

# British Empire Ord BTEM

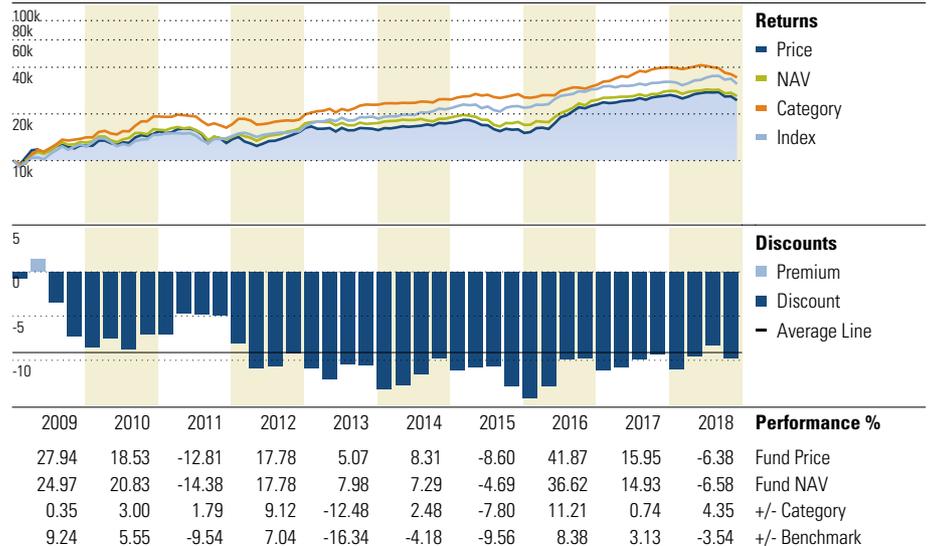
**Morningstar Rating™**  
 ★★★★★

**Morningstar Analyst Rating**  
**Bronze** 1/22/19 15:33  
 UTC-0600

**Morningstar Benchmark** MSCI World NR USD

**Morningstar Category™** Global Flex-Cap Equity

Last Closing Price GBP	7.02
Last Closing NAV GBP	7.73
Discount/Premium %	-9.22
Latest Published NAV	—
Latest Published NAV Date	—
Traded Currency	GBP
Yield	1.85
Dividend Frequency	—
Total Assets £ Mil	972.9
Net Assets £ Mil	857.6
Market Cap £ Mil	778.5
Net Gearing %	0
Avg Daily Shares Traded Mil (3 month)	0.15
Inception Date	01/01/1889


**Morningstar Analyst:** David Holder, Senior Analyst

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## Executive Summary

**People:** The team is well-resourced and experienced. John Pennink handed the reigns to Joe Bauernfreund in September 2015 and is now a diminishing influence on the investment decision-making process.

**Parent:** The long-standing investment manager Asset Value Investors Limited has moved to address weaknesses in sales and marketing with a recent arrangement with Goodhart Partners. This should help raise their profile to prospective investors.

**Board:** The board comprises six non-executive directors with extensive experience in financial services and broader industry, including service on investment company boards.

**Process:** The bottom-up process seeks investments trading below intrinsic value or where they are misunderstood by other investors. The process has been consistently applied dating back to the trust's origin from John Walton, through John Pennink and now to Joe Bauernfreund.

**Performance:** British Empire Trust has generated strong long-term returns, but medium-term performance has been disappointing. The style has been out of favour for some time but performance over Bauernfreund's albeit short tenure shows promise for investors.

**Fees:** The ongoing charge of 0.87% represents reasonable value for unconstrained and truly active management when compared with the broader universe of global equity funds available to investors.

## Role in Portfolio

Given the nature and style of the investment approach returns are likely to significantly deviate from those of broader global equity markets and the peer group. The fund would be a suitable choice to diversify a broader global portfolio.

## Morningstar Opinion

22 Jan 2019 | This fund has a unique approach to global equity investment where noted improvements help drive an upgrade to a Morningstar Analyst Rating of Bronze, from Neutral.

British Empire Trust's objective is to achieve capital growth through a focused portfolio of investments, particularly in companies whose share prices stand at a discount to estimated underlying net asset value. The mandate to run the trust has been in Asset Value Investors' hands since 1985. Shareholders had a disappointing experience in the latter part of the previous manager's tenure. It is encouraging to see the changes made by Joe Bauernfreund since his sole appointment in October 2015, to sharpen and refocus the investment approach, have been bearing fruit.

The team's strategy is to seek out-of-favour companies whose assets are misunderstood by the market or under-researched, and which trade significantly below their intrinsic value, or where AVI can exert pressure to enact change that will help realise shareholder returns. Whilst the value style has been out of favour, AVI have been consistent and resolute in maintaining its investment approach, which we find encouraging.

There are three primary investment themes employed in the trust: alignment of interest, constructivism, and asset-backed. Alignment of interest is expressed through investment in European holding companies or conglomerates, investing alongside private family investors. Due to the nature of these companies they tend to be under-researched, but they can provide access to very high-quality assets that are managed very

prudently on a long-term basis. Constructivism is largely achieved through investment in closed-end funds. As the name would suggest it involves actively engaging with boards, management, and other shareholders to realise value through buy backs, dividend policy and changes to strategy. Asset Backed involves investing in high quality assets at deep discounts to their current NAV or with over-capitalised balance sheets or archaic cross-holdings. In this space they often invest in Asian or Japanese property or more recently a basket of Japanese small cap stocks fulfilling the above criteria.

The team is well-resourced, composed of six members. Bauernfreund, who became CIO and sole manager of British Empire Trust as at 30 Sept 2015, has been immersed in the investment culture at AVI for 16 years and has been schooled in the firm's process by AVI's founder, John Walton, and previous manager John Pennink, who remains as chairman of AVI. Bauernfreund is the ultimate decision-maker here but can draw upon the team of five, including Tom Treanor, head of Research. The team have individual specialties but at heart are generalists able to challenge and add to the wider debate. The team is stable with incremental additions adding to its depth and capability leading to a very effective analytical resource.

Bauernfreund's tenure, whilst still relatively early days, has been characterised by a renewed focus and sharpening of the investment approach, which we think is significant. He has reiterated the disciplined and fundamental value approach to investing employed at AVI and built a substantial research resource. Early signs are encouraging and recognition of progress from the base of the Morningstar Analyst Rating upgrade to Bronze from Neutral.

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## People

Manager	Joe Bauernfreund
Manager Start	01/01/2013
Avg. Manager Tenure	6.0 Years
Other Funds Managed	—

Asset Value Investors was established by John Walton in 1985 to manage the assets of British Empire Trust. In 1999 John Pennink joined AVI and after working closely with John Walton he assumed full responsibility for the management of the trust in 2002. Walton left AVI in 2007. Joe Bauernfreund joined AVI in 2002 as an investment analyst and was named as comanager of British Empire in January 2013. At the end of September 2015 he assumed sole responsibility for its management and was appointed CIO of AVI as well as CEO in September 2016. The investment team of six is well-resourced and suitably specialised in nature. It consists of Bauernfreund; Tom Treanor, who is head of Research and deputy manager, and joined in 2011; Scott Beveridge (2005); Daniel Lee (2015); Darren Gil-

len (2016); and Wilfrid Craigie (2018).

Pennink is chairman of AVI but his day-to-day involvement in the management of the company has ceased. Historically each one of the team has had an area of specialisation but this position has developed in that each member of the team is becoming more generalist in nature. The approach remains collegiate and one of robust questioning, but clearly Bauernfreund has the final say in the positioning of the trust. We think he is very well-placed to bring together the input from the various analysts as he has been an integral part of the AVI investment process for 16 years, and he himself takes a keen interest in the key areas in which AVI invest such as European holding companies, real estate, and closed-end funds.

## Parent

Fund Advisor	Asset Value Investors Limited
Domicile	GBR
Subadvisor	Multiple

As AVI has gone through a number of changes in personnel it has sought to rearrange and broaden the ownership structure to better reflect the changing dynamics within the company and to better align existing employee interests. In part to address these issues and in recognition of shortcomings in how AVI communicated its strategies with potential investors, it has partnered with Goodhart Partners, which has a minority position in AVI (completed third-quarter 2016). Goodhart Partners was founded in 2009 and has taken small stakes in a number of small boutiques. It is closely involved with the investment consultant community and has the resources and experience

to improve how the AVI investment philosophy is articulated to institutional and other third-party investors. Goodhart also shares the long-term and value investment approach eschewed at AVI. The board was very keen to ensure that AVI thrive and continue to provide high-quality management for investors, and it has been actively involved and supportive in the Goodhart Partners arrangement. The intention is that this will ensure the long-term viability of AVI and increase assets under management. Joe Bauernfreund believes that the strategy followed at AVI has limited capacity and sees GBP 2 billion as a limit.

## Board of Directors

Tender Offer	No
Buyback Authorization	Yes

The board comprises six non-executive directors whose average tenure is a little under five years. Longstanding chairman Strone Macpherson stepped down at the AGM in December 2017 and was replaced by Susan Noble. She was appointed in March 2012 and has extensive investment experience having been a director at Newton, Robert Fleming, and Goldman Sachs. More recently she has served on the board at Alliance Trust Investments. The most recent appointments were Anja Balfour in January 2018, Calum Thomson in April 2017, and Graham Kitchen in January 2019. Balfour brings extensive investment trust board experience, and 20 years' Japanese and international equity investment management experience from her time with Baillie Gifford and AXA Framlington. Thompson is equally experienced in listed company board directorships, as well as 21 years as audit partner

within the asset management sector. Kitchen has been global head of Equities at Janus Henderson, having previously been head of UK Equities at Threadneedle. Steven Bates is the senior NED, having joined the board in June 2006. He brings longstanding experience in investment management, specifically within the emerging-markets region. Nigel Rich (appointed in March 2012) has a banking background with HSBC and Jardine Matheson. More recently he has served on the board of Segro and Slough Estates, which is extremely relevant given the focus within the fund on real estate at times. Four of the directors sit on the boards of other listed investment companies and all bar the newest appointment are shareholders here. We like to see directors as shareholders as we believe it aligns interests with those of their shareholders.

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## Process: Investment Approach

**Investment Objective:** To achieve capital growth through a focused portfolio of investments, particularly in companies whose share prices stand at a discount to estimated underlying NAV. Investments are principally in companies listed on recognised stock exchanges in the UK and/or overseas. The Company generally invests on a long-only basis but may hedge exposures through the use of derivative instruments and may also hedge its foreign currency exposures. There are no geographic limits on exposure, as the Company invests wherever it considers that there are opportunities for capital growth.

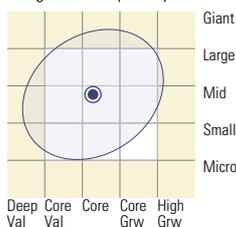
Hedging Policy NULL  
Tactical Use of Cash No

The investment process is long term, fundamental and contrarian. The focus is upon seeking out assets that are out-of-favour or misunderstood by investors and which are therefore trading significantly below their intrinsic value. The team looks for catalysts that will expose the unrealised value in their holdings such as M&A, liquidation, buy-backs, manager change, 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 value to be realised by the wider market. Bauernfreund favours a slightly more concentrated portfolio than his predecessor and as at the end of August 2018 there were 25 core holdings (not including the Japan special situations basket, which consists of

17 underlying individual stocks). The top 10 holdings account for over 65% of the overall portfolio. This is a concentrated portfolio but these holdings themselves will often have many underlying investments so there is significantly more diversification than may be optically obvious. Under Bauernfreund the remit will continue to exclude direct investment in the US. AVI consider this market to be too efficient for deep-value investors to be able to add value and minority shareholders' rights are often overlooked. This doesn't mean that the fund is absent from the US market, as it accounts for 24% of revenue from the portfolio's underlying holdings. The process here is consistent and disciplined in its scope and approach and we applaud AVI for their consistency and in recognising their specific skill set.

## Process: Portfolio Positioning

Morningstar Holdings Based Style Map



As at August 2018 the weighted average discount to NAV of the underlying holdings across the portfolio was in the region of 30% (August 2017: 25%). The portfolio has 25 positions (2017: 28). Over his tenure Joe Bauernfreund has restructured the fund in line with his preference for a high conviction best ideas portfolio. Given that a core focus is on European holdings companies, it is of little surprise to see look-through geographic revenue exposure to the region is 28.5% (2017: 30.2%), however despite the avoidance of

US-listed holdings it is interesting to see that the direct exposure to the US is actually 24.5% (20.6%), suggesting that there is more geographic diversification in the portfolio than immediately obvious. At the sector level exposure is spread predominantly through the consumer discretionary, industrials, and energy sectors. Investors should consider that a neutral weighting is 40% in closed-end funds (47% currently), 40% in family-backed companies (34%), and 20% in asset-backed ideas (19%).

World Regions	Assets %
<b>Greater Europe</b>	<b>38.66</b>
United Kingdom	0.20
Europe-Developed	29.82
Europe-Emerging	8.63
Africa/Middle East	0.01
<b>Americas</b>	<b>9.13</b>
North America	0.64
Latin America	8.50
<b>Greater Asia</b>	<b>52.21</b>
Japan	33.70
Australasia	0.00
Asia-Developed	18.52
Asia-Emerging	0.00
Not Classified	0.00

Asset Allocation	% Assets	Long	Short	Net
Cash	16.5	11.6	4.8	
Equity	59.3	0.0	59.3	
Bond	0.6	9.4	-8.7	
Other	44.6	0.0	44.6	

Top 10 Holdings 31/07/2018	% Assets
Pershing Square Holdings Ord	6.73
Jardine Strategic Holdings Ltd	6.01
EXOR NV	5.88
Pargesa Holding SA	5.50
Tokyo Broadcasting System Holdings	5.38
Tetragon Financial Ord	5.13
Riverstone Energy Ord	5.13
Wendel Ord	5.08
SC Fondul Proprietatea SA ADR	4.97
Third Point Offshore USD Ord	4.81

Sector Weightings	% Equity
<b>Cyclical</b>	<b>57.6</b>
Basic Materials	2.6
Consumer Cyclical	16.2
Financial Services	30.9
Real Estate	8.0
<b>Sensitive</b>	<b>33.3</b>
Communication Services	0.0
Energy	0.1
Industrials	31.5
Technology	1.7
<b>Defensive</b>	<b>9.1</b>
Consumer Defensive	2.6
Healthcare	0.0
Utilities	6.5



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## NAV Performance Analysis

Data as of —

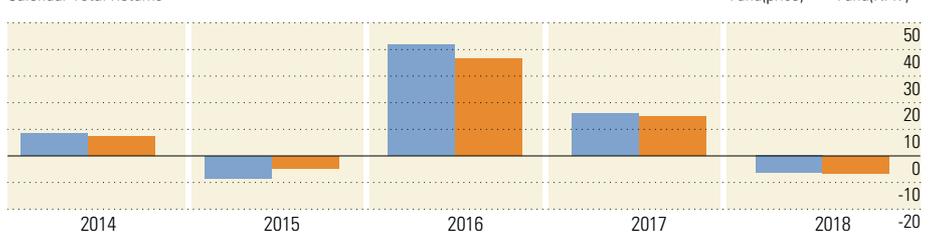
Trailing Returns Price	Total	+/-
	Rtn %	Bmark
3 month	-11.46	-0.11
6 Month	-10.16	-4.39
1 Year	-6.38	-3.34
3 Year Ann.	15.48	3.87
5 Year Ann.	8.80	-1.40

Trailing Returns NAV	Total	+/-	+/-	%Rnk
	Rtn %	Bmark	Cat	In Cat
3 month	-10.57	0.78	3.05	19
6 Month	-9.34	-3.57	2.52	27
1 Year	-6.59	-3.56	4.34	29
3 Year Ann.	13.34	1.73	5.17	4
5 Year Ann.	7.86	-2.34	1.55	25

Performance over Joe Bauernfreund's sole tenure beginning in October 2015 has been encouraging and ahead of peers and the Morningstar Category index, but it is still quite short-term to draw overly meaningful conclusions. Over the last 12 months to the end of December 2018 the fund returned negative 6.6%, which lagged the MSCI All Country World index return of negative 3.8% but bettered the category return of negative 10.5%. Holdings that excelled through the year

included Swire Pacific, Aker, and JPPEL Private Equity. Laggards included Pargesa, Wendel, and Tokyo Broadcasting System. TBS and the Japanese small-cap subportfolio were written down aggressively in the year-end sell-off. In addition, the inherent value style bias to the portfolio faced ongoing headwinds with growth continuing to outperform value indexes over the year. The MSCI ACWI ex USA index was comprehensively outperformed by the MSCI ACWI index over this period.

Calendar Total Returns



## Discount / Premium

Data as of 25-01-2019

Discount / Premium %	6 Mo	1Yr	3Yr
High	-6.46	-6.46	-6.46
Average	-9.07	+1.23	+1.50
Low	-11.68	-12.44	-15.56
Z-Statistic	0.95	1.23	1.50

There is no formal discount control mechanism in place here. Over the past 10 years to January 2019 the fund has traded from a modest premium to NAV in early summer 2009, all the way to a discount of 15% around the EU referendum in June 2016. As at January 2019 there were 18.6 million shares in Treasury, which is 16% of the 110.9 million shares in issue. Overall, investors are currently buying this book of assets for a dis-

count of around 35% factoring in the discount of the underlying assets and the current discount of the investment trust to stated NAV. The trust trades on a discount of around 9% (January 2019), which is a little tighter than its recent average, possibly reflecting greater investor demand for shares in the light of a sharpened investment process and a return to outperformance.

## Risk & Return

Data as of —

Morningstar Rating	Return	Risk	Rating
3 Year	High	Below Avg	★★★★★
5 Year	Above Avg	Below Avg	★★★★
10 Year	Avg	Below Avg	★★★
Overall	Above Avg	Below Avg	★★★★

The fund's unconstrained and niche investment focus means that investors should expect that its performance will diverge significantly from its peers and broader indexes. This is reflected in its regional and sector exposures. The fund is vulnerable to outperformance by the US market, given its investment focus. Risk as measured by stand-

ard deviation is in line with peers and broader indexes, whilst risk-adjusted returns are ahead under Joe Bauernfreund's tenure, as evidenced by the strategy's superior Sharpe ratio. The process with its inherent idiosyncratic drivers of returns can deliver uncorrelated returns versus peers and indexes.

Volatility Ratios	3 Yr NAV	5 Yr NAV	Risk vs Index	3 Year	5 Year
Standard Deviation	11.25	10.47	Alpha NAV	1.94	-1.38
Mean	1.12	0.72	Beta NAV	0.99	0.95
Sharpe Ratio	0.59	0.20	R-Squared NAV	78.11	76.94
Sortino Ratio	0.90	0.27	Treynor Ratio NAV	7.51	2.45

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## Fees

Management Fee %	0.70
Ongoing Charge ex Perf Fee %	0.01

In October 2013 the board simplified the fee arrangements. AVI 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 performance fee, but this

element has now been scrapped. The fund's ongoing charges for fiscal 2018 were 0.87% (2017: 0.87%), which is in line with the category average.

## Gearing

Total Assets £ Mil	972.9
Net Assets £ Mil	857.6

Gearing in the fund has historically taken the form of a GBP 15 million debenture (8.125%) which matures in 2023. In January 2016 the board arranged additional gearing (for the first time since 1996) in the form of two 20-year loan notes of GBP 30 million and EUR 30 million at an all-in rate of 3.79%. In October 2017 the board arranged an additional facility of EUR 20 million maturing in November 2037 at 2.93%. These facilities give Joe Bauernfreund additional flexibility to take advantage of opportunities and, given the large European asset base, denominating

some of the debt in euros makes sense. Prior to the addition of the newer borrowing facility in November 2017 the fund tended to not make material use of gearing, with the debenture offset through cash and bonds. Subsequently we have seen net gearing rise to trend between 5% and 10%. We feel that as much of the portfolio is underpinned with good quality assets and decent dividends, a relatively modest element of gearing here does not look unreasonable. As at January 2019 net gearing stood at 11%.

## Dividends

Dividend History	2016	2017	2018
Dividend	0.15	0.12	0.02
Special Dividend	0.13	0.00	0.00
<b>Total</b>	<b>0.27</b>	<b>0.12</b>	<b>0.02</b>

The fund's primary aim 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 financial years since 1985, which is an impressive feat. Over this period the dividend (ex-special)

has increased by an annualised 11.1%. For fiscal 2018 dividends per share were 13p (2017: 12p) per share on revenue per share of 14.83p (2017: 10.44p). The fund currently yields 1.87% (January 2019).

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## Morningstar Analyst Rating

	2017	2018	2019
Gold			
Silver			
Bronze			
Neutral			
Negative			
Under Review			
Not Rateable			

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The date shown next to the Morningstar Analyst Rating is the date on which Morningstar Manager Research Analyst assigned or reaffirmed the current rating for the fund based on the analyst's latest review and research report for the fund.

## The Five (5) Pillars

Morningstar has identified five key areas that we believe are crucial to predicting the future success of funds: People, Parent, Process, Performance, and Price. Each pillar is evaluated when assessing a fund as well as the interaction between the pillars, which we believe is crucial to understanding a fund's overall merit.

### People

The overall quality of a fund's investment team is a significant key to its ability to deliver superior performance relative to its benchmark and/or peers. Evaluating a fund's investment team requires that analysts assess several relevant items including how key decisions are made.

### Parent

We believe the parent organization is of utmost importance in evaluating funds. The fund's management set the tone for key elements of our evaluation, including capacity management, risk management, recruitment and retention of talent, and incentive pay. Beyond these operational areas, we prefer firms that have a culture of stewardship and put investors first to those that are too heavily weighted to salesmanship.

### Process

We look for funds with a performance objective and investment process (for both security selection and portfolio construction) that is sensible, clearly defined, and repeatable. In addition, the portfolio should be constructed in a manner that is consistent with the investment process and performance objective.

### Performance

We do not believe past performance is necessarily predictive of future results, and this factor accordingly receives a relatively small weighting in our evaluation process. In particular, we strive not to anchor on short-term performance. However, we do believe that the evaluation of long-term return and risk patterns is vital to determining if a fund is delivering to our expectations.

### Price

To reflect actual investor experience, price is evaluated within the context of the relevant market or cross-border region—for example, the United States, Australia, Canada, or Europe. In recognition of differences in scale and distribution costs in various markets, the level at which a fund is penalised for high fees or rewarded for low fees can vary with region. In Europe, for example, funds are penalised if they land in the most expensive quintile of their Morningstar category and are rewarded if they land in the cheapest quintile. The assessment is made using annual expense ratios, but in the case of funds with performance fees, expenses are evaluated excluding any performance fees and then the structure of the performance fee is evaluated separately.

## Morningstar Analyst Ratings

Morningstar Analyst Ratings are assigned on a five-tier scale running from Gold to Negative. The top three ratings, Gold, Silver, and Bronze, all indicate that our analysts think highly of a fund; the difference between them corresponds to differences in the level of analyst conviction in a fund's ability to outperform its benchmark and peers through time, within the context of the level of risk taken.

### Gold

Represents funds that our analyst has the highest-conviction in for that given investment mandate. By giving a fund a Gold rating, we are expressing an expectation that it will outperform its relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five

years). To earn a Gold rating, a fund must distinguish itself across the five pillars that are the basis for our analysis.

#### Silver

Represents funds our analyst has high-conviction in, but not in all of the five pillars. With those fundamental strengths, we expect these funds will outperform their relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years).

#### Bronze

Represents funds that have advantages that clearly outweigh any disadvantages across the pillars, giving analyst the conviction to award them a positive rating. We expect these funds to beat their relevant performance benchmark and/or peer group within the context of the level of risk taken over a full market cycle (or at least five years).

#### Neutral

Represents funds in which our analysts don't have a strong positive or negative conviction. In our judgment, these funds are not likely to deliver standout returns, but they aren't likely to seriously underperform their relevant performance benchmark and/or peer group either.

#### Negative

Represents funds that possess at least one flaw that our analysts believe is likely to significantly hamper future performance, such as high fees or an unstable management team. Because of these faults, we believe these funds are inferior to most competitors and will likely underperform their relevant performance benchmark and/or peer group, within the context of the level of risk taken, over a full market cycle.

Morningstar may also use two other designations in place of a rating:

#### Under Review

This designation means that a change that occurred with the fund or at the fund company requires further review to determine the impact on the rating.

#### Not Ratable

This designation is used only where we are providing a report on a new strategy or on a strategy where there are no relevant comparators, but where investors require information as to suitability.

For more information about our Analyst Rating methodology please go to

<http://corporate1.morningstar.com/ResearchLibrary/>

#### Morningstar Star Rating

The Morningstar Star Rating is a proprietary data point that is quantitatively driven. Funds are rated from one to five stars based on how well the fund performed (after adjusting for risk and accounting for sales charges) in comparison to similar funds. Within each Morningstar Category, the top 10% of funds receive five-stars and the bottom 10% receives one-star. Funds are rated for up to three time periods –three-, five-, and ten-years– and these ratings are combined to produce an overall star rating, which is noted within the Report. Funds with less than three years of history are not rated. Morningstar Star Ratings are based entirely on a mathematical evaluation of past performance. Morningstar Star Ratings are in no way to be considered a buy or sell signal nor should be viewed as a statement of fact.

#### Equity-Related Data Points

The Report lists the fund's top ten holdings as of the dated noted. For each underlying holding, a series of data points is provided including, where applicable, that security's Economic Moat as of the date noted.

##### Economic Moat

The concept of an economic moat plays a vital role in our equity analyst's qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of its fair value estimate. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a *narrow moat* are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. *Wide-moat* companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, *no-moat* companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

For more information about methodology in analysing stocks, please go to

<http://global.morningstar.com/equitydisclosures>.

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The Research Analyst has not served as an officer, director or employee of the fund company within the last 12 months, nor has it or its associates engaged in market making activity for the fund company.

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