



MAY 2024 • PARTNER LETTER

Dear Partners,

Protean Small Cap continued its strong performance and returned 7.2% in May. That is 2.2% ahead of the CSXRN (SEK) benchmark index for the month. Performance since inception in June 2023 stands at +37.2%, outperforming the index by 17.3% in its first year. We are particularly pleased with the quality of returns: the portfolio is diversified; no single position has at any time been larger than 5% until Acast reached that level due to its performance in May.

Top contributors were Acast, ITAB, Proact, and Raysearch. Notable detractors MT Hojgaard, Netel and Kojamo.

Protean Select posted a very satisfactory 3.7% return for the month. That's +8.2% YTD and 22.8% since inception. The volatility in the strategy remains below 7%, which can be interpreted as about a third of the risk of the overall market.

Top contributors were Acast, Raysearch, Lindex, Ambea and Fortum. Notable detractors were our short basket of small-caps, Evolution long, and Svitzer short position.

This month's letter elaborates on the amazing first year for the Small Cap fund and some expectation management for the future, the perverse incentives in the long-only fund management industry, and how to suffer successfully. Of course, there are also details on new holdings and recent performance.

Thank you for being an investor!

//Team Protean

Protean Small Cap

MAY 2024 • WRITTEN BY CARL GUSTAFSSON

Protean Small Cap continued its strong performance and returned 7.2% in May. That is 2.2% ahead of the CSXRN (SEK) benchmark index for the month.

Protean Small Cap has returned 37.2% since we launched it a year ago. This puts the fund 17.3% ahead of our index (CSRXN SEK). We started with 55 SEKm. A year later the fund manages SEK350m. Thank you for your trust.

Our top contributors in May were Acast, ITAB, Proact, Raysearch and CINT.

Acast performed strongly after a Q1 report that underlined that this podcast ad company is approaching profitability. The strategic importance of the platform Acast has built remains underestimated in our view, and as the advertising potential of podcasts is still far from where it should be, we still see considerable upside ahead. Acast has organically grown to become our largest position.

ITAB released a very strong Q1 report, benefitting from an improved mix where sales of technology solutions to prevent “shrinkage” (the euphemism used by retailers to describe in-store theft) is growing quickly. We initiated our position in ITAB post their Q4 report in February, and the share has more than doubled since, making it our best performer so far this year.

Detractors include MT Hoejgaard, Netel and Kojamo.

We have a few new names in the portfolio.

We added Embellence post its strong report for the quarter. This one has flown under the radar for us until now, but as a wallpaper company with a large Nordic footprint, it has shown impressive resilience. Being able to post organic growth during the last three years with a big consumer footprint in a high-interest environment is impressive. Makes you wonder how it will perform when we enter a low medium-interest environment in

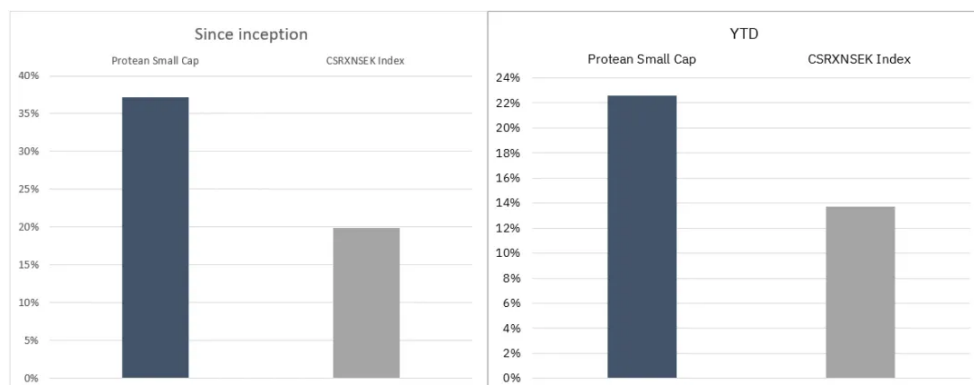
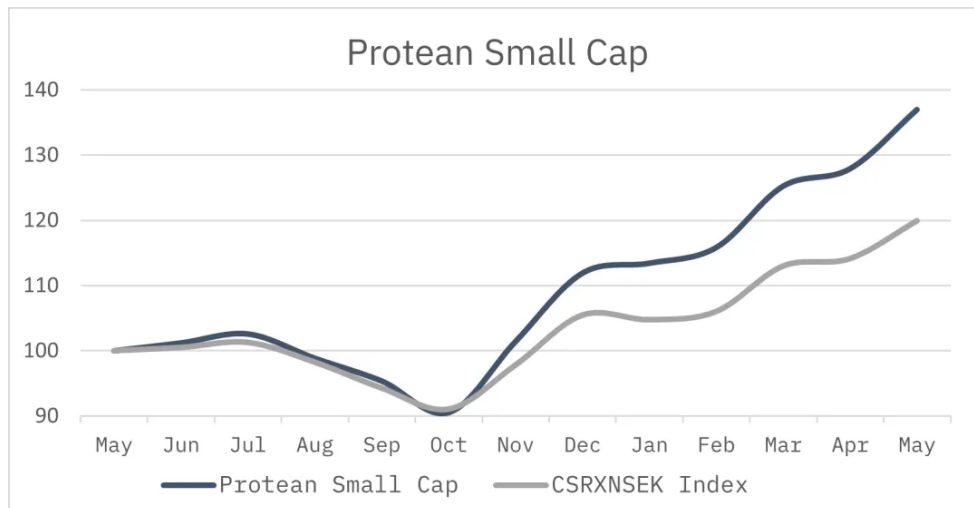
the coming years, no? To be fair, this is an international company with strong brands in several large markets, and mainly caters to high-end consumers, and the hospitality sector. We attended their recent CMD and were struck by the engagement and involvement from new CoB Magnus Welanders (former CEO of Thule). His energy and enthusiasm are likely to propel the company to new heights, as well as increase interest in the company. The Embellence PnL might suffer a bit from increased product investments but will benefit from their organic growth à la Thule. Valuation remains low despite strong recent performance.

If you mention Boule Diagnostics to a fellow Swedish portfolio manager, you're likely to get a tired look. It has disappointed a lot of people during the last decade. A lot of things have gone wrong for this Swedish maker of hematology instruments. They are several years late in bringing a new 5-part instrument to the market (spoiler: the device has more than five parts, so it's harder to build than what the name suggests). They have invested heavily in this instrument, which means that they have large amounts of capitalized R&D on the balance sheet (which might lead to a write-down). Boule had also just finished a new factory in Russia, leading to a loss of sales post the start of the war in Ukraine.

There are bright spots, however. Boule has a US-based OEM business for reagents. This has doubled in size during the past five years and now accounts for 20 percent of their overall business. The veterinarian business grew by 60 percent last year, almost reaching 10 percent of sales. There is an installed base of circa 32,000 instruments, on which 152m tests are made each year. And don't forget, the company is making good money: SEK19m during Q1 alone, which can be compared to the EV of close to 400m. A new CEO – Torben Nielsen – joined a month ago, and while there's a slight risk of a kitchen sinking exercise in the near term, there's a good chance that his track record from Danaher-owned companies such as Radiometer could do wonders for Boule. We have bought a starting position in Boule Diagnostics.



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The portfolio remains diversified, with roughly 50 names.

Acast	5.0%
Cargotec	3.7%
Ambea	3.6%
Devyser	3.4%
Proact	3.3%
Raysearch	3.2%
Nolato	3.0%
Lindex	2.9%
Tieto	2.8%

Valmet 2.8%

Expectation management

The strong performance of the Small Cap Fund is likely to attract interest, so some moderation of expectation is needed here. These are facts:

More assets reduce the ability to be nimble.

Let's just be honest with this: as the fund grows, the ability to outperform is reduced. Managing a small amount of money is easier than a big amount. However, Protean Small Cap will still have a bigger opportunity set than most of our competitors, as it is, and will remain a smaller fund. We will cap the fund at 4bn SEK. There are several "small-cap funds" in the Nordics with north of 30bn SEK in assets (the caps they own are on average not very small).

The magnitude of outperformance is unlikely to be replicated in year 2.

17.3% outperformance compared to the index is an unlikely outcome. Especially for a fund that has as many holdings as Protean Small Cap, i.e. a well-diversified portfolio. We have not had a single position larger than 5% until Acast managed to grow to that size all by itself due to performance. Many small cap funds posting big outperformance in a given year do so because of a huge bet in a single name that went ballistic. We don't like that type of risk. We are far too aware of the downside of being wrong with a >10% position.

We think risk/reward.

One of the drawbacks of being a portfolio manager is that you, a few times a year, inevitably look like a complete moron. Things don't turn out as you expect. We have in earlier Partner Letters made references to what we at Protean consider to be 'Idiot or Genius?' situations. In Protean Small Cap – where we optimize for returns, not low volatility and drawdown protection – these situations are more frequent than in Protean Select. So why do we end up in those kinds of situations? Because we believe – on average – a mindset of risk/reward will generate the best returns over the longer term.

One position in Protean Small Cap that can be used as an example is BICO. This Swedish MedTech company has had several issues. They have paid through the nose for acquisitions. They have used aggressive revenue recognition to inflate its share price, to enable more acquisitions, with the aim of building a bigger, and theoretically, stable company with a more diverse revenue base.

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That didn't work out, unsurprisingly. The share price has crashed, and the founders have all left the company. Left are unhappy shareholders, a stigmatized share, and a complete lack of confidence in the underlying business.

However, the companies acquired with that inflated share price should not be blamed for the acquirer's shenanigans. The management overhaul, with experienced and serious people coming on board, puts things in a very different light. Following the recent quarterly report, the share dropped considerably as more issues from the past resurfaced. We doubled our position at the lows, and the share has since gradually recovered. Is our position in BICO an idiot or genius trade? Who knows. But we think it could be an example of successful suffering.

The fund will look expensive.

There's a slight obsession with the total cost of owning a fund. Which makes perfect sense. All returns we mention are net of fees. This means that both fixed fees and performance fees are charged to the fund's NAV and P&L. We want to be entirely upfront about this: we charge a 1.4% fixed management fee, and a 15% performance fee of the outperformance when we beat the index. Given the initial results, this has become a decent amount. Transaction costs are also relatively high as we have a high portfolio turnover – reflecting our thinking that multiple smaller opportunities can be (and have been) profitable for a small fund.

At the other end of the spectrum, you might find a fund with very low turnover, that invests in quality companies for the long term, aiming to reduce costs. That should (also) work very well over time, but that fund is not Protean Small Cap. We have chosen to be very active.

Keep the above in mind if you want to partner with us.

Idiosyncratic and volatile, with a high active share.

The portfolio will remain idiosyncratic, and very personal. We turn a lot of stones. We might be too early in many cases, but being nimble makes it easier to correct course, or to jump on the bandwagon. The portfolio may grow, but opportunities remain abundant, and we are still miles better off in terms of the degree of freedom to operate a portfolio than our bigger, policy-driven peers. They must also cater to the needs of a sales force as well as a C-suite management team with a different agenda – things integrated into our roles at Protean as both portfolio managers and owners/operators.

We do what we consider to be in the best interest of the portfolio. Period. Given our considerable skin in the game, as big investors in the funds ourselves, this benefits us, as well as you, as partners in this project.



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Year one is done. If you are fine with buying an expensive, volatile fund that occasionally does stupid things, we're glad to welcome you on board. We plan to stick around for another couple of decades, (knock on wood) so stay tuned.



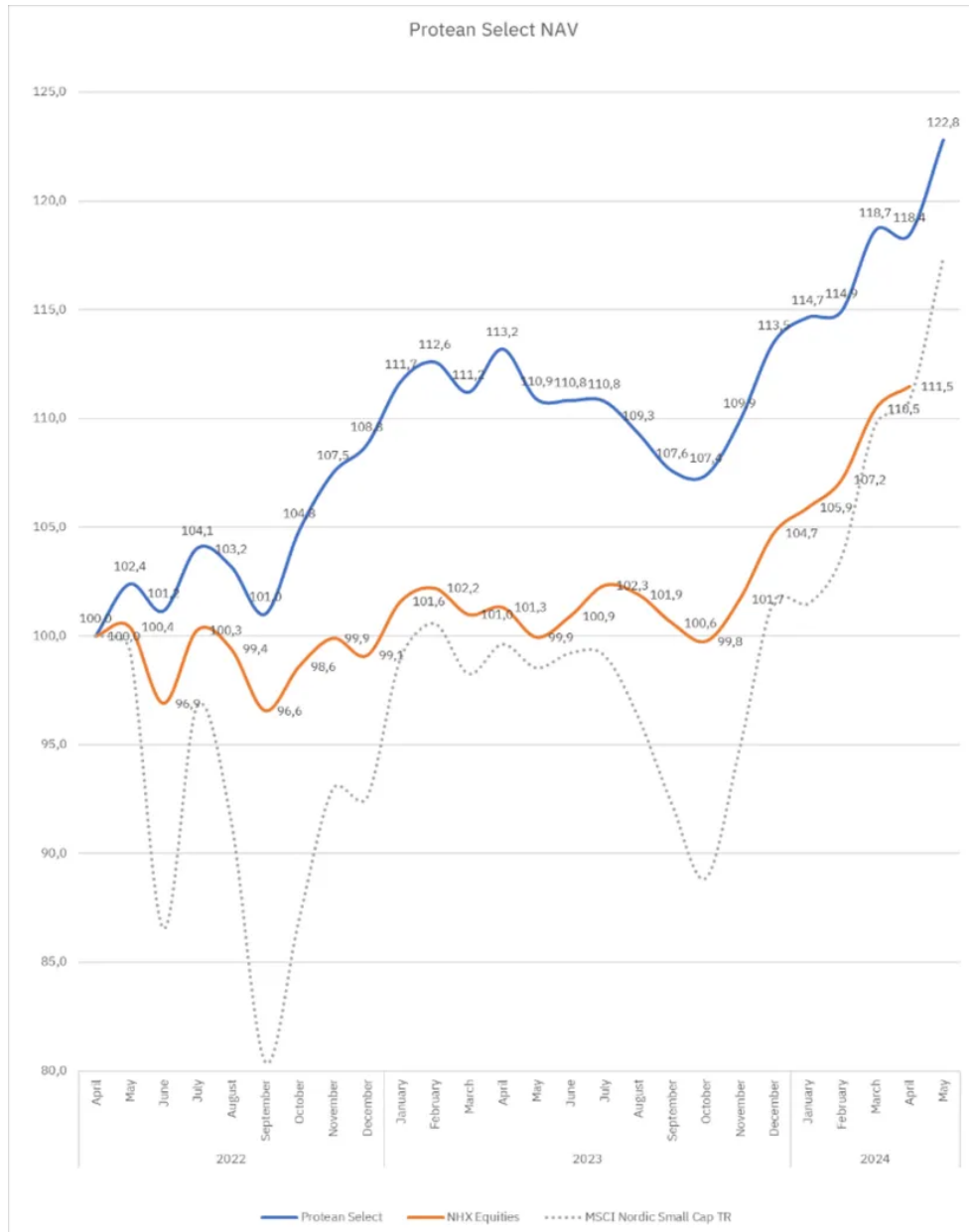
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Protean Select

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*We illustrate our performance by showing a comparison with the NHX Equities index. This is an index constructed from the performance of 54 Nordic hedge funds focusing on equity strategies. NHX is published after our Partner Letter, so updates with one-month lag in the chart above. We aim to have positive returns regardless of the market, but no return is created in a vacuum, and a net-long strategy will correlate. Our hurdle rate is 7,7% annualized (4% + 90-day Swedish T-bills). All figures are net of fees.

Protean Select posted 3.7% return in May. That's +8.2% YTD and +22.8% since inception two years ago. The volatility remains below 7%, which

gives a feel for how much risk we take to generate this return. It is approximately a third of the market.

We exit May with 43% beta-adjusted net long exposure, and 125% gross exposure. It is at the high end of the interval of the past two years. The portfolio remains diversified, with the biggest position accounting for less than 4% of the portfolio.

Top contributors were Acast, Raysearch, Lindex, Ambea and Fortum.

Notable detractors are a short basket of small-caps, Evolution long, and Svitzer short position.

Evolution

During May we initiated a position in Swedish online gambling supplier Evolution. Similar to the situation in Swedish Match (RIP), domestic funds shun it because gambling is considered a vice we should be without. This moral frowning is causing the valuation to be out of whack. The company continues to post unbelievable results, as it has done continuously for the past decade, but there isn't a single domestic fund with an overweight position in the stock (but us).

Our view is that companies that comply with local laws and regulations, regardless of industry, are potentially worthy of investment. A fund is a very poor way to express moral views. Heck, the only likely impact from funds collectively deciding gambling - one of the oldest past-times of humanity - should be excluded, is a lower return for its investors. It certainly won't change the demand for world-class gambling services. If exclusion causes the stock to become too cheap, it will be bought by someone more rational.

Evolution trades on low teens EV/EBIT, grows organically at 15-20%, with EBIT margins in the 70s, and has a net cash balance sheet. It rides on a global structural growth trend of offline to online migration. It keeps investing in capacity and innovation to maintain and hopefully expand the gap to its smaller competitors. The management team has repeatedly shown astute capital allocation skills with the timing of buybacks, and it would not surprise us if a new program were launched shortly.

The stock has continued its southward journey since we bought our starting position and added. Analyzing the potential reasons for the underperformance, be it the political situation in Georgia adding uncertainty, the significant investments in new capacity weighing on short-term margin expectations, the negative FX-impact, a large institutional shareholder selling part (or all) of their shares, or chatter about Asian crypto exposure, there is nothing that changes the fundamental and long-term picture for us.

Isadore Sharp, the founder of Four Seasons, is quoted saying “Excellence is the capacity to take pain”. Evolution has kept sliding through the month and qualifies as a top-three negative contributor to the fund’s return in May. Painful. But we take it in stride, as it has the potential to be excellent.

Nibe

We have also entered a medium-term call-spread in Swedish heat pump manufacturer Nibe. A controversial name of late, as the hangover from ESG love bombing, the bolus from the 2022 energy crisis and a bloated valuation has caused a sharp contraction in the share price in recent months.

When the starting point is an eye-watering valuation, and you face increasing competition, excess inventories, and a (temporarily?) slower end-market, it’s not a mystery the stock has dropped 52% in the last 12 months. In an interview about a year ago, we disclosed a short position in Nibe for the above reasons. But now we sense these concerns are in the price, and the tables might be turning.

The fundamental backdrop is that the energy efficiency of the current housing stock in Europe is terrible. Heating (and cooling) is currently very CO2-intense. Installing a heat pump makes total and utter sense and will likely see structural tailwinds for years to come. As inventories normalize, incentive schemes are instated, and the theory that Nibe has a potential competitive advantage with its long-standing distributor and installer network gets proven (or disproven), the stock could get its mojo back.

We choose exposure via derivatives as valuation remains challenging, just as calling the timing of this potentially benign outcome. If competition takes a bigger slice of the pie, or markets take longer to normalise, we have a defined and tolerable downside and have not tied up substantial capital in an underperforming name. But still stand to gain if our thinking is right in the coming 6 months.

Reflections from two-year data

As we now have two years’ worth of data on how Protean Select has performed and looked, we have spent some time analyzing what has worked and what has not. Still a bit too short track-record to draw strong conclusions, but worthwhile, nevertheless.

Since inception we have averaged 76% long exposure and 39% short exposure, resulting in a net exposure of 36% (some rounding errors here) and gross exposure (excluding cash management positions) of 115%. These are all lower numbers than we pictured when we designed the fund. It has been running a lower risk than what its hurdle and fund documentation suggests. This is fine with us – we have adapted to volatile

and uncertain market conditions. We are aware of the risks of getting stuck in a mindset and structure and are working actively with this.

Geographically

The long exposure has averaged 15% Denmark, 19% Finland, 6% Norway and 60% Sweden. The short exposure is heavily tilted to Sweden since the bulk is Swedish index futures and a Swedish small-cap basket.

On average we have had 44 individual names in the long book, and 17 names in the short book.

Our biggest position has been 3.8% of the fund (excluding the first 5 months where Swedish Match was a >10% holding). The top-5 positions 16.7%. Top-10 30%. We have run a conservative and diversified portfolio.

Attribution

Our longs have generated +28,7% return. Our single stock shorts +0,7% (even better short alpha actually, since markets are up double digits in the period). Our index and basket hedges have however been a drag of -6.8%.

Geographically we have positive attribution on the long side in all four countries since inception, with Sweden the biggest. On the short side we have positive attribution in Denmark and Finland, while Norway is flat and Sweden is slightly negative.

Our most profitable sector on the long side has been Industrials (example: Cargotec), followed by Healthcare (Raysearch, among others) and consumer staples (Swedish Match). On the short side we have made the most money in Real Estate (several names), Energy (Neste) and Consumer Discretionary (Electrolux, Husqvarna).

Learnings?

We could probably take bigger positions in high-conviction names, and given the positive attribution across geographies and sectors, we should structurally add to the gross exposure. As usual, we will let the opportunity set decide for us.

The problem with the long-only fund management industry

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100% of all serious research on actively managed funds concludes they underperform the index over time AFTER FEES. Compared to index funds, that sounds like a terrible product.

Fund management is scalable. The costs are fixed. It does not matter if you manage 100m or 100bn, the magnitude of cost is pretty much the same. But the income is not. The fee does not fall as assets grow. When you reach assets under management that cover your cost, any incremental fee comes at a 100% margin. This is why there is no cap on the size of funds (and why owners of successful fund management firms are the richest people around). This is also why the industry attracts so many hard-selling shenanigans. What is best for investors is not what is best for the investment management business.

Since fund companies are profit-maximizing, most funds start not by thinking “What’s the best product for investors”, but rather “What is a product we can sell and what is the highest fee we can get away with”. This is 100% putting the cart before the horse.

The biggest culprits are the banks. They manage their funds trying to please everyone. If there is a trend, they have a fund for it. They optimize for asset gathering and size. Their “advisors” (i.e. salespeople) are incentivized to recommend their products. Even if it’s not blatant (anymore), it is manifested in the selection of funds they offer. Pick any large bank and I bet you no less than 50% of funds on offer in pension

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solutions or ISA-shells are their own. In industry lingo, we call it “captive distribution”. It is a powerful barrier to entry and a lock-up mechanism. And they all have high fees.

Independent fund managers (like Protean) are left out in the cold, even if (particularly if) we offer a better or cheaper product. Our only chance of being “distributed” by a big pension scheme provider or bank, is either if we make tons of marketing so customers demand our presence (looking at you TIN Fonder - well executed), or if our fees are so high that the kickback (it costs 50% of our fixed fee for the courtesy of distribution) is better than that of their own products.

To own an index fund therefore makes a ton of sense. It’s cheap. It gives you the market return. No more, and no less. Historically, given a long enough time horizon, the market has returned approximately 9% per annum. Add compounding and reinvestment of dividends, and you have doubled your capital every 7-9 years. Assuming you have been sitting on your hands (a thing that sounds far easier than it actually is). It is pretty good. Particularly compared to actively managed funds that start 1.5-2.5% behind the index every year due to fees.

The problem with index funds is they own everything. The stock that dropped 75% in a year? Yeah it owned it. That stock that was a fad and turned out to be a complete hoax? Yup, it’s in there. That stock where management was obvious crooks that fooled a lot of people for a long time? Oh yeah, for sure. Neither do they contribute positively to governance, or price discovery. If passive funds continue to grow at the current rate, how do you suppose an IPO will price when the only variable for demand is size? The nonsense already now at “re-weighting” days kind of tells you where we are going with this.

The issue with indiscriminate ownership solely based on market valuation is just that: it’s indiscriminate. It owns everything. Solely based on how big something has gotten. It’s stupid. There’s no overlay. Not even the slightest second thought of “does this make sense?”.

Going back to academia: What works? What beats the index? It’s surprisingly simple.

- A low fee.
- Own quality and owner/operator companies.
- For a long time.
- Minimize transaction costs with limited trading.
- Don’t own bad business models and fads.



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Why are there no funds like this?!

Because running a fund with Very Low Fees requires substantial assets to break even.

Because, without captive distribution, a new fund will struggle to raise assets and awareness.

Because it requires a long track record to prove the point.

Because it doesn't promise heaven and earth, just an above-average chance of beating the index.

Because it doesn't promote or invest in the current plat du jour it can underperform for long stretches.

Because focusing on cost, quality, and sitting on your hands is not an exciting sales pitch.

Because it's not ESG. Neither is it 3X LEVERAGE, or AI, or GREEN TRANSITION, or MICROCAP.

It's just a cheap fund, that owns reasonable businesses, for an unreasonable long time.

Berkshire has underperformed the S&P 500 index roughly a third of the years since inception. They looked like old men who had lost their touch during the IT-bubble (as but one example). But over time Berkshire has outperformed massively thanks to low cost, compounding, and avoiding (too many) stupid things. Fundsmith in the UK has a similar history: it has had a tough past three years due to limited exposure to "Mag 7" but has outperformed bigly since inception thanks to low fees and few stupid holdings.

We have been vocal since day one that our ambition has never been to get rich off fees. We optimize for performance. Protean is a vehicle to manage our own money at scale, so we can access institutional information and deal flow. We only make money if we do really well.

Large passive index funds are at one end of the spectrum, and small and very active funds like ours are at the other end. The problem is there is too much capital in the bland and expensive middle. Is there perhaps room for a low-cost, low-turnover, active, long-term, quality-focused, owner/operator fund in the Nordics? Just to the right of the index funds. A fund that owns great businesses and compounds forever without fleecing investors on exorbitant costs.

It's tempting to give the industry a kick up the backside. But is there enough interest to keep it from being a loss-making venture?

How to suffer successfully

MAY 2024 • WRITTEN BY PONTUS DACKMO

The fourth chapter in the book “How Proust Can Change Your Life”, by excellent writer/philosopher Alain de Botton, has the headline above. Drawing from passages in Proust’s mammoth 7-volume “In Search of Lost Time” he picks nuggets of wisdom to address some of life’s challenges.

No worthwhile venture is executed without difficulty. Or as Henry J. Kaiser, the man who helped churn out no less than 2,571 “Liberty ships” during 1941-1945, put it: “Problems are just opportunities in work clothes.”

Encountering problems, or things not working out as expected, is literally what one should expect of life. Or running a company. Or, for that matter, managing a portfolio.

To Mr. de Botton, there are two types of sufferers. Those who learn nothing from adversity activate defence mechanisms such as rage, delusion, and arrogance. In an investment management context, this is what happens when managers of underperforming stocks blame short-sellers, analysts, or whoever. Or when an underperforming investor denies the problem (“the market is wrong”).

A good sufferer, on the other hand, embraces failure. Study it. Revel in it. Learn from it! What caused this failure? How do I minimize the risk of repetition? Acknowledge that failure is a permanent feature. An unavoidable part of life, particularly when actively taking risks.

In a sense, we should be grateful for all our failures, because they form the basis of our knowledge. If, that is, we can learn rather than be mortally wounded by them.

In Proust’s own words: “The whole art of living is to make use of the individuals through whom we suffer. Grief, at the moment when they change into ideas, lose some of their power to injure our heart.”



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The monthly reminder

We optimize for performance, not for convenience, size, or marketing.

You can withdraw money only quarterly (monthly in Small Cap).

We will tell you very little about our holdings.

Our strategy is tricky to describe as we aim to be versatile.

A hedge fund can lose money even if markets are up.

We charge a performance fee if we do well.

You do not get a discount if you have a larger sum to invest.

We do not have a long track record.

Thank you for being an investor.

Pontus Dackmo

CEO & Investment Manager

Protean Funds Scandinavia AB