Setanta
ASSET MANAGEMENT

Global Perspective

May 2010

	May %	Year-to-date %	1 yr %	3 yrs % pa	5 yrs % pa	10 yrs % pa
Setanta Global Equity	-2.5	8.6	32.8	-5.6	3.4	N/A
MSCI World	-2.0	9.2	31.1	-7.9	1.1	-3.0
FTSE 100 (UK)	-4.6	1.9	25.7	-10.5	0.4	-1.3
DJ Stoxx (Europe)	-7.2	-11.8	11.1	-12.7	0.6	-3.5
S&P 500 (US)	-1.1	14.5	38.6	-5.6	0.3	-3.5

Source: Bloomberg & MSCI. All returns in Euro. The Fund returns stated are based on the movements in the unit prices of a representative account, based on mid to mid prices, and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies.

All Eyes on Europe

The Sovereign Debt difficulties besetting some of the highly-indebted members of the Euro-zone continued to dominate global financial markets in May. The unresolved tug-of-war between European Policymakers who have set their face firmly against any ‘restructuring’ of the debts of a member state, and a skeptical market-place which has continuing doubts about how such an outcome can be ultimately avoided, raged largely unabated through the month. Volatility spiked, Money Markets stressed, Global Equities fell, and most impacted – the Euro exchange rate sank – down 7.5% versus the US $ and now down nearly 15% against the greenback since the beginning of the year.

Setanta Stock Focus: BP – Seeking Long-Term Value amid Crisis

In mid-April, a rig contracted to BP and its partners suffered a catastrophic well explosion in the US Gulf of Mexico causing eleven fatalities. The rig subsequently sank and the well has since been leaking an estimated 15,000 – 30,000 barrels of oil per day, potentially causing significant environmental damage and financial loss to local industries. During this time, BP has been the focal point of political and popular anger in the USA. Setanta was not an investor in BP when the crisis occurred. However, following a fall in market capitalisation of $30bn (or around $12bn on a relative basis), we saw value from a long-term perspective. We believe that the fall in the market value of BP is very much disproportionate to the likely ultimate financial cost to BP, based on our own estimates.

This reflects a number of factors:

a) BP management has been very pro-active in its response, investing significant money and effort, while publicly embraced its responsibility and liability at an early stage.

b) BP’s economic interest in the field is 65%.

c) A number of service companies (at least three) played crucial roles in the operation and hence will likely share responsibility.

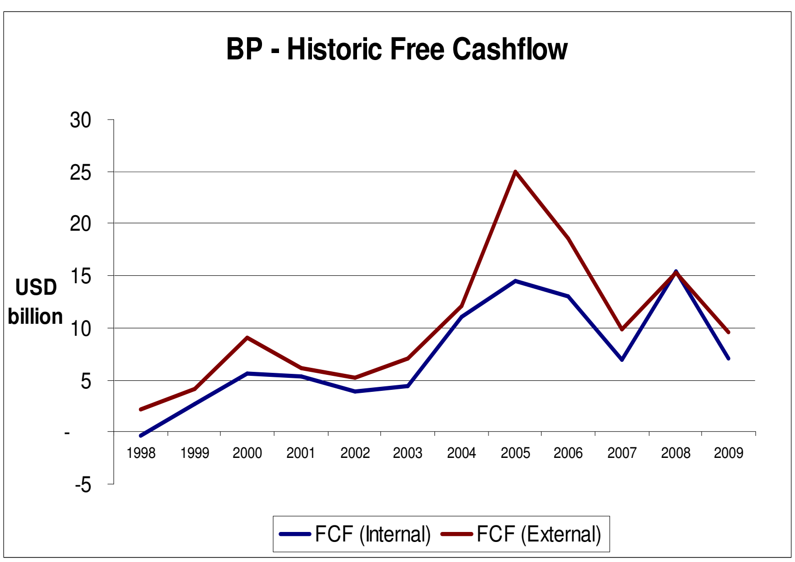
BP – The Investment Case

BP is one of the energy world’s five ‘Majors’. It is thus a company with both global scale and a large degree of integration between upstream (exploration and production) and downstream (refining, petrochemicals and marketing) operations. BP produces the equivalent of roughly four million barrels of oil and natural gas daily. At our time of purchase, BP offered a 7.7% dividend yield, which, combined with an impressive record of free cash generation (10Y FCF \ Adjusted EV of 5%); a solid balance sheet; and robust reserves, made an attractive investment proposition.

BP has a solid balance sheet. Stated net debt of $26bn is equivalent to a quarter of shareholder’s equity and less than a year’s cash from operations. This debt is spaced evenly over the next ten years, bearing moderate rates of interest. From a broader perspective, BP has total net obligations of $50bn, the additional amount reflecting post-retirement liabilities ($9bn) and minimum future operating lease obligations ($15bn). On this basis, adjusted net debt is approximately 1.8x 2009 cash from operations. We believe that this position, allied to BP’s typical free cash generation of around $10bn per year provides a strong bulwark against unexpected losses. As noted, BP has been a consistent generator of free cash flow - see the attached free cash flow chart over leaf.

Compared to a group of integrated peers, BP has generated the highest free cash flow per share over the past five years. Its discipline in relation to capital expenditure has been an important factor in this. BP has consistently augmented this internal free cash flow by divesting downstream businesses and reducing stakes in developed upstream fields. This portfolio management has yielded an additional $12bn in external, free cash flow over that same time period, in turn funding both a good dividend and large share buybacks.

BP's reserves management has also been impressive. The company has a proven reserve life of 12.4 years, above the industry average of 10.0 years and that of major peers of 11.0 years. Around 60% of these reserves are liquids (mainly crude oil); the remainder natural gas, a favourable balance given the much higher value that oil commands per unit of energy. Reserve replacement has averaged 115% over the past three years (and according to BP, more than 100% for the past 17 years). This is particularly impressive, been largely driven organically, rather than by costly acquisitions, while also countering the experience of falling reserves at many peers. Given the attractive value of BP, both historically and relative to peers, it makes a good long-term investment case.



Source: Bloomberg and Setanta.

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