

Finding Hidden Value in Neglected Nordic Companies

By Hamlin Lovell – HedgeNordic

Adrigo Small and Midcap Long/Short is up just over 28% from inception in October 2017 to February 2019. This is well ahead of its return target of 8-12% per year, and also higher than the 4-8% return target on Adrigo's flagship hedge fund.

Lead portfolio manager, Staffan Östlin, previously co-managed Origo Quest between January 2013 and June 2017. Adrigo's range of net exposure is expected to be between zero and 50% net long. Though Östlin cannot go net short, he anticipates that, "we might be able to profit during a bear market through stock selection that would make the portfolio behave as if it was negatively positioned". Östlin also believes in, "making use of the balance sheet and maintaining gross exposure of 175% or so, with a decent sized short book".



Staffan Östlin, Portfolio Manager – Adrigo Asset Management

Adrigo's investment universe is made up of 700-800 Nordic companies with market capitalization between SEK 500 million and SEK 55 billion; the sweet spot is expected to be firms between SEK 500 million and SEK 2 billion. Only about 25-30% of these 750 firms have regular sell side research coverage from major banks or brokers, and MiFID II – separating research from trading commissions - has probably reduced coverage. Some listed companies are even paying for research reports.

This extreme neglect opens up a wide field of opportunity for Östlin and co-portfolio manager, Johan Eriksson, who meet at least 200 companies each year and do in-house cashflow modelling. Östlin also leverages his, "extensive network of connections from 30 years in the markets, and picks up ideas from local media. We look at all IPOs but have only actually participated in three or four of them so far".

The key quality sought is change, which can include new management or structural changes at a firm. All current positions are located in Sweden, Norway, Denmark and Finland with some 50% of all positions outside of Sweden.

STOCK PICKS

Östlin runs a concentrated, high conviction book, with 15-25 long positions, of which five are classified as core, long term holdings, which can together make up around 50% of NAV. Dynamic longs (making up around 35% of NAV) can be shorter term, more opportunistic positions while high potential longs (targeted at 15% of NAV) are earlier stage positions.

Of course, some positions can migrate between these categories: Swedish firm, Bonesupport, which makes injectable bioceramic products to promote bone healing, started as a 1% position in the high potential longs bucket and has now grown to a 4-5% size.

Three of the core five longs are currently turnaround

situations. For instance, industrial tools and supplies distributor Momentum Group is a firm Östlin has followed for many years. He expects them to increase margins as a consequence of their strategic plan shutting down unprofitable stores. Husqvarna has been hampered by a market fixation on the US consumer products business, but now this has been closed down, Östlin expects investors will shift their attention to its other three, profitable divisions. Holding company Bergman & Beving is another turnaround play. The company will continue to downsize the distribution segment while focusing on its high margin and cashflow generative own proprietary brands offering. A continued distribution network expansion of its own brands on existing and new markets will be the primary growth driver for Bergman & Beving going forward.

Contract drug manufacturer, Recipharm, is perceived to be a turnaround story but Östlin argues that, "the firm should turn out to be a long-term compounder, growing 5-10% per year, from its niche of manufacturing patented drugs for large and small pharmaceutical firms. We have followed the firm since it listed and know the management well. An ambitious acquisition programme contributed to a halving of the share price, which provided a good entry point. We have visited plants in France and Germany and believe that the capex programme is on track despite some delays in 2017 and 2018".

Atlantic Sapphire has an ESG angle: "its business model of farming salmon onshore, arguably avoids the ecosystem disruption and damage to wild salmon that can arise from farming salmon in the sea. The consumer perception of the model allows Atlantic Sapphire to command premium prices for its fish. Though listed in Norway, Atlantic Sapphire has expanded into Denmark and is building a large-scale facility near Miami in the US, which is expected to produce 90,000 tonnes a year by 2026" says Östlin.

In the dynamic bucket, Northern Drilling – which is majority owned by Norwegian billionaire John Fredriksen and has no debt - is an asset play, partly a play on a

stronger oil price and could also profit if larger oil companies ramp up their exploration activity.

OVERLAP WITH FLAGSHIP FUND

In the long book, there is very little overlap with Adrigo's larger fund, the flagship Adrigo Hedge, which launched in 2006 (Recipharm is one current example) but the short books of the two funds have more common positions, partly because Östlin's short positions tend to be in rather larger companies than the longs. There is potential to use indices for shorts, but so far they have all been single stocks. Östlin is pleased to report he has never experienced a recall of stock borrowed.

The larger Adrigo fund last year moved to daily liquidity, but Östlin feels that, "monthly liquidity is more appropriate for the small and mid-cap fund, which is taking on some liquidity risk at least for the top five positions". This is one reason why the Swedish Special fund would not fit into a UCITS structure, which would require dealing at least twice per month. Östlin is confident that he could manage SEK 2 billion in the strategy, and intends to close the fund at SEK 3 billion.

ALIGNMENT OF INTERESTS

Adrigo owners and staff seeded the fund with SEK 125 million, and as such are substantial investors in the SEK 370 million fund. Additionally, 55% of the Adrigo management company is owned by management, staff and the board.

Adrigo's owners also include some high-profile businessmen in Sweden: Melker Schorling, former Chairman of Hexagon; Mikael Ekdahl, former partner of the Mannheimer Swartling business law firm, and Carl-Henric Svanberg, Chairman of BP and Volvo and former CEO of Ericsson. They have no input into the day to day management of portfolios, but can provide higher level strategic perspectives on industry dynamics.

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