

# British Empire Securities & General Trust

## See-through discount c32%

### Corporate activity to enhance performance:

**Oriel view:** We remain positive on **British Empire Securities & General Trust** (BTEM; **Positive**) even though its headline discount has narrowed to 2% at the time of writing, representing a 12 month high. Off-setting this narrower discount, manager John Pennink at AVI reports that the discounts on its underlying holdings have widened, and that the average discount on underlying holdings is now around 30% having been nearer 25% in September 2010.

### No more patience for Japan, rewards have been scant

The contrarian style of BTEM has served it well over the years and we think the portfolio looks well positioned for the current tough environment. BTEM has always been a patient investor but patience has finally run out with regard to its Japanese exposure where exposure has been reduced from 15% to around 2%. Whilst Japanese stock valuations appear cheap, AVI sees no catalyst to realise value – in stark contrast with certain other high profile managers, but a view shared by Hugh Young at Aberdeen Asset Management.

### Corporate activity looms

However, AVI is optimistic that the wide discounts of other investee companies will narrow as they become an increasing area of focus for investors and activists. It certainly appears logical to us that when returns become harder to generate elsewhere, the market will start to focus on corporate activity whereby a 30% discount can be turned in to a 10% one, generating positive upside ahead of the index for little or no additional risk. One recent example from within BTEM's portfolio is CNP a Belgian holding company, which until taken private recently by its parent, Albert Frère, on a 10% discount, was trading on a c25% discount. BTEM's third largest holding, **Groupe Bruxelles Lambert** (c6% of total assets) is also controlled by Albert Frère, trades on a mid-20's discount and arguably could also be taken private at some point. Pennink sees scope for other holdings to see discounts narrow whether by privatisation or other corporate means.

### Cash weighting reduced to 13%

BTEM's cash position has been reduced from 20% at the end of September to around 13% at the present time. The cash has primarily been deployed in Spain, which fell out of favour earlier in the year. Pennink has purchased what he believes are high quality businesses with international assets and strong balance sheets – all at reportedly distressed prices.

### Manager's outlook (extract from interim report)

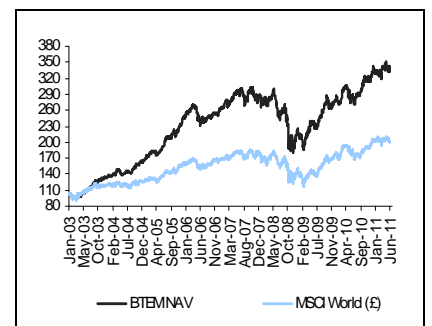
*"Despite the gradual recovery in the world economy the headwinds are significant for further strong progress in markets. The necessary reduction in Government spending in much of the western world is only in its early stages and the effects of it have not been fully felt. That said, there are now signs of a recovery in corporate activity which is starting to unlock hitherto hidden value in the portfolio."*

We share the manager's view that corporate activity could prove a powerful driver to BTEM's performance in 2011 and 2012. The contrarian, value oriented investment style, which has long proved successful for the trust, could result in significant further absolute and relative upside and we remain positive on the fund in spite of the narrower discount.

### Unconnected research

<b>Rec:</b>	<b>POSITIVE</b>
<b>Price:</b>	<b>526p</b>
<b>NAV (cum inc est):</b>	<b>541p</b>
<b>Discount:</b>	<b>2%</b>
<b>Discount range:</b>	<b>12% to 2%</b>
<b>Active leverage:</b>	<b>13% net cash</b>

<b>Market Cap:</b>	£846m
<b>Net Assets:</b>	£868m
<b>Reuters:</b>	BTEM.L
<b>Bloomberg:</b>	BTEM LN



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**Table 1: Global funds NAV total return ranked over 5 yrs**

Disc (Fair ex inc) %	Assets (£m)	Fund	NAV TR % 6 mths	NAV TR % 1 yr	NAV TR % 3 yr	NAV TR % 5 yr
6.1	1,107	Murray International	4	19	37	84
(6.4)	2,398	Scottish Mortgage	4	25	14	64
3.7	244	JPMorgan Overseas	0	15	38	57
6.1	71	Mid Wynd International	1	23	24	57
(5.2)	144	Gartmore Global Trust	1	17	21	55
6.0	447	Law Debenture Corporation	8	28	32	53
(6.5)	183	Edinburgh Worldwide	(1)	15	9	48
(9.3)	1,182	Monks	(2)	17	1	46
3.3	2,245	RIT Capital Partners	5	18	17	46
1.4	318	Personal Assets	5	14	32	41
<b>(0.6)</b>	<b>886</b>	<b>British Empire Securities</b>	<b>4</b>	<b>19</b>	<b>17</b>	<b>41</b>
(10.1)	1,251	Witan	3	18	21	40
(8.6)	2,223	F&C Investment Trust	4	16	10	37
(9.3)	549	Bankers	3	17	10	36
(7.1)	142	Martin Currie Portfolio	3	15	3	34
(3.1)	316	Electric & General	4	20	8	33
(6.3)	743	Scottish Investment Trust	2	17	8	32
(9.1)	154	Independent	7	35	33	28
(13.2)	3,106	Alliance Trust	1	16	13	26
(10.0)	271	Brunner	2	15	0	25
0.6	474	British Assets	3	22	13	22
3.0	408	Scottish American	3	19	10	21
(16.1)	1,221	Caledonia Investments	(4)	10	1	19
(10.4)	118	World Trust Fund	1	15	(13)	(4)
(13.6)	145	Majedie Investments	(2)	(1)	(43)	(29)
<b>Indices (% , £):</b>		<b>FTSE All-Share ex Inv Trusts</b>	<b>3</b>	<b>21</b>	<b>13</b>	<b>28</b>
		<b>MSCI World ex UK</b>	<b>2</b>	<b>11</b>	<b>14</b>	<b>31</b>
		<b>MSCI WORLD FREE</b>	<b>2</b>	<b>12</b>	<b>14</b>	<b>30</b>

Data as at 08.06.11  
Source: AIC / FT / Fidessa

We view the key attractions with regard to BTEM as follows:

- **Wide c32%, double discount cushion:** – Whilst the fund itself trades on a discount to cum income NAV of 2%, the average discount to NAV of the underlying portfolio is much wider at around 30%.
- **Long term NAV performance sound.** Table 1 above shows that performance has been solid over time relative to the main UK and global indices and its peer group.
- **Well positioned for the current challenging environment:** We share BTEM's view that in a low interest rate, potentially high inflation world, a portfolio of equities that offers exposure to companies with strong balance sheets, solid businesses, and a decent dividend yield at a discount to NAV of 30%, should serve shareholders well.

- **Low base fee and capped performance fee:** The annual base management fee is 0.6%, and the performance fee is capped at 1% of NAV.

**Fund objective:**

Established in 1889, the Company's investment objective is to achieve capital growth through a focused portfolio of investments, particularly companies whose shares stand at a discount to estimated underlying net asset value. British Empire is managed by Asset Value Investors Limited. AVI aims to deliver superior returns while managing risks and specialises in securities that for a number of reasons may be selling on anomalous valuations.

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**Here we highlight some of the key points raised in BTEM's interim results to 31 March:**

**Performance:**

For the first six months of the financial year to 31.09.11, the NAV rose 7.7% compared with gains of 9.9% for the Morningstar Investment Trust Global Growth Index and 11.9% for the MSCI World Index (£) (all figures are on a total return basis). Table 1 on page 2 shows how the figures stack up against peers over a number of different time horizons.

**Equities less risky than cash?**

Cash has been reduced from 20.2% at the year-end to 13.3% at 31st March 2011 and significant profits have been taken in a number of Far Eastern investments. New investments have been made in Europe, including, for the first time since 2005, Spain.

**Exploiting indiscriminate selling in Spain:**

A 7.5% weighting has been built in 5 Spanish companies: **Prisa, Telefonica, Ferrovial, NH Hoteles and Alba**. The weak Spanish economy and the ongoing problems in the property and financial sector have, in Pennink's view, masked the progress made by corporate Spain in strengthening its balance sheet. The companies in the portfolio generally have substantial foreign assets and are trading on significant discounts to NAV.

**Europe home to many investment bargains:**

The weighted average discount on BTEM's portfolio (excluding cash held) is around 30% and the European markets are seen as offering particularly good value with discounts on their holdings there of 34%. Investors perceive the European markets to be dysfunctional and are more willing to hunt for growth elsewhere but in BTEM's view, there are many very good companies listed in Europe on compelling ratings.

**Stale bull in Japan**

The holdings in Japan have decreased as a proportion of the whole as it remains unclear where the catalyst for improved corporate performance will come from. In addition, it is difficult to assess the impact the recent earthquakes and the enormous damage stemming from them will have on the Japanese economy given its already significant indebtedness. Exposure has come down from 15% to 2% at a time when other funds, like Ruffer have been turning more optimistic.

**Beware the value trap in Japan?**

Unlike some value investors, AVI has become less convinced by the case for Japan, and has reduced exposure over the past year. Whilst the entire equity market is seen as inexpensive on a price to book ratio of less than one, AVI sees that the major obstacle in realising this value is that Japanese corporate management does not strive to maximise value for shareholders as a core aim. On the macro-economic side,

AVI believes that it is too soon to say if the government's response to the terrible destruction caused by the earthquake and tsunami will be a positive or negative for the equity markets. With a government debt to GDP ratio of over 200%, the last thing Japan needs is more deficit spending argues AVI, pointing out that at some point the bond markets may rebel and send yields on government bonds higher, causing a fiscal crisis. Some of the spending may also be funded by higher taxes which are not helpful for an economy struggling with low growth and a deflationary bias, the Manager concludes.

**Corporate activity begins to add value outside of Japan**

The high discounts in the stocks in BTEM's portfolio are seen as an important store of value but are only of benefit if that value can ultimately be realised for shareholders. This can happen through the narrowing of discounts, and argues Pennink, more fundamentally, through corporate activity.

There has been some encouraging news in this regard during the period. The Manager reports that there have been bids for portfolio companies **Colonia, CNP and Forth Ports** generating material uplifts for the fund and stated that:

*"Overall, we are positive on the portfolio at this level of discount to NAV and see more potential for corporate activity to add value."*

**Asian portfolio outperforms, profits taken:**

Exposure to Asian holding companies was reduced through partial sales of holdings in Jardine Matheson, Jardine Strategic and Swire 'B' when AVI became more cautious on the valuation of the underlying assets following the *phenomenal* outperformance of Asia in recent years.

**Discounts wide as prices fail to keep pace with NAVs**

The Manager continues to focus on companies with strong balance sheets and which typically are valued in the markets at a discount to net asset value; the overall discount levels in the portfolio stand at 30%.

**Discount narrows as investors home in on underlying portfolio discounts:** The discount to NAV on the fund itself has narrowed to around 2% at the time of writing towards the narrow end of its one year range.

**Strong income flows allow for dividend increase:**

Although not a big yielder we view the increase in interim dividend from 1.8p to 2.0p as positive especially as the board expects at least a *"similar percentage increase in the final dividend based on the strong income flows in the portfolio since the half-year end."*

### Headwinds remain but hidden value being unlocked

Pennink concludes that it will not be plain sailing for the world economy:

*“Despite the gradual recovery in the world economy the headwinds are significant for further strong progress in markets. The necessary reduction in Government spending in much of the western world is only in its early stages and the effects of it have not been fully felt. That said, there are now signs of a recovery in corporate activity which is starting to unlock hitherto hidden value in the portfolio.”*

The largest positive contributors over the 6 month period to 31.03.11 were **Aker** (+1.1%), **Investor AB ‘A’** (+1.0%), **Deutsche Wohnen** (+0.8%), **Exor SpA Preference** (+0.7%), **Groupe Bruxelles Lambert** (+0.6%) and **Lundbergföretagen AB ‘B’** (+0.4%). The largest detractor from performance was **Kinross Gold** (– 0.4%).

### Geographics

As at 31 March 2011, the geographical profile was as follows:

#### Geographic profile (% of net assets)

Continental Europe	55
UK	5
Asia Pacific	16
Canada	7
Japan	3
Liquidity	13

*Based on country of listing except for London listed Japanese funds which are classified as Japan*

*Source: BTEM as at 31.03.11*

### Market rally may lack “staying power”

Pennink reports that the equity markets remained buoyant in the first 6 months of the Company’s financial year. *“There has been a cyclical upturn in the global economy, albeit purchased at the cost of increased government deficit spending and highly accommodative monetary policies. The levels of debt to Gross Domestic Product (GDP) in much of the developed world remain elevated but the burden has been shifted from the private to the public sector. As a result, the solvency of sovereign borrowers is now being called into question. The debt deleveraging cycle is still playing out and invites some caution in relation to the duration of the current economic recovery and the staying power of the equity market rally.”*

**Full Investment portfolio – see page 5**

**BTEM Investment Portfolio as at 31 March 2011**

Company	Nature of business	% of class	Cost £000	Valuation £000	% of total assets less current liabilities
Vivendi	Media Conglomerate	0.3	70,326	71,160	7.92
Orkla	Conglomerate	0.9	49,644	54,113	6.02
Groupe Bruxelles Lambert	Investment Holding Company	0.5	48,136	49,848	5.55
Investor AB'A'	Investment Holding Company	0.9	32,307	48,780	5.43
Jardine Strategic Holdings	Investment Holding Company	0.3	7,480	46,896	5.22
Sofina	Investment Holding Company	1.7	31,136	35,737	3.98
Jardine Matheson Holdings	Investment Holding Company	0.2	12,290	31,903	3.55
Aker	Investment Holding Company	2.0	22,736	27,649	3.08
Deutsche Wohnen	Real Estate Company	3.4	22,075	24,818	2.76
Exor SpA Preference	Investment Holding Company	0.6	12,056	22,346	2.49
<b>Top ten investments</b>			<b>308,186</b>	<b>413,250</b>	<b>46.00</b>
Telefonica	Telecoms Company	0.0	18,651	19,651	2.15
Swire Pacific'B'	Investment Holding Company	0.3	10,063	18,548	2.06
Prisa	Media Conglomerate	2.3	15,387	18,248	2.03
CIR SpA	Investment Holding Company	1.6	18,918	18,111	2.02
Paris Orléans	Investment Holding Company	3.2	13,112	17,193	1.91
Yamana Gold	Mining Company	0.3	14,435	16,431	1.83
Kinross Gold	Mining Company	0.1	18,567	15,703	1.75
Doosan Corporation	Investment Holding Company	0.7	12,612	15,073	1.68
Soco	Energy Exploration Company	1.1	15,110	13,904	1.55
Ferrovial	Infrastructure Company	0.2	12,988	13,487	1.5
<b>Top twenty investments</b>			<b>458,029</b>	<b>579,313</b>	<b>64.48</b>
Detour Gold Corp	Mining Company	0.8	8,672	12,975	1.44
Pantheon International Participations	Investment Company	3.2	9,366	12,953	1.44
BIP Investment Partners	Investment Holding Company	4.5	7,852	11,854	1.32
Nexen	Oil & Gas Company	0.1	11,983	11,799	1.31
Corporación Financiera Alba	Investment Holding Company	0.4	8,491	9,007	1
Bajaj Holdings and Investment Warrants 27/07/2015†	Investment Holding Company	0.6	7,577	7,683	0.86
Is Gayrimenkul Yatirim Ortak	Real Estate Investment Company	2.3	8,204	7,331	0.82
Daidoh	Textile & Property Company	3.2	6,739	7,208	0.8
Electra Private Equity	Investment Company	1.2	5,108	7,162	0.8
RHJ International	Investment Holding Company	1.6	7,142	6,956	0.78
<b>Top thirty investments</b>			<b>539,163</b>	<b>674,241</b>	<b>75.05</b>
CF Morant Wright Japan 'B'	Investment Company	1.8	5,292	6,902	0.77
JPMorgan Japanese Investment Trust	Investment Company	2.4	8,233	6,792	0.75
Mitra Energy*	Oil & Gas Company	2.2	4,080	6,589	0.73
Lundbergföretagen AB 'B'	Investment Holding Company	0.2	3,285	6,504	0.72
Amerisur Resources	Energy Exploration Company	3.1	4,848	6,406	0.71
NH Hoteles	Hotel Company	0.6	5,072	6,033	0.67
Macquarie International Infrastructure Fund	Investment Company	1.5	5,673	6,003	0.67
Cie Du Bois Sauvage	Investment Holding Company	2.0	7,723	5,994	0.67
Treasury China Trust	Real Estate Investment Company	2.7	4,669	5,552	0.62
Henex	Investment Holding Company	0.9	4,748	5,265	0.59
<b>Top forty investments</b>			<b>592,786</b>	<b>736,281</b>	<b>81.95</b>
GSD Holding	Investment Holding Company	5.1	5,361	5,006	0.56
Showa Aircraft Industry	Transport & Property Company	2.8	5,957	4,506	0.5
Alarko Gayrimenkul Yatirim	Real Estate Investment Company	6.0	3,977	4,199	0.47
JPMorgan Japan Smaller Companies Investment Trust	Investment Company	5.9	5,126	4,008	0.45
Alarko Holding	Investment Holding Company	1.4	4,207	3,954	0.44
Cofide SpA	Investment Holding Company	0.9	4,150	3,951	0.44
Tag Immobilien	Real Estate Company	1.1	2,462	3,939	0.44
Katakura Industries	Textile & Property Company	1.9	5,000	3,835	0.43
Vietnam Property Fund	Investment Company	0.0	2,579	2,699	0.3
Eurazeo	Investment Holding Company	0.1	2,386	2,565	0.28
<b>Top fifty investments</b>			<b>633,991</b>	<b>774,943</b>	<b>86.26</b>
Canaco Resources	Mining Company	0.3	1,701	1,642	0.18
Daibiru Corp	Real Estate Company	0.2	1,064	1,058	0.12
Resaca Exploitation	Oil Production Company	3.9	4,880	747	0.08
JPMorgan Japan Smaller Companies Investment Trust (Subscription Shares)	Investment Company	8.0	-	231	0.03
<b>Total equity investments</b>			<b>641,636</b>	<b>778,621</b>	<b>86.67</b>
Fixed income investments					
Treasury 5% 07/03/2012	UK Government Security		62,247	62,280	6.93
Treasury 3.25% 07/12/2011	UK Government Security		27,465	27,464	3.06
US Treasury Bill 30th June 2011	US Government Security		24,897	24,947	2.77
Total investments			756,245	893,312	99.43
Net current assets				5,085	0.57
Total assets less current liabilities				898,397	100

\* Unquoted investment. † Held through a Participation Note issued by JP Morgan  
Source: British Empire HY report 2011

## Disclosures

### British Empire & General Trust

Date	Recommendation
As at 01-May-10	Buy
01-Apr-11	POSITIVE

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