CPH CAPITAL COPENHAGEN

Founded in 2010, **CPH Capital** is an international asset manager, with one external shareholder (Formuepleje) and 27% employee ownership. The team behind CPH Capital previously worked together at BankInvest, Copenhagen. Currently there are two investment strategies; Global Equities and Global Consumer Equities. CPH uses a bottom-up stock picking investment process, translating into style-neutral, fully invested portfolios containing only active positions. Both portfolios seek stocks in high-quality companies at attractive valuations. They focus on strong cash flow-generating companies with well-built market position and the ability to create value in the long term. CPH currently has some $2 billion AUM.

Kenneth Graversen is on the Investment Board. He focuses on industrials, materials and energy companies. He previously worked at BankInvest and before that as an equity research analyst at Enskilda Securities. Prior to that, Kenneth worked at Alfred Berg, part of the ABN Amro Group.

You have $2 billion AUM, how much is in equities?

"All our AUM are in equities. Within our Global Equities strategy we have $1.8 billion. US equities presently make up close to 50%. Within our Global Consumer Equities product, we have $250 million and US equities make up just below 40%. So, in total, our US equity exposure is $1 billion."

What was the rationale for founding CPH?

"It provided us with the opportunity to build up an asset management boutique with a narrow strategy/product focus, allowing us to focus on our core competencies, which we believe are centered around Global Equities as well as Consumer Equities."

Where is CPH positioned in the Danish investment management community?

"We are among a small number of focused equity boutiques in Copenhagen with a long term investment focus as well as proven track record. Our target is institutional money."

What is your investment style?

"The strategies invest in listed equities using a long-only "bottom up" approach. We believe a portfolio of high quality companies, each with absolute positive return expectations, will yield better returns than our benchmark with better downside protection. We define high quality companies as companies with a high, sustainable CFROI (Cash Flow Return On Investment) above the cost of capital combined with a low CFROI volatility in the forecast period. In order to assess the sustainability of CFROI, we apply a strategic framework analysis based on Porter´s Five Forces; thus we focus on the market position and related threat of a new competitor, competitive rivalry, potential threat from product substitution as well as any strength (or lack of) from suppliers as well as customers. To assess the CFROI volatility we analyse capital expenditure (maintenance versus growth related capital expenditure) as well as working capital parameters, the latter to ensure that earnings are converted into cash, that may be allocated to shareholders. Discounted Cash Flow (DCF) analysis is used to estimate the value of a company.

We invest in companies that have an attractive valuation (minimum 20% upside to a fair value) and meet our criteria for a high quality company. Our list of criteria includes:

1. Capable management team.
2. Prudent corporate governance (including use of generated cash).
3. Strong balance sheet (low debt to market cap).

4. Strong earnings power (low earnings volatility).

5. High earnings quality (high cash conversion, stable margins, few one-offs).

6. Strong business fundamentals (strategy, competitiveness, brands, technologies, IPR).

Overall we would describe our investment style as “QALP”; Quality at low prices.”

What screens do you use?

“We use screens extensively. Examples of screening variables are ‘CFROI levels’, ‘low volatility in CFROI’, and ‘capital distribution’. The tools used in the quantitative screening process include Credit Suisse’s HOLT system, CPH Capital’s proprietary Equity Screening tool, and Bloomberg.”

What’s your active share ratio?

“Our active share is around 90%.”

Average holding period?

“We have a long term focus embedded in our investment style, with a holding period of around 4 years.”

Average market cap size of US holdings?

“Most of our US holdings would presently fall within the large cap segment ($10 - $200 billion).”

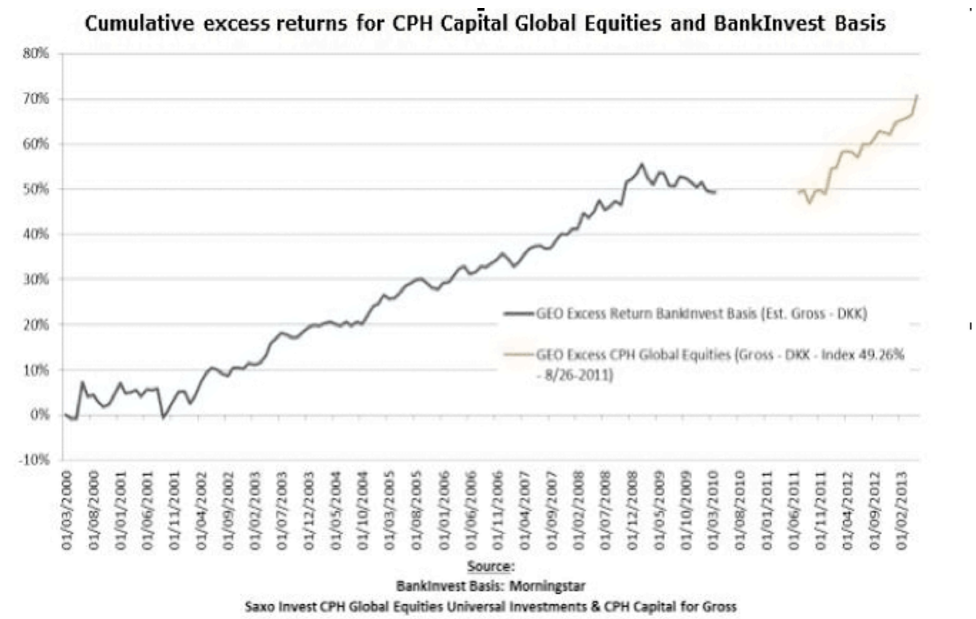
Which benchmark do you use?

“We use MSCI AC World as our benchmark.”

Performance?

“While the strategy was managed under the BankInvest brand it outperformed the benchmark every year from 2000 to 2008. The average annual outperformance under the BankInvest brand from 2000 to 2010 reached +400 bp gross of fees (Source: Morningstar). The strategy underperformed in 2009 due to an underweight in the banking sector, which was implemented late 2007. In 2009 the team was not able to forecast the future profitability of the banks and did not feel comfortable with the risk of investing in the banking sector. 2009 marked the strategy’s worst year of relative performance, underperforming ~1.5%.

Our ability to deliver outperformance has remained intact after establishing CPH Capital. The chart below illustrates the strategy track-record, with BankInvest Basis performance from 2000 – 2010, a flat period of gardening leave, and our continued track-record at CPH Capital. The graph is stitched together for the interim period using benchmark returns (flat relative performance).”



According to public filing data, some of your larger holdings in the US are McDonald’s, Yum!Brands and AutoZone. Can you explain what you like about these companies?

“Sure, if we start with McDonald’s, this company has been a consistent creator of value for more than 20 years now. The value created has been allocated to shareholders, as all free cash flow has been distributed as dividends as well as share buy backs. Going forward we expect more of the same, while we also like its strong market position globally, brand power and depth of management.

Yum! Brands is a somewhat newer position. The company generates healthy, predictable cash flows owing to its 80% franchised business model (90% franchised outside of China). Like McDonald’s, Yum! Brands has been a consistent creator as well as distributor of value, a key focus of ours. We see plenty of growth potential for many years combined with at least steady profitability.

AutoZone is another long term favorite of ours. Within the auto parts business, the company is the leader, especially when it comes to DIY. It does 30% more DIY sales per store than Advance Auto Parts and 50% more than O'Reilly Automotive, which feeds into industry leading margins. Combined with a fairly asset light business model, the cash flow generation is strong and stable. This has strongly benefitted shareholders, as AutoZone consistently has been buying back shares."

What about Canadian stocks ? Can you own them and do you ?

"We can own Canadian stocks, but currently we don´t have any Canadian stocks in our portfolios."

Favorite sectors?

"We have a bottom up focus, and as such we don´t have any views on sectors. Based on our bottom-up stock picking, we currently have overweight sector positions within Financials, Consumer Discretionary and IT within our Global Equities portfolio as well as underweight sector positions within Energy, Telecommunication Services, Materials and Utilities."

Do you vote your proxy?

"CPH Capital engages in proxy voting on all shareholder assemblies in company holdings. We use the service of an internationally-renowned Proxy Voting Service Provider (Manifest in the UK) to assist with proxy voting research and the operational matters in proxy voting on the portfolio holdings."

Are SRI/ESG considerations important?

"Yes; ethical guidelines are set according to client specifications. All portfolio companies adhere to a minimum ethical level and are compliant with UN conventions. We use EIRIS to screen for ethical violations and adhere to the Norwegian Petroleum Fund's list of excluded companies (currently 49 companies). We are signatories to the United Nations Principles for Responsible Investment (UNPRI)."

How do you know if you want to meet a company?

"If the company is not part of our portfolios, we use the HOLT database system to get a quick overview of its past performance (CFROI) and ability to generate value consistently or not. If the former is the case, we´re likely to meet the company, irrespective of its valuation. If we are invested in the company, then as default we always want to meet the company when in town."

Who do you prefer to meet (e.g. CEO, CFO, IR)?

"CEO/CFO, but IR is highly valued as well."

Any companies you'd like to see visit Copenhagen?

"McDonald's, Yum! Brands, AutoZone, Johnson & Johnson, Cisco, and Republic Services."

How does the team split sectors and geographies? If so, please explain.

"The portfolio managers all have global sector responsibilities. David Dalgas is Head of the Investment Board and CIO. I look at industrials, materials and energy.

Klaus Ingemann Nielsen looks at tech, telcos, utilities and pharma. Rasmus Hansen looks at financials. Per la Cour looks at consumer. Thomas Christensen, Head of Quant & Risk management, who among other things runs and provides each portfolio manager with sector specific screens."