Setanta Income Opportunities Fund
Q2 2019

Fund Description

The **Income Opportunities Fund** ('the Fund') is an actively managed portfolio primarily comprising global equities but with the flexibility to invest in assets which offer attractive income and reasonable value. These assets include fixed income, property (including REITs) and cash. The fund is not constrained by limitations on the level of any given asset. In practice, the Fund has had its greatest weight in equities, reflecting the breadth of that market, Setanta's expertise in that area, and the option writing strategy employed by the fund. Nevertheless, property, fixed income and cash have all played meaningful roles in past returns of the fund, at times, comprising up to 50% of the fund's assets. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good assets for the long-term at prices below what they think they're worth, carefully considering each investment's risk profile. 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.

The fund employs an option writing strategy. This entails the sale of both call and put options in return for a cash premium, representing an income stream that boosts the underlying income yield of the fund. This strategy is employed in a conservative fashion, as all options written are fully covered.

The Income Opportunities Fund has two investment objectives:

1. To generate an annual income yield at a target rate. This is declared at the start of each financial year.

2. To achieve capital appreciation 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

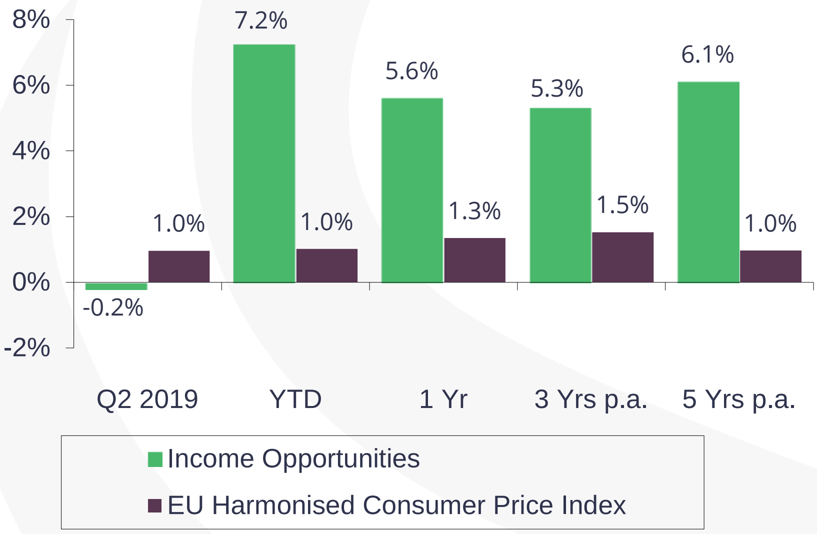
We consider scenarios rather than making forecasts

Businesses we own must have strong balance sheets

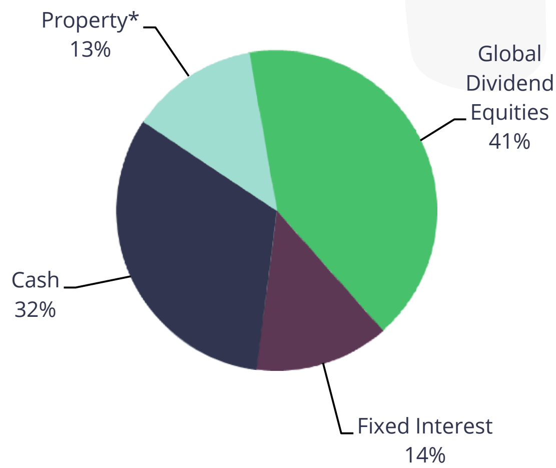
We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

Fund Performance – 30.06.19



Asset Distribution



*includes 1.2% in IRES REIT

Yearly Performance

Year %	2014	2015	2016	2017	2018
Fund	8.4	10.6	9.7	2.9	-1.2
Benchmark	-0.2	0.2	1.1	1.4	1.6

Performance Source: Setanta Asset Management Limited. Benchmark: European Harmonised Consumer Price Index. Fund returns are shown gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies.

* Inception as at 30.09.11

Historic Income

	Income Earned % of Fund Value
2011	6.2%
2012	5.6%
2013	5.5%
2014	4.8%
2015	5.5%
2016	4.7%
2017	4.1%
2018	3.9%

Top 10 Equity Holdings

COMPANY	SECTOR	% OF FUND
HARLEY DAVIDSON	CONSUMER DISCRETIONARY	1.8%
COCA-COLA AMATIL	CONSUMER STAPLES	1.8%
SAMPO	FINANCIALS	1.8%
NATIONAL GRID	TELECOMS & UTILITIES	1.7%
SVENSKA HANDELSBANKEN	FINANCIALS	1.7%
NWS HOLDINGS LTD	INDUSTRIALS & MATERIALS	1.6%
PROXIMUS SA	TELECOMS & UTILITIES	1.6%
GLAXOSMITHKLINE	HEALTHCARE	1.6%
VISCOFAN SA	CONSUMER STAPLES	1.5%
BASF AG	INDUSTRIALS & MATERIALS	1.4%

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.

[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

Contact Details:

Setanta Asset Management Limited,
Beresford Court,
Beresford Place, Dublin 1, Ireland.

Brendan Moran, Tel: + 353 1 612 4962
Email: brendan.moran@setanta-asset.com
www.setanta-asset.com

IMPORTANT INFORMATION

For this life assurance product, investors should refer to the relevant policy conditions available through Irish Life and via www.irishlife.ie. The strategy is also available on a segregated basis or a UCITS mutual fund via Beresford Funds plc. Investors should consider the investment objectives, risks, charges and expenses carefully before investing. See 'WARNING' and IMPORTANT INFORMATION' below.

Setanta Asset Management Limited is regulated by the Central Bank of Ireland, New Wapping Street, North Wall Quay, Dublin 1. This factsheet, which is for information purposes only, does not form part of any contract. This is a marketing communication that (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and (b) is not subject to any prohibition on dealing ahead of the dissemination investment research. The information contained in this document is based on current legislation and is, therefore subject to change. The contents are intended as a guideline only and should not be construed as an interpretation of the law. You should always seek the advice of an appropriately qualified professional. Performance disclosures are stated above.
The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages

WARNING: Past performance is not a reliable indicator of future results. The price of units and the income from them may go down as well as up and investors may not get back the amount invested. The return may increase or decrease as a result of currency fluctuations. Forecasts are not a reliable indicator of future performance

SETANTA
Asset Management