Setanta Global Dividend Fund (CAD)
Q2 2019

Fund Description

The **Dividend All-Equity Fund** ('the Fund') is managed by Setanta Asset Management Limited ("Setanta") and is a representative account of the Dividend strategy.

The is an actively managed equity portfolio, which holds 30-50 global high yield stocks. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good businesses for the long-term at prices below what they think they're worth, carefully considering each investment's risk profile. The Fund further distils this philosophy by targeting stocks where management have both the willingness and ability to distribute meaningful dividends to shareholders.

The fund is managed by three portfolio managers, who also look to leverage off the experience and knowledge of their colleagues. The aim is to achieve a sensible level of diversification on a sector and geographic basis. Stocks are chosen through bottom-up analysis, based on investment merit. The fund can hold up to 10% cash where investments of sufficient quality cannot be found. Rather than focusing on the historic level of volatility of an asset, the portfolio managers regard the probability of permanent impairment of capital as the most relevant measure of risk. In doing so, they seek to maximise downside protection by understanding the risks posed by the valuation, financial, and operational characteristics of the asset. The investment objective of the Fund is to outperform the MSCI High Yield index over the long term.

Portfolio Managers

Richard Doyle, CFA; David Pastor, CFA; Caroline White, CFA

Our Investment Principles

We do not believe markets are efficient

We invest below our estimate of intrinsic value

We invest in businesses rather than buying stocks

Preservation of our clients' capital is key

Investing is a marathon, not a sprint

We are not afraid to swim against the tide

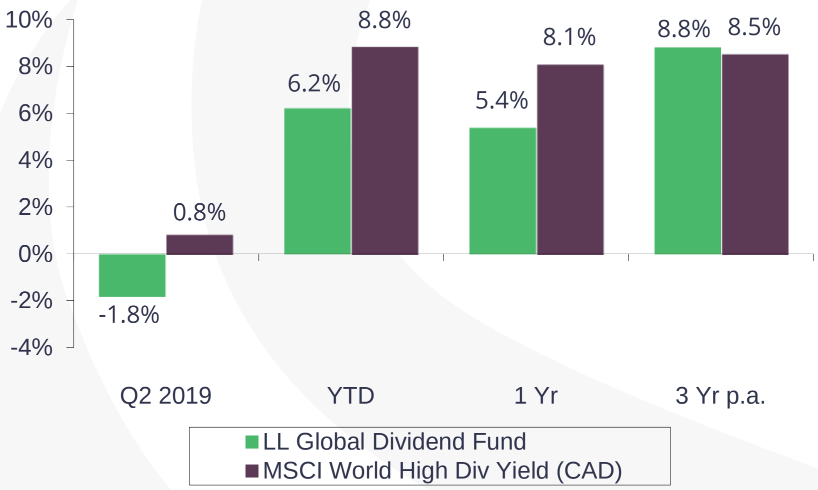
We consider scenarios rather than making forecasts

Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

Fund Performance – 30.06.19



Performance Source: Unit prices: GWL. Returns are based on LL - Global Dividend Fund 8.26SAM Account. Benchmark: MSCI High Yield Index (100% CAD). Returns are in CAD and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg. *Calculated using Index Method

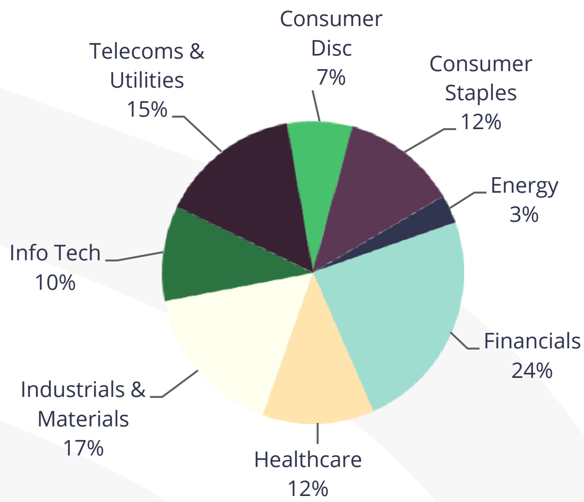
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
LANCASHIRE HOLDINGS	FINANCIALS	3.7%
GLAXOSMITHKLINE	HEALTHCARE	3.5%
COCA-COLA AMATIL	CONSUMER STAPLES	3.4%
SMITHS GROUP	INDUSTRIALS & MATERIALS	3.2%
HARLEY DAVIDSON	CONSUMER DISCRETIONARY	3.2%
NOVARTIS AG	HEALTHCARE	3.1%
FEDERATED INVESTORS	FINANCIALS	3.1%
CISCO SYSTEMS	INFORMATION TECHNOLOGY	3.1%
PROCTER & GAMBLE	CONSUMER STAPLES	3.0%
YARA INTERNATIONAL	INDUSTRIALS & MATERIALS	3.0%

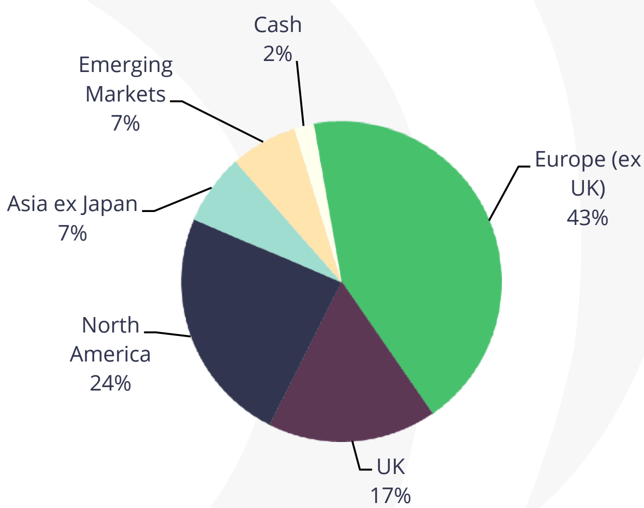
Fund Statistics

PRICE/BOOK	1.8
PRICE/EARNINGS RATIO (FY 1)	14.4
DIVIDEND YIELD %*	4.1
AVERAGE MARKET CAP C$BN	80.0
NO. OF HOLDINGS	44
DEBT/EQUITY %	56.9
ACTIVE SHARE %	78.9

Sector Distribution



Geographic Distribution



SETANTA Asset Management

Commentary

Our investments for you are a consequence of our investment principles and our process. We invest in businesses as opposed to trading in stocks. It is critical that we spend time getting to know the business, to comprehensively understand and get comfortable with what it does and what truly underpins its success or failure. While the research process is varied, far reaching and in many ways bespoke to the specific business, our focus on the strength of an investment's balance sheet and on the sustainability of its cash flows are key considerations which are common across all businesses we consider. We expend considerable efforts in trawling through numerous years of financial statements, reading the fine print, keeping an eye on the changes in the accounts and wording of disclosures over time, getting familiar with the company's culture, looking at how the business is managed and assessing the attitude to investors, in an attempt to assess the business as a whole and to mitigate downside risk.

To assist us in this we recently held a customised full day 'investigative accounting' session for our Portfolio Managers with an industry professional. We spent time on off balance sheet financing and on the nuances that go into recording revenues, among other things. This was particularly timely in the context of a spate of investigations into the world's 'Big 4' auditors. While those employing fraud or aggressive accounting are usually clever in their concealment of it from users of the output accounts we try to ensure that the businesses we choose for you are less likely to engage in dubious practices. Revenues are one of the most impactful ways of moving financial statements and metrics, therefore understanding how a business generates revenues, the economics of its transactions and how it records revenues is essential. Long term contracts and service contracts are associated with much higher degrees of flexibility in revenue treatment since they require judgements and estimates, therefore they are more vulnerable. These types of revenues warrant particularly close inspection. Off balance sheet liabilities, leases and related party transactions are ways in which very relevant sums can be hidden from plain sight. It is essential we get comfort on these to have confidence in the overall picture facing a business. Other items, including acquisition expenses, goodwill, one-offs, non-recurring items and restructuring costs similarly deserve attention.

With these in mind we will discuss some recent examples of companies with accounting troubles.

It is useful to reflect on Datalex, an Irish travel software company counting Aer Lingus and Lufthansa among its customer base. Datalex made an announcement earlier this year, shortly after changing its CFO, declaring that it had incorrectly recognised service revenues for certain long term contracts. In the early days of fixed fee contracts it under-estimated the life and cost of the contract meaning that when it applied the percentage of completion method to determine earned revenue it was booking revenue too early. In the preceding years its auditor PWC noted that '*significant judgement*' was involved in the revenue recognition, later adding wording of the *'need for improvements in the processes'*, before Datalex changed its auditor to EY who drew attention to a *'heightened degree of subjectivity'* being employed[1]. The issues led to the company restating its accounts, tipping a $16m profit to a $4m loss, and to the departure of the CEO, Chairman and another CFO. The shares are currently suspended as it has not been able to file its accounts.

UK-based Government outsourcer and contractor Carillion also had significant long term contracts on which it used the percentage of completion method. At a time of climbing debts, a spike in receivables, stationary cash flow and falling profitability, it recognised higher revenues. This would warrant a closer look. In hindsight Carillion was struggling to collect its receivables, costs and project durations were overrunning and it was seemingly increasingly optimistic in its assessment of profit, costs and completion periods on major contracts.

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[1] 2013, 2014, 2015, 2016 and 2017 Annual Reports of Datalex Plc.

In addition to this, goodwill was the company's largest asset in 2015, the conditions for clawback of directors' bonuses had been recently relaxed and alarmingly there had been significant turnover of senior management, including two CFO rotations in under a year. KPMG is being investigated for its role as auditor at Carillion. It is noteworthy that KPMG had been Carillion's auditor for almost 20 years which is not good practice but is all too common. Carillion went bankrupt leaving investors with nothing and 43,000 staff in the lurch.

Lastly we will consider Steinhoff, the Frankfurt listed South African retailer which owns Poundland and Mattress Firm. Steinhoff's balance sheet indicated a highly acquisitive period with rising debt. Days ahead of its 2015 Frankfurt listing Steinhoff was raided by the German authorities who the firm announced were *'reviewing the balance sheet treatment of certain transactions involving transfers of participations and intangible assets among SEGS, additional subsidiaries and third parties'*[2]. In 2017 Steinhoff's auditor, Deloitte, refused to sign off its financial statements. It transpired that Steinhoff had recorded false transactions with seemingly independent third parties which were, in fact, related entities controlled by Steinhoff executives. This meant off balance sheet related party transactions where sales were recorded between the parties, inflating sales and receivables on Steinhoff's books which would never be realised. In some cases Steinhoff would provide fictitious loans to related parties and recognise bogus income on these. To give the impression of receivables and loan collections it would move funds between entities and move balance sheet items around, swapping into goodwill, property and other asset labels. In doing so it was able to consistently show jumps in performance of acquirees shortly after acquisition. Fluctuation of asset balances was made possible by the volume of acquisitions and divestitures. PWC recently tallied questionable transactions at €6.5b. The company, its CEO, CFO and a number of others are under investigation, as is Deloitte. Again, this was a company which had retained the same auditor for almost two decades. The stock is down over 97% to date. While account creators may be inventive it pays to be wary of complexity, related party transactions and leverage.

[2] SEGS is short for Steinhoff Europe Group Services GmbH. Quote is taken from an article by Fin 24, dated Dec 04 2015 https://www.fin24.com/Companies/Retail/germany-raids-steinhoff-offices-ahead-of-listing-20151204

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