value. Aker’s success has made it controversial in some camps and it is this controversy coupled with the conventional wisdom that investment companies „should“ trade at a discount that explains it’s low rating. When I analyse Aker’s holdings, I believe that NAV per share will continue to compound at 15-25% per annum for the next few years, principally driven by value increases in Detnor, Aker Solutions, Akastor, Ocean Yield, Aker Biomarine and Fornebuporten.

If I am right in my view, Aker will be a terrific investment also in the years to come, I believe. A 6-7% current dividend yield and the fact that you are buying attractive assets at a big discount to their current value also gives you decent protection on the downside.

**HedgeNordic:** You plan to also allow 0-10 short positions in the portfolio. How do you identify and single out potential short trades in your conviction model?

**Svein Høgset:** We apply the same rigorous criteria when identifying short opportunities as we do when we investigate a potential long opportunity for our portfolio, although there is more emphasis on identifying just what will cause the value of a company to drop, which obviously is a requirement for a short position to turn profitable. A stronger emphasis on identifying catalysts also implies a somewhat shorter expected time horizon for a short position than for a long position to work out. If an asset is cheap enough, we will have a lot of patience for it to revalue. We will typically be more impatient for short positions to work out, since shorts that one gets wrong for a long time typically tend to be more risky and cost more than the corresponding undervalued long position that one gets wrong. For the same reason, a typical short position will also be smaller than our large investments on the long side.

**HedgeNordic:** How do you time the market when initially entering a new position, and how do you determine position size?

**Svein Høgset:** Typically, we pay little attention to what the broader market does as we spend the bulk of our time analysing individual companies as opposed to forming strong macro views. Ultimately, we want to build a collection of cheap cash flow streams and for a company therefore to make it into our portfolio, we have to find it attractive on an absolute basis, almost irrespective of what alternatives there are elsewhere in the market. Hence, we will have done a poor job constructing a portfolio if a 5 or 10 per cent move in the market up or down makes us change our mind on the attractiveness of our portfolio – our view should be more absolute than relative in that sense. Of course, this will not prevent the portfolio from displaying some beta – in a long biased portfolio, that will always be the case. At the same time, we believe that our inclination to look for value, often „off the beaten track“ and our concentrated, contrarian approach will lead to a truly unique portfolio.

**HedgeNordic:** How will the process for exiting an investment look like? Will it be the same for winning and losing positions? How long will you hold losing positions and how much pain will you take if „the market continues to be wrong“?

**Svein Høgset:** A stock price moving against us, in particular if we aren't at full position size will normally trigger a desire to get larger, not smaller in an investment. A pre requisite here is obviously that our investment thesis and assessment of fair value hasn't changed, i.e. that we didn't simply lose money because we got our investment thesis wrong to start with. Many of the companies we will invest in will be companies where something that has happened, either to the companies themselves or in the environment they operate in, causes other investors to sit on the fence or shift their focus elsewhere – it is of course this that creates the opportunity for us in the first place. Most of the time, our timing will not be perfect. An unpopular company may remain unpopular for a while, even after we invest in it. As a result, if we have a lot of conviction, which we should have in all situations where we are willing to commit our capital, we are likely to tolerate a period of “pain” as you call it, if this is warranted, considering the potential longer term gain the investment can produce for the fund.

When do we sell? Most of the time, after the investment thesis has been proven correct we hope, which typically happens when the controversy, cloud or confusion that caused the opportunity in the first place has cleared, so that the company in question again appears compelling to a much broader set of investors.

**HedgeNordic:** Your trading strategy makes it hard to backtest results, or trying to predict or model possible future scenarios. What are your risk / return targets for the fund?

**Svein Høgset:** Predicting investment returns is a close to impossible exercise, but our objective is to compound at around 15% per annum without exposing the capital to the risk of too large permanent losses – a challenge but not an impossible objective to meet. The fund will be concentrated with only a few holdings so our ability to select good investments, in particular on the long side will be critical for investment returns. Also, given that the fund will operate with a high net exposure, investors should expect some correlation with the market although we do believe that the portfolio composition will be completely different than the composition of any equity index. We will not use leverage to any meaningful degree – it is important for us to remain liquid, in particular at times when markets are jittery as those moments typically offer great opportunities for those with incremental capital to invest.

**HedgeNordic:** Norway is considered to be „hedge fund hostile“ territory. Why did you choose to set up shop in Oslo none the less?

**Svein Høgset:** First of all, I decided to move to Oslo because it is a good place to live so from that point of view, this was as much a personal decision as a business decision. With that said, I don't agree with the notion of Oslo being hedge fund hostile at all! Oslo isn't yet the hub for hedge funds that Stockholm or London are, but the number of successful funds operating out of Oslo is growing. I believe that the introduction of European wide legislation creates a level playing field which implies that one can manage an absolute return oriented fund as easily from Oslo as one can from other cities in Europe. With large institutional investors present in Oslo, more and more companies also find their way through the city for regular meetings with investors, so company access is also improving. And ultimately, we can reach most European capitals via direct 1-3 hour flights several times per day so if one is willing to travel to get in front of management teams, location is not an issue, in my opinion.

**HedgeNordic:** You are launching under Sector Asset Managements licence and umbrella. Can you

tell us more on that cooperation?

**Svein Høgset:** We have formed a partnership with Sector which I believe will last for many many years. Over the last decade, Sector has buildt out an impressive operations platform so when I started to prepare for the establishment of a new Oslo based investment management firm, it didn't take me long to realise the benefit that a partnership with Sector could bring to Incentive. Through a service agreement where Sector Fund Services (SFS) provides back and middle office support to the fund and to the investment manager, I, Niklas and Mikael can concentrate our effort on the investment management and research process - which is where we can add the most value. At the same time, SFS, led by Lars Tell, does an outstanding job providing just about everything we need operationally.

We have offices down the corridor from Lars and his team, so whereas technically, one can say we have outsourced back and middle office, we operate as seamlessly with SFS as we would with any inhouse platform.

The partnership with Sector also involves a marketing agreement with Sector Capital Advisors where Davide de Picciotto and his team ensures that all investors in the fund receive the first class service they deserve, including all the information they require about our how their capital is invested.

Finally, as a part of our relationship with Sector, we have also exchanged a small minority interest in Incentive AS against a small minority equity interest in Sector Asset Management AS.

HedgeNordic: At the end of an interview, we always ask managers to share some market wisdom with us.

**Svein Høgset:** I am afraid that I have little to offer when it comes to predictions about the market.

Needless to say, I am upbeat about what we are setting out to do and I am putting the majority of my own capital behind it - if I look at our portfolio right now, we own a selection of companies that we think offer great return characteristics for an investor with a long term perspective without too much risk for permanent loss, in my opinion.

We believe that a couple of years out, our portfolio is valued at around 7-8x earnings, earnings that broadly speaking are equivalent to expected operating cash flows. This low multiple, coupled with decent prospects of earnings growth thereafter and a healthy 4-5% current dividend yield represent an attractive cocktail that I believe will compound nicely in the years ahead.

I would certainly rather own that than the S&P500 at 15x next year's earnings and definitely much rather than owning bonds, where the likely long term return is likely next to nothing, in my opinion, considering that the 10 year bund yields less than 1% as we speak.