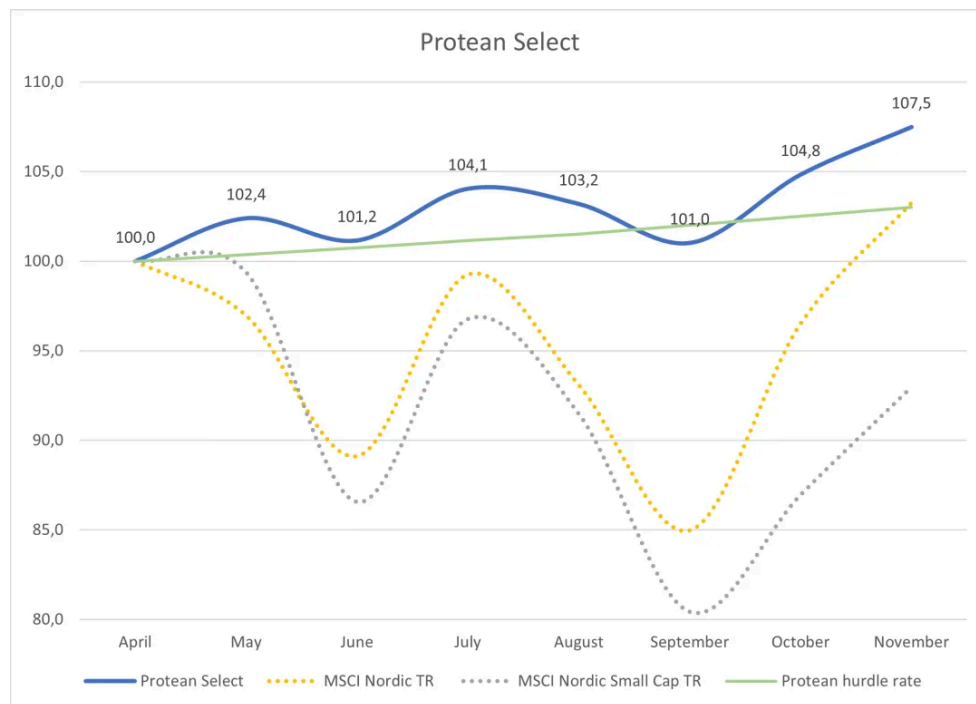


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NOVEMBER 2022 • PARTNER LETTER

Dear Partners,

Protean Select returned 2,5% in November. Since our start, at the beginning of May, the fund has returned +7,5%. Our hurdle rate for the period is roughly 2,9%. Thanks to performance and inflows we start December with SEK 600m+ in assets under management. Thank you for your trust.



*We illustrate our performance by showing a few indices as reference. But we do not compare ourselves to an index. We aim to have positive returns regardless of market. No return is created in a vacuum, and a net-long strategy will correlate. Our hurdle rate is 5,8% annualized (4% + 90-day Swedish T-bills).

TL;DR

The “too-long; didn’t read” version of the November Partner Letter:

- Good performance: +2,5% in November and +7,5% since May.
- We have added risk to the portfolio, particularly in small caps.
- Skin in the game is important. We have all our money in the fund.
- Have a multi-year view and be prepared for periods of underperformance. It’s inevitable.

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- A lot of the IPOs in 2021 have crashed. Several were both mispriced AND mis-sold. We own several.
- Outlook: “meh-territory”. There’s nothing brilliant to do.
- Recommendation: listen to the Founders Podcast.
- Our long-only strategies are outperforming relevant benchmarks.
- We note meaningful investor interest for a small-cap long-only fund.

What happened in November

The first two weeks of November were among the trickiest we have experienced in our almost 20-year experience. Everything that’s worked year-to-date went into reverse, and everything that’s underperformed started to perform. Some days it felt like the market was crazy. We are very satisfied to have navigated these markets acceptably, and we have been rather active in changing our portfolio exposures. We consider this to be a very good month for Protean Select.

Notable contributions came predominantly from long positions. Byggfakta Group, RVRC Holding and Nolato were top of the league. Detractors have mostly been found in the hedging portfolio, with index-futures, put options and short baskets at the bottom. We do not have large short positions in single stock names currently.

After months of focusing on protecting the downside, we are pleased to participate on the upside despite a relatively low market exposure. As with October, we believe it offers an early proof we can and will be adaptive.

We enter December with around 40% positive net exposure to the market. This remains lower than what we think will be the long-term average for our strategy. But during both October and November we have added risk, particularly in the small- and mid cap part of the portfolio, where we have seen ample opportunities.

Reminder: there will be times of sub-standard performance. It’s a mathematical certainty. Particularly over shorter periods of time. We manage the portfolio with a multi-year horizon and optimize for long-term performance (at least three years). This is not an excuse for short-term underperformance: we will always choose action ahead of inaction and try our best to minimize friction and mental biases that justify drawdowns, also in the short term.

Since inception in May we have beaten most indices, we do not expect this to be the case for long in strong upwards moving markets. The real feature of the strategy is however that the return is generated with

significantly lower risk. Our approximate standard deviation since launch is well below 10%, roughly half of what the market has realized in the same period.

A consequence of skin in the game, and an owner-operator mindset, is that we think of the portfolio in dollars and cents (or, rather, kronor och ören). We work for ourselves, and every basis point of absolute performance matters.

With our long-term ambition it is our wish that anyone who invests with us evaluates our performance on a multi-year basis. This is how we evaluate ourselves. If we fail to generate decent risk-adjusted returns on a three-year-rolling basis I solemnly promise to close this fund down. There is an evolutionary argument to Skin In The Game we wish to honor: if you don't suffer when making poor decisions, evolution stops working and keeps sub-standard organizations alive. We do not want to fall down that rabbit hole.

Skin In The Game

In many aspects of professional life, there is a lack of symmetry between risk and reward. War mongers propagating for a war but are certain never to suffer personally in a battle. Fund managers taking outsized risks (or closet-indexing) but not investing their own money, therefore not noticeably impacted along with investors when returns are negative.

Nassim Nicholas Taleb, famous trader-turned-author, a few years ago devoted an entire book to the concept. Reading it was described by the FT as “being trapped in a cab with a cantankerous and over-opinionated driver”. I concur. But he still has a point: many players only have incentives, no dis-incentives. If you carry zero downside for your actions, you have no Skin In The Game (SITG). In a nutshell: don't put someone else's skin in the game, unless yours is right in there with it.

It's not a new concept, but perhaps forgotten in certain industries today. Already Hammurabi, King of Old Babylon (1800 B.C.), codified, in what is widely considered the first set of laws, that:

“If a builder builds a house for a man and does not make its construction firm, and the house which he has built collapses and causes the death of the owner of the house, that builder shall be put to death.”

Harsh, maybe, to translate to asset management in 2022, but you get the point: no skimping on construction standards if your own skin is in the game. No shortcuts allowed. Utilize self-interest – the purest and powerful interest known to man.

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This is what shapes Protean's whole being, by explicit design. Avid readers of the Partner Letter will recognize that we started the fund company to be able to manage our own capital. But the crux is we need institutional access. We need size to be relevant to company managements, liquidity- and research providers. Skin In The Game is not a marketing pitch – it's the consequence of us needing to entice other investors to co-invest with us. We have SITG by default.

Graveyards are fertile soil

A record number of companies were put on the stock exchange in 2021. Private equity companies are no dummies. They will inevitably make sure to feed all the quacking ducks in no-time when the public markets are willing to pay premium multiples for correctly packaged and labeled equity stories.

I've been in enough pitch-meetings to know this process. These meetings are where investment banks sell their service of doing an IPO. In plain speak: "here's how we can get you the highest possible price" (without feeling too ashamed of ourselves).

You'd be surprised how much of it is "what peer group can we get away with using" (to justify an eyewatering valuation), "how little historical data can we justify" (as most brides are dressed up beyond recognition at time of IPO), and "here is the equity story/narrative we have dreamt up" (to make it appeal to buyers). As an IPO is an extremely profitable venture for investment banks, you can rest assured all sorts of creative spin is being utilized. Remember, a seller of an asset about to IPO can pick the ideal timing, massage the margins/growth/NRR/IRR/ROIC, or whatever key metric is in vogue in the year leading up to the public offering, and laugh all the way to the (investment) bank.

Back in the old days, investment banks committing an IPO were also underwriting the issue – meaning they had to commit own capital to the process, SKIN IN THE GAME, thereby ensuring a fairer valuation. Not so anymore. Wouldn't it be nice if IPO-banks had to buy stock in the companies they bring to market, with, say, a two-year lock-up? One can be allowed to dream.

Anyhow, of the companies listed in 2021, a majority are miles below the manicured price at the time of IPO. They listed in a different environment, you may object. And you would be right. But there are also those that listed not only at the wrong price but also with the wrong equity story. The highest multiples were paid for SaaS-businesses. Anything with a recurring revenue and decent retention-ratios could pick a high-flying peer-group and justify multiples that would make Sam Bankman-Fried blush. But not all companies pitched as recurring software were.

A prime example is one of our small cap positions: **Byggfakta Group Holdings**. Reading the initiation research reports from November 2021 triggers an irresistible urge to roll both eyes and into fetal position. Jam packed with buzzwords we (Protean) think are not applicable to this business: “cloud- and subscription based digital enabler”, “SaaS-level margins”, etc. To us, this is a business services company with strong relationships. To evaluate this business using the “rule of 40” or net retention ratio will send you straight into the woods. Yet this is what the market did back in 2021. Because it was a way to maximize the price.

Since IPO the stock is down 40%+, while 2023 EBITDA estimates are down a mere 7% (from a likely over-optimistic base, as the only banks in the “consensus” are the ones that were in on the IPO). They have delivered according to plan and continue to execute bolt-on acquisitions at a well-balanced pace. But instead of paying 23x EBITA and 8x sales at time of IPO, we now get to buy the stock at 14x EBITDA and 4,5x sales. Byggfakta Group Holdings was one of our best contributors in November and has returned 20%+ since we acquired our shares. The company is doing the right things, have a reasonable moat, and keeps growing. We think there’s more to come and are happy owners.

Another stock that deserves a mention in this context is digital only B2C retailer Revolution Race. Following a period of tremendous turbulence as the covid-boost in mature Nordics seeped into numbers, and the founder/main owner/CEO decided to jump ship in an abrupt and unorthodox fashion. Simultaneously, RVRC released a report that missed expectations. The result was predictable: the stock took a nose dive. However, this is not a bad business. As any follower of Peter Lynch will know, retail is powerful, particularly when it travels (i.e., works in several geographies). In the internet age, the barriers for a local online-only brand to go global are lower. We think this is what RVRC has going for them: while the growth in the Nordic home markets is stalling thanks to post-covid saturation, impressive growth in DACH and a budding presence in the US is showing significant promise.

Instead of a founder with limited experience running a global online brand and retail operation, we now have an experienced operator at the helm. The market took the resignation of the founder VERY negatively. To us it was positive, and we took action. The stock is up almost 60% since we bought our first shares. And, funnily enough, there’s still 100% upside to the price at the IPO back in June 2021.

Mispriced and cratered IPOs are very interesting. We currently own several of them.

Another excellent hunting ground is spin-offs. Swedish niche steel manufacturer Alleima has been a strong contributor to returns for us

recently. Known by its acronym SMT under its long tenure within Sandvik, it was spun off from Sandvik in late August. The cost for this exercise was a staggering SEK990m (close to 10 per cent of the current Alleima market cap of 10bn). That's a lot of money for something that has been met with shrugs by the market, as investors apparently focus on shedding what they perceive to be a tiny cyclical name from their portfolios. The close to 10 per cent exposure to oil and gas has also been a (ESG) reason to sell. Funnily enough, it appears that this exact same exposure was reasonable to own when it was a part of Sandvik, as the exposure was diluted by being part of a larger group. But when Alleima became an entity of its own, the exposure became "too big". Hey, it's the same business!

This is not common sense ESG investing. This is a market inefficiency.

So what's not to like in Alleima? As most readers of this letter are aware of, spin-offs tend to outperform. Good starting point. It might be cyclical, but valuation is low also using a normalized approach. It's close to debt free, despite having an elevated working capital position (creating a sizeable buffer in the event of a cyclical slowdown). Many have focused on their O&G exposure but overlooked their exposure to fast-growing niche markets. A nugget of this was made public recently: a SEK350m order (ca. 3% of top-line) for ultra-fine medical wire to be used for remote monitoring of patients.

Bygghälsan, RVRC and Alleima have all entered our portfolio from a special situation perspective, but they have another common denominator: they are all small caps. More on this later in this letter.

What's around the corner

With potentially the most hated rally to date behind us since mid-October (nobody is/was correctly positioned) it's interesting to note the commentary from various macro-onlookers: "we were open to the possibility...", "like we said in the note from September...". They all saw it coming. Apparently. Like someone said: would you please give me a one-handed economist! (Since they have a distinct tendency to say "on the one hand this /on the other hand that").

Reading the grand exclamations from my own previous writing, it's easy in hindsight to see how we all are/were influenced by the zeitgeist of despair. Reading the autobiography of Vannevar Bush, a certified 20th century overall genius, scientist and inventor, hammers home the point: we humans are prone to worry. But we worry about the same things throughout history. Every generation thinks the same thing about "today's youth", and is concerned the world is about to end, but only for different reasons at every iteration.

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I do not mean to belittle the concerns that currently sweep our collective consciousness. They're as fundamental now as they were during the Cuban missile crisis or the first World War, but the point is we have persevered for thousands of generations, just because this type of alarm triggers an impetus to act.

Markets have rallied (hard) off the lows, and the jury remains out on whether we have seen the bottom of this version of a bear market. Luckily, Protean's stubborn attitude to remain net long, as upside insurance, and testament to our belief in human ingenuity, have meant decent participation in the rally, despite remaining cautious.

We are genuinely uncertain about where things go from here. As we wrote before the market chopped a lot of wood (discounted a lot of negatives) back in September, and a lot of that wood has now become un-chopped.

During October and November, we have been a raccoon in a dumpster in certain small caps, as described in last month's letter. Overreactions paired with a lack of liquidity presented excellent buying opportunities in certain names we would like to potentially own on a multi-year basis. Following the sharp appreciation we've seen, we now think the market has returned to what Howard Marks would call a "zone of reasonableness", a fairer territory where there is nothing particularly brilliant to do. We don't have strong views on the near term, so remain in meh-territory with our usual cautious positioning.

What we're thinking and reading

- Building in public

After strong inflows and decent performance, we start December 2022 with north of 610m SEK in assets under management, doubling our capital since launch. Thank you to all that invest with us and allow this exploration of our strong belief that experience, intellectual versatility, limited size and skin in the game is a potentially winning concept.

When we reach 2bn SEK, we will close the fund for additional investments and aim at building a long-term partnership, with investments allowed to compound undramatically over the years without significant draw-downs.

We keep adding to our edge as the P&L allows. After hiring a senior Chief Operating Officer, we are now discussing adding an excellent fourth high-caliber member to the team. Minding Hammurabi, we do not skimp on construction standards.

- Founders podcast

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Continuing the “building in public” theme, we must recommend the excellent podcast “Founders”, hosted by David Senra. In a single-minded pursuit, David has set out to record 1,200 podcasts where he reads, condenses, and comment on biographies of some of the world’s pre-eminent founders of great businesses.

Like Marc Andreessen said on why he reads biographies:

“There are thousands of years of history in which lots and lots of very smart people worked very hard and ran all types of experiments on how to create new businesses, invent new technology, new ways to manage etc.

They ran these experiments throughout their entire lives. At some point, somebody put these lessons down in a book. For very little money and a few hours of time, you can learn from someone’s accumulated experience.”

It is an absolute treasure trove of inspiration and lessons to be learned from historic and current greats. After consuming some 50-odd episodes of the 270+ so far published, what shines through as common denominators are the doggedness, relentlessness, and urge to move forward.

We don’t think we are God’s gift to asset management, but we think there’s more to do. We are likely far from an optimal structure, process, team, product portfolio, or investment universe. But we learn. We grow. We try to figure out what’s doing poorly and what’s doing well. And do less of the former, and more of the latter.

- Do more of what’s doing well

Evaluating what’s working, what stands out is our long-only strategies are performing (surprisingly) well. As an example, the small-cap bucket has outperformed the local benchmark by 8% since inception, and the large-cap portion is 7% ahead (data until Oct 31, likely even better now). Imagine this outcome over 20 years compounded!

- Protean Nordic Small Cap

Considering the above – both on founders and small caps – we are today evaluating a small-cap long-only fund. We already have a handful of sizeable investors expressing an interest to invest in a higher-risk fund managed by Protean.

The Nordic small-cap space is our home turf, and we see the rationale for the self-allocating investor looking for thoughtful and opportunistic exposures in Scandinavia. We think there is a white space for a local



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limited-size long-only small-cap fund aimed at global professional investors (local odd-balls welcome too, of course).

True to our why, it would have similar characteristics to Protean Select. The same skin-in-the-game approach, opportunistic mindset, and hunt for asymmetries. The same versatile multi-year strategy, but with the support wheels of hedges, shorts, and large caps removed. I can see the rationale, and I can see it working. Our idea is for me to be the main responsible for Protean Select, and Carl for Small Cap. It's a good distribution of responsibilities and fits our skill sets well. Economy permitting, we would like to add an analyst to cover more ground.

Watch this space.

Pontus Dackmo
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