

Mundane World Leaders Fund Ltd (MWLF) Investment Advisor's Letter

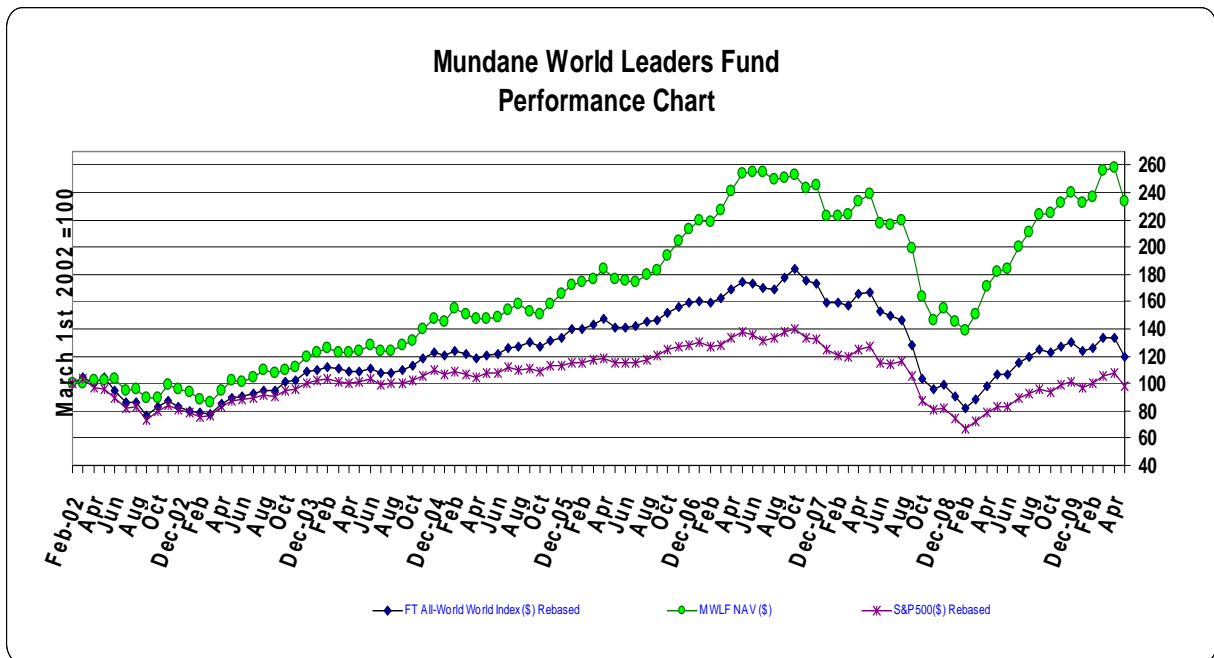
June 2010

Dear Investor,

The main narrative for the past six months has been the European sovereign debt crisis. In this letter we touch upon the associated recalibration of the Euro currency and discuss how it affects the Fund. We also update you on the slimming of the holding of C.B. Richard Ellis, the fattening of the position in Paris Orleans and some of the other developments surrounding the companies owned.

The NAV (unaudited) of the MWLF at the end of May 2010 stood at \$233.92 per share, a fall of 9.5% from the all-time high of \$258.36 recorded at the end of April 2010. In the past twelve months, the NAV of the MWLF has risen by 28.9% compared to an 11.9% advance for the FTSE All-World World Index (\$) and an 18.5% gain by the S&P 500.

The chart below shows performance over the longer term.



An investment of \$100 in MWLF on 1st March 2002 is now worth \$233.92.

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The table below displays the performance of the MWLF and that of the FTSE All-World World Index (\$) and S&P 500 Index in the past eight financial years and from past calendar year ends.

<u>Mundane World Leaders Fund Ltd</u>			
<u>Performance to End May 2010</u>	MWLF NAV <u>Change</u> %	FTSE All-World (\$) <u>Change</u> %	S&P 500 <u>Change</u> %
From December 31st 2009	-2.4%	-7.8%	-2.3%
From December 31st 2008	51.2%	20.3%	20.6%
From December 31st 2007	-4.8%	-31.0%	-25.8%
From December 31st 2006	9.9%	-24.8%	-23.2%
From December 31st 2005	41.4%	-10.7%	-12.7%
From December 31st 2004	58.9%	-2.8%	-10.1%
From December 31st 2003	95.4%	10.1%	-2.0%
From December 31st 2002	145.3%	44.7%	22.4%
From Inception (1/3/2002)	133.9%	19.7%	-1.6%
Financial Year ended Sept 30th 09	12.1%	-2.6%	-9.4%
Financial Year ended Sept 30th 08	-20.6%	-27.7%	-23.6%
Financial Year ended Sept 30th 07	37.5%	20.8%	14.3%
Financial Year ended Sept 30th 06	19.6%	12.9%	8.7%
Financial Year ended Sept 30th 05	19.2%	18.2%	10.2%
Financial Year ended Sept 30th 04	19.1%	15.6%	11.9%
Financial Year ended Sept 30th 03	20.4%	23.8%	22.2%
Financial Year ended Sept 30th 02*	-10.7%	-23.1%	-26.3%
<i>* a 7-month period</i>			
Compound Annualised Growth Rate (CAGR)	10.9%	2.2%	-0.2%

The fund's NAV has fallen by 2.4% in the calendar year-to-date and has advanced 133.9% since inception.

The compound annual growth rate in MWLF's NAV per share over the past 8 years and three months is 10.9%. This compares with 2.2% for the FTSE All-World World Index (\$) and a decline of 0.2% for the S&P 500 Index.

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To date the long-term returns from the Fund have outpaced the returns of the major world indices. We track these returns from historic quarter start dates, as shown in the table below.

Mundane World Leaders Fund	FTSE All-World World Index	S&P 500	
%	%	%	
From Inception (1/3/2002)	133.9%	19.7%	-1.6%
From Mar 31st 2002	134.4%	14.7%	-5.1%
From Jun 30th 2002	126.0%	26.7%	10.1%
From Sep 30th 2002	162.0%	55.6%	33.6%
From Dec 31st 2002	145.3%	44.7%	22.4%
From Mar 31st 2003	170.5%	53.4%	28.4%
From Jun 30th 2003	130.7%	31.6%	11.8%
From Sep 30th 2003	117.6%	25.7%	9.4%
From Dec 31st 2003	95.4%	10.1%	-2.0%
From Mar 31st 2004	89.8%	7.4%	-3.3%
From Jun 30th 2004	82.7%	7.7%	-4.5%
From Sep 30th 2004	82.7%	8.8%	-2.3%
From Dec 31st 2004	58.9%	-2.8%	-10.1%
From Mar 31st 2005	54.8%	-1.3%	-7.7%
From Jun 30th 2005	57.1%	-1.6%	-8.6%
From Sep 30th 2005	53.2%	-8.0%	-11.3%
From Dec 31st 2005	41.4%	-10.7%	-12.7%
From Mar 31st 2006	32.3%	-16.2%	-15.9%
From Jun 30th 2006	33.3%	-15.1%	-14.2%
From Sep 30th 2006	28.2%	-18.5%	-18.4%
From Dec 31st 2006	9.9%	-24.8%	-23.2%
From Mar 31st 2007	3.2%	-26.3%	-23.3%
From Jun 30th 2007	-8.4%	-30.8%	-27.5%
From Sep 30th 2007	-6.8%	-32.5%	-28.6%
From Dec 31st 2007	-4.8%	-31.0%	-25.8%
From Mar 31st 2008	4.5%	-23.8%	-17.6%
From Jun 30th 2008	7.8%	-21.8%	-14.9%
From Sep 30th 2008	17.3%	-6.7%	-6.6%
From Dec 31st 2008	51.2%	20.3%	20.6%
From Mar 31st 2009	55.5%	36.2%	36.5%
From Jun 30th 2009	27.2%	12.7%	18.5%
From Sept 30th 2009	4.7%	-4.1%	3.1%
From Dec 31st 2009	-2.4%	-7.8%	-2.3%
From Mar 31st 2010	-8.8%	-10.2%	-6.8%

In the financial year to date the MWLF's NAV has risen by 4.7% compared with a 4.1% decline for the FTSE All-World World Index (\$) and a 3.1% advance for the S&P 500 Index.

Currency movements have had a major impact on the dollar denominated returns of the fund this calendar year. In aggregate the eleven European listed holdings made up 43% of portfolio weighting at end May 2010. For these European equities, the portfolio weighted currency decline of their listing currencies against the US dollar has been 12.2%. In order of importance to the fund these listings are in Euro, Swiss Franc, Swedish Krona and Sterling.

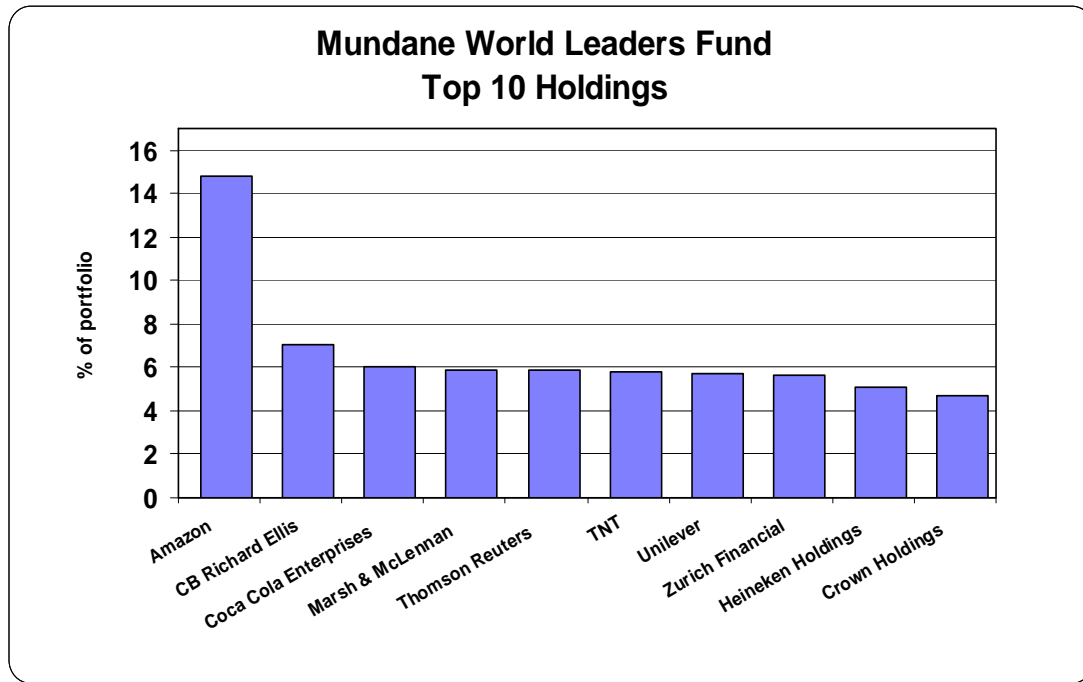
Since December 31st 2009 the MWLF's NAV has declined by 2.4%; we estimate that European currency moves alone contributed about - 7.7% to the decline. In other words, if currencies had not moved, all else being equal, the MWLF NAV would have recorded a gain of 5.3% in the year to date.

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Mundane Portfolio

The top ten holdings in the MWLF portfolio as at 28th May 2010 are shown below.



The MWLF was valued at \$64.4m at end May 2010. The top 10 investments shown comprised 66% of assets, there being 18 listed investments in all. Cash made up 8.3% of assets at the same date.

Since we last wrote to investors in March 2010 we have made only minor adjustments to the portfolio. In early May we sold a third of the position of CB Richard Ellis, the stock having breached fair value targets. We also added to the position in Paris Orleans (the holding company for the Rothschild banking group) having met with senior officers of the company in late April.

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The table below ranks the MWLF holdings at end May 2010 in order of their total return for the past 12-month period. We have not included the performance of Coca-Cola Enterprises which is a February 2010 addition to the list of holdings.

<u>Mundane World Leaders Fund</u>	Total Return in US\$ End May 09 to End May 10
	%
C.B. Richard Ellis	117
Live Nation	114
Electrolux 'B'	83
Amazon.com	61
Intercontinental Hotel Group	55
TNT Group	33
Heineken Holdings	27
Unilever Plc	20
Thomson Reuters Corp	20
Marsh & McLennan	20
Zurich Financial Services	17
SES Global	11
Husqvarna 'B'	11
ABB	8
Crown Holdings	0
Syngenta	-6
Paris Orleans	-19
FTSE All-World World (\$)	12

Total return (including dividends) from 29/05/2009 to 28/05/2010.
FTSE All-World World (\$) data is without dividends included. Dividends included would add about 2.6%, in a full year, to total return.

Source Bloomberg.

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Sovereign Debt Crisis and the MWLF Portfolio

Europe is important for our companies. Eleven out of the eighteen of the holdings in the Fund are listed in Europe and roughly 42% of underlying portfolio weighted revenue derives from European business activity (2009 financial year analysis).

In our last newsletter, we wrote about our surprise at the rate at which corporations had repaired and reinforced their balance sheets. We are now into the fourth quarter of US economic expansion and there is plenty of evidence that US households are also deleveraging fast. In Europe, we believe this process is also occurring but lagging the US.

A recent update from Bank of America Merrill Lynch spells out the American experience.

Household assets rose 1.4% QoQ [in Q1 2010], or \$965 billion, to \$68.5 trillion. The rise in assets was driven entirely by financial assets – the recovery in the equity market. Household equity assets rose 4.3% or \$496 billion, to \$12.1 trillion. However, household real estate assets dropped marginally, falling 0.3% QoQ to \$18.1 trillion.

Households continued to repair their balance sheets by shedding debt. Total household liabilities fell \$98 billion, or 0.7% against the previous quarter. Liabilities have declined now for six consecutive quarters, and over that time nearly \$600 billion of debt has been extinguished, highlighting the speed at which US households are deleveraging. This brought the household debt to income ratio down to 125.9% - the lowest since the second quarter of 2005.

With consumers less willing to take on debt, it implies that whatever growth in spending we get is likely going to come out of organic wage and salary growth. And, since consumers will use some of that income to pay down debt, look for spending to lag the income and savings rate to rise.

Bank of America Merrill Lynch, US Economic, 10th June 2010

A year ago talk of another Great Depression spurred governments around the world, supported by scores of economists, to enact fiscal stimulus packages to complement the monetary stimulus that had already been applied. Just a year later we see a mirror image; scores of economists (are they the same?) are calling for the soaring budget deficits in many countries, but particularly in Europe, to be brought back under control.

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Thomas Sowell, in his 2010 published book, *Intellectuals & Society*, makes a compelling point about why we can expect governments to be the very last to begin the process of deleverage.

The fundamental difference between decision-makers in the market and decision-makers in government is that the former are subject to the *continuous and consequential* feedback which can force them to adjust to what others prefer and are willing to pay for, while those who make decisions in the political arena face no such inescapable feedback to force them to adjust to the reality of peoples desires and preferences.

A business with red ink on the bottom line knows that this cannot continue indefinitely, and that they have no choice but to change whatever they are doing that produces that red ink, for there is little tolerance even in the short run, and which will be fatal to the whole enterprise in the long run.

In short, financial losses are not merely informational feedback but consequential feedback, which cannot be ignored, dismissed or spun theoretically through verbal virtuosity.

In the political arena, however, only the most immediate and most attention-getting disasters – so obvious to the voting public that there is no problem of 'connecting the dots' – are comparably consequential for political decision makers.

[Intellectuals & Society by Thomas Sowell, Amazon.co.uk](http://Amazon.co.uk)

Should we be surprised by recent events? Probably not. As Sowell suggests, the attention getting (and here the media plays its part) is vital to initiate the process and create the political will for change. Our reading is that this deficit 'big story' has been so effectively nurtured by the press that it has started to create its own feedback loop of damage. The anxieties and uncertainties generated by a poorly co-ordinated and unclear European response to sovereign debt issues have fed back into stock market and currency volatility. Investors have once again moved away from the instruments and asset classes at the more hazardous end of the spectrum of risk just as they did in late 2008.

Everyone is expected to have a view on deficit reduction today, but that's the point. When governments, such as the United Kingdom's, are asking the public to come up with ideas for debt reduction and communicate these ideas to them, has it not become somewhat akin to a popular phone-in television talent competition? No wonder a recent Financial Times Lex column concluded a piece, contrasting the wobble in the stock market with elements of recovery seen in the Eurozone economy, with the line 'Reality these days, is hard to pin down'.

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Our companies are embedded in the world economy of which Europe is a major part. At the end of May 2010 the portfolio was balanced with 43% of portfolio weighted underlying company sales from the Americas (chiefly the United States) approximately 42% from wider Europe and the balance of 15% from the rest of the world.

We expect fluctuations in currencies to exert both detrimental and favourable translational effects on the MWLF's reported monthly NAV over the years but as every investor in the fund will be aware we don't, won't and can't hedge out currency movements. We do however expect the underlying companies in which we invest to make currency hedging decisions based on long-term considerations of creating and protecting shareholder wealth from the regions that they operate in. Every company has a different response to the hedging of assets and liabilities, receivables and payables, transactions and translations, as only they know their detailed exposures and dynamics of their balance sheet, cash flow and profit and loss statements.

In the first 6 years of the MWLF's life Sterling rose against the US dollar by over 40%. In the past two years it has given back most of that rise with the result that the £/\$ rate is back within 5% of where it was when the MWLF launched in February 2002. In other words, Sterling and US dollar investors would have received nearly the same return.



Looking at the Euro, which now seems to be in decline against the US dollar, the Eurozone currency is still 40% higher than it was eight years ago.



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We point this out but we do not have any idea where the rates will lie in three, five or ten years time. We are long-term investors so currency movements are not nearly as relevant to us as they are perhaps to other portfolio managers. A manager with incentives and rewards skewed towards relative or absolute performance over nearby periods of time, perhaps judged by quarterly or annual review, may succumb to the temptation to optimise for the short-term. We have removed that handicap by having the vast majority of our own capital invested in the MWLF. We therefore behave and act as principals, as opposed to agents, in investment decision-making.

External factors such as currency movements (but also regulatory and taxation changes) are phenomena to which well-managed businesses have to be prepared to adapt. It has always been this way. Our portfolio of world leaders, each with a spread of activities across the globe, are well placed to draw on past experience as these factors change. We reaffirm, on our part, that it would be imprudent for us to attempt to overlay their decisions with our own bets on currency fluctuations.

Portfolio Actions

C.B Richard Ellis Partial disposal

In early May we sold about a third of the holding of C.B. Richard Ellis. Buoyant first quarter financial results, in which leasing revenues advanced 23% and investment sales revenue rose 51%, had propelled the stock market price above our 'fair value'. At the time the market capitalisation touched \$5.5bn and the share price at \$17.30 was some 4.5x greater than the rights issue price of \$3.77 of November 2009, and nearly 5x the price we paid to accumulate stock that same month.

Facilities and property management now represents CBRE's largest business segment with 40% of revenues. Relative to the brokerage businesses of leasing and sales this activity is lower margin and so limits somewhat the margin potential for the group as a whole.

There are many encouraging signs for real estate service companies, as activity picks up this year from the abnormally low volumes of 2009, but the company suspects that the velocity of property turnover may not return to normal levels until a more traditional financing environment returns. J.P. Morgan estimates that the sizeable UK commercial property market is only now returning from a period of 'negative equity'. At the end of 2009 the loan-to-value (LTV) ratio for overall UK commercial property market was 100% and with capital values rising about 5% since then this ratio will be in the mid-nineties now. There is about £250bn of outstanding commercial property lending in the UK of which £35bn matures this year. Similar conditions prevail in the US. We suspect that this debt burden will remain an influence for some time to come. First, banks have become more prudent on LTV advances than in the past. Secondly, equity for debt capital transactions may be where the action is and not so much in physical property transactions. There may not be a flood of distressed property sales.

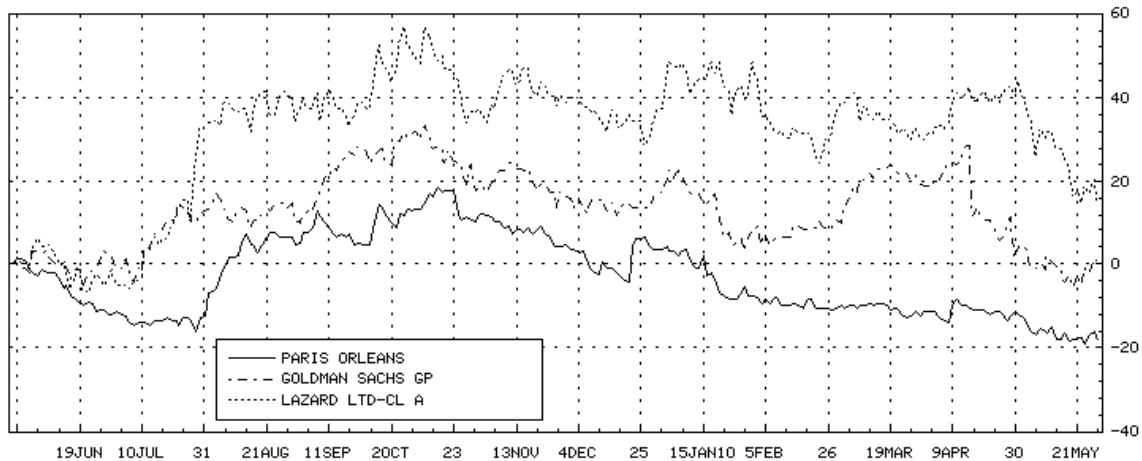
The next six months should see very positive year-on-year financial performance for CBRE with its admirable real-estate services platform positioned in most of the leading metropolitan centres of the world. We reduced 3% of portfolio weighting from CBRE as enthusiasm for the stock had priced in a generous recovery followed by steady growth thereafter. If our assessed 'fair value' is breached again we will lighten the position further.

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Paris Orleans Addition to holding.

Paris Orleans, the holding company for the Rothschild banking group, has been the worst performing stock owned by the Fund. The stock price has also underperformed against other leading investment banks. Goldman Sachs, for example, which has recently been in the news for mostly the wrong reasons, has seen its stock price drop back to where it was a year ago. Paris Orleans, however, is 20% lower.



When we acquired shares in the company back in June 2005 some of the features we most admired about Rothschild were its fee based advisory business, free from the conflicts of interest all too common in the major integrated investment banks, and its leading position in restructuring and debt advisory where activity had all but disappeared. These attributes are just as important today as they were then.

Where we were blind, at the time, was to the extent to which the relatively unlevered commercial banking business (chiefly within the London-based N.M. Rothschild) could be pained by write-off and impairments like all other banks. Even though Rothschild has contracted its balance sheet steadily since 2006 it has still taken impairments that have exceeded net interest income. The banking group's total assets (less cash) to total equity ratio had been brought down to 5.1 at the end of March 2009, a level much lower than many other banks.

In April we met with senior management and had reaffirmed to us that the direction of the bank is firmly and squarely towards building the advisory franchise and scaling down remaining commercial banking activity. This might take a while as loans to customers mature, or could conceivably take place faster if interest is shown in parts of the lending book by another financial institution. Whatever the course, the outcome is set.

In the year to date Rothschild leads the league table of European bank advisory mandates by deal number and is ranked 7th by value. This tracks the 2009 performance, with the bank again leading on M&A deal volume and placed 10th in terms of aggregate value of deals.

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Recently, Jim Lawrence, a former CFO of Unilever, has been appointed chief executive of Rothschild North America and other hires have been made to build the independent, conflict-free advice practice in North America. Last year Rothschild advised the US government on the bankruptcy of General Motors and has been guiding the special committee directors of AIG on the repayment of government debts.

The MWLF position in Paris Orleans had fallen below 5% in late April 2010 and recent purchases have been intent on restoring that level of weighting. A string of bad years for the banking industry has perhaps now ended. Paris Orleans investment portfolio, where gross value is equivalent to 80% of the Paris Orleans market capitalisation, contains some gems that are not faring so badly. For example, the 24% holding in Les Domaines Baron de Rothschild (DBR), which manages and markets Chateau Lafite and owns a number of other prestigious vineyards, will see an excellent 2009 vintage!

Portfolio Holdings Update

Marsh & McLennan Companies (MMC) Legacy Issues.

In early June MMC agreed to sell Kroll to global security firm Altegrity for \$1.13bn in cash. Altegrity is owned by private equity firm Providence Capital Partners and is run by Michael Cherkasky. He ran Kroll from 2001 to 2004 and briefly held tenure as chief executive of MMC from 2004 to 2007. Kroll had been put up for sale by MMC early in 2010.

In mid June, Mercer, MMC's consulting unit, settled out of court a lawsuit filed by the Alaska Retirement Management Board (ARMB) for work performed by Mercer between 1992 and 2004. Mercer has agreed to pay \$500m, of which \$100m is covered by insurance, in a case that represents the largest ever actuarial settlement in the U.S. Under the terms of agreement Mercer denies liability and the payment resolves all claims against Mercer by ARMB and the State of Alaska. The civil lawsuit had been amended in May 2009 to include a clause seeking damages of at least \$2.8bn and MMC had been concerned about the upcoming trial by jury in Juneau, Alaska, scheduled for July 2010.

We read these announced outcomes as positive. MMC bought Kroll for \$1.9bn in cash in 2004 and had already written down \$855m of goodwill and sold off some smaller elements of its business. MMC's structure is now simplified and management energy can be focussed on two world-leading businesses, Marsh and Mercer, each generating annual revenues of c. \$5bn. Mercer's Oliver Wyman strategic consulting practice, in particular, will need to be invested behind. Two of the large competitors, AT Kearney and Booz & Co are merging and Oliver Wyman is now the smallest of the big five strategy firms. McKinsey & Co, the industry leader, is three times the size of Oliver Wyman.

The Alaska settlement is a huge relief for the company. The settlement can either be paid from the proceeds of the Kroll sale or from cash on the balance sheet. Brian Duperreault, MMC chief executive since January 2008, has been cleaning up legacy issues at MMC and this action carries his hallmark decisiveness.

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Intiguingly, FBR Capital Markets, recently published a detailed research note on Marsh & McLennan with the strap-line 'Nine years in the making – a deep dive on why we are finally bullish on MMC'. This note was the first we have seen in years which highlights the potential for Marsh and Mercer, and the good long-term prospects for the industries in which they operate.

Thomson Reuters Strength in Westlaw.

Thomson Reuters has recently been providing more information about its important legal business; it was the focus of a whole investor day at Eagan, Minnesota on June 3rd. Legal makes up 66% of the group's Professional division sales and 26% of total company sales. Legal is the most prodigious producer of group cash, with operating margins above 30%.

Earlier this year a new platform called WestlawNext was rolled out to provide lawyers and researchers with enhanced legal search. This was a much-watched event not just because of its heralded benefits for lawyers but also because it is the first of two major investment projects to come onstream since the Thomson and Reuters merger. Thomson Reuters was sensible in not cutting spending on these projects in the downturn. The success of WestlawNext is being scrutinised as it will be the benchmark against which the autumn roll out of Project Eikon is judged. Eikon is designed to upgrade the financial markets user interface to match and perhaps leapfrog the acclaimed Bloomberg Markets offer.

Peter Warwick, chief executive of Legal, says the WestlawNext launch has been successful as it enhances law firm productivity and efficiency. Westlaw already has a 2-to-1 preference against competitors for legal research. Litigation drives two-thirds of law firm revenues in the US and litigators are the heaviest users of research.

WestlawNext Update

- 3,700 signed up customers since launch in February 2010.
- Equivalent to 5% of old Westlaw customer base.
- WestlawNext is seeing a 10% average price premium to Westlaw.
- 20% of customers are brand new.
- 40% of these new customers have been taken from competitors.
- 60% of these new customers are new to the service and haven't come from competitors.

Vin Caraher, President US Core Legal, 3rd June 2010

Tom Glocer, chief executive of Thomson Reuters, has recently suggested that LexisNexis, the major competitor to Westlaw, owned by Reed Elsevier has been starved of investment in content to the tune of \$500m. He commented that without that investment it would not be in position to compete with Westlaw or WestlawNext. It is quite rare for executives to comment in public on a competitor's positioning; they have to be quite sure their words will not come home to haunt them.

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The message coming from Eagan, Minnesota, where eight senior executives took to the podium, speaks volumes of the confidence that is felt within the Legal division. Thomson Reuters is uniquely positioned to provide the content, tools and services that legal firms now require to improve their own productivity and efficiency. Indeed, it is that ability to help customers improve their own productivity that is key to understanding why Thomson Reuters should thrive well into the future.

Heineken Holdings Femsas beer business secured.

At the end of April 2010 Heineken completed the acquisition of the beer business of Fomento Economico Mexicano S.A.B. (Femsa) for an implied enterprise value of €5.25bn. The non-cash deal, satisfied in shares, makes Femsa the group's second largest shareholder with a 20% economic interest. The acquisition lifts group beer volume by a quarter to over 200mhl and gives Heineken better access to three of the four largest country profit pools – United States, Brazil and Mexico - which collectively account for over a third of the global beer profit pool. Mexico represents 75% of the acquired revenues and Heineken inherits a 43% market share here, second only to Modelo.

Heineken now terms itself the world's 'most balanced beer company' with 60% of operating profit (on a pro-forma basis) from developed markets and 40% from emerging markets. The Americas as a whole will shortly contribute about a third of group annual operating profits against just 11% two years ago. Unlike the acquisition of Scottish and Newcastle in the UK, which was completed in April 2008 ahead of both a sharp decline in Sterling and a general weakening of the British beer market, the timing of this transaction seems more fortuitous. It will benefit from both US Dollar and Mexican Peso strength against the Euro, at least in the short term.

We have seen a number of negative research commentaries on Heineken. These are similar in nature to those we received early this decade when Heineken bought BBAG in Austria to give it a leadership position in Eastern Europe, and also after the Scottish and Newcastle purchase. There is absolutely no doubt that these acquisitions take time to prove themselves but management has never disguised this fact.

The most pessimistic report we have come across is from a Swiss bank. Here the suggestion is that if the exclusive beer selling arrangements with Femsa's Oxxo convenience store chain in Mexico fall away in 10 years time there will be a diminution of company value. By their reckoning the difference between a pessimistic total loss of exclusivity and a more positive maintenance of exclusivity amounts to just €4/share of present value. Put in the context of a 'fair value' in excess of €50/share and a current Heineken Holdings share price of €32, that possible event, in ten years time, does not appear too troublesome.

Heineken should generate about €1.8bn of free cash in 2011. On this basis, if the company were never to grow again, a Ben Graham valuation would suggest an equity value of €18bn. The market capitalisation of Heineken today derived through Heineken Holdings (which owns 50% of the outstanding equity) is €18bn.

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SES Emerging Growth.

The world's leading satellite operator has been celebrating its 25th anniversary this year; the company was listed in June 1998. Our investment commenced in early 2002 and has delivered a 9% compound total return; it is one of our longest held positions.

In early June the company gave a well-attended investor day in London and the theme was very much 'growth from emerging markets'. In the past decade SES has grown revenue at a CAGR of 10% and operating profit at 8%, with most of that growth coming from transponder demand in Europe and the Americas. Projections for the next eight years suggest industry transponder demand from regions such as Russia, Latin America and the Middle East will grow at about three times the rate of Western Europe, with direct-to-home satellite television the most important driver.

At the end of 2009 SES's fleet of satellites in 26 orbital positions carried 1,173 transponders, equivalent to 23% of the world capacity. By 2015 the group expects to operate 1,533 transponders in 30 orbital positions equivalent to about 25% of projected global capacity. SES currently has an investment programme for 16 new satellites to provide replacement and growth capacity. Some 85% of that capacity growth will serve emerging markets.

At the London event SES was tantalisingly reticent about another important investment initiative. In February 2010 the company announced plans to take a 30% participation in O3b ('other 3 billion') a company established to offer affordable broadband connectivity to telecoms carriers in developing nations that do not have access to fibre optic networks. A constellation of 20 MEO (mid earth orbit) satellites is planned to provide cover to the 70% of world's population that lives in latitudes between 45 degrees N and 45 degrees S of the equator. The project will initially cost over \$1bn and founder shareholders include Liberty Global, Google, Allen and Co and Northbridge Ventures, all of which have impressive track records backing innovative technologies and companies.

O3b sets out to solve the problem of the communications bottleneck in emerging markets where lack of affordable, low-latency and high-speed backhaul makes it costly and difficult for telecoms and ISPs (internet service providers) to connect emerging market consumers to the Internet content we now take for granted in the developed world. O3b expects to offer Internet trunking to customers at pricing well below other market rates (fibre, undersea cable, existing GEO satellite) because of the low cost of the MEO satellite fleets. As ever, we expect SES to secure anchor tenants on this new fleet well before launch so that investment returns are secured ahead of lift-off.

SES has a 25-year track record of competence in the satellite industry and has been chosen by the O3b project to provide a range of technical and support services including marketing. It is early days but we believe the O3b platform, which should be launched by late 2012, could be scaleable and provide a new avenue for SES's growth ambition.

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Syngenta Monsanto Hubris.

Monsanto's share price has fallen 38% in the past year wiping out \$17bn of equity value. In the same period Syngenta's share price has been flat in dollar terms. Both are in the crop protection and agricultural seeds business. What has happened to Monsanto in the past two years is a rather disturbing study of the 'capital cycle' at work and one that all crop chemical companies should study.

By way of background, Monsanto developed for farmers the broad-spectrum systemic weed killer glyphosate in the 1970's. It sold glyphosate under patent until 2000. Monsanto branded the herbicide, Roundup, and with the advent of genetically modified crops, pioneered by Monsanto, the chemical became the largest crop protection product in the world. Glyphosate sales were probably three times the volume of the next best selling crop chemical.

As demand from farmers for Monsanto's genetically modified Roundup resistant corn and soybean seed grew in North and South America so did demand for Roundup. Glyphosate capacity shortages developed in late 2007. In 2008, Monsanto announced a \$200m project to de-bottleneck their giant Luling plant in Louisiana to address the tightness of supply. In the same year Roundup was contributing 32% of Monsanto's gross profit at an eye-watering gross margin of 48%. The first signs of trouble came late in 2008 when Chinese-supplied generic glyphosate started to arrive in the US. By mid 2009 prices for the chemical had started to decline.

At first Monsanto were surprisingly unconcerned about the new supplies, commenting:

"In short we are fully aware and have always anticipated that the Chinese manufacturers will bring more supply into the marketplace and lower price. That lower price however is based on the cost position that is roughly one-third higher and we believe is the new standard for generic production. Current estimates indicate that the new manufacturing facilities are incurring 15% higher costs to incorporate environmental controls." (Monsanto Earnings Call 8th October 2008)

The company went on to report superb 2009 annual results for their agricultural chemicals division with glyphosate alone contributing \$1.8bn of gross profit at a 52% margin - more reminiscent of a branded consumer products company than a commodity producer.

Even before Monsanto had reported results for the full year (ended August 2009) the company had quickly trimmed their expectations for Roundup. US inventories of glyphosate had grown to four times the normal level.

"We now believe it [Roundup] will deliver in the neighbourhood of \$1bn longer term. That said even our amazing Seeds and Traits business cannot in one year offset a \$1bn decline in Roundup gross profit." (Monsanto Earnings Call 24th June 2009)

Further downgrades of Roundup's gross profit potential followed but management clung to the theory that efficiency improvements could rectify the damage caused by a halving of the market price of generic glyphosate.

"We now believe that for 2010, the gross profit contribution is going to be in the range \$650m to \$750m." (Monsanto Investor Presentation 10th September 2009)

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Asset Management

"Our ability to optimise gross profit at \$1bn in 2012 is a function of things we control."
(Monsanto Earnings Call 7th October 2009)

By May 2010 Monsanto had taken down their 2010 Roundup gross profit expectation to \$600m and then the final capitulation came. In late May Monsanto called together analysts at short notice to announce:

"Roundup in 2011 and going forwards will be in the range \$250m to \$300m a year. This steady state recognises China is currently selling below cost, but it assumes that pricing does not erode further. China is profoundly overbuilt and there is no indication that capacity has been rationalised at this time. The embedded total supply infrastructure represents twice the world current glyphosate demand." (Hugh Grant, Monsanto CEO, 27th May 2010)

The final act of this capital cycle story has not yet played out; that is for the years ahead, but the speed of events, hubris to humility, is astounding. In early 2009 Monsanto was voicing optimism about a \$2bn gross profit run-rate for Roundup. Now, a little over a year later, Roundup operations are running at a loss!

There are broad lessons here about the dangers of commoditisation, brand pricing and, most importantly, about how the capital cycle works in practice. Attractive profit margins attract new entrants that over-invest in capacity. New entrants diminish the profitability of existing players. Often, and it is true in this case, existing players also add capacity in order to remain competitive. For those who point to China as the culprit, a re-reading of Graham and Dodd's investment classic, *Security Analysis*, written in the early 1930s, is in order. A capital cycle does not need a China to peak.

'A business which sells at a premium, does so because it earns a large return on capital; this large return attracts competition; and generally speaking, it is not likely to continue indefinitely. Conversely, in the case of a business selling at a large discount because of abnormally low earnings, the absence of new competition, the withdrawal of old competition from the field and other natural economic forces should tend eventually to improve the situation and restore the normal rate of profit on the investment '

[Security Analysis: The Classic 1934 Edition: Amazon.co.uk: Graham: Books](http://Amazon.co.uk: Graham: Books)

Syngenta generated just 6% of group sales and 2% of gross profit from glyphosate (Touchdown) in 2009 but the message from Monsanto's nightmare has certainly not been missed by the world's largest crop chemical company. Syngenta's own plant expansions are specifically for the insecticide, Actara and the fungicide, Amistar. The Amistar plant in the UK has just doubled production and already the company reports demand is meeting capacity. In 2009 Amistar contributed about 10% of crop protection revenues. Syngenta are happy to report there have been no competitors, or new entrants, building similar plants.

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Asset Management

ABB Deal Junkie.

In March this year ABB had cash balances of \$7.4bn. Now, after a decade long lull, in which the balance sheet was repaired, the company has gone on the offensive and announced over \$3bn in acquisitions.

On May 5th ABB announced the acquisition of Ventyx, a leading provider of energy and utility management software with revenues of \$250m. The price paid was over \$1bn and the seller, Vista Equity Partners, had cobbled together the company just three years previous.

On May 17th ABB announced its intention to increase its shareholding in ABB India from 52% to 75% at a cost of \$965m. The offer was made at a 34% premium to the pre-announcement price. ABB has its own factories in India and the deal makes it easier to optimise for group efficiency in the country.

On June 8th ABB made a recommended offer for UK company Chloride, a leading supplier of uninterruptible power supplies (UPS). The bid values the business at about £860m. Chloride has been a well-recognised turnaround success. In the past five years it has increased revenue at 20% CAGR and lifted operating margin (ebitda) from 9% to 16%. ABB's US-based competitor, Emerson, which has its own well-regarded UPS business, had previously made two approaches to buy Chloride and may enter a bidding war with ABB.

Having over \$7bn of cash on the balance sheet and receiving little interest income on it must make it difficult to resist the temptation to spend. The company has presented good arguments why these acquisitions will be successful but there is a most definite air of scepticism amongst those who have watched the company over a decade or more. Joe Hogan, ABB's chief executive, was at the helm of GE Healthcare when it paid nearly \$11bn in GE shares for Amersham Plc back in 2004. The deal, at a 45% bid premium, was priced at nearly 30x cash flow from operating activities and nearly 100x free cash flow! Since then nobody has convincingly explained the worth of that deal, perhaps because the answer is so transparent.

In June 2008 we scaled down our investment in ABB when the market capitalisation of the group exceeded \$70bn. At the time this was above our 'fair value' appraisal. Today about 1% of portfolio assets remain invested in ABB with a market capitalisation of \$41bn, somewhat below our current assessed 'fair value'. ABB's leading position in power and automation is undoubted; its redeployment of corporate cash flow is understandably under scrutiny. As FT journalist John Kay reminded us recently; 'business success depends on being able to do something better than other people'. We have difficulty believing that the ability to pay for acquisitions is relevant to this.

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Asset Management

Intrinsic Value

Our most recent assessment is that the MWLF portfolio of world leading companies is now priced at a weighted average discount of 21% to fair value, or at 79c in the dollar. This is little different from the 23% discount we reported in early March 2010.

From inception in 2002 the fund has only purchased twenty-nine different holdings, eighteen are still owned today and six were bought in the first year of the Fund's life. We have not made any new investments since February 2010.

In a release to shareholders last year, Borje Ekholm, the chief executive of Investor AB, the Wallenberg-controlled investment group, summed up his approach to investment discipline and patience.

'New investments are always attention-grabbing. However, it is important to remember that the bulk of value creation stems from the daily grind within our investments. This work creates few headlines, but it is where true industrial value creation takes place. We have remarkable boards and managers in place in our companies doing fantastic work.

Rest assured, dear shareholders, we will keep our discipline and not be pressured into making investments that do not meet our financial and quality criteria.'

Borje Ekholm, CEO Investor AB, 13th October 2009.

Our sentiments entirely. On 1st June 2010, Greg and I made further purchases of Mundane World Leaders Fund shares.

Anthony Garnett
Greg Mackay

17th June 2010

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Asset Management

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Our website www.mundane.co.uk has further details of the Mundane World Leaders Fund including monthly NAV statistics and top equity holdings.