

British Empire Securities Ord BTEM

Morningstar Benchmark MSCI World Value NR USD
 Morningstar Category™ Global Large-Cap Value Equity

Morningstar Analyst Rating



Analyst Rating Spectrum

Gold Silver Bronze Neutral Negative

Morningstar Rating™ ★★★★★

| | |
|---------------------------------------|-------------|
| Last Closing Price GBP | 518.00 |
| Last Closing NAV GBP | 581.02 |
| Discount/Premium % | -10.85 |
| Latest Published NAV | 573.25 |
| Latest Published NAV Date | 07/01/2015 |
| Traded Currency | GBX |
| Yield | 2.03 |
| Dividend Frequency | Semi-Annual |
| Total Assets £ Mil | 836.3 |
| Net Assets £ Mil | 821.3 |
| Market Cap £ Mil | 728.8 |
| Net Gearing % | 1 |
| Avg Daily Shares Traded Mil (3 month) | 0.13 |
| Inception Date | 01/01/1889 |

Morningstar Analyst: Jackie Beard

Executive Summary

People: The team is small, but close-knit; both comanagers have been involved in the fund's management for over a decade.

Parent: Asset Value Investors Limited stays within its circle of competence, but disclosure could be improved.

Board: The board comprises five non-executive directors with extensive financial experience.

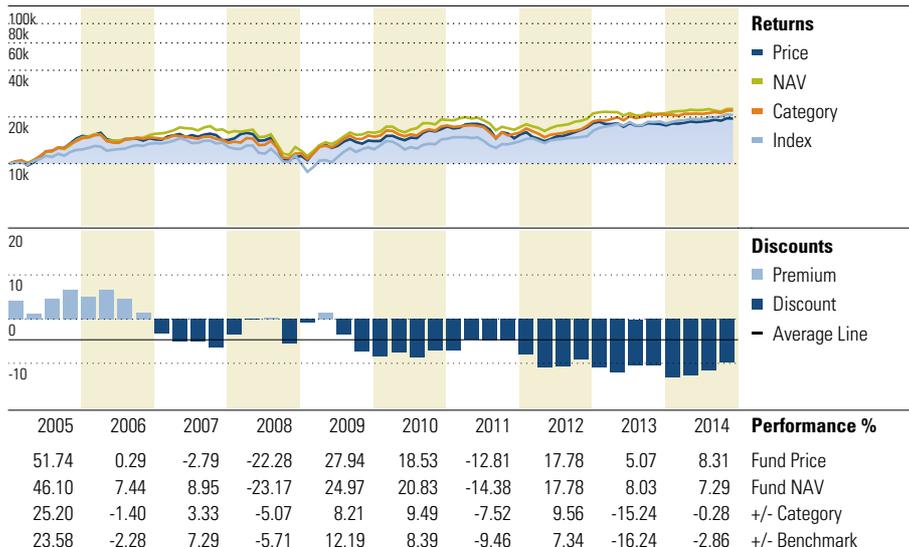
Process: AVI is a value investor that seeks companies trading below their intrinsic value.

Performance: The managers have generated strong long-term risk-adjusted returns, but investors should beware the volatility.

Fees: The fund is considerably cheaper than its category median peer.

Role in Portfolio

Supporting Player. The fund is suitable for investors seeking exposure to a diversified pool of global equities, but its exclusion of the US makes it more fitting as a supporting player.



Morningstar Opinion

12 Sep 2014 | British Empire Securities and General Trust has returned to form for investors.

There were several factors that caused the fund to underperform its Morningstar Category peers in 2013. First, the managers held too much cash for too long in rising markets. Second, the lack of exposure to both the US and Japan hurt, as both markets posted solid gains by year-end. Third, two gold mining stocks underperformed significantly—while one had a rescue rights issue, to which the team subscribed, both were ultimately sold.

The lack of exposure to the US is a deliberate part of the team's strategy. In their view, that market is highly efficient and does not lend itself well to active management. So they focus their efforts on markets in which they think they can add value. That said, they have reduced the active position in Japan and bought a couple of names, cognisant that extreme country positions haven't always worked.

The team's strategy is to seek out-of-favour companies whose assets are not fully recognized or are misunderstood by the market and trade significantly below their intrinsic value. Although companies are selected from the bottom up, the deep-value philosophy does not lend itself well to investing in all sectors, with defensive names being an example of an area that's unlikely to feature in the portfolio.

The team tends to invest lower down the market-cap scale than its typical peer, too. While the

average category peer has some 50% invested in giant caps, at this fund it tends to be much lower, in favour of mid- and small caps.

The team has demonstrated that they stick to their areas of expertise and they have added value for shareholders over the long term, albeit with volatility at times. Indeed, the fund has comfortably outperformed its Morningstar Category and MSCI World ex-US index under Pennink's tenure and that is without taking excessive risk, too. That said, it tends to suffer in periods when growth companies outperform value; likewise, its lack of exposure to the US can weaken returns when that market rallies hard and its bias to Europe and Asia can hurt when those markets are weak.

The team is small, but close-knit, comprising just five. Comanagers John Pennink and Joe Bauernfreund have been with Asset Value Investors for over a decade and both were schooled in the firm's process by John Walton, AVI's founder and former manager of this fund.

Indeed, this fund is the firm's largest client, although they manage some assets in open-ended funds, too. Our concerns over their plans to gather assets and boost the firm's size are mitigated by the fact they have launched very few funds overall and only then to match their proven areas of expertise. While the firm itself is small, the fund's board provides an extra layer of oversight and due diligence, which is a benefit to shareholders here.

All said, the team has proved its ability to add value. It retains its Silver rating.

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People

| | |
|---------------|--------------|
| Manager | John Pennink |
| Manager Start | 01/04/2001 |

| | |
|---------------|------------------|
| Manager | Joe Bauernfreund |
| Manager Start | 01/01/2013 |

| | |
|---------------------|-----------|
| Avg. Manager Tenure | 7.9 Years |
|---------------------|-----------|

Other Funds Managed

CF Asset Value Inv Gbl Instl Acc

John Pennink has managed the fund since 2001. Pennink joined Asset Value Investors in 1999 and worked alongside former manager John Walton at this fund as well as others in the AVI stable. Pennink was officially appointed as Walton's comanager at British Empire in 2001 and then became the sole manager in Dec 2002, when Walton stepped back from this fund. Pennink started his career in 1994 as an Asian equity analyst in Hong Kong with Regent Pacific. In 1997 he moved to Moscow and spent two years investing in emerging European markets with Regent Pacific and then EPIC Securities. In 2012 Joe Bauernfreund was formally named as Pennink's comanager, although his involvement extends back earlier. Bauernfreund joined Asset Value Investors in July 2002, initially working with John

Walton on the European sleeve of the portfolio; in 2008, he became involved more broadly with Pennink across the whole portfolio. Prior to joining AVI, Bauernfreund spent six years as a chartered surveyor, managing a portfolio of commercial properties across central London.

The duo is supported by three analysts: Scott Beveridge, whose focus is European property, Tom Treanor on closed-end funds, and Robert Clough on Asian companies. Although the team is small, it appears close-knit and all team members bring reasonable experience in their respective fields. The decision-making process is collegial with each team member taking a lead within his field, but Pennink has the final say as the longer-serving manager.

Parent

| | |
|--------------|------------------------------------------------------------------------|
| Fund Advisor | Asset Value Investors Limited |
| Domicile | UK |
| Subadvisor | Winterflood Securities Limited |
| Website | www.british-empire.co.uk |

Asset Value Investors Limited is an employee-owned investment boutique established in 1985 by John Walton to manage the assets of British Empire Securities and General Trust (BTEM). The firm has had various owners, but it has been independent since a management buyout in 2003. In 2003 AVI managed some GBP 600 million, primarily in BTEM. Since then the firm has diversified its client base, acquired some assets through segregated accounts and launched an open-end fund, CF AVI Global, but they have not expanded their fund range outside of their core area of expertise, global equity. This helps to allay our concerns that the firm would launch new funds simply to gather assets and thus grow the

business. BTEM remains their largest client. At 31 Dec 2013, the firm managed some GBP 1.2 billion in assets. The team is close-knit and shares a strong investment and stewardship culture. That said, there is no direct link between incentive pay and performance of the funds, and we think they could better align their interests with fund investors' by addressing this. AVI's level of openness and transparency with investors is of a fairly good standard, in our view. The firm's website is informative and easy to navigate, but we believe investors would benefit from having access to full portfolio holdings there, too, and portfolio and market commentary in fund's fact sheets.

Board of Directors

| | |
|-----------------------|-----|
| Tender Offer | No |
| Buyback Authorization | Yes |

The board comprises five non-executive directors whose average tenure is more than six years. Individual tenures range from nearly 12 years right down to less than three years, with a good balance across the spectrum. The chairman Strone Macpherson is the longest-serving member, having been appointed in 2002; he took on his current role in 2007. He brings extensive experience having served as a director of Robert Fleming, chairman of Tribal Group and executive deputy chairman of Misys, among others. He also serves as chairman of Close Brothers Group. Until Dec 2012, another director had a 10-year tenure—Rosamund Blomfield-Smith, and two dir-

ectors joined in mid-2012 ahead of her departure. The directors bring extensive financial skills, as well as some direct smaller-company experience. The chairman's four fellow directors all sit on the boards of other listed investment companies. All directors are shareholders here, which we like to see as we believe that aligns their interests with those of their shareholders. The board meets 10 times a year on a formal basis and holds an additional strategy meeting; this is more frequent than the average we see, due mainly to the extra due diligence and oversight needed over a small firm such as AVI.

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Process: Investment Approach

Investment Objective: To generate capital growth through a focused portfolio of investments, particularly in companies whose shares stand at a discount to estimated underlying NAV.

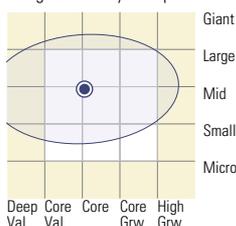
| | |
|----------------------|--------------|
| No Holdings Range | 40-50 |
| Expd Turnover | Below 75% |
| Sector Constraints | None |
| Regional Constraints | Global ex US |
| Yield Requirement | None |
| Hedging Policy | Unhedged |
| Tactical Use of Cash | Yes |

The team invests predominantly from the bottom up. They seek out-of-favour companies whose assets are not fully recognized or are misunderstood by the market, and which are therefore selling significantly below their intrinsic value, as determined by the team. They would only consider buying an asset that trades at just a small discount to its intrinsic value if they see a strong case for a rerating. The team also looks for catalysts that will prompt that value to be realised, such as M&A, liquidation, buybacks, manager change, mean reversion and special dividends. They are patient investors and focus on good businesses with strong balance sheets and robust cash flows that pay dividends, which helps to compensate them as they wait for a company's true value to be realised. This discipline helps them avoid value traps, too. In addition, the team likes to see an alignment of interests at their tar-

get companies and they scrutinize management to ensure they have the right attitude toward corporate governance and plans for the business. Indeed, company meetings play an important role here and the team aims to meet the management of companies they own every year. They have built a monitor list comprising stocks they have followed over the years, while new ideas result from company meetings and occasionally from brokers, too. The fund is unconstrained; however, the team avoids investing in stocks with a market cap of less than GBP 100 million for liquidity reasons. This results in a fairly concentrated portfolio of some 40 to 50 names invested globally, excluding the US--although diversification is higher when drilling down into the fund holdings. In the team's view, the US market is highly efficient and does not lend itself well to active management.

Process: Portfolio Positioning

Morningstar Holdings Based Style Map



The fund differs from its category peers in a number of ways. Firstly, it holds no direct exposure to the US, while its average peer invests almost a third of its total assets there and this stance is likely to remain. Thus, the fund tends to be overweight in Europe and Asia relative to its average peer. At a sector level, defensives are unlikely to feature heavily here, as they tend not to fit the team's philosophy of deep-value investing. The team has a penchant for investing in holding companies and conglomerates, as well as other in-

vestment trusts that are trading at a wide discount to their NAV. While the average category peer and MSCI World ex-US index tend to have at least half of their assets in giant caps, this fund tends to have a much lower weighting, in favour of mid- and small caps. The introduction of new attribution systems has led them to reassess and reduce the extent of their active country positioning, particularly with regard to the underweight in Japan.

| World Regions | Assets % |
|-----------------------|--------------|
| Greater Europe | 54.07 |
| United Kingdom | 5.05 |
| Europe-Developed | 45.49 |
| Europe-Emerging | 3.53 |
| Africa/Middle East | 0.00 |
| Americas | 17.68 |
| North America | 17.68 |
| Latin America | 0.00 |
| Greater Asia | 28.25 |
| Japan | 6.64 |
| Australasia | 3.96 |
| Asia-Developed | 15.47 |
| Asia-Emerging | 2.18 |
| Not Classified | 0.00 |

| Asset Allocation | % Assets | Long | Short | Net |
|------------------|----------|------|-------|-----|
| Cash | 2.8 | 0.0 | 2.8 | |
| Equity | 79.1 | 0.0 | 79.1 | |
| Bond | 0.1 | 0.0 | 0.1 | |
| Other | 20.0 | 2.0 | 18.0 | |

| Top 10 Holdings 30/06/2014 | % Assets |
|------------------------------------|----------|
| Jardine Matheson Holdings Ltd | 6.45 |
| Investor AB Class A | 6.36 |
| Groupe Bruxelles Lambert | 5.47 |
| Aker ASA Class A | 5.34 |
| Sofina | 3.95 |
| First Pacific Co Ltd | 3.46 |
| Vivendi SA | 3.44 |
| Hyundai Motor Pfd | 3.36 |
| NB Private Equity Partners Ord | 3.11 |
| HarbourVest Global Priv Equity Ord | 2.79 |

| Sector Weightings | % Equity |
|------------------------|-------------|
| Cyclical | 71.0 |
| Basic Materials | 0.5 |
| Consumer Cyclical | 11.5 |
| Financial Services | 39.1 |
| Real Estate | 19.9 |
| Sensitive | 21.0 |
| Communication Services | 4.5 |
| Energy | 1.0 |
| Industrials | 12.3 |
| Technology | 3.3 |
| Defensive | 7.9 |
| Consumer Defensive | 6.4 |
| Healthcare | 0.0 |
| Utilities | 1.5 |

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NAV Performance Analysis

Data as of 31-12-2014

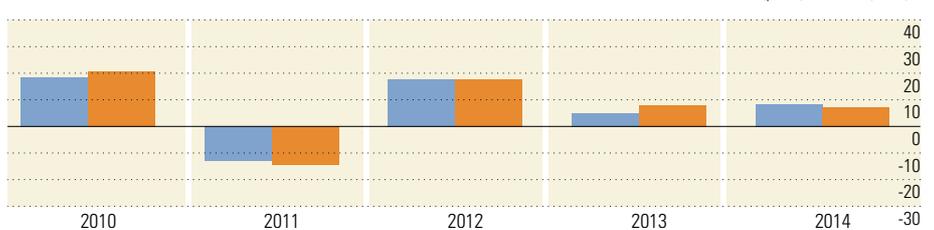
| Trailing Returns Price | Total | +/- |
|------------------------|-------|-------|
| | Rtn % | Bmark |
| 3 month | 1.70 | -1.95 |
| 6 Month | 5.28 | -0.94 |
| 1 Year | 8.31 | -1.83 |
| 3 Year Ann. | 10.26 | -4.51 |
| 5 Year Ann. | 6.74 | -3.34 |

| Trailing Returns NAV | Total | +/- | +/- | %Rnk |
|----------------------|-------|-------|-------|--------|
| | Rtn % | Bmark | Cat | In Cat |
| 3 month | 1.17 | -2.48 | -2.19 | 63 |
| 6 Month | 0.98 | -5.24 | -3.77 | 75 |
| 1 Year | 5.19 | -4.95 | -2.37 | 57 |
| 3 Year Ann. | 10.45 | -4.32 | -2.47 | 78 |
| 5 Year Ann. | 7.19 | -2.89 | -1.10 | 77 |

Since Pennink's appointment in April 2001 to 31 Aug, the fund has comfortably outperformed its average Morningstar Category peer, as well as its MSCI World ex-US benchmark index. That said, 2013 was very disappointing. The managers held too much cash for too long at times and this was a drag on returns; in addition, two gold miners underperformed--both have since been sold. Further, the lack of exposure to the US and Japan

was also negative as both markets posted strong gains last year. The latter's underweight has been reduced in 2014, partly in an attempt to reduce strong active country bets. The fund tends to suffer in periods when growth companies outperform value but over the long term the patient approach has been well rewarded--year to date to 31 Aug being a case in point.

Calendar Total Returns



Discount / Premium

Data as of 08-01-2015

| Discount / Premium % | 6 Mo | 1Yr | 3Yr |
|----------------------|--------|--------|--------|
| | High | -8.79 | -8.79 |
| Average | -10.93 | -11.88 | -10.81 |
| Low | -13.55 | -14.31 | -14.31 |
| Z-Statistic | -0.22 | 0.48 | -0.23 |

The board does not operate a hard discount control mechanism but it does have shareholder approval to buy back shares. Any shares bought back are held in treasury so they can be sold back into the market at a future time; any reissuance must be value-enhancing. The board has given the fund manager the parameters under which to execute buybacks, which they do when they think

they can enhance the value of the company. Indeed, they have been active for some time given the wider discount combined with weak returns throughout 2013. The fund's three-year average discount has increased, to more than 11% (12 Sept); shorter term, over the last six months, it's wider still at more than 13%.

Risk & Return

Data as of 31-12-2014

| Morningstar Rating | Return | Risk | Rating |
|--------------------|-----------|------|--------|
| 3 Year | Avg | Avg | ★★★★ |
| 5 Year | Avg | Avg | ★★★★ |
| 10 Year | Above Avg | Avg | ★★★★★ |
| Overall | Above Avg | Avg | ★★★★★ |

The managers have used risk well here. Granted, the fund tends to be more volatile than its peers, as measured by its standard deviation over all time periods, but since Pennink's appointment the fund has outperformed its category peers to 31 Aug. On a risk-adjusted basis—as measured by the Morningstar Risk-Adjusted Returns--Pennink and his team have compensated investors for the

risks taken in the fund over the long term, but shorter term has been less compelling. The fund's unconstrained nature means it will differ from its peers and this is borne out in its regional and sector exposures. The fund is susceptible to strong rallies in the US, given its lack of exposure there, and conversely to weak European and Asian markets, where the bulk of assets reside.

| Volatility Ratios | 3 Yr NAV | 5 Yr NAV | Risk vs Index | 3 Year | 5 Year |
|--------------------|----------|----------|-------------------|--------|--------|
| Standard Deviation | 9.68 | 11.99 | Alpha NAV | -3.10 | -2.65 |
| Mean | 0.91 | 0.64 | Beta NAV | 0.98 | 1.00 |
| Sharpe Ratio | 0.89 | 0.41 | R-Squared NAV | 76.64 | 80.35 |
| Sortino Ratio | 1.43 | 0.57 | Treynor Ratio NAV | 11.21 | 6.37 |

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Fees

| | |
|------------------------------|------|
| Management Fee % | 0.70 |
| Ongoing Charge ex Perf Fee % | 0.90 |

In Oct 2013 the board simplified the fee arrangements. Asset Value Investors is entitled to receive an annual management fee of 0.7% of net assets (up from 0.6%), taken on a monthly basis. Previously, they were also entitled to a perform-

ance fee but this element has now been scrapped. The fund's ongoing charges of 0.71% for 2013 make it highly competitive among its category peers.

Gearing

| | |
|--------------------|-------|
| Total Assets £ Mil | 836.3 |
| Net Assets £ Mil | 821.3 |

There is a debenture in place of some GBP 15 million in value, which was drawn down in the 1990s to finance an acquisition. This is offset by cash and short-term bonds and the debt is not used actively by the managers to amplify their convictions. They believe that while gearing is a

good idea in theory, the reality is somewhat different, so rather than be distracted by its use, they prefer to focus on getting stock selection right. Hence, the effective gearing position is likely to be flat at this fund for the foreseeable future.

Dividends

| Dividend History | 2012 | 2013 | 2014 |
|------------------|--------------|--------------|--------------|
| Dividend | 9.50 | 10.50 | 10.50 |
| Special Dividend | 3.50 | 2.50 | 0.00 |
| Total | 13.00 | 13.00 | 10.50 |

The primary aim of the fund is to produce capital growth and there is no formal income target. That said, the board has managed to maintain, if not increase, the level of dividend payouts in all fin-

ancial years since 1985, which is an impressive feat. It has also built the revenue reserves to a sufficient level that the current dividend is covered for well over two years.