PANDIUM

Pandium Global

Strategy and method

Guiding principles

I have some guiding principles that you should know about.

1. My goal is to maximise the long-term returns my partners' capital

It might sound like an obvious thing to say, but based on how the industry operates, it is not. What I mean is that all my time and energy will be spent on trying to maximise the long-term return on my existing partner's investment. (Throughout this document, I will use the terms partner, investor and customer interchangeable.) Activities that do not add value to my existing partners, such as raising new funds or personal promotion, will be kept to an absolute minimum.

It might sound altruistic and noble, but it is not. It is just the best way to do it. If I just focus on adding value to my customers, they will be happy and that, in turn, will be good for business.

The consequence of the principle is seen in many aspects of what I do. One example is that I will stop all fundraising activities when I have enough assets under management so that fixed fees cover my costs.

Further, I will not let irrelevant factors such as my ego or fund marketability impact how I manage the fund. My investors have not hired me to be an original thinker, but to make good investments. I will also rather do simple and safe investments than complex more "marketable" investments.

2. Alignment of interest

I will always maintain a proper incentive structure and make sure that I share the downside with my investors. All my net worth is and will be invested in the fund.

3. Provide the information I would want if the positions were reversed

I will be transparent about both the advantages and disadvantages when describing the fund. It is not only the right thing to do, but it will hopefully also lead to that the partners that join us are a better match.

4. Continuous learning

I will make mistakes. I promise. But I will do everything I can to prevent them, and I will never stop learning. If there ever comes a day when I lose interest in the work and learning process, I will close the fund.

Fundraising is like dating

When you are dating, you are best off showing who you are instead of pretending to be something you are not. It will probably take a longer time to find a partner, but once you do your odds of happiness improves significantly.

I think the same applies to finding the right kind of partners to Pandium. The aim of this presentation is therefore not to try to convince you to invest, but to as transparently as possible tell you about Pandium and myself. It will surely lead to fewer investors, but that is a good thing, since the ones that join us, will be a better match.

Reasons not to invest

In the interest of not wasting your time I thought I would list the top reasons why some chose to not invest with me.

1. I do not care about short-term performance. All investments I make are with a horizon of 3-5 years. This means that will likely have shorter periods of underperformance. If you care about short-term results (some do), I will disappoint you.

2. Pandium is in practice me, and I work alone. I do not have any committee that approves my investments. I believe that this makes Pandium better, but some people do not.

3. My view on risk differs from that of most market participants. My primary concern is to not lose money, as opposed to minimising volatility.

4. I work with a concentrated portfolio, and as a result, our returns might be more volatile than a diversified fund. But in my book, a lumpy 15% is always better than a smooth 10%.[1]

5. Pandium Global is still a small fund. Although this gives us a larger investment universe, some are not comfortable with small funds.

6. Pandium is different. We have an unusual fee structure and terms and high expectations of our partners. But, everything that makes Pandium different is a choice I have made because I think it will help me achieve my main goal: to produce superior long-term returns. I do it at the expense of not being easily classified and thereby investable for some institutions.

If the above sounds like the wrong approach to you, you should not waste any time reading the rest. We will not be a good match.

---

[1] If I write something that sounds intelligent, it is likely borrowed from someone else. This time from Warren Buffett.

About me

Pandium Global is managed by me, Mikael Tarnawski-Berlin. I was born and raised in Lund, a small university town in the south of Sweden. After serving as a Ranger in the Swedish Army I studied at Lund University where I completed two Master degrees, one in Law and one in Business Administration and Economics.

I started my career as a management consultant at The Boston Consulting Group in Stockholm. After promotion in 2006, I did a six-month detour into investment banking in London, UK. While working in the UK, I won a green card to the US. At the same time, I had the idea to start a Chipotle-like restaurant chain in London. Since I knew nothing about running a restaurant, I went to Los Angeles and worked at the Chipotle restaurant in Burbank, while developing the business plan. After a couple of months of research and training, I realised that I would not enjoy running a restaurant (read: would suck at it).

Then I got lucky. I was travelling with a friend in Spain and had no books left to read. (This is pre-Kindle times.) So, I was forced to read the only book my friend had brought. It was the Intelligent Investor by Benjamin Graham and it changed my life. Being taught the Efficient Market Hypothesis I had always regarded the stockmarket as a big casino, not worthy of any attention. But learning about the concepts of the stock as part ownership of a company I immediately became fascinated. What got me interested was the combination of a sound model from which to approach the market and endless opportunity for learning more. There was also an aspect of being able to create value by just sitting and thinking. This suited me perfectly since my start-up project had taught me that I am more of a thinker than a doer. I subsequently "discovered" Warren Buffett and became completely obsessed with value investing. I devoured everything I could find on the subject and started to invest small amounts of money. Eager to start working with investments I went to work for a mid-sized private equity firm, figuring that it would be a good learning experience. In 2010, on the same day, I was promoted to Partner, a colleague and I initiated a management buyout of the company. About a year later we sold the company to another private equity firm. I made some money and decided to start a fund, something I had dreamt of for a long time. I first founded a private holding company and invested full time for two years. After reviewing the process and the results, I decided to launch Pandium Global in February 2014.

I live in Stockholm with my wife, Bonnie, who works as a doctor, and our two daughters, Ebba and Fanny. When I am not working, I spend time with my family and our friends. If there is any time left I read books. (My bookshelf: https://www.goodreads.com/mtb77.)

I should point out that my family will always come before my work. I believe anything else would be a huge mistake.

I am driven by curiosity and joy in the work itself. I would do this even if I didn't get paid. It gives me great pleasure that I, sitting on my own, avoiding doing stupid stuff, can produce better returns than huge investment firms filled with smart

PhDs and MBAs. My ambition is to belong to that minority of investors who have beaten the market over a long period. Hopefully by a big margin.

Investment strategy

I look for cheap and safe investments. In practice, that means that I only invest in good companies, with good management at a good price.

Good companies

A good company is a simple, stable low-risk businesses with good prospects. I cannot analyse or value a company unless I can figure out its economics and the industry it operates in. I, therefore, focus on simple companies in industries I understand. Since I value companies based on future cash flow, I limit myself to the stable companies that are suitable for that kind of analysis.

Since capital preservation is my number one priority, I seek businesses with low business- and financial risk. Business risk is the danger of a loss of quality and earnings power through economic changes or deterioration in management. That limits me to companies that have a competitive advantage, stability, or great management. Everything else equal, I prefer higher quality businesses since the business risk is lower. That said, I never forget that wonderful businesses make wonderful investments only at wonderful prices. Financial risk is managed by avoiding companies with excessive leverage or other balance sheet risk.

Good management

Good management is honest and capable. There is no way to make a good deal with a bad person. Honesty and integrity are must-haves, and any sign of dubious character will prevent me from investing, no matter the price or business quality. When it comes to management competence and incentives, I adjust my requirement based on businesses quality. Some companies are inherently so good that the management quality almost does not matter while some operate in tough competitive industries that require management to be on top of their game every single day. I also prefer when there is someone with influence to share both downside and upside with us.

Good price

A price is good when it is half of the intrinsic value. I only invest when the expected annual return is at least 15% for 3-5 years. This provides us with enough margin of safety for mistakes and bad luck. I never invest if I think there is any likelihood of a permanent capital loss.

Process

Hunting ground

Narrowing a fund's mandate is often driven by marketing rather than investment considerations. The only rational restriction for a sound investment operation is the portfolio managers circle of competence, which most often is not confined to a specific country or market cap. It is also unwise to define the circle upfront since it is hopefully expanding. So, I consider everything fair game, if I can understand, analyse and value it.

Deal sourcing

I find interesting companies through reading, researching industries and competitors, stock screenings, newsletters, conferences, blogs, other smart investors' investments and targeted searches.

Since I try to work smart instead of being smart, I search for companies where they are more likely to be undervalued. What they have in common is that the expectations are low. I try to leverage the fact that I have a longer investment horizon than most. It is a huge advantage to analyse a company with a five-year horizon as opposed to trying to figure out how next quarter will play out. Sometimes I do investments that benefit from Pandium's size and flexibility. There are many situations and companies where most fund managers cannot or are not allowed to invest due to internal restrictions or size.

Many of the investments I do come from my watchlist. It is a list of companies that I have analysed and liked but felt were too expensive at the time. Then I just set an alert price at which I would be interested in investing.

Analysis and valuation

Most of my time is spent on fundamental research. The purpose of the research is to reach contrarian conviction. I do everything I need to, with reasonable certainty, be confident in betting against the collective judgement of the market. I do that by reading annual reports, listening to management and market and competitor analysis. I mainly sit and read by myself, but if it is necessary, I interview knowledgeable people. The work is both quantitative and qualitative.

The time spent on research depends on the specific case. I am done when I have reached contrarian conviction. It can take weeks or months but is most often impossible. I also believe you cannot research yourself to a position of certainty. The future is always uncertain, and no amount of due diligence can change that. Sometimes it is better to incorporate more margin of safety compared to doing more research.

When working, I try to not forget my shortcomings. I have a checklist to help me minimise mistakes and discover cognitive biases. Working alone, I do not get the benefit of probing questions from knowledgeable colleagues, but I deal with that by talking to smart people that can help me in identify weaknesses in my reasoning. After the due diligence, the valuation part is often a simple exercise. I try to figure out what return I can get for each investment so that I can compare it to the alternatives. I estimate the expected return on the investment over 3-5 years by adding the growth in normalised free cash flow per share with the capital returned to investors, and adjusting for the difference between the entry and exit multiple. I always work with several scenarios. Valuation is an art and not a science, so instead of building complex, detailed models with false precision, I focus on the few critical variables that matter.

Portfolio, positioning, holding period and cash

I assemble the portfolio bottom-up and include companies based on their upside potential (since I only look at companies with very limited downside).

I believe in keeping a concentrated portfolio of 10-20 companies. That is enough to mitigate non-market risk and is manageable from a research perspective.

I sell investments either when the expected future return is too low compared to the alternatives or when I have made a mistake. I evaluate my investments continuously and critically. If I think I am wrong, I sell, even if it makes me look stupid.

Historically, I have kept a large share (20-25%) of the portfolio in cash. Since the market has risen during the period, it has cost me a couple of percentage points annually.

Risk management

Traditional risk management is mainly concerned with trying to minimise volatility in various forms. This is understandable and rational if you recognise that most managers are investing short-term and not long-term. If you are being evaluated based on your monthly or even weekly returns you will do anything you can to avoid big price fluctuations. But to let volatility guide your investment decisions when you are long-term investor does not make any sense at all.

Although volatility might have some explanatory significance when it comes to uncertainty about the value of an asset, it is not a good indicator of true downside risk. Risk and uncertainty are not the same. Risk is not knowing what will happen in the future, and the likelihood and size of the loss when something bad happens. The problem is that true risk is not easily quantifiable. But that does not justify using a meaningless ratio to estimate it.

Since I have the luxury of being long-term, and a manager of investment risk as opposed to career risk, volatility is not important to me. My only concern is to minimise the risk of a permanent capital loss. (In fact, volatility can be a good thing. Since most institutional investors try to avoid it, volatility can lead to mispricing.) My approach to minimising the risk of capital loss is simple:

1. I only invest in low-risk businesses. This means companies with fewer risk exposures that also possess characteristics that should help them handle unexpected unfavourable events. I am not interested in companies whose fortunes are dependent on factors outside of their control, such as oil prices, interest rates, a dominant customer, the credit markets and so on.

2. Since the future is uncertain and I might be wrong, I always include a margin of safety in my analysis and in the price I am willing to pay.

3. On a portfolio level, I make sure that I do not have too large exposure to individual risk factors. I analyse each company on a see-through basis and determine what risk factors affect their success and then make sure that there is no concentration.

In general, I do not hedge any risks. I say in general because although I have not done it historically, I do have the option to do it. I might, for example, hedge out currency risk if the fund is overly exposed to one currency. I have chosen to not use leverage or short selling since it creates risks that I am not comfortable with.

Since Pandium is a one-man show there is obviously the risk that something would happen to me. Should I for some reason be unable to manage the fund, there is a clear procedure in place. First, one of the board members gets access to my files so that he can sell down our positions in a controlled manner. Then all investors are redeemed. Since the fund only owns liquid positions, the process could be finalised in a couple of days.

Edge

If it is not obvious yet, I do not have any unique insights. Although my concentrated portfolio lets me spend more time on research than most market participants, that can probably be achieved by just reading a single annual report. The problem is that I am not competing against individual investors, but the collective wisdom of the crowd, that as I have mentioned, is a tough opponent. My edge is therefore not analytical. But, I do have three important advantages that few others have.

1. My likeminded long-term partners

My most important advantage is my likeminded, long-term partners. Since the absolute majority of fund managers are evaluated on a quarterly, monthly or even daily basis their investment horizon is equally short. That will prevent them from investing in situations with short-term uncertainty, even if there is long-term certainty.

Since I have been very clear on what Pandium is and is not, I am certain that my partners subscribe to our philosophy. I know that they care about long-term results as opposed to meaningless measures such as volatility or short-term performance.

(Most of our investors have committed their capital for at least three years.) Being one of few that can accept short-term uncertainty gives me a big advantage.

2. Alignment of interest

If you, as a fund manager, earn most of your income from a fixed fee you will not care too much if you outperform the index or not. Since there is no upside in trying, you might even be inclined to stay close to the benchmark to not underperform. You will also be inclined to raise more assets even if it might have a negative effect on your performance since it is a sure-fire way to earn more. Another common problem is that fund managers do not "eat their own cooking".

I have structured it so that my investors and I are in the same boat. When they lose money, I lose money. And I only make money if I add value (by outperforming the index).

3. Being small and independent

If you are employed as a fund manager within a large institution your priority is to keep your job. That is usually best done by not standing out too much. It is not worth risking underperformance by reaching for outperformance since it is better to fail conventionally than to succeed unconventionally. The problem with that is that you must be unconventional to beat the market.

Another common problem that large funds have is that they have a limited number of potential companies they can invest in. This is especially true if you have limited the mandate to a specific country.

Pandium is a small fund and has about 27,000 companies in our investment universe. Further, by being CEO and majority owner of the fund management company I have no problem in making unconventional investments.

Performance

I have an audited track record of more than five years. Although it is long enough for a meaningful review, it does not include a real down period. The results should therefore be taken with a grain of salt.

With that caveat, I have produced outperformance versus MSCI World during the period, despite a large share of cash (more than 20% on average). For detailed performance data please refer to the latest Fact sheet or our website.

Incentives & terms

I am strong believer in the power of incentives. I have therefore created a fee structure that will always force me to focus on adding value to my partners. I think that the management fee should cover fixed costs and the performance fee should provide the profits, and have set it up accordingly.

- Management fee: Declining as assets grow. The scale is set so that the management fee cover Pandium's fixed costs, but does not provide any profit. See table below.

    - SEK 0 - 499 million (in AUM): 1% management fee
    - SEK 500 – 999 million: 0.75% management fee
    - SEK 1000 – 1499 million: 0.50% management fee
    - SEK 1500 – 1999 million: 0.30% management fee
    - SEK 2000 million and above: 0.20% management fee

- Performance fee: 20% on the outperformance against MSCI World Total Return Net.

The purpose of this slightly more complex fee structure is to align incentives between me and my partners. I will never be able to sit back and relax collecting high management fees.

The fee is only one part of the incentive structure. It is critical to share the downside as well. Therefore, we as employees and owners of the fund are together the largest investor in the fund, representing 40% of AUM. I have also made the legal commitment to my partners that I will commit 100% of my current and future investable capital to the fund. My only investment outside of the fund is the apartment I live in.

The fund is currently denominated in Swedish kronor but we offer other currencies as well.

Legal & administration

Pandium Global is an Alternative Investment Fund according to the AIFM-directive. Pandium Capital AB is the AIF-manager. We are an authorised AIF-manager by Sweden's financial supervisory authority, since February 2014.

Pandium has three employees, one full-time and two part-time. Our risk manager is Moa Långbergs. Tom Svedenstrand is responsible for all internal administration. Our compliance officer Cecilia Wennerholm is a lawyer at Apriori Law, a law firm serving the financial sector. We also have an independent auditor, Leif Lüsch, that monitors the work of the risk manager and compliance officer.

Our custodian is SEB, the largest custodian in Sweden. Our fund administrator is ISEC Services, also the largest in its field. We are audited by Jesper Nilsson at Ernst & Young. Jesper is amongst others the auditor for Svenska Handelsbanken.

Pandium Capital AB

Website and email

www.pandiumcapital.com
info@pandiumcapital.com

Phone

Tel. +46 8 400 262 50
Fax. +46 8 509 096 26

Postal address

Box 7392
103 91 Stockholm
Sweden

Visiting address

Norrlandsgatan 15
111 43 Stockholm
Sweden