

ARISAIG DIARY

June 2010



Arisaig Partners is an independent investment management company founded in 1996. Our focus is on dominant consumer sector businesses in emerging markets. We run an Asia Consumer Fund, an Africa Fund, and a Latin America Fund, which will be open to third party subscribers from 31st October. In addition to our head office in Singapore, we have research offices in Hong Kong, Mumbai, Dubai (the Africa team), Buenos Aires (the Latin America team), and the United Kingdom.

	NAV (USD)	Size (USDm)	Performance to 30 June 2010 (%)										Since Launch	Annualised Return
			10 yr	5 yr	3 yr	2 yr	1 yr	6 mth	3 mth	1 mth	YTD			
Arisaig Asia Consumer Fund*	30.87	1,509.0	+267.5	+80.8	+1.9	+19.1	+52.7	+16.2	+7.6	+4.1	+16.2	+360.3	+12.0	
Arisaig Africa Fund	11.95	213.0		+20.0	(3.2)	(15.7)	+22.9	+9.7	+4.2	+0.8	+9.7	+19.5	+3.5	
Arisaig Latin America Fund**	17.37	6.3						+6.6	+0.2	+2.9	+6.6	+26.2	+42.1	

* Reflects the performance of the Arisaig Asian Small Companies Fund from 31.12.96 to 21.1.00 and thereafter the AACF
 ** The Arisaig Latin America Fund is not yet open to third party investors

June Diary Highlights

- Our Funds continued to perform well in June. Year-to-date the Asia Consumer Fund is up 16.2% which compares to a decline of 3.7% in the MSCI Asia Index; the Africa Fund is up 9.7% versus a 2.1% decline in the MSCI Africa Index; and the Latam Fund is up 6.6% versus a decline of 10.6% in the MSCI Latam Index.
- In the **Asia** section we discuss what could go wrong; our impressions of China from a recent trip; the way in which indigenous Indian companies are dealing with the MNC threat; and our approach to water shortage issues.
- In **Africa** we report on our recent trip to Kenya and South Africa and assess the impact the World Cup is having on the host nation.
- In **Latam** we look at the performance of dominant consumer companies across the region and discuss, in particular, our two holdings in Colombia.

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What we look for in our stocks

- **Market leadership** – dominant companies tend to do better;
- **Scalability** – large target markets;
- **Strong “moats”** – brands, distribution, innovation;
- **Low capital intensity** – high ROCE;
- **Predictability** – compounding growth;
- **Access** – management who welcome our involvement.

What our investors can expect from us

- **Alignment of interests** – capped funds, no segregated portfolios, co-investment;
- **Transparency** – holdings booklets, monthly portfolio summaries, copies of research reports;
- **Coverage** – 15 analysts; five research offices; 150 target stocks;
- **Minimal trading** – active management destroys value;
- **Focus** – consumer staples tend to out-perform, so we won't be doing anything else.



Fund Details

Geographic allocation (%)

	AACF		AFRF		ALAF
China/Hong Kong	40.2	Kenya	15.2	Brazil	39.4
India	35.5	Nigeria	14.9	Mexico	30.0
Indonesia	5.6	Morocco	13.5	Chile	10.4
Korea	5.5	South Africa	12.8	Peru	6.1
Sri Lanka	4.1	Ghana	5.9	Colombia	5.2
Philippines	2.4	Turkey	5.8		
Vietnam	2.2	Uganda	5.2		
Pakistan	2.0	Lebanon	5.2		
Malaysia	0.7	Ivory Coast	4.9		
		Senegal	3.9		
		Egypt	3.5		
		Tunisia	2.9		
Cash	1.8	Cash	6.3	Cash	8.9
	100		100		100

Sector allocation (%)

	AACF	AFRF	ALAF
Food & Beverage	41.3	38.0	12.1
Fast Moving Consumer Goods	26.9	6.5	39.1
Retail	18.5	21.0	39.9
Fast Food	7.4	-	-
Services	4.1	9.0	-
Finance	-	19.2	-

Valuations (Dec 10/Mar11)

	AACF	AFRF	ALAF
EV/Sales (x)	2.4	2.0	1.5
PER weighted (x)	25.4	15.6	18.9
PER harmonic (x)	23.2	13.1	13.9
P/BV (x)	9.7	6.0	4.8
Yield (%)	2.0	4.8	2.3

Portfolio Concentration

	AACF	AFRF	ALAF
No. of holdings	26	23	16
Top 10 holdings (%)	60.2	63.9	72.4
Top 20 holdings (%)	87.6	91.3	91.1
Average market cap (USDm)	3,204	1,651	6,308

Performance metrics (Dec 10/Mar 11)

	AACF	AFRF	ALAF
ROCE (%)	52	43	24
EPS growth (%)	18	17	24
Net margin (%)	10	13	8

The Arisaig family of Funds are daily valued, open-ended, BVI or Mauritius domiciled, Investment Companies. The Asia and Africa Funds are listed on the Irish Stock Exchange and their NAVs are shown in the Financial Times and on Bloomberg. This Diary is intended to be for the information of holders of one or more of Arisaig's Funds. It is not intended to constitute investment advice and should not be relied upon as such. Investors should be aware that, as the Funds are invested in the securities of some smaller companies, share prices can be more volatile and trading liquidity much lower than those of larger companies.

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Artwork courtesy of Sophie Macpherson



Arisaig Asia Consumer Fund

Performance

The NAV of the Arisaig Asia Consumer Fund rose 4.1% in June which takes its gain for the year to plus 16.2%. This compares to a decline of 3.7% for the MSCI Asia ex-Japan (Net) Index year-to-date.

Over the twelve month period since we repositioned the Fund the NAV has risen by 52.7%. This compares to an increase of 22.1% for the MSCI Asia ex-Japan (Net) Index. The Fund has done better than the Index in nine of the past twelve months, including, hearteningly, all down months.

The best performers year-to-date have been [Unilever Pakistan](#) and [Unilever Indonesia](#), up 73% and 63% respectively. Each of our 26 holdings bar one ([Uni-President China](#)) has generated a positive return this year.

For those wishing to assess our performance relative to the opportunity set, the MSCI Asia Consumer Staples Index (which, as we have explained before, is unfortunately not a very representative index) is up 4.1% and 38.6% over the past six and twelve months respectively. Meanwhile, the Arisaig Asia Dominant Consumer Companies Index, which is made up of the 54 businesses we regard as being Asia's best placed, is up 11.4% and 53.5% over these periods.

The Arisaig Index has delivered a compound annual return of 35.4% over the past ten years. This compares to 7.6% generated by the MSCI Asia ex-Japan Index over this period and shows, as we have mentioned before, that dominant consumer companies tend to do much better than other more cyclical, capital intensive and corporate governance-challenged sectors.

What could go wrong?

Although it is gratifying to see our new approach working, we are not complacent. What keeps us awake at night is the possibility that one of our holdings does something foolish – for example a lapse in safety standards or a poorly conceived acquisition.

With respect to the former we have continued to build a “sustainability” framework into our analysis, our latest initiative being an exercise to see how our beverage companies are approaching water shortage issues – for the most part, it seems, with a blindfold (see below).

There is also a risk that an MNC parent attempts to transfer-price the profits of its listed subsidiary from out of our grasp; but, in truth, there has been no indication that this strategy is contemplated by the likes of Unilever, Nestle or Glaxo. Proctor & Gamble, sadly, is a different story.

The other risk is that our portfolio is de-rated. This is inevitable once growth starts to slow. But as our businesses are only now starting to point up the “S” curve, a multiple decade event, the opposite outcome is, in our view, the more likely.

China travels

James joined the China team for a week-long tour of Beijing, Inner Mongolia, Hunan province and Hong Kong. As usual a trip to China invokes mixed reactions: on the one hand of break-neck speed and can-do attitude, of fortunes made in a jiffy and a deep sense of self-belief and destiny; on the other hand of unacceptable environmental damage – the pollution in Hunan Province was truly shocking – and of social degradation.

The social issues came home to us as we surveyed gigantic tower blocks in Changsha, a “town” of 15 million, into which a whole farming community had been moved to make way for an industrial complex. We wondered how they feel gazing down from soulless windows onto the asphalt that had been their homes.

Likewise we struggled to square our morning in Hohhot, Inner Mongolia in the company of a Want Want salesman, who said his goal was to increase per capita consumption of his rice crackers across the province to USD10 cents per person per annum, with a lunch-time stroll through a huge department store stuffed to the gunnels with luxury products costing several hundred USDs each. When one contemplates the vast disparity between rich and poor, news of suicides in industrial complexes and copy-cat mass murders in kindergartens comes as no surprise.

Keeping a lid on such social issues will be the main challenge for China's leaders and explains their tacit support for significant increases in wages in response to recent strikes. China's success has come at considerable cost to its people who have had to tolerate ridiculously low wages and miserly real returns on bank deposits, as a result of which the cost of both labour and capital have been artificially depressed.

Reversing these trends, as is now inevitable, will be supportive to the consumption story to the extent that wages are allowed to rise. Higher margin brand-owning consumer staples companies are better placed, of course, to withstand cost pressures than companies in other sectors with limited pricing power.

Whilst in Beijing we caught up with [Wumart](#), our seventh meeting with the company this year, although our first with founder Zhang Bin whose brother and co-founder still languishes in gaol on trumped-up charges for supporting a discredited former vice-mayor of Beijing many years ago. The fact, however, that the company recently hosted a high profile store visit from Premier Wen Jiabao suggests rehabilitation is now complete, as does, albeit less symbolically, the extension of a USD600m loan facility from a state-owned bank.

Wumart, dominant in the Greater Beijing region, but with country-wide ambitions, has clearly been anointed as a potential “market consolidator” and national champion to counter balance the ambitions of the likes of Wal-Mart, Tesco and Carrefour. With the highest net margins and best systems in the sector (we toured its new distribution centre), it has a better chance than many.



In Hong Kong, we met the new CEO of our soy milk producer, Vitasoy. Our initial investment of USD10m made ten years ago is now worth USD46m which takes no account of the USD12m we have been paid in dividends over the period.

This firm is rapidly being professionalised now that the founding Lo family has stood aside. The loss-making US business has been closed; capacity is being upgraded significantly in both Hong Kong and Australia; plans are afoot to expand to Eastern China (the company has an 80% market share in the South); and a senior person has been hired to explore M&A initiatives.

The Indigenous Indians

One of the issues that troubles us is how India's home-grown consumer businesses will cope once the onslaught from MNC majors intensifies. The likes of Marico have done well by populating niches, for example coconut hair oil, in which the MNCs have no expertise or, for now, no interest.

Hence it is with some fascination that we are watching the way in which Godrej Consumer is addressing this challenge. Recognising that, long term, it will struggle to compete with the likes of Revlon and L'Oreal in its key hair colourant sector, not to mention Unilever and P&G in soap and Reckitt Benckiser in mosquito coils and insecticides, the company has decided to leverage off its expertise in the low end segments in India (where it is the country's second largest FMCG group after Unilever) by launching forays into other emerging markets.

Consequently, over the past several years, it has spent USD780m buying businesses with well-known brands in the likes of Nigeria, South Africa, Argentina and Indonesia. Its ebullient leader, Adi Godrej, believes he can address the needs of consumers at the bottom of the pyramid in all these markets in a way that MNC competitors cannot. For instance, L'Oreal and Wella have not yet been able to adapt their products for non-Caucasian hair; nor does Reckitt have the distribution reach or product expertise to sell insecticides for USD10 cents a sachet.

Whilst this global strategy clearly carries execution risks, it seems probable that some future MNCs will be born in emerging markets. Godrej stands as good a chance as any.

Key Markets – Local currency performance (%)

	June	YTD	12 mth
Hong Kong	1.8	(8.0)	9.5
China	(7.5)	(26.8)	(19.0)
Taiwan	(0.6)	(10.5)	13.9
South Korea	3.5	0.9	22.2
Indonesia	4.2	15.0	43.8
Philippines	3.1	10.5	38.3
Malaysia	2.3	3.2	22.2
Singapore	3.0	(2.1)	21.5
Thailand	6.2	8.5	33.4
Vietnam	(0.1)	2.5	13.1
India	4.5	1.4	22.1
Pakistan	4.0	2.2	33.0
Sri Lanka	8.9	36.2	89.6

For now, we are giving the company the benefit of the doubt, but will continue to follow closely. Indeed last month Puneet and Johnny met the management of Megasari in Jakarta, the large business it has just bought in Indonesia, and Rui, our man in Latin America, met the newly acquired team in Argentina.

Sustainability and beverages

The effect that a tarnished reputation can have on consumer businesses is disproportionately high given the fact that brand integrity is so essential to their continued prosperity. Coca-Cola, McDonald's and Nestle all have all had their fingers burnt in the past on account of lax standards in this regard. Albeit in another sector, the sad plight of BP also comes to mind.

Amongst our holdings, the beverage players are those that worry us most, not least because water stress in Asia is looming as a serious threat to the well-being, and possibly peace, of the region (hence the sensitivity surrounding the ownership of the Tibetan plateau). This is why we commissioned a report on this sector from Responsible Research, a Singapore-based consultancy that helps companies and investors better understand the risks posed by environmental, social and governance (ESG) issues.

Our holdings generally fared poorly, with Nestle India and Unilever Pakistan the only beverage players ranked as "leaders" on a range of ESG benchmarks. We were not surprised to see that the "laggards" category is dominated by Chinese, Taiwanese and Korean firms for whom this issue has yet to properly register.

As a result, one of the recommendations Henry Root has been making to our holdings is that they adopt and disclose quantifiable targets for energy and water use reduction, rather than the platitudes reluctantly churned out in their annual reports.

It is clear that these companies also need to get to grips with risk management issues along their entire supply chain. As the Chinese tainted milk scandal has shown, safety lapses on the part of upstream suppliers are not only tragic in themselves, but a threat to the business model of brand-owning consumer businesses, a point last month's meetings with Inner Mongolia's two giant dairies, Yili and Mengniu, brought home.

Key Currencies – Performance vs USD (%)

	June	YTD	12 mth
Hong Kong	0.0	(0.4)	(0.5)
China	0.7	0.7	0.7
Taiwan	(0.5)	(0.5)	2.1
South Korea	(1.6)	(4.7)	4.3
Indonesia	1.1	3.6	12.5
Philippines	(0.2)	(0.4)	3.9
Malaysia	0.8	5.9	8.7
Singapore	0.0	0.4	3.4
Thailand	0.2	2.8	5.0
Vietnam	(0.4)	(3.0)	(6.6)
India	(0.2)	0.2	3.1
Pakistan	(0.3)	(1.5)	(4.8)
Sri Lanka	0.3	0.7	1.2



Arisaig Africa Fund

Performance

The NAV per share of the Africa Fund increased by 0.8% in June, leaving our performance for the year up 9.7%. For the six month period the regional MSCI Index was down 2.1%, whilst our internal African Dominant Consumer Companies Index, which tracks the 39 leading names in our universe, rose 5.8%.

Our markets all went south at different rates over the month, with the exception of Kenya (flat) and Turkey (up 1.0% – all in USD). Ghana fell out of bed, down 8.9%, whilst “MENA” also struggled – Egypt dropped by 6.2%, Morocco by 3.3%, and Lebanon by 2.5%.

Kenya – Release the Pressure

Suren and Torquil were back in Nairobi in early June. The new owners of Zain Kenya (lately Celtel Kenya), Bharti Airtel, announced a halving of their key interconnect tariff rate.

One company that will benefit will be Scangroup Telecoms companies account for 28% of advertising total volumes, a trend that looks unlikely to reverse for the time being. Scangroup is acquiring the holder of the Bharti account – which should prove to be lucrative as Bharti aims to rebrand Celtel a second time.

This is an exciting ‘step change’ for the company that will take it further afield than ever before and accelerate its transition from a national player to one that comfortably bestrides the continent.

Further evidence of its growing professionalism came in the 349% increase in operating cash flow in FY09, despite an increment of just 25% in net profits, thanks to the more capable back office installed on WPP’s watch.

Scangroup benefits from some major secular trends sweeping Africa. The share of advertising spending channelled through agencies in East Africa rose to 57% in 2009 (from 48% in 2008). Consumption of electronic media is exploding: there are now 650,000 Kenyans on “Facebook”, from 50,000 in 2008.

O Tempora, O Mores

Suren and Torquil then found themselves felicitously in South Africa for the start of the World Cup. Sadly, the number of foreign visitors able to see at first hand what the continent has to offer is turning out to be significantly lower than initial forecasts.

Over four days we visited ten (mainly) consumer companies. All complained that the trading environment remained challenging with South Africa late into the global downturn. The economy will deliver 3.2% growth for 2010 – a modest return from an economy which suffers from considerable and fluctuating headwinds such as mass unemployment and commodity price volatility.

The abiding impression we got is that real disposable incomes are falling and that competition for “share of wallet” remains extremely keen. Even the most optimistic of our interlocutors said that it will take 12-18 months for a recovery to kick in.

Overall, it is hard to get a clear sense of where South Africa goes from here. When the Vuvuzelas have been put back in the cupboard and the warpaint has been scrubbed off, it remains to be seen whether the World Cup legacy will be a cluster of visually impressive but useless sports stadia, or something more tangible.

Results

More results flowed from our holdings in the month. Societe Generale des Banques de Cote d'Ivoire reported excellent FY09 results. Earnings for the year increased 23% on those of FY08.

Another Ivoirian holding was not so quick out of the blocks: Unilever Cote d'Ivoire's earnings fell 93% year-on-year for FY09. This is however down to the one-off nature of FY08's earnings, when the company sold its palm oil assets and reaped a large one-time gain as a result. A similar process has been started at Unilever Ghana which has agreed to sell its stake in Twifo Oil Palm; it will gain a reasonable one-off cash fee as a result. More importantly, it will focus its operations, reduce its fixed cost base, and speed its exit from the unattractive cooking oil market.

Key Markets – Local currency performance (%)

	June	YTD	12 mth
Egypt	(5.7)	(2.2)	6.1
Ghana	(8.1)	18.3	21.5
Kenya	2.3	33.6	31.7
Lebanon	(2.5)	(3.5)	5.7
Morocco	(3.0)	11.4	2.2
Nigeria	(3.0)	22.0	(3.2)
South Africa	(3.3)	(5.1)	19.1
Tunisia	(0.6)	14.5	33.6
Turkey	1.3	5.1	47.8
Uganda	1.4	39.2	28.9
Francophone West Africa	(4.8)	8.1	(0.9)

Key Currencies – Performance vs USD (%)

	June	YTD	12 mth
Egypt	(0.6)	(3.7)	(1.8)
Ghana	(0.9)	(0.7)	3.7
Kenya	(2.1)	(7.2)	(6.3)
Lebanon	N/A	N/A	N/A
Morocco	(0.6)	(12.2)	(10.7)
Nigeria	1.0	(0.2)	(1.1)
South Africa	0.0	(3.6)	0.6
Tunisia	(0.9)	(12.9)	(11.6)
Turkey	(0.7)	(5.4)	(2.8)
Uganda	(3.3)	(16.7)	(9.9)
Francophone West Africa	(0.4)	(14.6)	(12.8)



Arisaig Latin America Fund

Performance

The NAV of the Arisaig Latin America Fund increased by 2.9% in June. The Fund is up 6.6% year-to-date which compares to a decline of 10.6% for the MSCI Latin America (Net) Index. Since becoming fully invested in October 2009, the Fund has returned 26.2% versus a decline of 1.1% for the MSCI Latam Index over this eight month period.

As in Asia and Africa, we have done some digging into how dominant consumer companies have performed in the region. To this end we have culled the population of listed companies to come up with an Arisaig Latin America Dominant Consumer Companies Index.

This Index is made up of 42 companies which are either number one or two in their consumer staples/retail sector; have sales of over USD100m and a free float of 15%. 17 of these are in Brazil; 13 in Mexico; and the rest spread across Chile, Colombia, Peru and Argentina. We require constituents to have sales of branded items accounting for at least 80% of revenues, and so exclude commodity type companies such as meat producers or sugar refiners - both large industries in Brazil.

The Arisaig Index has returned 23.1% per annum over the past ten years. This compares to a return of 16.5% per annum generated by the MSCI Latin America (Net) Index over the period confirming that dominant consumer companies have outperformed in Latin America as they have in Asia and Africa. We own 16 of the 42 stocks that make up the Index in our Latam Pilot Fund.

Colombia

We wrote last month about Mexico. This month it is the turn of Colombia, a country associated in the minds of many with the narcotics trade and the related longstanding guerrilla war.

Thanks, however, to the efforts of out-going two-term President Uribe, the drug industry has been contained – to the disadvantage, incidentally, of Mexico, where it has re-rooted. So, although this is still not widely understood outside the country, Colombia is now “safe”, something which President-elect Santos (formerly Uribe’s Defence Minister) has said he will do his utmost to uphold.

Hugely fertile, with two mountain ranges, both a Pacific and Atlantic coast, and an energetic population of 45 million, widely noted for its physical beauty, Colombia has a lot going for it. Indeed, there is nowhere we enjoy visiting more in the continent.

The stockmarket, still embryonic with only 106 listed companies, is dominated by the national oil company and a small number of banks. The existence of a large and well-developed pension fund industry, which is restricted from investing offshore, means that the market tends to benefit from more buyers than sellers and accordingly is not cheap, trading on about 25x 2010 earnings.

The Fund has two holdings in Colombia: the largest branded food producer, Grupo Nacional de Chocolates, and the dominant hypermarket/supermarket operator, Almacenes Exito, which is headquartered in Medellin. We have met them six and four times respectively over the past two years, either in Bogota or Medellin or at investor conferences in Chile.

Chocolates

Chocolates, which was founded over 50 years ago, boasts revenues of USD2.5bn and, as such, is one of the largest listed food companies in South America. We have written a 60 page research report on the business and so feel we know it well. As a result of our attentions, and despite our paltry “pilot fund” stake in the stock in USD terms, we are one of the few foreign institutions that the CEO, Carlos Piedrahita, will meet.

The company’s six main product categories, all branded, are cold cuts (33% of sales), biscuits (20%), chocolates (20%), coffee (15%) with ice cream and pasta accounting for the rest. About 60% of revenues are in Colombia with the balance from 11 neighbouring countries including Venezuela and Peru in the “Bolivar” region to Guatemala, Costa Rica, El Salvador and Panama in Central America, Mexico and four of the Caribbean Islands.

Counting its six product categories and twelve target markets as being 72 segments in total, we have calculated, based on a study of each segment in each market, that it has either number one or number two market share status in over 40 of these.

The company has grown through acquisition having spent almost USD1bn on buying 14 businesses over the past ten years. Led by a team of capital market savvy ex-bankers it has taken advantage of the reluctance of MNC type competitors to engage with the region on account of the history of hyperinflation and political risk-type worries. Chocolates’ strategy is to use its well-established distribution infrastructure to push newly acquired products across the Bolivar and Central American regions.

The company has grown revenues and earnings per share at a rate of 15% and 17% respectively over the past five years. There are signs, however, that growth is now slowing which may have something to do with its matrix management structure which results, in our view, in somewhat mixed incentives given that team leaders wear two hats: as heads of a both a product category and a geographical region, a point we have been discussing with the CEO.

It is clear that, with a USD500m war chest on hand, Chocolates is on the look-out for new growth engines, most probably in the larger markets of Mexico and Brazil. Indeed, a beach-head has recently been established in Mexico following the acquisition of Nutresa in 2009, a small local confectionery company.



Meanwhile, at his request, we have sent the CEO a list of potential targets in Brazil, although the size and complexity of this market may mean he focuses, wisely in our view, north for now.

One difficulty we have with the stock is that it is treated as something of a holding company by its controlling shareholder the SurAmericana Group. As a result, Chocolates owns 11% of the Group's dominant cement businesses, Argos, and 12% of SurAmericana de Valores, the largest local insurer. These stakes are valued at about USD1bn in its books. In return, both Argos and SurAmericana own a combined 36% of Chocolates.

The CEO admits that the reason for the cross-holdings is to prevent an acquisitive multi-national making a bid for Chocolates. He accepts our argument that this has the effect of potentially destroying value for minority shareholders, but concedes that the SurAmericana Group is unlikely to change its policy.

The result of the corporate structure, and, as we said earlier, the mismatch between buyers and sellers in the local stockmarket, means that Chocolates is expensive, trading on 25x 2011 earnings. If, however, we strip out the value of the cross holdings it is showing a one year forward PER of 20x which is more reasonable. That said, using our twenty year Residual Cash Flow valuation approach, the stock shows a forecast long term return of 10.5%, which is less than the 12.5% we look for.

The corporate structure also means that Return on Capital, the metric that concerns us most, is depressed at only 5%. If one strips out the impact of the cross holdings this number is higher at 8%, but still not as high as we would like.

Given the strength of the business in terms of brand portfolio and market shares we believe that returns should be higher than they currently are. We would increase our stake beyond our current 3% holding if we were to see steps taken to increase ROCE.

Exito

Exito is the largest food retail chain in Colombia with a 50% market share. Starting out 100 years ago as a textile retailer the company has arrived at this exalted position following three

significant mergers, the most recent being the purchase in 2007 of Carulla-Vivero, the number two player. As a result Exito has doubled the market share of its closest competitor, Carrefour.

The company is 55% owned by Casino of France which also controls Pao de Acucar, the market leader in Brazil, as well as Big C in Thailand, both businesses we follow closely.

Modern retail is still comparatively under-developed in Colombia accounting for 40% of total retail. This compares to say 55% in Mexico, 50% in Brazil and 30% in China. Unlike China, where same store sales growth has continued to power ahead, Exito has struggled in recent years, suggesting that Latin America, and Colombia in particular, has been more impacted by the global slowdown than Asia.

There is no doubt also that Exito has, following its most recent acquisition, ended up with something of a mismatch of formats, including 11 different food retail brands. Once Carulla-Vivero has been absorbed and its formats rationalised – the plan is to end up with just three: Exito in hypermarkets, Carulla in Supermarkets and Bodega in convenience stores – we expect growth to return.

We also anticipate further changes to the competitive landscape following rumours that Carrefour may exit having failed to make a profit; and that both Wal-Mart and Jeronimo Martins of Portugal may enter. Either way, they will face a challenge given Exito's very strong position.

Like Chocolates, Exito's ROCE is lower than we would wish at only 6%. Given that its EBITDA margins are high by industry standards at 7.7%, the low returns are mostly explained by the fact that the company owns 70% of its retail store sites. Recent talk of off-loading some of the properties into a listed REIT is encouraging.

Unlike Chocolates, the company is not particularly expensive, trading at about 10x EV/EBITDA and 0.7x sales. We are waiting to see how the company rationalises its formats and deals with its property portfolio before adding to our 3% holding.

Key Markets – Local currency performance (%)

	June	YTD	12 mth
Argentina	(0.8)	(5.8)	37.6
Brazil	(3.3)	(11.2)	18.4
Chile	4.6	13.5	31.5
Colombia	1.7	7.3	26.0
Jamaica	0.4	3.6	6.8
Mexico	(2.8)	(3.0)	27.9
Peru	(4.0)	(7.5)	(3.3)
Venezuela	4.9	18.3	46.3

Key Currencies – Performance vs USD (%)

	June	YTD	12 mth
Argentina	(0.6)	(3.3)	(3.4)
Brazil	0.9	(3.3)	8.2
Chile	(2.9)	(7.1)	(2.3)
Colombia	3.8	7.6	12.8
Jamaica	2.2	3.8	3.5
Mexico	0.0	1.2	1.9
Peru	0.7	2.2	6.4
Venezuela	0.0	(50.0)	(50.0)