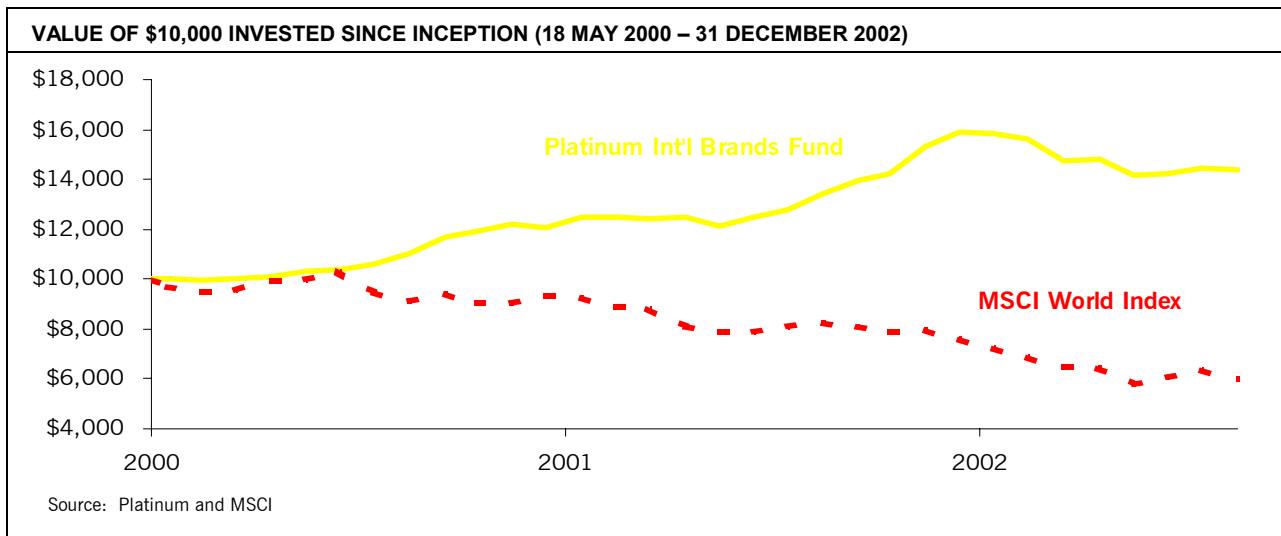


Platinum International Brands Fund

Performance

REDEMPTION PRICE: \$1.3122



The MSCI World Index rose by 3.9% in the quarter, whilst our proprietary index of branded goods and services fell by 2%. The International Brands Fund essentially held its value for the quarter with performance of 1.3%.

We began our previous quarterly report noting that we were concerned about the relatively high valuations of the large, very well known companies, notably Procter & Gamble, Coke, Colgate and Anheuser Busch. Over the past quarter these companies have *fallen* in value by between six and 12% and for reasons highlighted below, we continue to believe that these US global icons will sustain further share price declines. We have therefore maintained short positions in a number of these US stocks.

In Europe, we had noted that we were selectively buying into leading brand names such as Adidas, Beiersdorf (Nivea skin care) and Wella (haircare). We were not the only ones to have seen value in Beiersdorf. Not long after our purchase the European press began to speculate that Procter & Gamble were in discussions to purchase the company, the share price appreciated rapidly on this speculation and we decided to sell our position on this excitement. Since then, despite continued media speculation that the discussions are ongoing, the share price has gradually declined. We still believe that Beiersdorf with their leading brand Nivea, has outstanding prospects and we would be eager buyers at the right price.

Adidas (+19%) and Wella (+27%) also both performed exceptionally well. We had previously commented that Adidas was well positioned to



benefit from a shift in consumer buying patterns to the mid-range priced products. Over the quarter Footlocker, a leading US retailer of sneakers, and Nike have been

very public in their dispute over stocking of Nike's top of the range products. Footlocker appears to have wanted to stock less of the highest priced *marquee* products as they respond to a difficult retail environment and a frugal consumer. Nike appears to be resisting this and the outcome has been public announcements by Footlocker that they are reducing future orders for Nike products by US\$300-400mn, up from previous commentary that orders would be reduced by US\$150-250mn. Allowing the dispute to be seen to escalate publicly and publishing reductions in *planned* orders is clearly indicative of the stress within these companies, exasperated by a difficult environment.

Examples such as this and ample evidence of discounting, price wars and an extremely competitive environment reinforces our cautious view of the



universe of consumer companies. We would note though that to be successful it is not just about price, Adidas has also introduced new products. The

consumer is still very discerning, it must also be the right product especially in the fashion and

performance arenas, such as sneakers.

Changes to the Portfolio

We have added some new names to the portfolio, Canon (consumer products manufacturer) in Japan, Metro (a retailer) in Germany and Woford (luxury stockings and bodywear) in Austria, each of these companies having strong brand names and positions in their respective markets. Woford has struggled in



the current market with the decline in spending by the consumer for luxury stockings leading to not only poor results but also a substantial drop in the



company's valuation. New manufacturing facilities to support innovative materials (the world's finest biofibre) and a new product range

position them well, evidence of rigorous cost control is also showing through in recent results. They report a strong improvement in the initial orders for the new range albeit the real success will be measured in the repeat orders and the follow on products, something we will watch for later this year.

Commentary

A recurrent issue this quarter has been the extremely competitive environment across many different consumer categories and geographies. Last quarter we highlighted that in the US, WalMart, despite their reputation as a leading discounter, was continuing to bring down expectations of their rate of sales growth. This has continued. We speculated that this would give rise to yet further discounting competition as smaller competitors attempt to stem the flow of customers to this leading retailer. Overlaid on this dynamic for many US retailers were concerns that the number of shopping days between Thanksgiving and Christmas were significantly reduced on the previous year, down from 32 to 26 days. Add to this an already difficult year and a consumer more interested in value and bargain hunting than in the joys of shopping per se and you have all the ingredients of a difficult and competitive environment. We are therefore not surprised that we see discounting and price wars.

In France, cosmetic retailers started to compete more aggressively on price with reductions of 15% across most of the range. This is unusual, the French retail market is more tightly regulated than most in respect of when and how discount "sales" happen. The key to us were the comments by the retailers that the cost of this discounting would be passed back to the suppliers, companies like L'Oreal and Clarins.

In the US, the evidence of discounting and price wars can be found in a number of categories, two examples being Burgers and Diapers. MacDonaldis have turned their attention back to a deteriorating home market and initiated a \$1 menu promotion, a burger for a dollar, which forced competitors such as Burger King to respond with their own discounts. Despite the lower price, sales across the industry deteriorated, forcing Burger King's second largest franchisee with over 300 outlets, into bankruptcy proceedings. An industry term, HFFU pronounced "hoofoo", denotes "Heavy Fast Food Users", with this group characterised by the young single male that frequents, more than most others, the fast food outlets. "Heavy" meaning the frequency of visits, not their waistline, although the two may clearly be related. According to MacDonaldis, it is the impact of unemployment on the "hoofos" that is contributing to the weakness in sales. That may be so, but it's only part of the story, we would add that an extended period of easy access to capital has seen a significant oversupply of fast food outlets and further closures voluntarily or through bankruptcy are inevitable.

As the different segments of the consumer population adjust to rising unemployment and deal with high debt levels, we would expect to see a continuation of the fierce competition for fewer

consumer dollars. This scenario can be extrapolated to the US retail industry more generally as WalMart increases the price competition in an industry that has seen significant expansion of retail space over the years.

Likewise within the supermarket, we see companies competing for market share gains as a way of maintaining growth in categories that no longer afford easy gains for all. The Diaper market has been extremely competitive as Procter & Gamble attacks Kimberly-Clark's market leading position. Part of the tactics have been to reduce the pack count, reducing the number of diapers from 48 to 40 per pack whilst trying to maintain the price. To match Kimberly-Clark's shelf price (just under the US\$10 mark) Procter & Gamble will sell their 48 pack for the same price as Kimberly's 40 pack until they can reconfigure their packs. We doubt whether the discounting will cease when the pack sizes are realigned.

Other leading global branded goods companies that were rewarded for the promise of sustainable growth are also showing signs of more difficulties to come. Coke's share price is still at a premium despite the issues that they face. The Coke promise to investors was to take this brand into regions like China, India and Eastern Europe, significant populations where the aspirations of consumers for affordable luxuries and images of success would ensure robust growth. Coke is currently facing difficult consumer conditions in many of its operations and the regional expansion is proving even more difficult in areas where boycotts of icon US companies and brands are taking effect. In the Middle East, an Iranian company has grown to 17 factories and 7,000 employees on the success of supplying their ZamZam Cola across the region and has plans to expand into Western Europe and Asia. Coke has also relied upon a system of "Bottlers", public companies that have raised capital to build the manufacturing and distribution networks essential to making Coke ubiquitous. The success of this from Coke's perspective has been to use external capital whilst controlling the profitability of the Bottlers (predominantly through supply agreements for the

Coke concentrate "syrup"), the outcome of which is that the external investors have not seen anything like an acceptable return on that capital. Coke is under increasing pressure to restore the profitability of the Bottler network and ensure investors receive an adequate return on the capital.

With pressure on the growth of brand Coke and carbonated soft drinks generally, together with pressure on their profitability from the bottler network, Coke has turned to bottled water to drive growth and sustain profitability. There is no doubt that this has been a successful move for Coke, using their extensive distribution system, however we wonder how sustainable it is to be charging a price premium for bottled tap water. Bottled water can be either "named water" from a natural spring or well, or else it's tap water that's filtered and bottled. Both Coke with *Dasani* and Pepsi with *Aquifina* have bottled tap water brands, and neither of the brands can be considered as strong as the Coke or Pepsi brands, yet they are currently priced at a premium. Coke makes more profit selling a case of water than a case of cola. So we remain unconvinced that selling an undifferentiated product for a price premium will be sustainable. When the distribution gains stop delivering the growth, we suspect the companies will turn to price as the weapon of choice to sustain the growth.

Interbrand, the leading consultant of brand values ranks Coca-Cola as the world's most valuable brand and investors are still willing to pay a premium for the company. However we see a company, like many others, searching for



the next leg of growth whilst having to correct past abuses, be they excessive price umbrellas, over-investment in capacity, under-funded pension liabilities or unsustainable profit targets. The retailer, the competitor, the regulator and above all the consumer are becoming more sophisticated and more demanding. Leading branded consumer companies must revisit the core proposition of their brands and rebuild the confidence of both the consumer and the investor in the value of the brand.

Outlook

The outlook for consumer branded goods companies remains uninspiring. Concerns surrounding the Middle East will continue to curtail tourism, high levels of consumer indebtedness (mortgages, car

loans and credit card debt) in the US economy and an extremely competitive environment conspire to make trading difficult for many of our companies. In many cases valuations are also still relatively high as

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investors have sought out and paid a premium for the perceived security of reliable earnings. As companies bring down growth expectations and adjust to a harsher environment their valuations

should continue to fall, perhaps even to interesting levels. We will continue to be opportunistic and invest only when we believe the fundamentals are not reflected in the share price.

Simon Trevett
Portfolio Manager