

Lansdowne-Approach Brings Characteristics Investors Cannot Usually Get

Stockholm (HedgeNordic) - As the first employee on the investment side at Lansdowne Partners, one of London's largest and longest-established equity hedge funds, Mikael Petersson (*pictured*) was trained and nurtured by Steven Heinz in late 1990s and early 2000s. Fast forward twenty years, Petersson is now applying a Lansdowne-inherited investment approach to manage **Coeli Absolute European Equity**, a long/short equity fund like few others.

Petersson describes the fund he manages as a "European-focused equity long/short fund managing a concentrated portfolio with a focus on pure stock picking." There are many equity-focused long/short funds in the Nordics, but few of them have Europe as their hunting ground.

Swedish Version of Lansdowne-Approach?

The Malmö-based portfolio manager primarily uses a Lansdowne-inherited approach to manage Coeli Absolute European Equity, but his own experience in investing has helped him fine-tune the investment approach. Describing the investment approach, Petersson says "I am looking to invest in misunderstood companies with significant value creation potential that are managed by people focused on creating value."

"I am looking to invest in misunderstood companies with significant value creation potential that are managed by people focused on creating value."

What all his holdings have in common is a management team focused on value creation. "If the management is not switched on, I just walk away." The reason behind this is straightforward. The skill with which corporate managers allocate capital, mostly the internally-generated free cash flows, has a massive impact on the value of a business.

As Petersson explains, the total free cash flow a business generates has four main uses: dividends, share buybacks, reducing debt levels, and fuelling growth (either organic or acquired). And only capable management knows how to allocate that free cash flow in a way that generates the most value for shareholders. "If you do not have the right people managing a company, sooner or later you will wake up in disappointment. This is what 20 years of experience taught me," argues Petersson.

Research-Heavy Approach to Stock Selection

Valuation represents an essential characteristic for Coeli Absolute European Equity's stock selection process. "If you know how much of its free cash flow a business can reinvest, what level of incremental returns the reinvestment generates, and you also know the cost of capital for that business, you have a very good understanding of what valuation multiples that business should be trading at," explains Petersson. This is easier said than done, as this entire process requires extensive research on the ground in addition to detailed number crunching in the form of building valuation models.

Whereas analyst Fredrik Östlind spends most of his time building extensive valuation models, Petersson spends most of his time talking to management teams, the customers of the companies he

owns, and other industry representatives. “This [Coeli Absolute European Equity] is a luxury product for investors, meaning that investors should rightfully assume that we do more work in our effort to produce high risk-adjusted returns,” argues Petersson. “Around half of the entire portfolio consists of small- and mid-cap companies, where I know the people managing the companies. I talk to them daily. I saw them creating value before, and I expect them to create value again.”

“This [Coeli Absolute European Equity] is a luxury product for investors, meaning that investors should rightfully assume that we do more work in our effort to produce high risk-adjusted returns.”

Despite taking a contrarian view on most occasions, Petersson acknowledges that “it seldom works out nicely if you have momentum against you.” For that reason, he usually tends to invest in companies “where I see many catalysts that will make market participants excited.” As he explains, “even if I have a long-term investment horizon, which I define as two to three years, obviously my interest is to make money in the long book, so I need share prices to go up.”

Short Book and Inception-to-Date Performance

Because of the fund’s long-bias, Petersson spends “more time looking for companies to populate the long book because this basket makes the most money for the fund.” On average over time, Coeli Absolute European Equity owns between 10 and 20 names in the long book, runs five to 20 short positions, and maintains a net market exposure in the range of 40 percent to 80 percent. The fund’s net exposure since its inception averaged around 65 percent.

To reduce the fund’s exposure to the market, Petersson builds three main blocks. One block consists of individual short positions, which include both core short positions and hedges. The second and third blocks consist of futures on European stock market indices, as well as out-of-the-money put options on those indices.

The number of short positions depends on the available set of opportunities, with Petersson usually shorting companies with “too high multiples according to our standards and aggressive accounting,” and deteriorating working capital management as reflected by unsustainable receivables or other signs. Despite employing a bottom-up investing approach, Petersson’s assessment of macroeconomic conditions has an important role too. “I have some sort of market intelligence. If I do expect that the market will go up or down for different reasons, I take action,” says Petersson.

“This fund offers some characteristics that a typical investor cannot usually get.”

Coeli Absolute European Equity gained 11.6 percent since launching at the beginning of last year, with the fund delivering 13.7 percent in the first quarter of 2019 alone. A portion of returns stems from several unlisted holdings. “After working in Europe for so many years, I have built a strong network that provides me with opportunities. This fund offers some characteristics that a typical investor cannot usually get,” concludes the portfolio manager.