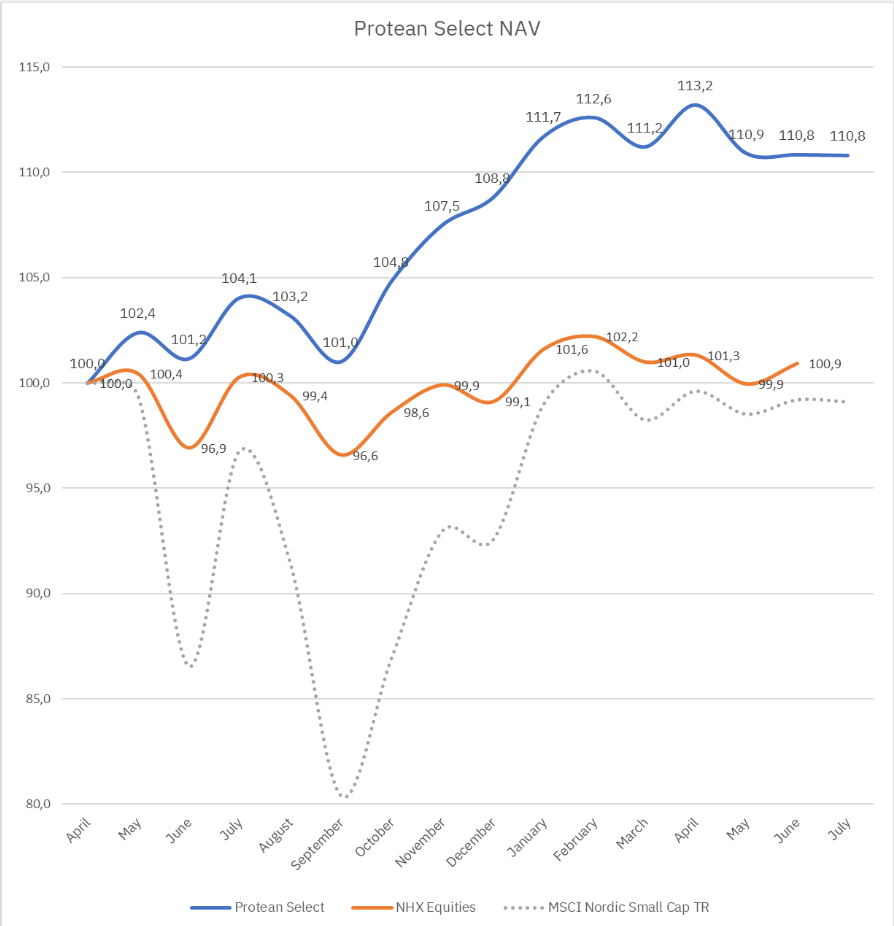
Disclaimer: Before considering an investment in any of Protean's funds, please refer to our prospectus and KIID-material. Investments in a fund can both increase and decrease in value. Full return of capital is not guaranteed.

July Partner Letter

Small Cap(s) For The Win

Dear partners,
Protean Select was flat for the month (ish, -0.05%). The year-to-date return is now +1.8 %. Since our start, 15 months ago, the fund has returned +10.8% (with lower risk than the general market). **Protean Small Cap** returned 1.4% in its second month putting it 0.6% ahead of its benchmark. Thank you for being an investor. Since our start of Small Cap in June, the fund has gained 2.6%, compared to the benchmark increasing 1.3%.



**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. We aim to have positive returns regardless of the market. No return is created in a vacuum, and a net-long strategy will correlate. Our hurdle rate is 7.2% annualized (4% + 90-day Swedish T-bills). All performance figures are net of fees.*

TLDR

- **Protean Select** returned -0.05% for the month, 1.8% YTD and 10.8% since inception.
- **Protean Small Cap** returned 1.37% in its second month, beating its benchmark by 0.6%-points.
- For best and worst performing stocks please see below for respective fund.
- We start August with **800m+ SEK in AuM** in Protean Select, and **80m SEK** in Protean Small Cap.
- Our net exposure to equities in Protean Select is currently 45%, our gross exposure 112%. We have added length and gross to the book and upped our allocation to small caps during August.
- The portfolio **remains diversified**. No long position is bigger than 3.8%, and no single short position is bigger than 1.1%.

What happened in July

Big Q2 reporting month, with the volatility that comes with it. The Nordic indices are pointing in all sorts of directions, with a tilt to the negative side. Notable is that small cap indices outperform large cap for the first time in a while. A trend shift?

Reading a report from one of the bigger investment banks, July was a tough period particularly for hedge funds. It has seen significant de-grossing (reducing gross exposure, i.e. risk) and short-covering. There certainly have been opportunities to go wrong and be caught out in some vicious moves. We are secretly pleased we have managed to stick to W. Buffett's rule number one: don't lose money (although we feel slightly like a reverse Madoff for reporting two months in a row with a fraction negative performance). In contrast to the median hedge fund, we have added to our gross and length throughout July (and outperformed most of them by being flat).

We think the backdrop for equities turned more supportive, as we have seen better than expected data on growth and easing inflation pressures. Lower macro volatility is an underappreciated driver of equity returns if you take a step back. On a macro level, weak balance-sheet stocks have started to outperform in recent weeks, as have super-cyclical stocks like pulp and paper-producers, despite shockingly poor Q2 numbers. Positioning matters.

Because of the slightly changing playing field, we have adapted the portfolio to now run a net exposure in the 40-50% range. This marks a strategy shift in Protean Select, which has been running a net exposure in the 20-30% range since inception. We believe there is a lot of bad news discounted in share prices, particularly in smaller capitalization companies. Our exposure to small cap companies is also at its highest since inception (>50% gross, >35% net). Time will tell if this assessment is correct.

Since our start, the realized volatility of Protean Select is approximately 7%. That's about a third of the volatility of the Nordic indices. It is a measure of risk, and we have been risk averse. It is important to remember that we do not manage for a certain volatility level – it is a residual of our big-picture view and bottom-up portfolio construction. Right now, we think taking on more risk, adding length to the book, and accepting and absorbing more variance, has a positive risk-reward. Hence the higher net and ramped-up exposure to small caps.

We remain opportunistically hedged on the SEK/EUR currency pair, as we think today's extreme levels are an outlier. While we by no means are FX-experts, and do not intend to hedge currencies as a feature of the funds (it's a zero sum game and what's our edge?), we note the perception driving the weakness are of a transient nature. For how long will concerns over Swedish commercial real estate linger? How long can Turkey and Hungary stall the inevitable accession to NATO? (Note the SEK/EUR-move when Turkey agreed.) How long will the negative delta in perception of our inept Riksbank continue? We fade this SEK-weakness with EURSEK-futures. A cheap way to insure (costs approx. 1bps/quarter) against a rough 1,5% loss in the fund, should the SEK strengthen by 10% agains the EUR and DKK.

Danish insurer **TRYG** has during July become our biggest position at 3,8% of the fund (yes, we run relatively small positions, relative to most of our peers). We think it's a classic case of overreaction. Small quarterly deviations triggered a negative reaction that has seen this stable, well-run, oligopoly business de-rate to valuation levels not seen in decades. Arguably some of the move has been amplified by the sector's underperformance, driven partly by rotation from insurance to banks. We think TRYG is facing an interesting period in H2 2023 with likely substantial insider buying, improvement in operational performance from continued price hikes and a normalisation of valuation. Looking at the chart one could think the wheels have fallen off this business. They have not. We financed the increased position by reducing our holding in sector peer Sampo.

What went well this month

Promimic was the biggest contributor to Protean Select in July. This was in absence of any news flow, apart from a CFO departure, and should be seen in the context of this being an illiquid nano cap. It could reverse, but we are believers in the long-term story of this interesting medtech company. **RaySearch** rebounded from the CEO sell-down, becoming the next biggest contributor. More on this interesting case later in this partner letter. Other notable contributors - apart from short position in index futures - were **Storskogen**, **Castellum** and **UPM-Kymmene**, while **Knowit** and **Instalco** generated positive performance on the short side.

What went pear shaped this month

The biggest detractors in July were **Cargotec**, **Viaplay** and **Tryg**. We'll dwell a bit more on the underperformance from the Finnish industrial Cargotec**.** It showed just what we expected in its Q2 earnings: operating profits grew almost by triple digits, with the margin reaching 13%, as bottlenecks eased, and pent-up demand drove deliveries. Taking a step back: if you said five years ago that Cargotec's margins would surpass those of **Kone**, you'd probably be categorized as a lunatic. Considering that Cargotec's share price has flat-lined over those five years, despite this out-of-the-box case materializing, we feel that no-one is paying attention.

Cargotec fell 14% during July despite beating estimates handsomely on profitability as attention (as elsewhere in the sector) was put on orders, where they missed by 9%. While we can sympathize with the 'the order delta is negative and PMI's are declining' kind of set-up - in which Finnish industrials are typically sold - we believe the market is disregarding the transformation of Cargotec that has happened during the last couple of years.

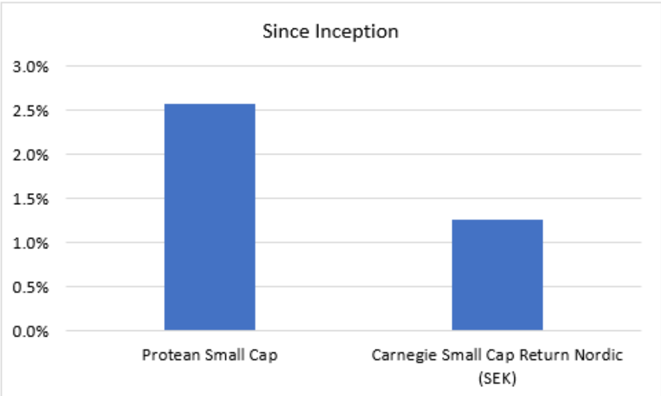
Protean Small Cap – update for July

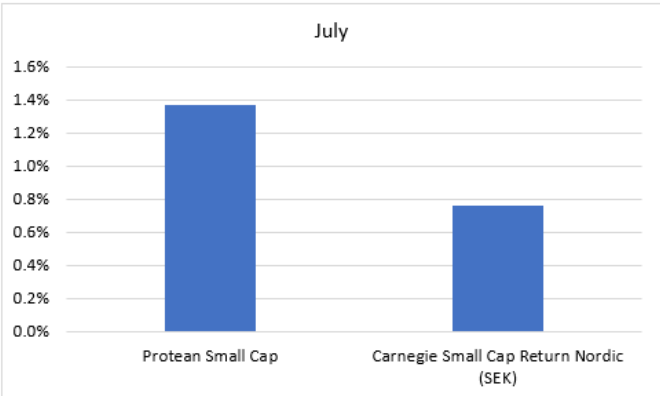
The second month of existence for Protean Small Cap resembles the first month in many ways: we've had our fair share of misses, and our fair share of winners. The fund gained 1.4%, beating its benchmark with 0.6% after fees.

Similar to Select, our biggest loser was **Cargotec,** while other cyclicals such as **Fagerhult** and **Alimak** also performed poorly. In our view, the market is being a bit myopic in these names, disregarding longer-term trends and transformations while focussing on order intake falling (from high comps) but we are maybe biased as holders.

We are not that fond of real estate companies. They are in our view, vehicles of long-term wealth preservation. Protean Small Cap is aiming for wealth creation. That being said – there's opportunities to be found. Castellum became our biggest gainer during July. We identified **Castellum** as the safe bet in the sector, relatively speaking, with a sector-low LTV post its recent share issue. Other notable contributors in July were **NCC**, **Storskogen** and **Raysearch**.

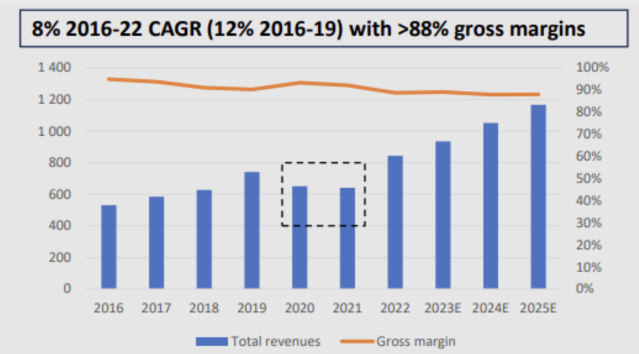
As we enter August, our biggest positions are **Balder** (which has replaced Castellum as the real estate pick), **Alleima** (performing well, underrated growth prospects), **Raysearch**, **Beijer Ref** and **Storskogen**.

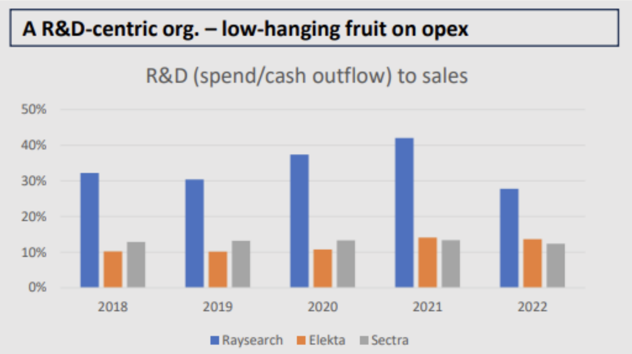




RaySearch – World class products could turn into a world class business.

We have mentioned RaySearch in passing in two previous Partner Letters. We have now done more research and accumulated a sizeable position in both funds. Our research has strengthened our conviction there is substantial potential upside. When we mention the company to other portfolio managers who know of the company, we get a blank stare and “yeah that one, it never seems to work, it’s just poorly run”. There are lots of prejudice based on history in RaySearch, which is keeping many from sensing the change. There is a crisis of confidence in management. This is the source of opportunity. The products are excellent, the market is in a strong secular growth trend. RaySearch has every opportunity to turn its world class products into a world class business.



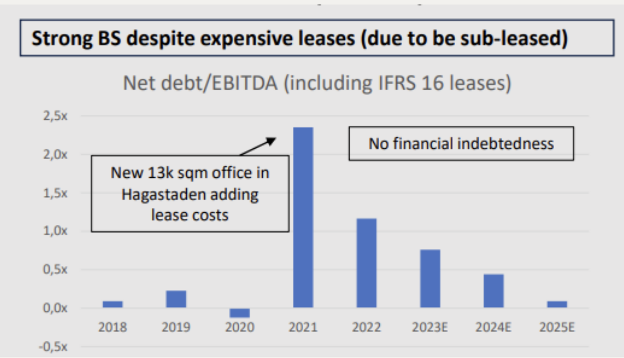


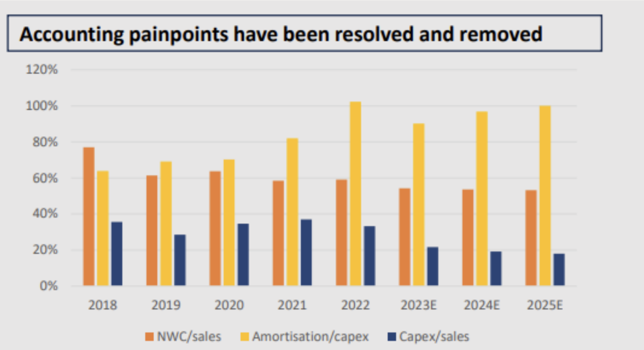
RaySearch is a Radiation Oncology software provider listed all the way back in 2003, founded and headed by main owner and CEO Johan Löf (49% of votes, 16% of capital). Main products are RayStation (dose planning software) and RayCare (OIS, Oncology Information System – think of it like an all-encompassing CRM-system for an oncology department). The radiation oncology market grows by 7-10% per annum. RaySearch has averaged 20% revenue growth the past 20 years. In 2022 revenue was 845m SEK. The product USP is quality, innovation, and user friendliness.

Homemade problems have triggered a crisis of confidence…

- The company has had a period of **CFO-turnover** (3 CFO’s in 2 years!), with reasons stemming from personal issues and poor on-the-job performance. This has amplified the impression CEO and Founder Mr Löf is “difficult” and erratic. From our research we conclude this is not an entirely accurate conclusion.
- Management is fumbling the strong financial and operational performance with simple mistakes, like the **breached covenant** they communicated at Q1-reporting; how does a **debt-free** (lease adjusted) company manage to breach a covenant?
- **Loss-making**. In 2020-21 the company had its first two loss-making years since its IPO in 2003. This was all Covid. The company had ramped its salesforce ahead of a big product launch just as the entire market shut and killed top-line growth.

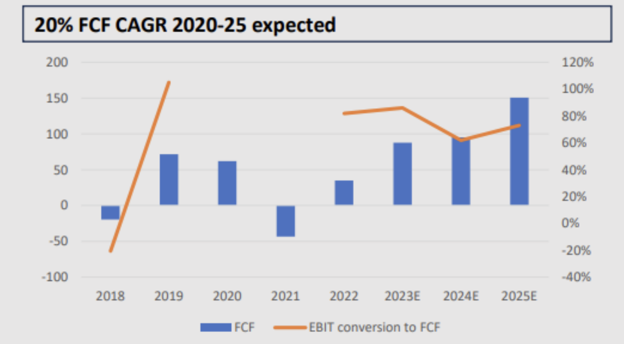
- A few years ago, the company was under short-seller fire for **poor cash conversion, high unbilled receivables,** and wonky **capitalization of R&D**. These issues have all been cleared, but still linger in investor's minds. This is unjustified but explains the investor apathy.
- The company has a **bloated cost structure** both on SG&A and R&D, particularly if peered vs other medtech companies. It also has too expensive (and too big) office space, particularly when growth was muted due to Covid.
- Investors have **lost patience** and the stock is generating **minimal attention**. Research coverage has dropped from 5 analysts to only 1.
- The company is run by an owner/operator that is **focusing on the project of improving cancer care, not on massaging analysts and participating in capital market events**. We can forgive him for that. In fact, we even applaud it. This is the right approach, but it **needs to be paired with a focus on shareholder value.** An area which has been lacking in recent years.

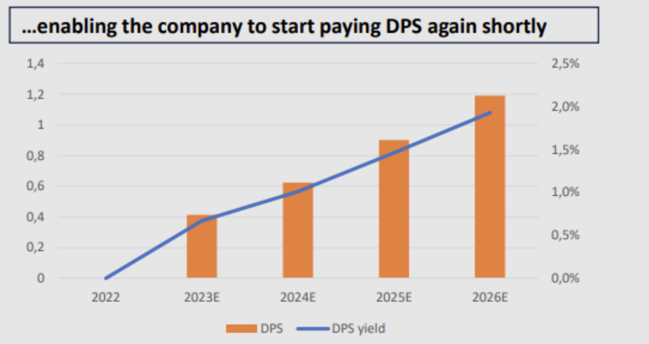




... but a world class product portfolio, excellent market dynamics and changed management attitude...

- The company is taking market share, has a record order backlog and order intake.
- A heavy multi-year R&D investment period in the RayCare product has just finished.
- Treatment planning software RayStation holds a near-monopoly in the growing Proton therapy niche.
- Adjusted for leases, the company is debt fee.
- Market dynamics for a sticky, vertical software product, operating in a growing market with limited competition, are excellent. There is basically no churn.
- Key competitor Elekta is strong in LINAC hardware but is perceived as weak on software. Elekta is spending the equivalent of RaySearch's market cap in software R&D every year to catch up. So far unsuccessfully. In the unlikely scenario of Elekta and RaySearch combining, there are very (very) big synergies.
- We sense there is a change in management attitude. Recruitment of Mr Mårder to the board speaks volumes; he has made his career as "Sweden's most cost aware". Exactly what RaySearch needs. Our conversations with management hints at an openness to focus more on shareholder values. We welcome this pivot and think it is much needed.





... means there are easy fixes to restore confidence...

- Keep delivering on growth.
- Implement a minimum of cost awareness, allowing margins to show some of the software model scalability. We estimate gross margins on the >85% of sales that does not come from hardware passthrough comes with gross margins of close to 100%.
- New financial targets. Commit to a medium and long-term margin.
- Re-engage with the financial community.
- Re-instate dividends.

Playing with numbers, you do not need to assume a lot goes well to see ample upside in the equity valuation. Should RaySearch just return to the historical average 20% growth, at 23% EBIT-margins... What's a fair multiple on that? If margins are allowed to scale, and growth continues, we will soon find out. Conversely, at 3% LTM FCF yield, the natural inclination to always inverse would indicate that, unless current, post-pandemic market trend reverses, we see risk/reward as heavily skewed to the upside.

We recognize this change in perception will happen only if the company shows progress on particularly cost awareness for some time. We encourage CEO Mr Löf, his fellow management team and board of directors to travel in this direction and have had fruitful discussions on these topics with various stakeholders.

Paradoxes of investing

We are proud of our investors. We think most of you have taken the time to understand our strategy. You appreciate that we are fully invested ourselves alongside with you. You know that there are no guarantees in the world of investing. We do our best but are guaranteed to be wrong occasionally. You realize – as we have repeatedly warned – that we will have rough patches. Even the best money managers in history have had months, quarters and even years of underperformance. Which makes sense – there is so much noise in the prices of equities and other instruments, not even a quantum computer can make sense of it all.

Noise, defined as stories and data that do not change the long-term outlook of the business, can have outsized impact on share prices. It is a long-term opportunity and a short-term threat. Someone's wrong, or there's a clash of horizons. Or like Charlie Munger said: "if people weren't so often wrong, we wouldn't be so rich".

Sometimes, when a stock goes down, the best thing to do is nothing (or buy a little bit more). It depends on why it went down in the first place. It is one of the more intriguing paradoxes of investing: if you have made a good decision in the first place, the less you do with that holding the better.

Hearing anecdotes of "had you bought Amazon at the IPO your 1.000 would now be 1.5m" it's easy to be impressed, but to generate that return you would had to be able to sit through multiple periods of significant underperformance, including an 80% draw-down during the bursting of the tech-bubble. Plus, obviously, you would have had to have a multi-decade holding period.

In Protean Select we have an explicit allocation to a handful of stocks that we think could return 3-5-10x over the coming years. We treat them slightly different to the other holdings in the fund. We are more likely to absorb short term variance, as long as the key metrics (for each case) remains intact. For multi-baggers to do just that (multi-bag, i.e. appreciate multiple time) one of the key ingredients is **time**.

Reading the **C. Mayer** book "*100-baggers, Stocks that return 100-to-1 and how to find them*" reveals some interesting statistics. The value to me from the book was that it offered some counter-intuitive proof that stocks that go up 100 times share very **few** characteristics. They are not necessarily microcaps, they are not particularly cheap, they are not all in fast-growth industries, or asset light, or subscription based, or all that jazz that is high on today's agenda. One thing many share, however, is they are <u>owner operated</u> – management either own a substantial part of the equity, or they have an outsized focus on maximizing shareholder value. With agent managements, without skin in the game, you tend to get focus on glitzy deals, on EPS, on adjusted EBITDA, or whatever metric the incentive program is based on…

One of the key ideas of our investment strategy is to find great companies, buy them well, and allow them to compound over time, paired with being vigilant on protecting the downside. We think the big money is made owning growing companies for a long time. I don't know who said it first, but "*buy right and sit tight*" is a pretty good axiom. At the same time, today's market throws up many temporarily mispriced equities, both on the long and short side. In our experience, it would be silly not to participate in those too – this is why the strategy also is to be versatile and allow trading in all kinds of opportunities where we think there is a skewed risk/reward.

We like to think our investment strategy is mirrored by the fund structure. We have maximum flexibility and skin in the game. We care about returns first and last. We do not care for marketing-friendly labels, such as targeting a hot niche “green transition”, “ESG” or “multi-strategy” or whatever.

Why the high fees?

Occasionally we get the question why we don’t have lower fees. We have thought a lot about this. A key idea of Protean Funds is we think smaller funds perform better, or at least has the opportunity to do so, as many investment ideas are in small caps and therefore inaccessible for a larger fund. The costs or running a fund management operation, however, is the same for a small fund and a large fund. Which is one of the paradoxes of investing we are not particularly pleased with. Despite this, our fee structure is in the lower end of the market range. And we have a substantial hurdle to beat before we can charge a performance fee (almost 8% p.a. in Protean Select, and Carnegie Small Cap Nordic Index in Protean Small Cap). We note other funds that have no hurdle whatsoever, and small cap funds that contain mostly mid-caps but charge well above our 1.4% fixed fee.

As a side note, Protean is approaching 900m SEK in assets under management, but remains a loss-making operation on a fixed fee basis (running this business comes with a lot of costs). Looking from the outside that might sound strange, but be aware that distribution platforms (where most retail investors have their money) charge as much as half the fixed fee for the privilege of distributing the fund (i.e. ticking a box in their software suite). To summarize: we have every incentive to create performance.

Take right now in Protean Select as an example: given we have a high water mark for performance fees, and had one poor month in May (-2%), followed by two flat months in June and July, we need north of 5% performance from here to charge a performance fee. And every month another 0,7%-points is added to that 5%. The hurdle accumulates. This is a challenge for a variable-net strategy, but fair to investors. If we don’t do really well, we don’t get paid. And if we do only semi-well, you are free to fire us as custodians of your capital every three months with no questions asked.

The question really is: why don’t the 15-30bn SEK funds have lower fees?

We’re all contrarian in the same way?

We note fund flow statistics from the big online brokers in Scandinavia show **outflows from Small Cap Funds** in recent months. We can sympathize with the sentiment – the performance of the asset class has been poor in recent quarters. We are happy with the poor performance, as it allows us to buy into the small cap segment with our recently launched Protean Small Cap fund at multi-year lows in a number of stocks.

One of the online brokers published a “If you want to be contrarian, here are four historically successful small cap funds to consider”-article a few days ago. It showed the top 10 holdings of these established funds. I don't mean to be critical, but **the holdings are borderline identical**. Lagercrantz, Addtech, Vitec... When your small cap fund grows to 15bn SEK and above, there are only so many small caps you can realistically deploy capital in. You end up with a quality-factor-heavy mid-cap fund. Institutional fund products suffer from size. Profit maximizing fund management companies want big funds. It makes perfect sense from a corporate perspective but not from an investor's perspective. We therefore cap the size of Protean Small Cap at 4bn SEK. Obviously, it's a long way there, but we think it is important to strongly signal intent of not profit maximizing at the expense of potential returns.

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.
We have skin in the game.

Pontus Dackmo
CEO & Investment Manager
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