Phoenix
INVESTOR RELATIONS

Our guest:
BP Investment Management Ltd (BPIM)

Attracting longer-term investors is an important priority of any sustainable investor relations program. So when targeting a city such as London, French companies should pay particular attention to in-house pension funds such as BP Investment Management. With their long-term approach they can accompany management through good and bad times thus providing stability to the shareholder base. But these investors need to be convinced of management's commitment to shareholder value and transparency. As a case study we talked to BP Investment Management about their approach.

Sarah Watters started out in fund management in 1993 at JP Morgan Investment Management where she worked for 4 ½ years, before moving to BPIM in 1998 where she is currently one of the two European equity (ex-UK) portfolio managers.

How would you describe BPIM?

BPIM is one of the largest in-house pension fund managers in the UK and it manages the majority of the UK pension assets of the company. It has roughly £13 billion of assets under management (€16 billion), with a 75% benchmark weight in equities, a level set by the fund's trustees. The fund currently manages £1.4 billion (€1.75 billion) in European equities and has a benchmark weight or 12.5% of the total assets. The fund, which is also one of the oldest defined benefits schemes in the UK, has always had a strong equity bias, reflecting a belief that superior long term returns can be achieved through the stock market.

How are the fund management operations organized?

BPIM's investment team is organized on an asset-specific and geographic basis, with separate UK, North American, Asian and European equity specialists. Within the framework set out by the trustees, asset allocation between these regions can be modified over time. The European equity team is made up of two fund managers: myself and Simon Courtney and we each manage approximately half the fund splitting the sectors so that we both have a balanced mixture of cyclical (capital goods, basic materials), financial (banks, insurance) and defensive (pharmaceutical, food manufacturing) stocks to choose from. Whilst each of us are responsible for our own portfolio construction relative to the benchmark many ideas are discussed between us, and there is a high degree of knowledge about each other's stocks.

How would you characterize your investment approach?

As an in-house pension fund, BPIM does not need to have a particular methodology or "house style" that it has to sell to clients, but the overall approach could be characterized as long-term and fundamental. We are a very stable team, looking for companies with good solid businesses. We try to add incremental performance every year, not to reach exotic targets, so this encourages us again to take a long term approach. We are able to wait for market opportunities such as short term price weakness to accumulate positions and as we are not under any pressure from short term trends or fads, we further use that to our advantage.

Our long term approach is reflected through the individual manager's incentive bonus which is calculated against the benchmark (FTSE Europe ex-UK) on a rolling three year basis and through the fund reporting rolling 5 year returns to the trustees. This strategy has served BPIM well in terms of performance over the long term, to the benefit of all the participants.

What is the basis of your screening process for companies?

The screening process in Europe is qualitative first and quantitative second. Generally, we look for sound companies with product superiority, geographic superiority, good capital discipline and visible earnings growth. We have a preference for companies that are managing the business for the long-term and that are shareholder focused. We prefer management that subscribes to these values and are transparent. Usually, but not always, good managers have been with their company for a fair amount of time and understand the business of the company thoroughly. This set of "ideal companies" are not a given as companies can improve over time; so part of the job is to always look for new investment opportunities.

Once we like the stock and have done the due diligence, a process that requires meeting management and can take up from a month to a year, we take a position. Afterwards, we like to meet with management on a regular basis and to keep a close track of our companies.

Because we only have one client to service, we can dedicate more time than most to meeting companies.

How many companies do you typically meet per year?

We each try to see up to 100 companies a year, and we see them through a variety of means: one-on-one meetings, group meetings, results presentations, conferences etc. I travel less than in the past, and that's because direct access to companies here in London is much better than before, whereas in the past it used to pay to go to France or Germany.

Do you make specific bets on sectors or companies?

BPIM is a very diversified and low-risk fund. The fund tends to hold its core holdings for the very long term, on average 3 years, but we also use opportunities to increase or reduce positions temporarily based on relative valuation. We use metrics, such as cash flow, dividend yields, earnings upgrades or downgrades to identify the relative attractiveness of a stock at any particular time. These identified valuation discrepancies are set against the team's degree of confidence in companies, as we keep a close track of each company's relevant issues and trends.

The fund is generally constructed on a bottom up basis with a focus primarily on company-specific bets. We tend not to take big sector bets, especially at present given the volatile nature of the markets; although some sectors have long periods of outperformance or underperformance. For example the airline industry or the semiconductor industry which have very poor capital discipline have been perennial underperforming sectors.

But we are also conscious that sometimes things change, and sectors can become better managed, like the steel industry, which was a very poor performer for many years. The degree of consolidation, the scarcity of resources and the rising demand coming from emerging markets have made the fundamentals for investing in that sector stronger over the recent past.

Do you exclude sectors altogether?

We do not exclude sectors "by mandate", although, as I said, we may underweight some of them if we believe there are capital issues concerning the sector. You can't be dogmatic about your approach and that's one of the nice things about our approach is that we are not fixed. We can change our mind when we see fit.

We do not have ethical guidelines, for say tobacco, gambling or alcohol and, because we are a low-risk fund, we cannot avoid these stocks completely because that would increase our tracking error too much. We would just be underweight instead.

Do you have restrictions in terms of market capitalization?

There is no strict limit in terms of market capitalization for the companies in the portfolio but because the team is comprised of only two people and we have time constraints, we tend to cut off stocks under consideration below £500 million with a further limit of a minimum 50% free-float. But we will occasionally consider smaller companies if they have the required attributes.

How many holdings are there in your portfolio?

Our basic universe (FTSE Europe ex UK index) comprises 381 stocks. Of those, we have chosen to hold 305, and 30 more companies that we hold are non-index. The average size of holdings is £4.2 million (€5.25 million), while the biggest position, held in Total, amounts to £45 million (€56.25 million). We have 145 overweight positions (44% of positions) and 189 underweight positions (56%). Our overweight positions tend to be across the more defensive sectors and technology.

Are there specific French companies you particularly like to invest in?

Yes. France is very well represented on the whole by good companies and has a number of them which lead their industry, and therefore are very suitable for our portfolio.

I will just mention four that come to mind:

1. BNP Paribas: it has a very stable, well diversified global franchise, is conservatively and sensibly managed for the long term, and usually acts opportunistically.

2. Publicis: one the best positioned media agencies globally, very well managed in a notoriously difficult 'people' industry. Management is quite visionary about the direction of the industry and to date have executed well.

3. Axa: a company which has a solid track record, with potential to benefit from demographic trends and emerging market exposure.

4.Total: A company which has consistently delivered results, with a history of very few nasty surprises. The management has a reputation for competence.

But there are others such as; Schneider, Saint-Gobain, Air Liquide, Essilor, L'Oreal, Unibail - Rodamco, Société Generale, Danone, Technip, Bouygues, and Vinci. The company that has improved most over recent years is Alstom.

What do you look for in a company in terms of investor relations?

Companies must be targeting their long term shareholders and know them. I have to say it is easier to get access to companies through independent IR companies like Phoenix, because we are not one of the biggest or most actively trading funds. I would say the companies that just rely on brokers are generally the least well organized. We do not pay specifically for access through brokers and they will tend to favour those investors generating the most commissions. That is often not in a company's best interests, because they might not be seeing the long-term holders of their equity.

Therefore, I tend to see more of the companies that have a dedicated IR programme. I will listen to presentations but it is useful to have one-on-ones occasionally because it gives you the opportunity to go in depth and discuss your own issues or subjects directly with management. Small group meetings of 3 or 4 investors are also quite useful and productive. But generally, the more I see a company, the better I will understand it and the more inclined I might be to invest in it. I will sometimes make the effort to contact the company myself, but in theory it should be the other way round, although it does not always work that way.

Do you see differences between French and UK companies in their focus on IR?

IR is not really an issue regarding French or continental European companies as opposed to UK companies. The differences have more to do with transparency, corporate governance or voting at AGMs, poison pills, or very dilutive rights issues in the event of a take-over, although I have seen a general trend of improvement in this field over the years. We monitor companies closely for these aspects and consider that as part of our due diligence. We vote each year at AGMs, using an external provider.

Is it always a requirement to meet management?

It depends from company to company, but usually the most productive meetings are with the CEO or CFO. But there are some companies where the IR officer is particularly knowledgeable and because of their close involvement with senior management, has the ability to discuss strategic issues that are important to us. But that is not always the case.

Which French companies stand out in terms of good IR?

Some companies are generally better at maintaining contact with investors. BNP Paribas and Société Générale always are amongst the best in their industry. For industrials, I would highlight Saint-Gobain, Schneider and Air Liquide. Danone, Axa, L'Oréal and Publicis are also very good.

Which French companies do you not see enough and would like to see in London?

I would like to see more of the companies which present less frequently in London than other French companies such as: Sanofi, Alstom and Vinci, Unibail and Klepierre.

What are the most visible changes in the way companies and the market behave since you started in fund management?

Since I started in 1993, access to management has improved dramatically over the years. There are regular roadshows for results or in the event of a strategic move like a large acquisition for instance. The availability of accounting data is also better, and the dialogue with management has improved a lot. But the biggest change is in the structure of the market, the market participants. Before, long-term shareholders were the majority, but now there are many more short-term players, and it has changed the dynamics of how the stock market works.

It may also affect companies in that they are always focused on their share price and they are getting affected by some of these short-term investors. They push stocks up or down or force companies to do things that are not necessarily in their long term strategic interests. That's why I prefer companies that know what long-term shareholder value is about and can think a bit above what the market participants are saying. In the end I believe fundamentals always win out. The principles have not changed but the dynamics of how we get from A to B have changed.

What is your view of the stock market currently?

Our views of the market are that we are now in value territory but I do not think the stock markets are going to go up from here quickly. Earnings are still a bit too high for this year and next, and the problems that we have seen unfold are not finished. There are still issues out there to be digested and it will take a long time for the consumer debt burden to be overcome. But the stock market is already reflecting quite a lot of that negative news. So, on a long term basis we are approaching or in value territory. We are in a waiting period now looking for opportunities.

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It specializes in helping public companies market their stocks to shareholders and potential shareholders throughout the U.K., continental Europe, the United States and Canada.