

# Great Brands of Tomorrow

STRATEGY

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## The Power of Brand Investing

**An underappreciated investment thesis.** There are few true competitive advantages in modern industry: scale, proprietary technology, monopolies, and network externalities come to mind. We believe *brand* is an equally powerful and even more sustainable advantage, but one often ignored by financial markets owing to its intangible nature. Our research indicates that companies focused on brand building consistently generate outsized long-term growth, profitability, and returns. An equal-weighted stock index of companies that spend at least 2% of sales on marketing outperformed the S&P 500 by more than 400 basis points annually since 1997; the top quintile of these companies outperformed the market by an amazing 17% per year.

**The Credit Suisse brand framework.** Our brand filters help determine how and when to invest in brand stocks by: (1) identifying industry- and company-specific conditions necessary for brand success; (2) understanding the brand lifecycle and key inflection points. Using case-study analysis of dozens of brand stories from the past century, we found that most brands follow a similar arc with five distinct stages: emerge, hit the wall, transform and proliferate, dominate, and reinvent. While early-stage brands are exciting and offer the highest potential return, they can be risky. However, companies transforming from niche player into a powerful brand that can proliferate across new markets and categories offer investors highly attractive returns, and this is also typically the brand lifecycle stage where the largest absolute market value is created.

**Our picks.** Using our framework and global network of analysts, we identified 27 *Great Brands of Tomorrow* at various stages of development that we believe will significantly outperform the market over the next three to five years as they build and leverage brand equity to grow in size, scale, and profitability.

"Products are made in the factory, but brands are created in the mind." - Walter Landor



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# Executive Summary

## 27 Great Brands of Tomorrow

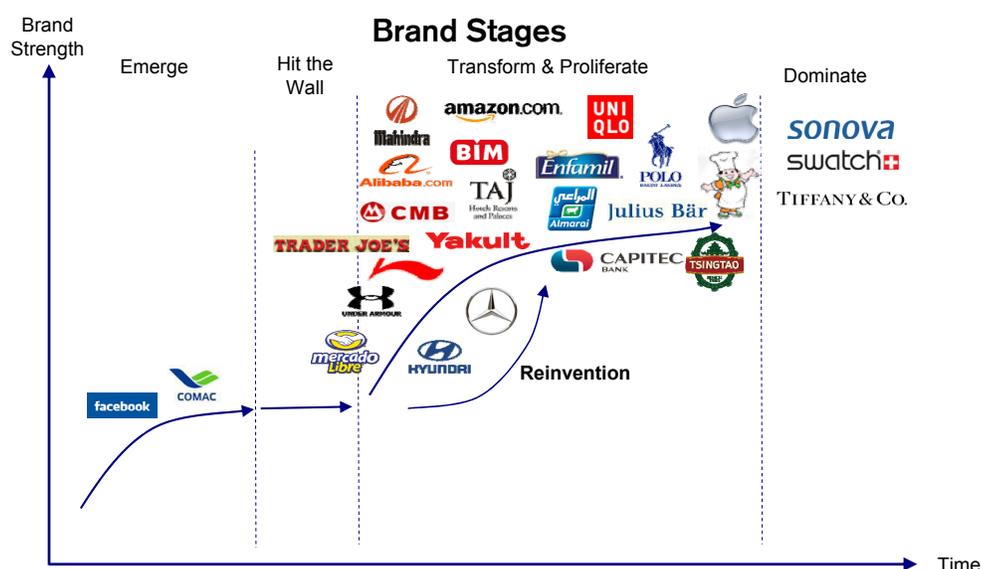
We have created a portfolio of 24 next great brand stocks (plus three private company picks), identified by our framework and Credit Suisse analysts as stocks likely to outperform over the next three to five years as they grow in size, scale, and brand equity with consumers. Credit Suisse has created a Delta One basket that tracks an equal-weighted investment in the stocks (Ticker: CSGLBRND).

### Exhibit 2: 27 Exciting Brands of Tomorrow

Brand	Ticker	Region	Description
Alibaba.com Limited	1688.HK	NJA	Vast Chinese Business-to-Business eCommerce site poised to leverage its first mover advantage (and memorable name) as it shifts its model from subscription- to transaction-based.
Almarai	2280.SE	EMEA	Deeply tied to and rooted in the culture in which it thrives, Almarai, a Middle Eastern dairy brand, is expanding its footprint into Egypt and baby food.
Amazon	AMZN	US	Positioned to leverage its scale, infrastructure, and first mover advantage to grow its mind share and take advantage of the secular eCommerce tailwind.
Apple	AAPL	US	Known for aspirational, consumer-friendly innovation, positioned to proliferate in new markets for smartphones, tablets, PCs, as well as internationally.
BIM	BIMAS.IS	EMEA	Unique Turkish discount food retailer recognized for value and consistency expanding into the Middle East and North Africa.
Capitec	CPIJ.J	EMEA	An innovative South African retail bank with aggressive plans to increase presence in more affluent areas and gain an edge through pricing.
China Merchants Bank	3968.HK	NJA	Deregulation and increasing borrowing by the Chinese consumer should allow this trusted retail bank to increase product penetration in the marketplace.
Comac	Private	NJA	Poised to take advantage of the captive Chinese airline market, this startup aircraft brand is developing a 150-seat airliner to compete directly with Boeing's 737 and Airbus' A320.
Enfamil	MJN	US	High-quality baby formula Enfamil brand with global reach, leveraging worldwide trend away from breast feeding.
Facebook	Private	US	International growth, mobile devices, and advertising revenues offer profitable upside for this rapidly growing social media site.
Hyundai Motor	005380.KS	NJA	Korean car brand repositioning its image toward "affordable luxury", poised to take advantage of Toyota's missteps and accelerate US market share gains.
Indian Hotels	IHTL.BO	NJA	Upscale Indian hotel brands represent a unique play on domestic India tourism growth as well as international expansion.
Julius Baer	BAER1.VX	Europe	Emerging from the recent financial tumult, Julius Baer has realigned its structure and strategy to return to its original model focused on passion, transparency, and tradition.
Li Ning	2331.HK	NJA	The most recognized Chinese domestic athletic footwear brand founded by a Chinese Olympic legend with further upside in China and abroad.
Mahindra & Mahindra	MAHM.BO	NJA	A very affordable, compact and stylish Indian truck and tractor brand well positioned in India and other emerging markets, attempting to break into the US market.
MercadoLibre	MELI	Lat Am	Highly recognized first mover, well-positioned for growth in the online consumer marketplace in Latin America.
Mercedes-Benz	DAIGn.DE	Europe	Legendary brand reinvigorating its image by moving more toward younger, more stylish, and eco-friendly products.
Polo Ralph Lauren	RL	US	A transcendent classical American brand that can continue to leverage itself into Europe, Asia, and new product categories such as handbags.
Sonova Holding	SOON.S	Europe	High end, high quality European hearing aid brand known for its discrete products well positioned to take advantage of aging population.
Swatch	UHR.VX	Europe	Following a successful repositioning, luxury brand Omega exudes longevity, expertise, and reliability in an industry marked with change and consolidation.
Tiffany & Co.	TIF	US	Iconic American brand with an aspirational yet attainable image that is poised for increased penetration in China and Europe.
Tingyi	0322.HK	NJA	Well-known, market leading Chinese instant noodle maker with scale advantages that is also making inroads into fast growing ready-to-drink beverage market.
Trader Joe's	Private	US	Significant growth opportunities for this food retailer focusing on specialty niche private label products.
Tsingtao Brewery H	0168.HK	NJA	Known for quality, consistency, and taste, aspirational beer brand well positioned in the large, growing, and consolidating Chinese beer market.
Under Armour	UA	US	Authentic performance sports brand rapidly growing into new product categories, sports, channels, and regions.
Uniqlo	9983	Japan	Dominant Japanese basics apparel brand with a scalable retail model that is poised for massive expansion in China.
Yakult Honsha	2267	Japan	A Japanese maker of probiotic drinks, which stands to benefit as the emphasis on health and wellness grows in the Americas and Asia.

Source: Company data, Credit Suisse estimates

**Exhibit 3: A Balanced Portfolio of Brands across the Various Development Stages**

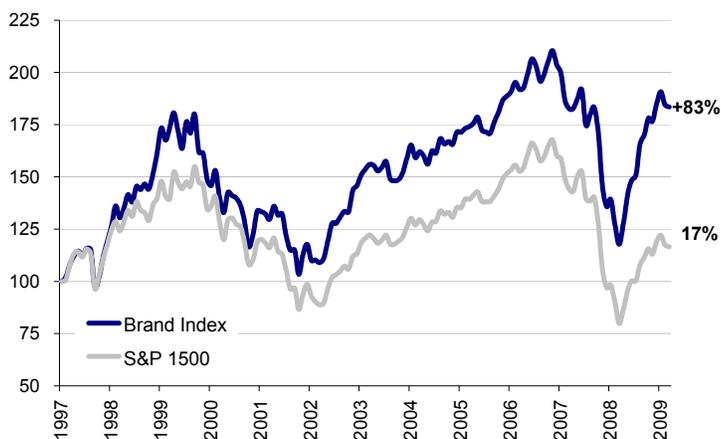


Source: Company data, Credit Suisse estimates

## Brand Companies Outperform

We believe a strong brand is one of the most powerful and sustainable advantages in modern industry, but one that is often ignored by financial markets. Strong brand companies have consistently generated outsized long-term growth and returns for shareholders. We used advertising spend as % of sales to identify companies focused on brand building and found that an equal-weighted index of companies spending at least 2% of sales on marketing outperformed the S&P 500 by more than 400 basis points annually since 1997. (See Exhibit 4.) The returns skyrocket if one can consistently screen for the top performing brand companies: the top quintile of these companies outperformed the market by an amazing 17% annually over that period. While marketing spend may be an overly simplistic proxy to identify brand companies, it at least tells us that companies focused on brand building perform well, and that's even before any real filtering process.

**Exhibit 4: Brand Companies Have Outperformed the S&P 500 by 64 Points Since 1997**



**Notes**

- (1) Brand Index is a market-cap-weighted index of all companies with disclosed advertising spend of 2% of sales or more in 1997. Screen conducted using 1997 data to mitigate survivorship bias.
- (2) S&P 500 Index is a broad market portfolio representing large-, mid-, and small-cap segments of the U.S. market

Source: Company data, Credit Suisse estimates.

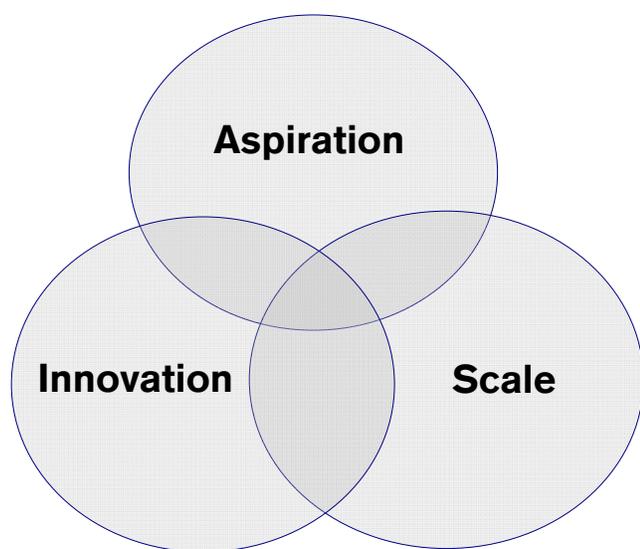
In today's markets of overwhelming choice, strong brands are able to help consumers and end users filter out the noise and simplify choices. And because of their ability to leverage their brands into new markets, categories, demographics, and geographies, well-run brand companies typically generate strong organic growth and consistent returns for shareholders. Plus, perhaps one of the most famous investors in history, Warren Buffet, could also be classified as a brand investor.

## Key Ingredients for Brand Success

Using case-study analysis of dozens of brand stories from the past century, we developed two key filters to determine how and when to invest in brand stocks by: (1) identifying the industry- and company-specific conditions necessary for brand success; (2) understanding the brand lifecycle and key inflection points. There are numerous paths to brand success and great brands of all shapes and sizes have leveraged a wide variety of strengths and attributes. Broadly speaking however, we believe there are three core sources of brand value: aspiration, innovation, and scale. Each one of these attributes on its own can be enough to create a great brand (e.g. Four Seasons heavily relies on aspiration, while Microsoft is largely a scale-driven brand). However, the combination of these key brand strength attributes can elevate a brand's power and longevity (e.g. Coke adeptly combines aspiration and scale, while BMW famously blends aspiration and innovation). And of course there is the rare brand that can combine all three qualities aspiration, innovation, and scale (e.g. McDonald's, Apple, Goldman Sachs, Disney, and Nike for example). Great brand companies can leverage these core sources of strength via superb marketing, innovative new products, strong leadership, and quality end product.

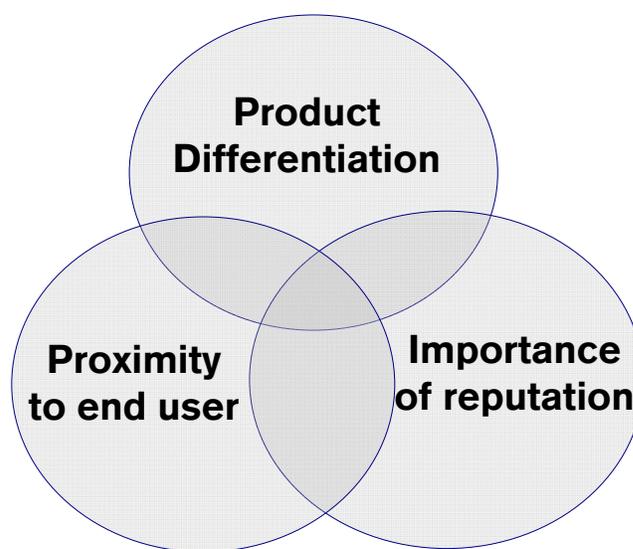
We believe there are a handful of key attributes that all great brands must have, including: brand authenticity, quality product, a strong core market, operating in a brand-friendly industry, and developing a brand-centric corporate culture. But there are also many other traits that a strong brand company should aspire to (though not necessarily a precondition for success) such as: innovation, long-term thinking, effective marketing, taking a scientific approach, scale, aspiration, global reach, and cross-category leveragability.

**Exhibit 5: The Three Core Sources of Sustainable Brand Value Creation**



Source: Company data, Credit Suisse estimates.

**Exhibit 6: Screening for Brand Friendly Industries**



Source: Company data, Credit Suisse estimates.

## Industry Matters

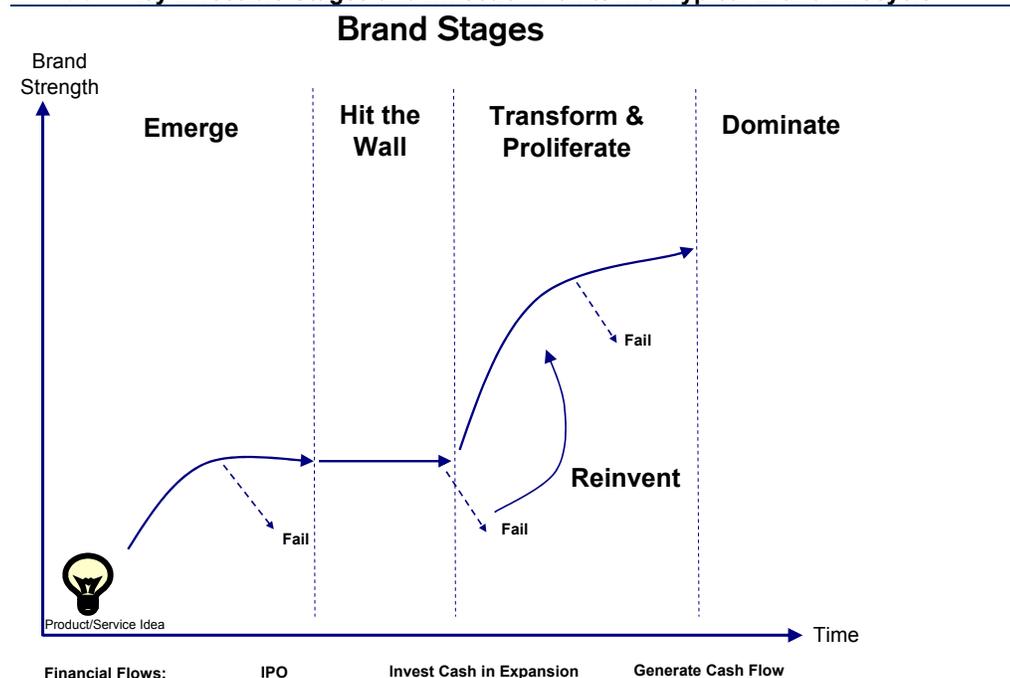
The starting point for building a world-class global brand is to compete in an industry that is brand friendly. While it is widely understood that brand companies are prevalent in consumer sectors, we believe there is and will continue to be ample scope for brand development in many other sectors, ranging from financials to industrials to energy.

The three critical components of such an industry are (1) proximity to the end-user (i.e., fewer steps or firms between the customer and the brand), (2) the perceived product differentiation among competitors, and (3) the importance of reputation in customers' purchasing decisions. Some of the most brand friendly industries include some obvious choices, such as fashion, leisure, autos, and restaurants, but also some less apparent sectors, such as financials and media. However, industries for which branding is virtually nonexistent include office supply, waste management, metals and mining, utilities, and basic materials.

## When to Invest in Brand Stocks

Using the case-study analysis of dozens of brand stories from the last century sprinkled throughout this report, we found that most brands follow a similar arc with five distinct stages: emerge, hit the wall, transform and proliferate, dominate, and reinvent. While early-stage brands are exciting and offer the highest potential return, they can be risky. However, investing in companies that are transforming from niche player into a powerful brand that can proliferate across new markets and categories offers investors attractive returns and is typically the phase in the brand lifecycle that generates the largest market value creation.

**Exhibit 7: Key Investible Stages and Inflection Points in a Typical Brand Lifecycle**



Source: Company data, Credit Suisse estimates

### Emerge

Emerging new brands naturally generate the most excitement with investors, and rightfully so, given that these brand stocks that are still emerging generate the highest absolute and relative returns of any of the brand phases. There are a number of ways new brands emerge, usually either innovating into a new product or market, or taking advantage of an inefficiency in the marketplace. For example, Starbucks created and harvested a completely new market for high-end and convenient coffee shops, Amazon leveraged its

first mover advantage and name recognition in essentially the entirely new industry of internet shopping, and Gatorade developed an entirely new and innovative product in a “green field” market. Phil Knight, founder of Nike, seized an opportunity to take advantage of the inefficient cost structure of the German shoe companies (adidas and Puma) who were still sourcing sneakers in Europe at the time) by tapping into the vast supply of cheaper labor in Asia.

### **Hit the Wall**

Highflying exciting brand stories can sometimes stall and lose momentum for a variety of reasons, often a painful experience for shareholders. For example, Blockbuster was synonymous with watching movies at home but ignored a paradigm shift of new distribution mechanisms and technologies (that were even easier than a 15 minute car ride). Saturn had great brand momentum in the early years, but its products and level of innovation failed to live up to its brand promise of being “a different kind of car company.” Reebok was one of the fastest growing brands in the 1980’s, growing from \$500 million to \$3 billion in only 7 years, however, the company strayed from its core women’s fitness market and diluted the brand. And Marvel, a brand that owned the comic book category made the mistake of sacrificing quality for cost by outsourcing writing and illustration.

### **Transform and Proliferate**

This is when a company *makes the leap* from product company to brand company and companies are able to leverage a strong brand to new channels, countries, and product categories. Characterized by consistently strong top-line growth and margin expansion (despite big re-investment into infrastructure build), this period is usually one of the best times to own brand stocks, especially on a more broad basis for investors, because this is by far the stage where these companies generate the highest amount of absolute market value. For example, Intel achieved its massive success by transforming a technical product into a stamp of approval, while Avon transformed from a business model and brand that had become less important in the U.S. due to the proliferation of malls and found massive new growth opportunities for its brand and model in emerging markets. L’Oreal and P&G both outspend competitors in R&D to develop innovative products as a way to leverage their market leading brands, while Microsoft transformed to a global iconic brand by creating network externalities with its software products that it became the standard PC operating system for the world.

### **Dominate**

Dominant brands are well-known, well understood brands that are global, iconic companies with scale and a great reputation. However, when brands reach this phase, it is usually (though not always) time to sell the stocks. Once investors and consumers realize how great the brand is, shareholder returns slow dramatically. Wal-Mart is an example of a powerful giant that has developed a great brand in the U.S. but as it neared domestic saturation, the company has been hurt by the law of diminish returns and difficulty extending its brand and business model overseas. Sony, an extremely well-know and highly respected brand around the world that has been so strongly associated with innovation, is now such a large company that it has become harder to continuously out-innovate smaller, more nimble competitors.

### **Signposts for Brand Failure**

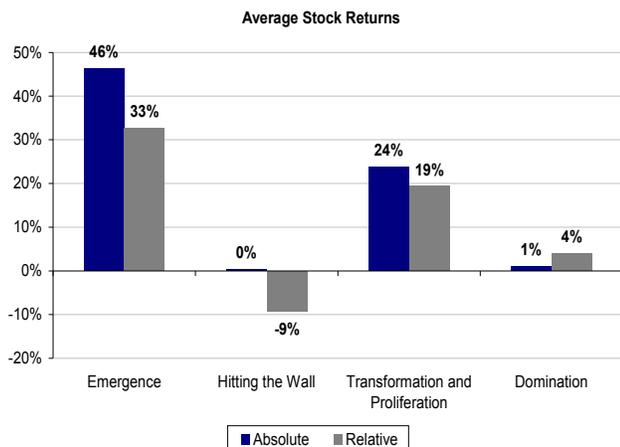
While successful brands can generate spectacular returns for shareholders, stocks of brands caught in a tailspin can be equally spectacular...in the opposite direction. The big mistakes brand companies often make include not knowing when to say no, failing to innovate, underinvesting, inexperienced management, superfluous new brand or product launches, and distracting acquisitions. Crocs fell into the trap of chasing the trend too aggressively and ended up over distributing its product into too many channels resulting in a massive inventory issue. Palm was never able to make the leap from product to brand, and Kodak missed the digital revolution in cameras. Many brands have been hurt by deteriorating quality (Buick, Gap, Macy’s, American Airlines, Pierre Cardin, Xerox to name

a few). Once the great American retailer, Sears Roebuck became distracted when it expanded into many non-core categories (real estate, brokerage, PCs, credit cards).

### Brand Reinvention

Brand reinvention can be a powerful tool fallen companies, and can offer investors highly attractive returns. Though it might seem unlikely, under the right leadership and with a focused strategy, weak or dying brands can often be remade in a new light that catalyzes an extend period of strong growth and profitability. There are many famous brand reinvention stories, including Coach, which added excitement and fashion to its iconic American handbag offering, which allowed it to simultaneously raise prices and accelerate growth. Both Nintendo and Apple revitalized their brands with unique new product offerings in consumer electronics (Wii and iPod) which creating a halo over the entire brand. Esprit, once a West Coast U.S. reinvented itself as a power player in Europe in Asia following an ownership and management change. The tennis-inspired preppie French brand Lacoste that was so popular in the 1980s has remerged in the last several years with updated fashion, an aspiration brand image, higher price points, and global appeal.

**Exhibit 8: While Share Returns Are Strongest in the Emerge Phase . . .**



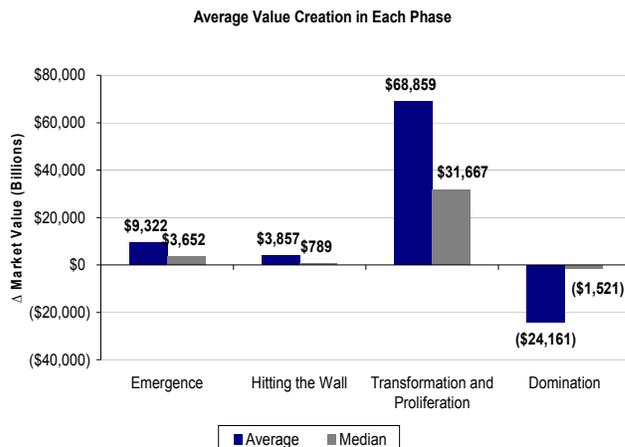
Source: Company data, Credit Suisse estimates.

On average, the brand stocks in our lifecycle sample generated 46% annual returns in the emerge phase, 0% annually when they hit the wall, a 24% CAGR during the transform and proliferate stage, and 1% annually once they achieve dominant iconic status. What is even more jarring is that our sample generated \$9 billion of market value on average during the emerge phase, \$4 billion during the hit the wall stage, \$70 billion during the transform and proliferate stage, and then proceeded to destroy \$25 billion of market value, on average, once they achieved dominant status.

### Strong Outlook for Brand Investing

We believe the future for brands and brand stocks is very bright given their universal appeal and reach in virtually every corner of the Earth. Brand companies are particularly well positioned in a global environment that is poised to elevate hundreds of millions of new individuals into the modern consumer economy across Asia, India, Eastern Europe, and Latin America over the next decade. Whether it will be already well-recognized brands expanding their reach to new markets or new brands emerging to take advantage of product or geographic opportunities, we believe there will be many chances to invest in exciting brands in the coming years. Another Credit Suisse Research Institute Report “China Consumer Survey – Consumption Jump” (dated January 8, 1010) is an excellent resource for understanding evolving consumption patters in China.

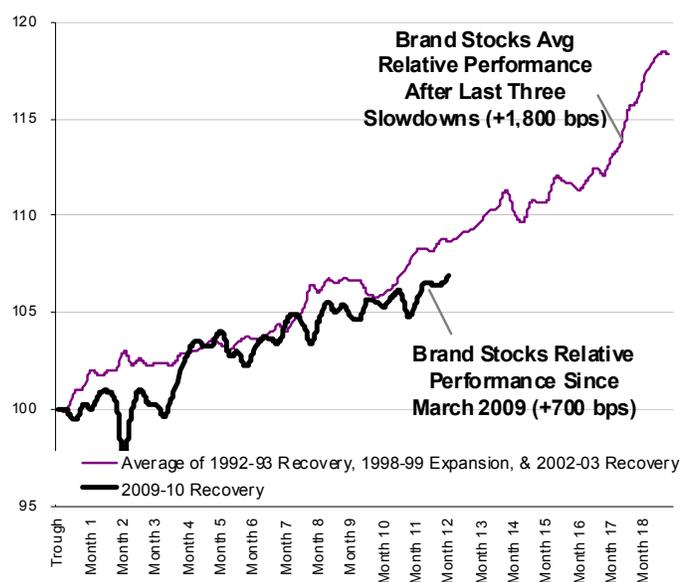
**Exhibit 9: . . . the Majority of Shareholder Value Creation Occurs During the Transform and Proliferate Stage**



Source: Company data, Credit Suisse estimates.

We believe that the brand investment platform works especially well coming out of recessions, owing to primarily the common (and reasonably plausible) assumption that consumers will no longer be willing to pay a premium brands and instead view all goods and services as commodities, making purchase decisions based purely on price. In fact, tough financial times are often the most opportunistic backdrops for great brand companies to solidify strong existing brands, as weaker competitors scale back and new entrants delay risky plans. Brand stocks historically have outperformed by 1,800 basis points in the six quarters following an economic slowdown. History looks set to repeat itself following the Great Recession of 2008-09, as brand stocks have already begun to outperform (700 basis points since March 2009).

#### Exhibit 10: History Suggests Strong Returns for Brand Stocks Coming Out of Economic Slowdowns and Financial Disturbances



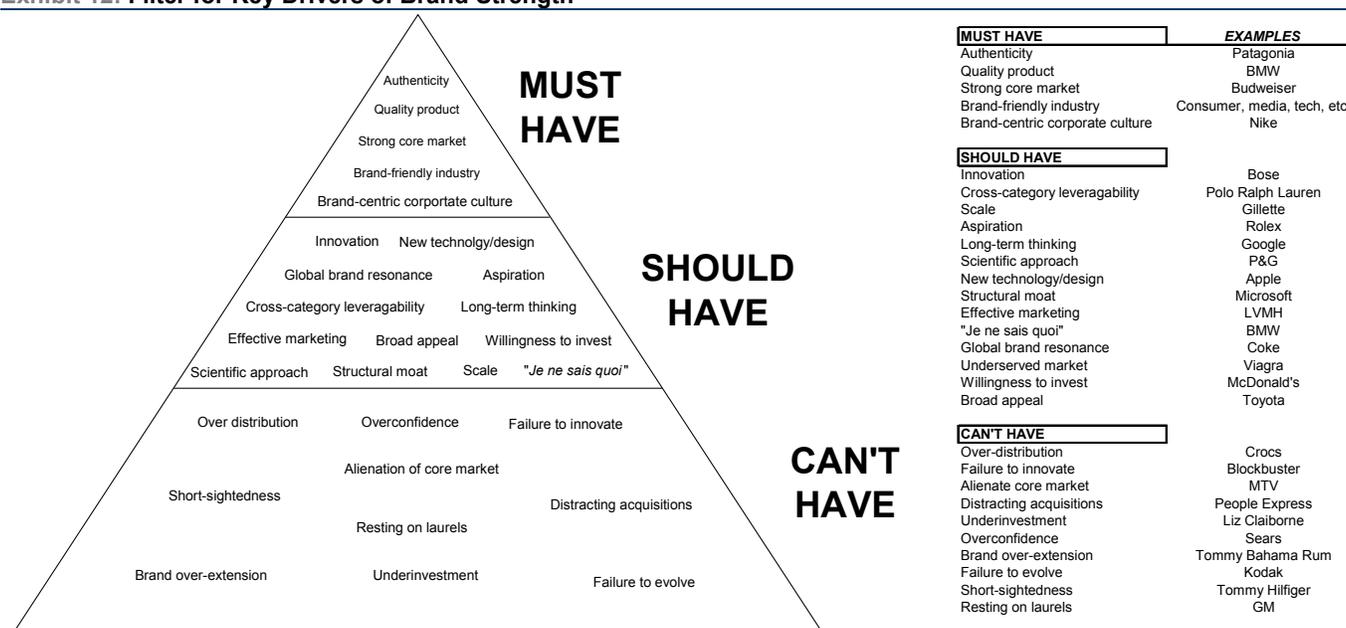
Source: Company data, Credit Suisse estimates



# Identifying High Potential Brands

While there are a few characteristics that all great brands share (authenticity, quality products/services, brand friendly industry, strong core market, and brand-driven corporate culture), there are many characteristics that all brands should strive to achieve: innovative, aspirational, cross-cultural appeal, scientific approach, scale, long-term vision, among others. There are many pitfalls brand companies should avoid, such as overdistribution, underinvestment, short-term focus, failure to innovate, and alienation of the core market.

**Exhibit 12: Filter for Key Drivers of Brand Strength**



Source: Company data, Credit Suisse estimates.

## Three Core Sources of Brand Value

While there are many great brands that leverage a wide variety of strengths and attributes, as previously mentioned, we believe there are three core sources of brand value: innovation, aspiration, and scale. It is from these core sources that great brand companies create and leverage their brands via superb marketing, innovative new products, strong leadership, and a reputation for quality.

### Innovation

These brands innovate continuously and more rapidly than competitors, in product development or in business processes. Intel introduced new chips every two years instead of the traditional four years. Southwest continues to find ways to reduce gate turn-around time, through boarding procedures and limiting food on flights to simplify clean-up and loading. L'Oreal invests more than double in R&D as a percentage of sales than competitor Revlon.

### Aspiration

Probably the most obvious of the branding success stories, these brands use emotion, associations, and personality to grow their strength with customers. LVMH brings to mind unsurpassed luxury, creativity, and craftsmanship. Budweiser connotes qualities such as American, masculine, humorous, sports, and casual. These brand intangibles can also be evident in a distinctive corporate culture and in attracting and retaining employees. Google's nontraditional workplace environment springs to mind as does Nike's headquarters with its state-of-the-art gym and buildings named after famous athletes.

**Scale**

These brands leverage their power over suppliers or distributors or through an installed base to maintain their brand positioning and competitive advantage. Toyota rings inventory carrying cost savings from its suppliers. Coke controls its bottlers, which sell and distribute its product. Facebook grows organically by leveraging the connections of its members. Microsoft benefits from people sharing files and needing to have the same software programs to do so.

Exhibit 13: The Core Sources of Brand Value



Source: Company data, Credit Suisse estimates.

# Industry Matters

The starting point for building a world-class global brand is to compete in an industry that is brand friendly. While it is widely understood that brand companies are prevalent in traditional consumer sectors, we have found that brands can be extremely relevant in other, non-traditional industries as well.

**Exhibit 14: The Influence of Brands Extends Far Beyond Traditional Consumer Sectors**

Consumer Staples	Consumer Discretionary	Leisure	Industrials	Media	Telecom	Financials	Healthcare	Internet	Energy	Technology

Source: Company data, Credit Suisse estimates.

The three critical components of such an industry are (1) proximity to the end user (i.e., fewer steps or firms between the customer and the brand), (2) the perceived product differentiation among competitors, and (3) the importance of reputation in customers' purchasing decisions.

There are certain industries in the nexus of these three criteria that are especially fertile for brand development. Most of the global iconic brands reside in those industries, such as media/entertainment, consumer products, branded apparel, restaurants, resorts/casinos, and autos. However, there are competitors that can build a global iconic brand in a somewhat less brand-hospitable environment, such as Marlboro in tobacco products and Microsoft in software.

## Industries with Strong Potential for Branding

Industries that show high potential for brands include those for which trust is a growing purchase criteria because of lack of product track record, a proliferation of unknown competitors, or risk to health or safety. Others include industries where intermediaries are disappearing, and the end user is becoming closer to the potential brands.

### Environmentally Conscious Branding

The eco-friendly consumer products industry is emerging, which presents opportunities for new brands to emerge. Building a new category is an especially rich vein to pursue in building brands, as the consumer will link the category with your brand from the outset.

Method Products, a private company started in 2001 to sell environmentally friendly soap and other cleaning products. The brand has grown to an estimated \$71 million in 2006 from \$11 million in sales in 2003 and continues to grow and expand distribution. Originally launched in Target, but now sold in Stop & Shop, Costco, and Office Depot, among others, this focused brand commands a 15-100%-plus price premium over equivalent, traditional cleaning products. It was ahead of the green wave with a strong management team. Its rival, in a subset of cleaning products, is Clorox with its Green Works brand, also priced at

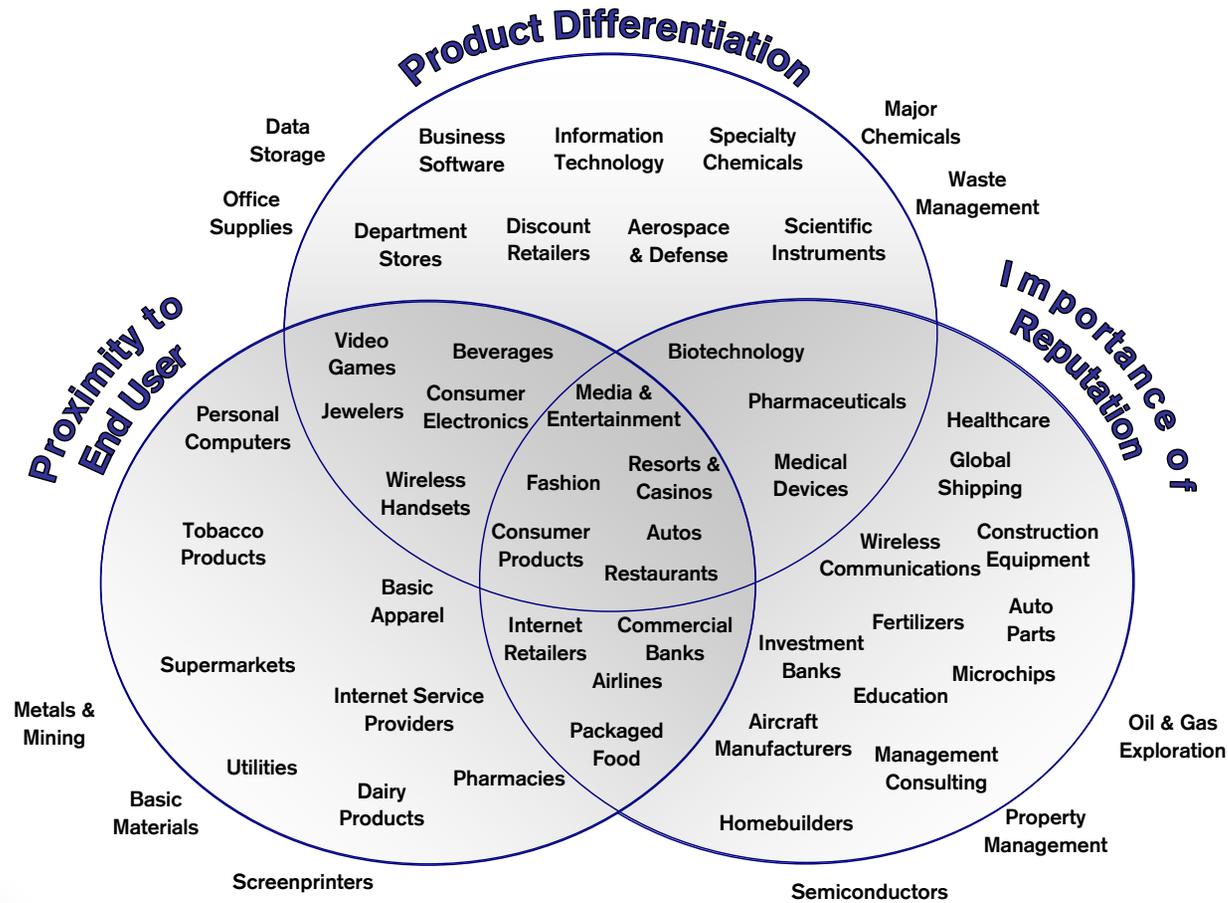
a 30-40% price premium to regular Clorox products. Whether consumers will prefer a known brand such as Clorox or a new, tightly focused eco-brand such as Method remains to be seen. Regardless, the white space of green innovation should be fertile for brand development.

### **Healthcare Disintermediation**

With the turbulence in the healthcare industry with new legislation and a possible individual mandate to buy health insurance in the future, health insurers, pharmacy benefit managers (PBM), and even hospitals may have branding opportunities. Medco, the mail-order PBM, which is primarily a B2B brand, could move into the consumer space and further expand its brand. Health insurers such as Blue Cross Blue Shield, owned by WellPoint in 14 states, could leverage additional brand growth as new customers emerge from the possible legislation. Hospitals too could get in the game and build a brand relationship with the consumer. This type of industry, where trust is paramount, is ripe for branding. For a deeper dive into the branding dynamics in the healthcare industry, please see page 76.

Exhibit 15: Framework for Identifying Brand friendly Industries

# Framework for Identifying Brand-Friendly Industries



Source: Company data, Credit Suisse estimates.

# What Is a Brand?

Walter Landor, the founder of legendary brand and marketing consultancy Landor Associates (owned by global marketing powerhouse WPP) was once asked how, exactly, does a company go about turning a product into a brand. Mr. Landor, who passed away in 1995, answered “products are made in the factory, but brands are created in the mind.” In other words, brands are subjective manifestations of consumer intent and opinion, are not so easily manipulated, and are just as often as not, an unintended consequence.

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Consider the famous UK soccer franchise Manchester United. To many “Man U” is the very definition of athletic supremacy. A storied franchise, the past, current, and future home of the games’ very best practitioners, the pinnacle of soccer passion evenly applied with envious results. To others, Man U represent everything that’s wrong with sports today: big market arrogance, with a wallet fat enough to ensure yearly success and perpetual anonymity for small market competitors whose total payrolls can be dwarfed by the annual take of the Manchester United striker. The Manchester United brand is powerful, but also polarizing, and taking on different meanings to different constituents.

David Ogilvy, known for jewels such as “the customer’s not a moron, she’s your wife,” and arguably the father of 20th century advertising, was a bit more direct: “any damn fool can put on a deal, but it takes genius, faith, and perseverance to create a brand.”

Ogilvy would argue that a brand is not a strategy. A brand is not a tactic. Having a brand that resonates with consumers is a consequence, the outcome of a consistent behavior, respect for the customer, and an understanding that brand, far from being static, are indeed organic entities themselves. Michael Eisner, former CEO of one of the greatest brands the world has known, The Walt Disney Company, explained “a brand is a living entity, and it is enriched or undermined cumulatively over time, the product of a thousand small gestures.”

Brands do not originate in conference rooms or in TV commercials, and the marketing landscape is littered with examples of marketers humbled by their conviction that some clever TV commercials and a big ad budget can spontaneously generate the loyalty and economic success of leading brands. Ogilvy frequently reminded his staff that good advertising cannot compensate for a poor product experience and will likely only hastened its death. How a brand acts is far more important than what a brand says. However, that is not to say that marketing cannot play a meaningful role, or that clever product positioning and messaging strategy cannot help what in truth is a commodity product to break away into category leadership.

## Commodity, Brand, or Both?

The credit card industry offers an interesting example of a commoditized product category where superior marketing has had a dramatic impact on competitive performance. For much of their history, the product distinction between payment network (do not say credit card) giants Visa and Mastercard has been nearly indistinguishable. Both cards offered comparable affinity reward programs, competitive rates, and nearly identical merchant acceptance. Yet over a period of ten years, Visa opened up a considerable performance gap, consistently taking transaction share from Mastercard (and others), vaulting Visa to coveted *front of wallet* status and highest brand awareness among most consumers. We would argue that Visa’s 20 year *everywhere you want to be* campaign offered consumers a consistent, aspirational, and emotional hook of a message that helped the company distinguish itself from its peers while offering little in the form of distinct product features.

Of course, the pinnacle of brand building achievement occurs when a brand exerts a nearly clean intellectual lock on a particular product or service, when a brand crosses the threshold of high awareness into a sublime *verb or proper noun state*—Xerox, FedEx, Google, Band Aid, Kleenex. While not necessarily translating into guarantees of perpetual category domination, such levels of brand familiarity and awareness, we would argue, present competitors with additional, intangible challenges.

## Brand Is in the Eye of the Beholder

Brands play a key role in customer's purchasing decisions, whether as a short cut or as an image enhancer. By implying a certain level of product or service quality and/or price expectations, brands serve as a way of simplifying routine purchase decisions. For industries such as consumer products, retailers (CVS, Home Depot), airlines, media (ESPN), and even search engines and express delivery, brands play a key role in helping consumers sort through the available options. Brands can also embody the image that the customer wants to project. These brands tend to fall into industry categories such as fashion, jewelry and watches, athletic footwear, automobiles, consumer electronics, hotels, cosmetics, retailers (Target, J. Crew) and even high-end coffee. Companies can leverage one or both of these customer benefits in building their brand.

Owing to the roles brands play in customers' purchase decisions, keeping a brand consistent, focused, and current is critical to building and reinforcing the customer's perceptions of the brand over multiple years.

## The Corporate Advantage of Brand Building

For companies, brands create financial value as well as softer benefits. Sales growth, margin expansion, and pricing power all can come with brand leadership. Other benefits can include distributor/channel power, supplier power, and even employee recruitment and retention advantages. These benefits far outweigh the costs involved in establishing and maintaining a leading brand.

**Exhibit 16: Credit Suisse Analysts Speak—Benefits to Companies of Building a Brand**



Source: Credit Suisse estimates.

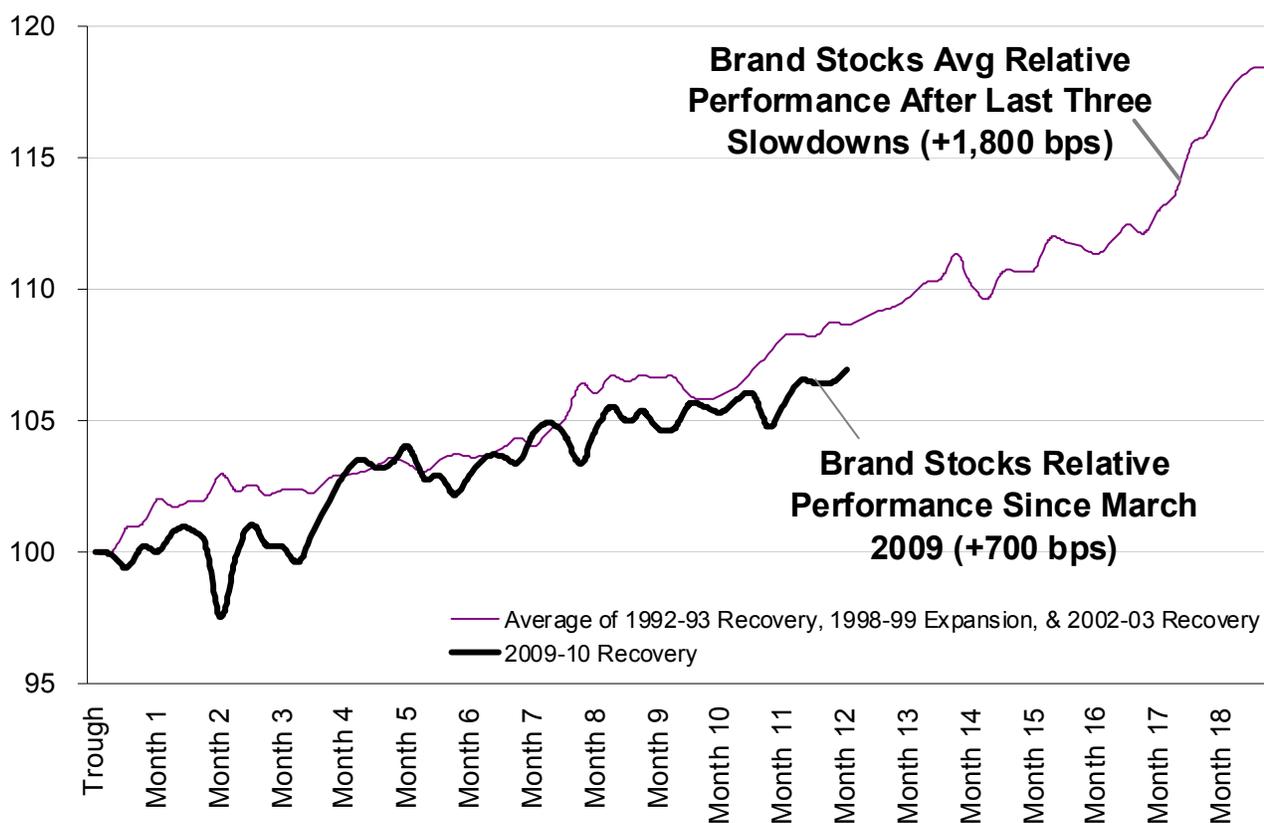
U.S. brands were twice as successful at expanding internationally as non-U.S. brands, according to our analysts. This may be because of the diverse and large nature of the domestic U.S. market as a testing ground for brands. Those that succeed in the United States have a higher likelihood of succeeding outside of the United States.

# Outlook for Brand Investing

We believe the future for brands and brand stocks is bright, given their universal nature, appeal, and reach in virtually every corner of the Earth. In our view, brand companies are well positioned in a global environment that is poised to elevate hundreds of millions of new individuals into the modern consumer economy across Asia, India, Eastern Europe, and Latin America over the next decade. Whether it will be already well recognized brands expanding their reach to new markets or new brands emerging to take advantage of product or geographic opportunities, we believe there will be many chances to invest in exciting brands in the coming years.

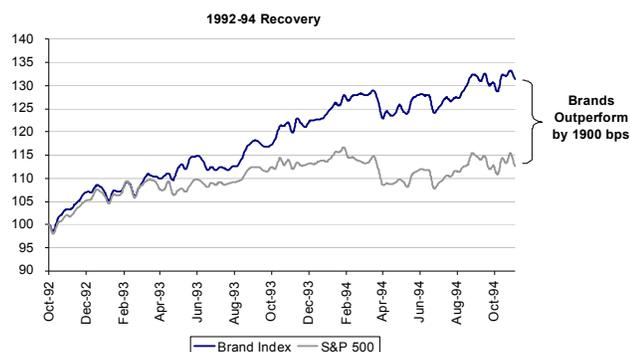
We also believe brand stocks will outperform the market in the near term. Brand stocks historically have outperformed by 1,800 basis points in the six quarters following an economic slowdown. History looks set to repeat itself following the Great Recession of 2008-09, as brand stocks have already begun to outperform (700 basis points since March 2009).

**Exhibit 17: History Suggests Strong Returns for Brand Stocks Following Economic Slowdowns**



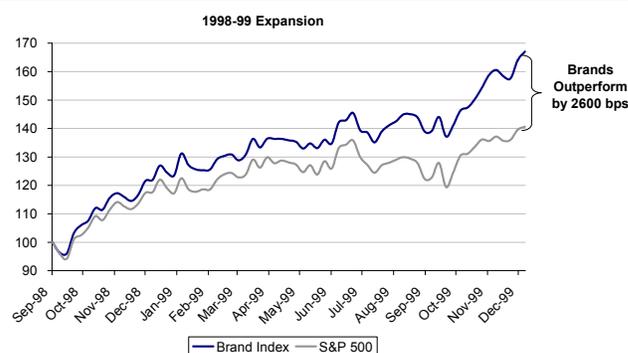
Source: Company data, Credit Suisse estimates.

**Exhibit 18: Brand Stocks Outperformed in the 1992–94 Recovery . . .**



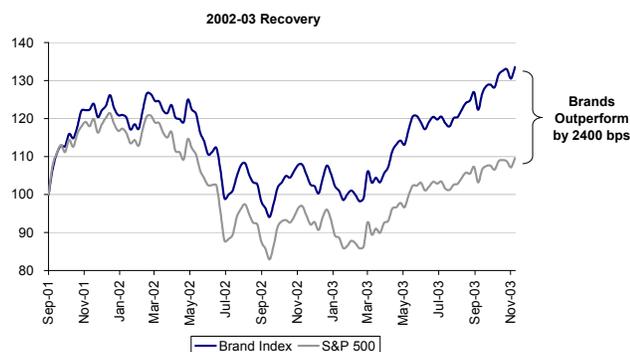
Source: Company data, Credit Suisse estimates.

**Exhibit 19: . . . and the 1998–99 Expansion . . .**



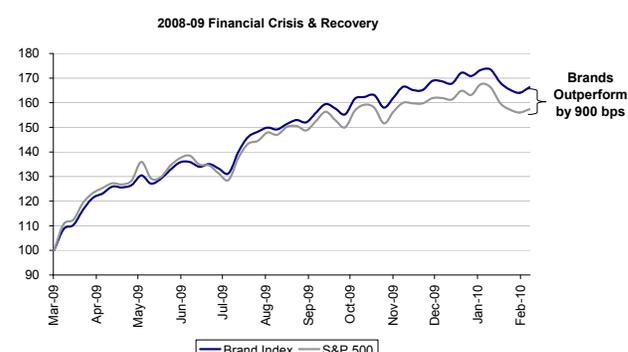
Source: Company data, Credit Suisse estimates.

**Exhibit 20: . . . and the 2002–03 Recovery...**



Source: Company data, Credit Suisse estimates.

**Exhibit 21: . . . and Have Started Outperforming Now**



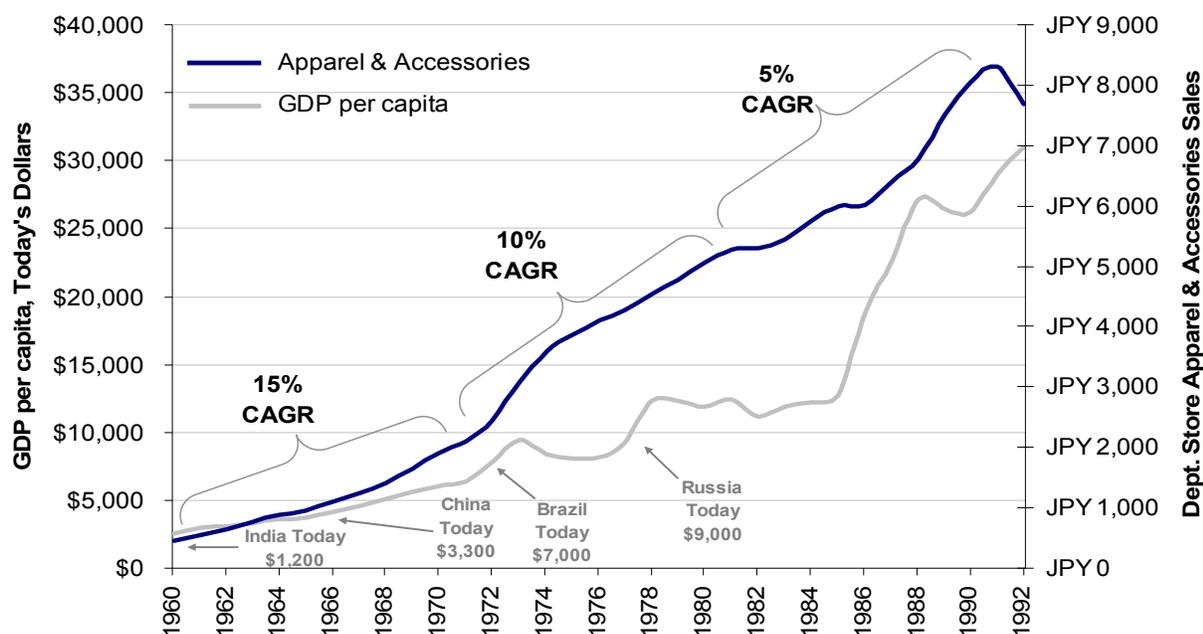
Source: Company data, Credit Suisse estimates.

## Emerging Market Brand Outlook

In our view, the outlook for brand stocks is especially strong in emerging markets, as we believe that consumption of brands is approaching an inflection point. Many consumer staples companies already enjoy robust penetration in these markets (e.g., McDonalds, Proctor & Gamble, and Coca-Cola), and we believe more discretionary branded categories such as apparel, consumer electronics, hotel/leisure, and Internet shopping, are poised to follow their lead. A similar chronology as occurred in Japan in the 1960s, 1970s, and 1980s. For example, when GDP per capita breached the \$3,000 mark (roughly where China currently is), spending on branded fashion goods exploded, quadrupling over the following ten years.

## Exhibit 22: Affordable Luxury: Branded Products Can Post Strong Growth in the Early Stages of Economic Development

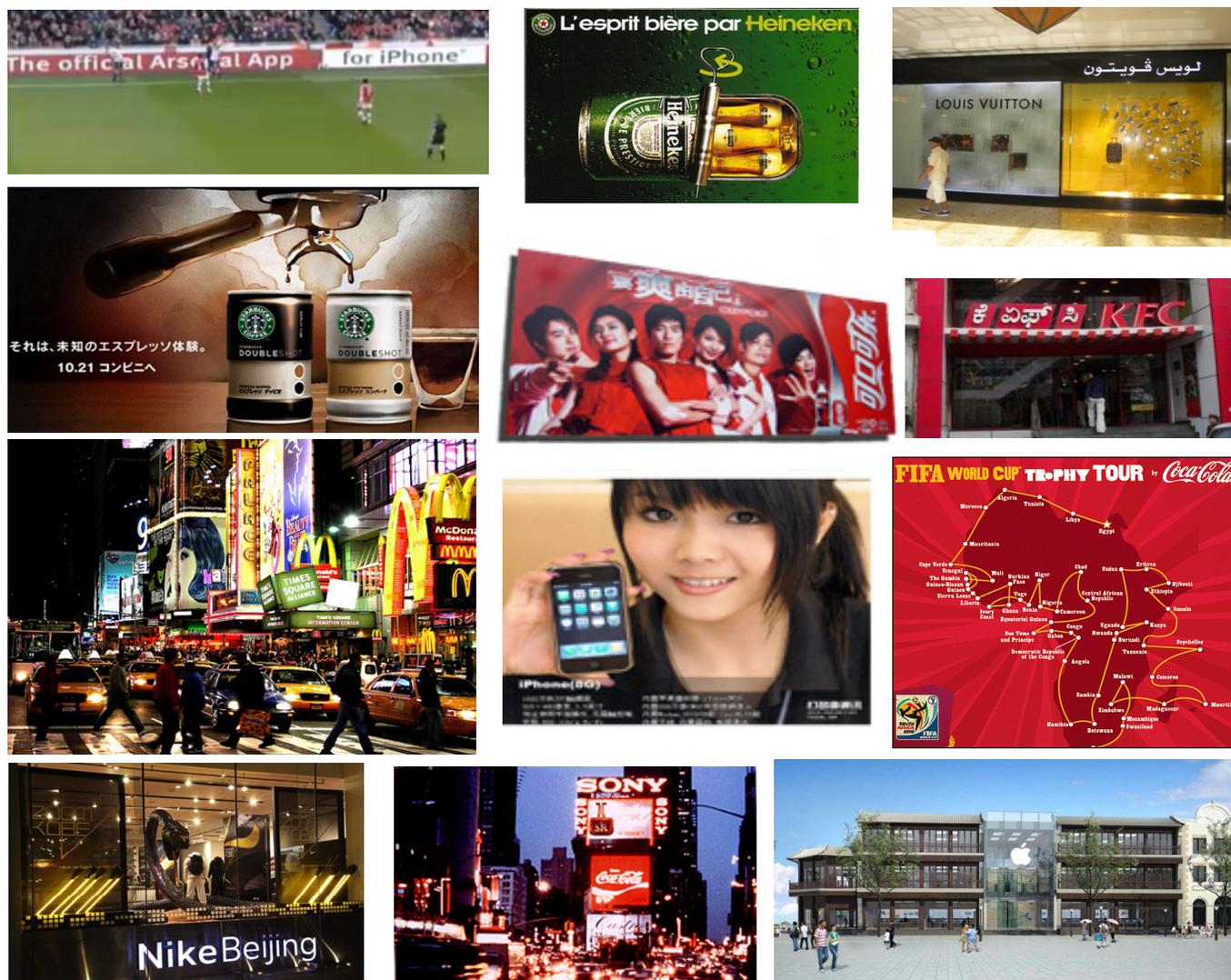
### The Japanese Fashion Explosion



Source: Factset, Company data, Credit Suisse estimates.

Although perhaps counterintuitive, many branded consumer goods companies have found that emerging market consumers are often *more* brand loyal than their counterparts in the developed economies despite their generally lower incomes and higher price points of branded goods versus private (or *no-name*) labels. To some extent, the greater willingness of developed market consumers to buy private label is attributable to having more shopping experience, which has given them a greater trust of generic products. Also relevant is the unwillingness of low-income emerging market consumers to take risks on unproven products, given constrained personal budgets, which prevents them from taking risks on unknown generics where product reliability is perceived to be a potential issue. We often find that consumers in emerging markets are highly brand- and image-conscious. Many people in *up and coming* regions desire to showcase their personal advancement through consumption of conspicuous branded goods.

Exhibit 23: People Love Brands Everywhere



Source: Company data, Credit Suisse estimates.

Intellectual Property Protection

One important dynamic in emerging market brand investing is that those markets often have a lower degree of intellectual property protection, which often scares investors. For example, the plethora of Chinese knockoff brands in coupled with poor enforcement of intellectual property, poses the risk that global brands will not be able to maintain its pricing or sales growth. While logos and product styles can be copied, brand authenticity cannot be stolen, and we believe emerging market consumers are increasingly discerning between genuine and imitation brands.

## Exhibit 24: Many Emerging Market Firms Struggle to Create Original Brands

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Nike Logo



adidas Slogan

“Impossible is Nothing”

Li Ning Logo



Li Ning Slogan

“Nothing is Impossible!”

Source: Company data, Credit Suisse estimates.

Furthermore, we believe the lack of intellectual property protection in some emerging markets hinders the development of competitive *home grown* brands that are innovative and authentic because the entrepreneurs are not motivated to innovate create intellectual property, knowing it might be knocked off without repercussion. Meanwhile, the global brands with vast resources have become quite adept at brand building in markets with little intellectual property protection. Though local brand companies are less sophisticated with regard to marketing and brand building relative to the large global players, we do expect locally grown brands to continue to emerge and compete in their home markets.

## Developed Market Brand Outlook

While the outlook for discretionary spending in many developed markets is clouded by high consumer leverage and constrained access to credit, we believe brand stocks are well positioned to take share and drive organic growth for two key reasons: (1) when considering the age old debate of content versus distribution, we believe that the proliferation of the Internet and a vast array of alternative distribution mechanisms has served to accelerate the shift in power toward content generators (i.e., brands); and (2) we believe there remains room even in mature highly developed markets for new innovative existing and new brands to take advantage of white space in across product categories, channels, and price points.

## Outlook for Brands in Several Key Industries

### Financials

In the wake of the financial crisis, shaken public confidence in the banking industry, and an ever-evolving regulatory framework, we believe brands in the financial industry will become increasingly important. We believe retail and private banking brands that are able to channel trust, confidence, loyalty, and stability in the minds of their customers could outperform in terms of deposit growth and price leadership. Some financial brands certainly became tarnished (or even destroyed) during this crisis, leaving the window of opportunity open for other brands to take and keep market share.

### Internet and Media

Despite strong growth in e-commerce and many other segments of the Internet and media space, we believe we remain in the early stages of brand evolution in this ever-changing industry. For example, despite Amazon's 24% average annual sales growth over the past five years, we believe consumers are just discovering the value proposition of this channel, learning the interface, and associating the brand with a reliable and positive consumer experience.

## **Telecom and Wireless Equipment**

We believe the proliferation of higher price point smartphones and increasing competition in the wireless handset market has created an environment ripe for brand value creation. We believe the expansion of Apple's telecom product offerings, product improvement, and refinement of Verizon smartphones, and the entry of Google and potentially others will increase market share volatility and the importance of building and investing behind wireless handset products and brands. We believe the product bundling dynamics created by exclusivity arrangements (e.g., Apple's iPhone and AT&T's wireless network) could create additional market share volatility, driven by changes in underlying network strength and changes in exclusivity arrangements. An individual's phone has become an incredibly personal object that we touch, feel, use, constantly throughout the day. To the extent that a company can provide a superior product experience, there is a tremendous opportunity to capture this value on a long-term basis by fostering brand loyalty.

## **Automotive**

We believe the collapse in global auto sales, the erosion of profitability in American and key foreign car industries, and the recent product recalls at Toyota has created a tremendous opportunity for brand value creation in the automotive industry for companies able to reinvent, reposition, or build from scratch a strong brand coming out of this fray. An individual's car is also a personal item, and we believe companies able to create a strong association in their consumer's minds with value, quality, reliability, and style may succeed in gaining market share as auto sales rebound.

# How to Invest in Brands

All brands tend to follow a similar arc of development, from concept to peak success (or failure). We call this the brand lifecycle and have broken it into five distinct stages: emerge, hit the wall, transform and proliferate, dominate, and reinvent. In each of these phases, there are key success factors and capabilities that brands must achieve to succeed, including consistency, continuous innovation, brand control, marketing, and strong management. Without these, a brand can fail at any point along the way.

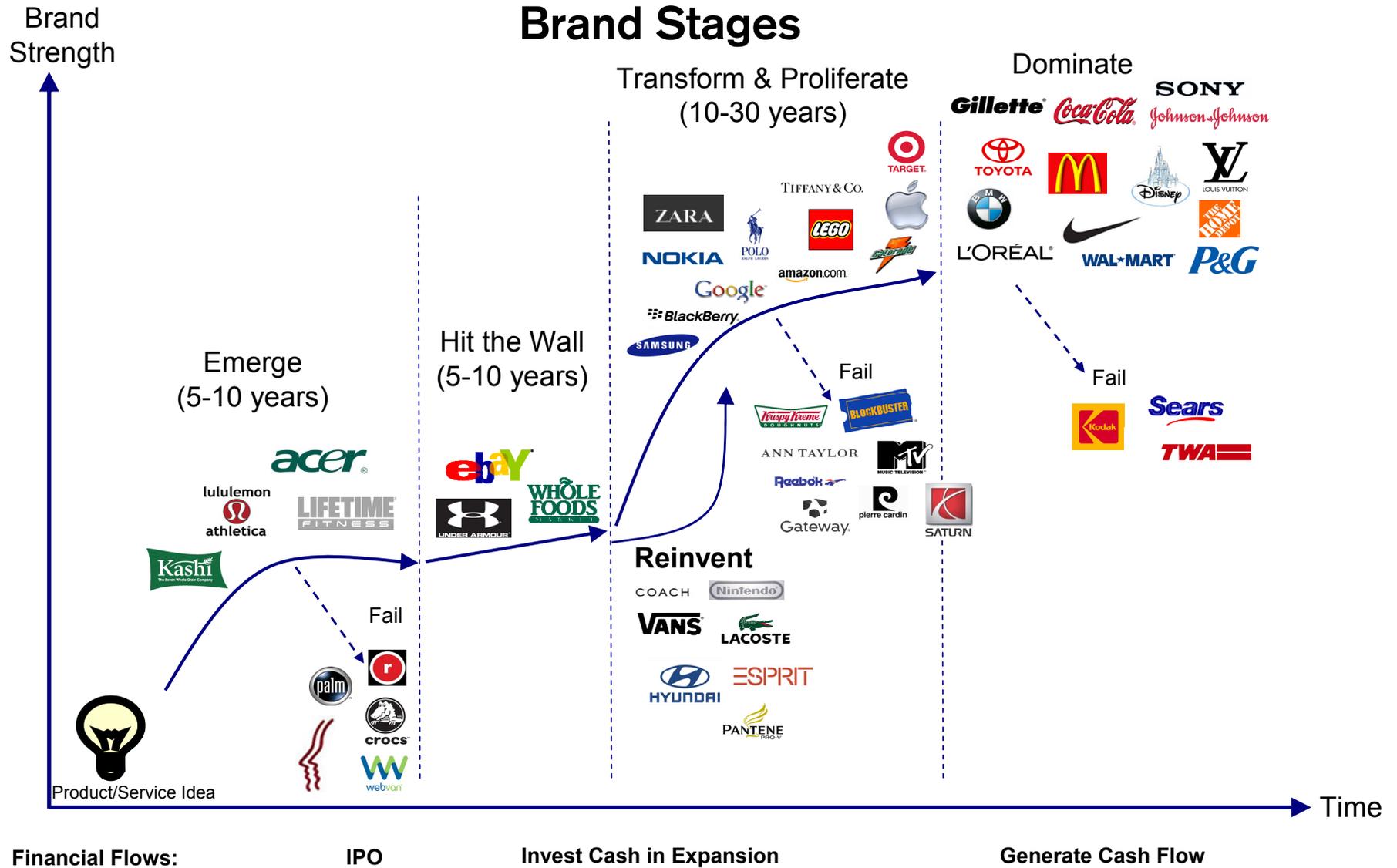
## Brand Lifecycle and Investing in the Various Stages

1. *Emerge*. This is when a brand establishes itself as a relevant new presence in a marketplace, and is identified by consumers/customers for its unique product or service proposition. The emerging stage is relatively short (five to ten years) and is usually characterized by fast growth, an IPO, and strong shareholder returns, though a fairly small market capitalization. The vast majority of brands fail during or just after emerging, and picking the winners here can be challenging.
2. *Hit the wall*. This is when a company has difficulty making the critical step of transforming itself from a product company to brand company (which is when a brand can profitably leverage its brand across product categories and geographies). Most brand companies hit a wall before transforming themselves in a way that enables the brand to establish the next leg of sustainable, leveragable growth.
3. *Transform and proliferate*. This is when a company *makes the leap* from product company to brand company, a process that can last from 10-30 years. Brands are validated in this stage by expanding distribution to new channels, countries, or product categories while simultaneously continuing product development and innovation. Characterized by consistently strong top-line growth and usually some margin expansion (despite big re-investment into infrastructure build), this period is usually one of the best times to own brand stocks, as this is when they generate the most absolute market value.
4. *Dominate*. Reaching this stage is the ultimate goal of any brand company. A brand is dominant when it has the top one or two market share, the brand essence or meaning is almost universally understood by consumers/customers, and the company starts to generate meaningful free cash flow because it has less need to invest heavily. It is also characterized by much slower growth and little margin opportunity. When brands achieve dominant status, it is usually time to sell the stock, as they can stagnate for years once becoming dominant (e.g., Wal-Mart and Sony).
5. *Reinvent*. Sometimes, a once-popular brand that faded from the landscape can reinvent itself and emerge as a strong growth brand once again, sometimes even stronger than before. This situation can often be a high returning brand investment opportunity for investors (e.g., Coach and Apple).

### Brand Failure

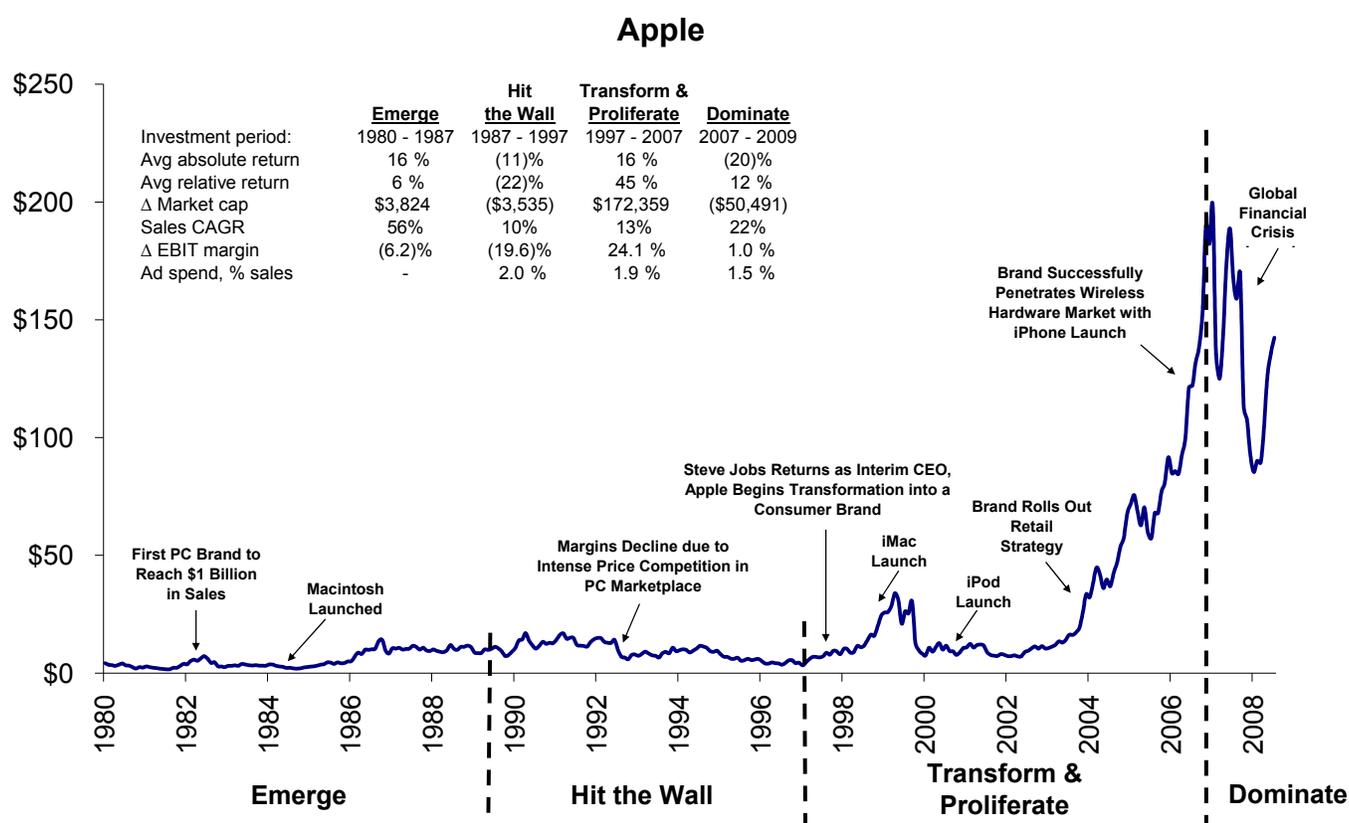
Failure or brand value destruction is a common occurrence that can happen at any point in the brand lifecycle. Crocs and Palm failed as they tried to emerge while Sears and Kodak fell from grace long after they had been universally recognized as dominant brands. Failure can occur for many reasons, including overdistribution (i.e., brand dilution), lack of innovation (resting on your laurels), underinvesting/marketing, ineffective management, distracting nonstrategic acquisitions, etc.

Exhibit 25: Brand Life Cycle Framework



Source: Company data, Credit Suisse estimates

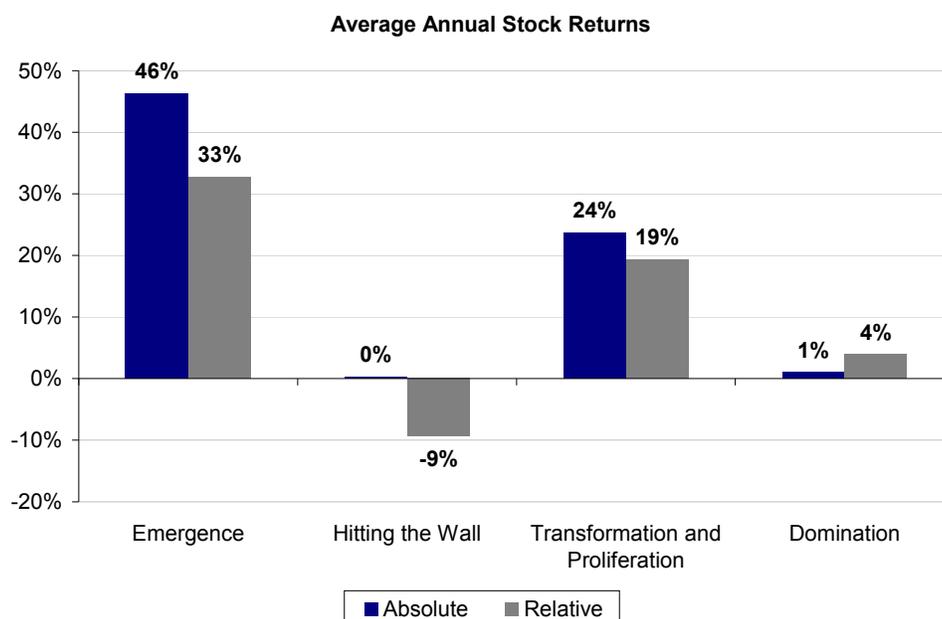
## Exhibit 26: Apple's Brand Lifecycle: The Wall Street View



Source: Company data, Credit Suisse estimates.

Apple is a great example of how a stock really outperforms during the transform and proliferate phase. Apple stumbled along as it emerged and hit the wall, but then returned 45% relative returns when it found its brand differentiation with the iMac launch in 1998 and followed by the iPod and its retail store strategy in 2001.

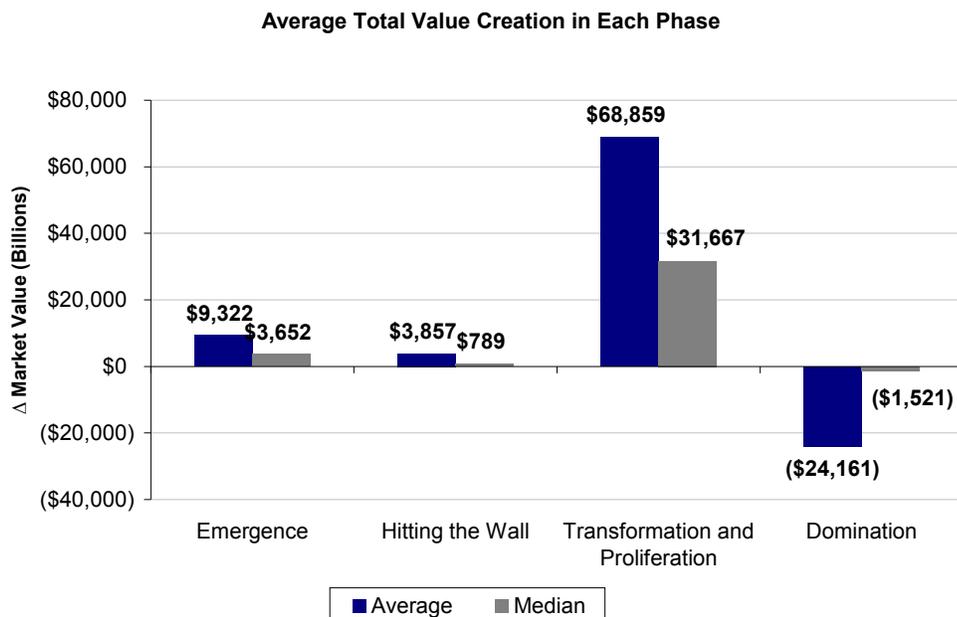
### Exhibit 27: Share Returns across the Various Stages of the Brand Lifecycle



Source: Company data, Credit Suisse estimates.

On average, if one can pick the winners as they emerge, this is the most financially lucrative time to own the brand's stock. Picking winners is highly uncertain, given all of the moving parts involved in establishing a new brand, as well as the often creation of a new product/service category. Often, brands IPO toward the end of the emergence phase, limiting the upside potential to investors. If a brand struggles, or hits the wall, after emerging, this can be a trying time for early investors, one that can last for 5-plus years. Therefore, focusing on getting in early in the transform and proliferate phase and knowing the key factors by which to evaluate a brand can be the best time to invest, with relative returns averaging 20%. This is the phase when the most shareholder value creation occurs, averaging \$66 billion. While the brand may enjoy success as a dominant brand, investors do not. Most of the uncertainty has been vetted for stocks of dominant, global brands, and the brand's power is fully priced into the stock.

**Exhibit 28: The Majority of Shareholder Value Creation Occurs During the Transform and Proliferate Phase**



Source: Company data, Credit Suisse estimates.

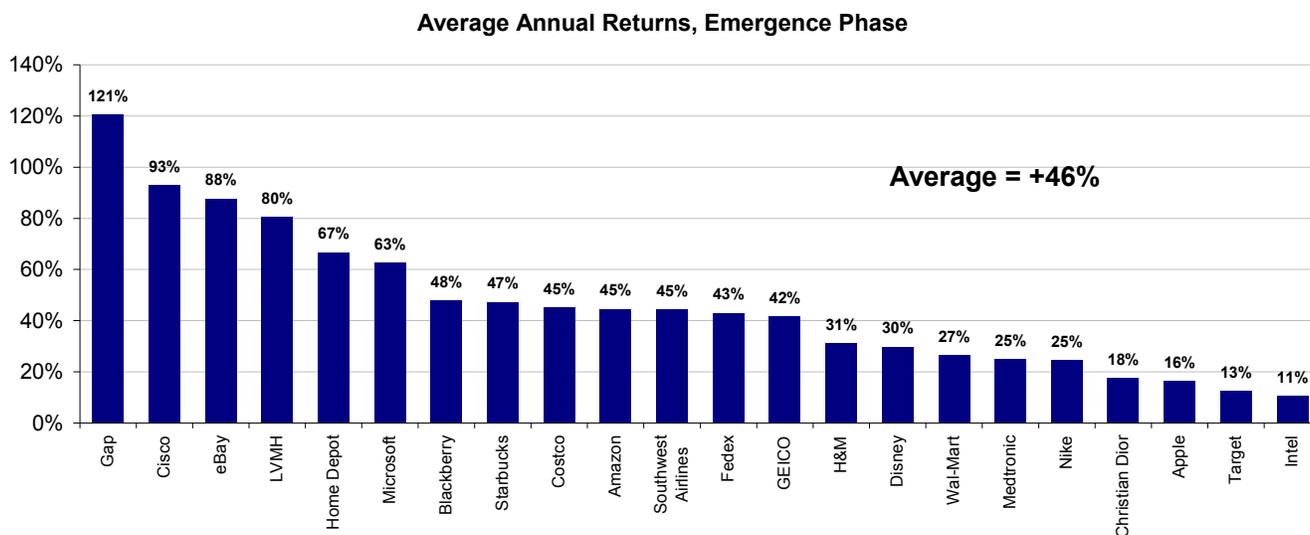
**Exhibit 29: Brand Performance by Phase—Own the Stocks During Emerge and During Transform and Proliferate Phases**

Brand	Annual Stock Returns																		
	Emergence				Hitting the Wall				Transformation and Proliferation				Domination				IPO to Today		
	Dates	Abs.	Rel.	Δ Mkt Value	Dates	Abs.	Rel.	Δ Mkt Value	Dates	Abs.	Rel.	Δ Mkt Value	Dates	Abs.	Rel.	Δ Mkt Value	Abs.	Rel.	Δ Mkt Value
Southwest Airlines	1972 - 1983	45 %	39 %	\$796	1983 - 1991	8 %	(4)%	\$640	1991 - 2001	23 %	12 %	\$12,729	2001 - 2010	(5)%	(4)%	(\$4,937)	19 %	12 %	\$9,228
Target	1972 - 1985	13 %	7 %	\$3,890	1985 - 1995	5 %	(6)%	\$938	1995 - 2001	37 %	23 %	\$31,667	2001 - 2010	3 %	3 %	\$1,099	12 %	5 %	\$37,595
Sony	-	-	-	-	-	-	-	-	1989 - 1999	14 %	(1)%	\$118,442	1999 - 2010	(14)%	(12)%	(\$126,220)	2 %	(5)%	\$14,211
Wal-Mart	1972 - 1990	27 %	19 %	\$33,970	1990 - 1996	7 %	(6)%	\$17,951	1996 - 2000	47 %	27 %	\$185,106	2000 - 2010	0 %	2 %	(\$33,485)	18 %	11 %	\$203,542
Christian Dior	1991 - 1996	18 %	5 %	\$3,394	1996 - 2002	0 %	(3)%	\$32	2002 - 2006	26 %	12 %	\$13,235	2006 - 2010	(3)%	5 %	(\$1,665)	9 %	4 %	\$14,996
Gap	1984 - 1986	120 %	87 %	\$1,083	1986 - 1995	19 %	7 %	\$4,759	1995 - 1999	31 %	33 %	\$33,114	1999 - 2010	(8)%	(5)%	(\$25,344)	20 %	11 %	\$13,612
Disney	1962 - 1970	30 %	24 %	\$554	1970 - 1984	6 %	2 %	\$1,340	1984 - 1987	14 %	39 %	\$5,862	1987 - 2010	9 %	2 %	\$50,746	14 %	7 %	\$58,502
Toyota	-	-	-	-	1985 - 1989	19 %	2 %	\$36,994	1989 - 2006	11 %	(0)%	\$177,563	2006 - 2010	(24)%	(18)%	(\$117,463)	5 %	(2)%	\$97,094
Apple	1980 - 1987	16 %	6 %	\$3,824	1987 - 1997	(11)%	(22)%	(\$3,535)	1997 - 2007	16 %	45 %	\$172,359	2007 - 2010	1 %	15 %	\$8,731	15 %	7 %	\$181,378
Microsoft	1986 - 1992	63 %	48 %	\$23,212	1992 - 1994	20 %	17 %	\$11,694	1994 - 1998	53 %	36 %	\$312,592	1998 - 2010	(2)%	(1)%	(\$94,613)	27 %	19 %	\$252,884
Starbucks	1992 - 1995	47 %	31 %	\$1,392	-	-	-	-	1995 - 2005	28 %	19 %	\$21,526	2005 - 2010	(6)%	(4)%	(\$5,583)	22 %	15 %	\$17,335
Polo	-	-	-	-	1997 - 2003	(1)%	(5)%	(\$233)	2003 - 2007	7 %	13 %	\$3,421	2007 - 2010	14 %	29 %	\$1,657	8 %	6 %	\$4,844
McDonalds	1965 - 1996	-	-	-	1996 - 1997	5 %	(20)%	\$1,225	1997 - 2007	9 %	5 %	\$35,906	2007 - 2010	5 %	19 %	\$1,219	-	-	-
Zara	-	-	-	-	-	-	-	-	2001 - 2007	14 %	11 %	\$28,636	2007 - 2010	1 %	15 %	(\$1,521)	10 %	12 %	\$27,116
Amazon	1997 - 2001	45 %	35 %	\$3,479	-	-	-	-	2001 - 2010	34 %	35 %	\$48,358	-	-	-	-	38 %	35 %	\$51,620
Home Depot	1981 - 1992	67 %	48 %	\$22,266	1992 - 1996	(0)%	(13)%	\$1,734	1996 - 1999	15 %	46 %	\$134,165	1999 - 2010	(8)%	(5)%	(\$106,950)	27 %	17 %	\$51,215
GEICO	1979 - 1985	42 %	28 %	\$924	-	-	-	-	1985 - 1995	16 %	4 %	\$3,717	-	-	-	-	13 %	7 %	\$4,640
Cisco	1990 - 1996	93 %	72 %	\$41,618	-	-	-	-	1996 - 2008	11 %	5 %	\$53,827	2008 - 2010	42 %	18 %	\$44,097	33 %	25 %	\$139,542
Gatorade	-	-	-	-	-	-	-	-	1983 - 2001	16 %	4 %	\$12,277	-	-	-	-	10 %	2 %	\$12,277
Nike	1980 - 1992	25 %	13 %	\$5,850	1992 - 1993	(44)%	(48)%	(\$2,825)	1993 - 1996	58 %	48 %	\$13,842	1996 - 2010	6 %	3 %	\$14,066	17 %	9 %	\$30,932
H&M	1985 - 1992	31 %	16 %	\$632	-	-	-	-	1992 - 2000	68 %	27 %	\$14,174	2000 - 2010	13 %	15 %	\$29,571	28 %	19 %	\$44,377
Fedex	1978 - 1985	43 %	28 %	\$2,901	1985 - 1992	(2)%	(11)%	\$33	1992 - 1998	14 %	3 %	\$10,200	1998 - 2010	6 %	7 %	\$12,415	15 %	6 %	\$25,548
Intel	1981 - 1987	11 %	1 %	\$2,773	-	-	-	-	1987 - 1999	31 %	19 %	\$269,969	1999 - 2010	(6)%	(4)%	(\$159,504)	14 %	6 %	\$113,239
Medtronic	1978 - 1990	25 %	14 %	\$2,410	-	-	-	-	1990 - 2010	16 %	9 %	\$45,910	-	-	-	-	19 %	11 %	\$48,364
Costco	1985 - 1991	45 %	29 %	\$7,322	1991 - 1995	(20)%	(27)%	(\$4,814)	1995 - 2010	7 %	11 %	\$23,357	-	-	-	-	15 %	8 %	\$26,018
eBay	1998 - 2000	88 %	69 %	\$7,919	-	-	-	-	2000 - 2010	12 %	14 %	\$21,328	-	-	-	-	24 %	23 %	\$29,428
Google	-	-	-	-	-	-	-	-	2004 - 2010	34 %	34 %	\$144,515	-	-	-	-	34 %	34 %	\$143,868
LVMH	1987 - 1989	80 %	54 %	\$11,891	1989 - 1993	(7)%	(13)%	(\$4,218)	1993 - 2000	11 %	4 %	\$34,130	2000 - 2010	1 %	3 %	\$6,306	12 %	4 %	\$48,109
Blackberry	1999 - 2006	48 %	46 %	\$22,977	-	-	-	-	2006 - 2010	17 %	26 %	\$14,993	-	-	-	-	38 %	40 %	\$38,721
<b>Average</b>	<b>7 years</b>	<b>46 %</b>	<b>33 %</b>	<b>\$9,322</b>	<b>6 years</b>	<b>0 %</b>	<b>(9)%</b>	<b>\$3,857</b>	<b>8 years</b>	<b>24 %</b>	<b>19 %</b>	<b>\$68,859</b>	<b>8 years</b>	<b>1 %</b>	<b>4 %</b>	<b>(\$24,161)</b>	<b>19 %</b>	<b>12 %</b>	<b>\$62,151</b>
<b>Median</b>	<b>6 years</b>	<b>44 %</b>	<b>29 %</b>	<b>\$3,652</b>	<b>6 years</b>	<b>3 %</b>	<b>(6)%</b>	<b>\$789</b>	<b>8 years</b>	<b>16 %</b>	<b>14 %</b>	<b>\$31,667</b>	<b>10 years</b>	<b>1 %</b>	<b>3 %</b>	<b>(\$1,521)</b>	<b>16 %</b>	<b>10 %</b>	<b>\$38,158</b>

Source: Company data, Credit Suisse estimates.

# Emerging Brands—Strong Returns if One Picks the Winners

Exhibit 30: Attractive Returns During the Emerge Phase



Source: Company data, Credit Suisse estimates.

Brands emerge by doing one of two things (or both): innovating or tackling inefficiency. Innovation includes identifying a new or underserved market, launching a new technology, or developing a differentiated product. In each instance, the brand is closely associated with this innovation, often a new category, and derives its brand identity from it. Inefficiency includes identifying inefficiency in the production system or the distribution process in an industry and leveraging that into a new business process. Again, the brand develops a defining characteristic that becomes integral to the brand's identity early on.

Returns during the emerge phase can be extremely high, averaging 46% for the brands we tracked. However, the average is so high partly because of survival bias (i.e., we do not include brands that failed after emerging). However, if one can catch a rising star brand, it can be lucrative.

Exhibit 31: Factors in Brands Emergence

Brand	Innovation			Inefficiency	
	White Space	New Technology	Differentiated Product	Production Inefficiency	Distribution Inefficiency
Starbucks	√				
GEICO	√				
Goldman Sachs	√				
Target	√				
Wal-mart	√				√
Medco	√				√
Sony	√	√			
Disney		√	√		
Cisco Systems		√	√		
Gillette		√	√		
Intel		√	√		
Blackberry		√			
Medtronic		√			
Samsung		√			
eBay		√			
Google		√			
L'Oreal		√			
Nokia		√			
Apple		√			
Microsoft		√			
Amazon.com		√			√
ESPN		√			√
Coke			√		√
Gap			√		√
BMW			√		
Nintendo			√		
LVMH			√		
Kellogg's			√		
P&G			√		
Lego			√		
Tylenol			√		
Polo			√		
Gatorade			√		
Tiffany & Co.			√		
McDonald's				√	√
Dell				√	√
Nike				√	
Zara				√	
Toyota				√	
H&M				√	
Southwest Airlines					√
Costco					√
The Home Depot					√
Fedex					√

Source: Company data, Credit Suisse estimates.

## White Space

### Starbucks

On the innovation side, Starbucks served a new market by creating neighborhood espresso cafes modeled on those seen on Howard Schultz's 1983 trip to Italy. By identifying the potential for applying this concept in the United States, leveraging the high-quality coffee being roasted by Starbucks in Seattle, he branded that concept, originally under the Il Giornale brand, but quickly acquired the Starbucks brand in 1987, which had an existing local reputation for excellent coffee built for over 15 years. The white space that Starbucks filled was for a coffee shop that delivered a high-quality, handcrafted coffee beverage and served as an inviting gathering spot for the community, a third place besides home and work. The concept spread quickly, growing in cities primarily, which drove their expansion strategy, first to Chicago, then Portland, LA, and San Francisco. In



Created a new market

addition, Starbucks had launched a mail-order catalog in 1988, which helped the company decide to which geographies to expand next. By 1992, Starbucks was profitable and had 165 stores, out of an estimated 500 coffee cafes in the United States. The company successfully had an IPO that year and began to *make the leap*.

### Tata Motors

Tata Motors' Nano brand innovated by redesigning the four-person automobile from the chassis up through *frugal engineering at its best*. In the process, Nano created a new category, becoming the world's cheapest car at US\$2,000 for the basic Nano model, half the price of its nearest Indian competitor. By competing with high-polluting two-wheelers in the Indian market instead of traditional cars (reminiscent of Southwest Airlines competing with buses), the brand effectively "grew the pie" of the Indian car market from 1.5 million units currently to include 10% of the 7 million two-wheelers that sell for over US\$1,400. In doing so, Nano staked out ownership of this category and quickly was oversold with a waiting list of 200,000 units in April 2009. By adding in style and aspirational qualities for the Indian middle class, Nano became a brand rather than just a product. The brand now hopes to leverage this early mover status and category-ownership with international expansion to Africa, Europe (in 2011), and the United States (by mid-decade). While adjustments will have to be made to comply with safety and emissions tests (with implicit price increases) and competitors like Bajaj/Nissan/Renault, Hyundai, and others nip at its heels, Nano is not yet a lay-up. However, if the brand continues to innovate in design and manufacturing within this new category, it could be a formidable brand and catapult Tata Motors, a \$14 billion mostly commercial vehicle brand, into a passenger/consumer market leader in India and internationally.



Redefined product and pricing assumptions

### GEICO

Auto insurance giant GEICO found a white space in targeting an underserved customer segment, U.S. government employees, and military personnel, who move often and are looked upon as higher risk because of that. The name GEICO stands for government employees insurance company. The husband and wife team that founded it during the Great Depression focused on delivering excellent coverage at low prices to their customers. It soon broadened its approach, but this initial targeting helped establish its brand positioning as *saving people money*.



Target profitable, underserved customers

## New Technology

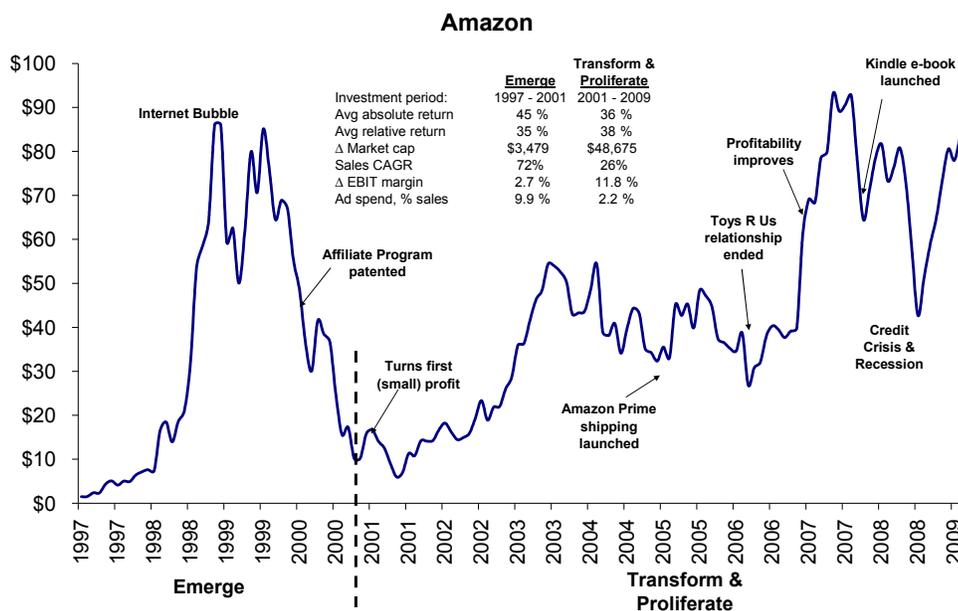
### Amazon

Amazon leveraged the new Internet technology to sell books online in 1995. A first-mover, but a steady growth proponent in a time of break-neck change, Amazon's business plan did not expect a profit for four to five years, a lifetime in the dot-com world. It used this time to build its technological and category leadership, from books to CDs and DVDs to software. Early on, Amazon pioneered *one-click* ordering, which simplified and streamlined the ordering process for customers. It also saw the value in the Internet's capacity to link people, through its customer review technology. Recommendations figured into the company's appeal for customers. These innovations helped deliver a superior shopping experience for customers and built customer loyalty early on. This in turn led to market share dominance of online book-selling and branded Amazon as an emerging online superstore merchant.



Steady growth, even in technology, creates winners

## Exhibit 32: Amazon Brand Lifecycle: The Wall Street View



Source: Company data, Credit Suisse estimates.

### BlackBerry

In new technology innovation, BlackBerry focused on the potential of a wireless e-mail application, which it had identified as a point of pain for customers. It created push e-mail software that constantly monitors user's inboxes for new mail and delivers them to the smartphone via wireless networks. It also developed a special keyboard for thumbing, which was focused on mobile e-mail use. For several years, it owned this application and branded it, as evidence by *crackberry* making it into Webster's dictionary in 2006.

### Acer

Acer began as a parts distributor in Taiwan, but gradually forward-integrated into PC manufacturing and then focused on notebooks for consumers, private label and its own brand. It focused on low-cost manufacturing and high service levels for retailers, cultivating this channel exclusively. While its initial bids to gain market share were at the expense of margins, it increasingly focused on branding versus price competition. When it shed its manufacturing operations in 2000 to focus exclusively on marketing, sales and R&D, the brand had emerged. It is currently trying to transform and proliferate with its launch of the netbook in 2008, an early mover in this new category, a good scenario for building a powerful brand. Acer gained three percentage points of market share in 2008 to 10.9% whereas Dell was flat at 15%.

### Cisco Systems

Cisco Systems started as the husband and wife team of founders tried to develop the technology to connect their own computers. While they did not invent the router, Cisco pioneered the first commercially successful router supporting multiple network protocols. This was key before the now widely accepted Internet Protocol (IP) was in place. After it emerged, Cisco continued to innovate and also grew through multiple large acquisitions of technology and talent.



Identify customer's point of pain to drive product and brand development



Innovated and forward-integrated to build its own brand and perhaps a new product category



Well-managed acquisitions can allow a brand to accelerate growth

## Differentiated Product

### Gatorade

An example of offering a differentiated product (and a new category), Gatorade was developed by medical researchers for the University of Florida Gators football team to relieve dehydration during hot summer training. What started as a kidney specialist's experiment on a few players (only freshmen), mixing a concoction of salt and other electrolytes, several sugars, and lemon juice, turned into a sports drink phenomenon. Gatorade was credited for the team's Orange Bowl win in 1967 by their coach, leading to inquiries from colleges across the nation. An Indiana company then bought the rights and began mass producing the beverage for distribution nationwide. But its authentic beginning in college sports helped Gatorade emerge as a drink for athletes, becoming an instant phenomenon. The *Gatorade Shower* at the end of American football games quickly followed as a tradition, and the brand was born. To this day, the University of Florida receives royalties each year, totaling more than \$80 million.



Grassroots followings can solidify the foundation of great brands

### Natura

Brazilian cosmetic direct seller Natura differentiated itself by being an early proponent of eco-friendly processes and positioning. Starting a refill program as early as 1983 and a longtime tagline of *Well-Being-Well*, Natura uses indigenous species, no animal testing and other hallmarks of a sustainability focus. Its Ekos line uses Brazilian plants and biodegradable packaging to differentiate itself from larger rival Avon. Could Natura be the next generation's Avon? The test will be whether the brand can transform and proliferate successfully abroad. It launched a flagship in Paris in 2005, entering the highly competitive and sophisticated European market but has delayed its planned 2009 U.S. launch.



Consistent positioning builds brand integrity

### Kellogg

Kellogg's from the beginning wanted to offer *better for you breakfast food* with its corn flakes in 1906. It strove for uniform quality and nutritional and health benefits in its products. W.K. Kellogg put his signature on each box to show that it was authentic, "The Original." He also was an early user of sampling, believing that if customer tried his cereal they would switch because of the higher-quality taste. Later, in the 1930s, Kellogg's was the first to fortify its breakfast cereals with spray vitamins, furthering their perceived quality compared to competitors.



Quality backed up by creative and consistent marketing strategies build winning brands

## Production Inefficiency

### Nike

On the inefficiency side, Nike found an opening in producing its shoes in low-cost Asian countries (then Japan), the first shoe brand to do so. At first Phil Knight, a former runner, distributed Tiger running shoes, but Bill Bowerman quickly persuaded him to design and source their own product in Japan (originally called Blue Ribbon Sports). Nike thereby overcame the scale economies that incumbent European competitors such as Adidas and Puma had established over the years. As a newcomer, Nike could design its products and source them in Asia and then market them aggressively with athletes to gain credibility and status in the U.S. market. While Nike did have the waffle technology innovation as well which made the shoe lighter-weight, it could not have broken into the athletic shoe industry without its approach to production. In 1971, the brand's name was changed to Nike, and Steve Prefontaine was recruited as a first endorser for the emerging shoe brand.



New production/cost structures can provide an entry point for a new brand

### H&M

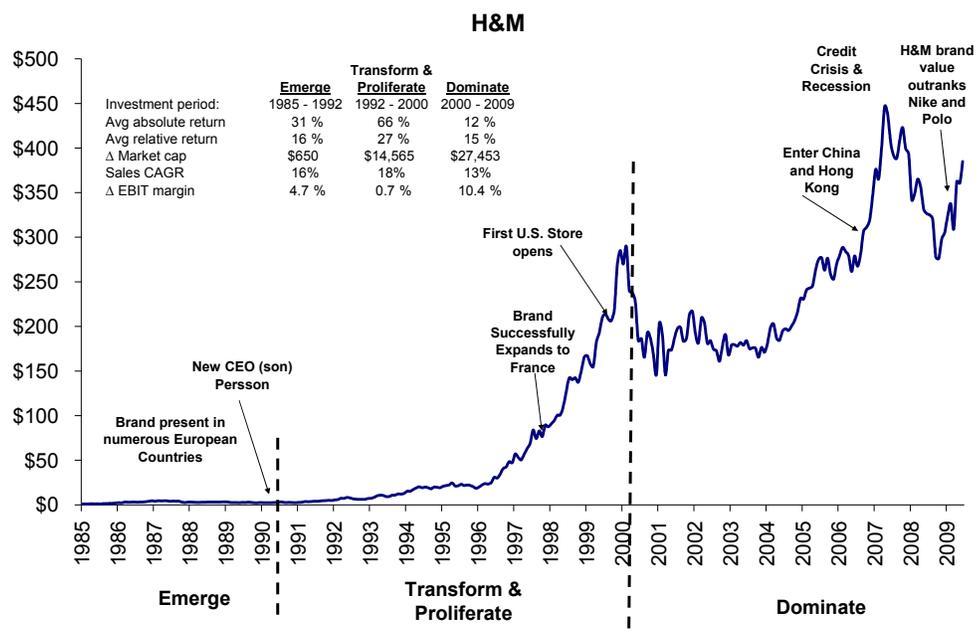
H&M started as a women's only store inspired by its founder's trip to the U.S. in 1947, where he saw the dynamic Macy's turning over its merchandise more quickly than shops in his native Sweden. After expanding in Sweden in the 1960s and several neighboring European countries in the early 1970s, H&M found its brand personality as a casual, fashionable brand which was in tune with the pop culture of the times. When H&M entered the stodgy German market in 1980, the retailer made headlines and put itself on the map. This was its breakthrough moment as it emerged as a retail fashion brand, and Germany



Time to market can define and differentiate a great brand

is still its largest country market. As for its innovation, H&M took the production of fashion apparel and segmented it into staples and fast fashion. The staples were slow-boated from low-wage countries, and the fashion items were produced closer to the markets in Europe, which was more expensive, but reduced the process time to under a month from design to store. H&M also integrated its information flows with suppliers' factories, to further facilitate rapid production times. This production innovation enabled H&M to offer current hot items, so-called *disposable fashion*, in subcollections to its customers.

**Exhibit 33: H&M Brand Lifecycle: The Market's View**



Source: Company data, Credit Suisse estimates.

## Distribution Inefficiency

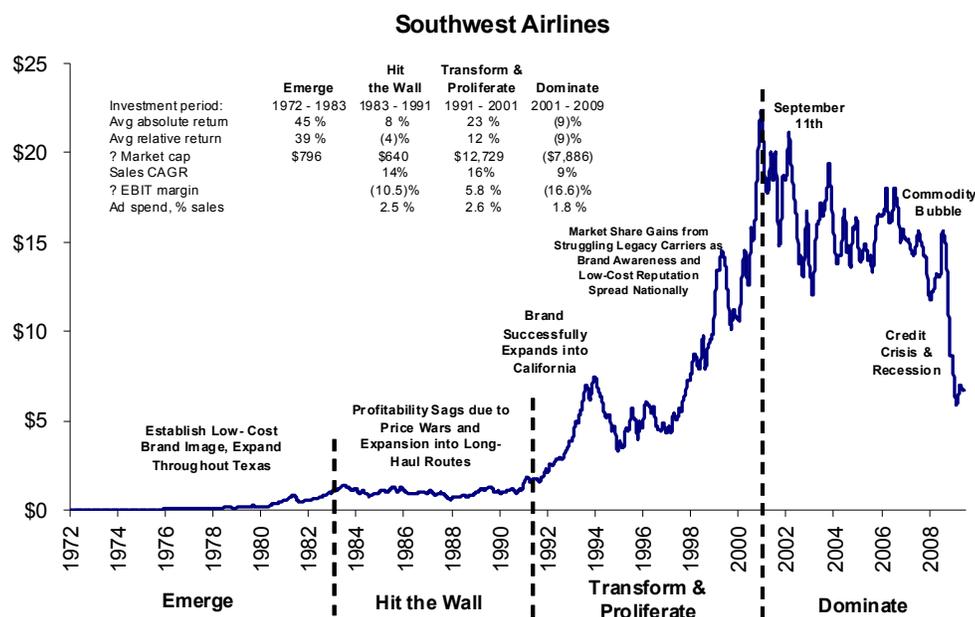
### Southwest

Founding Southwest to offer a low-cost alternative to driving in Texas, Herb Kelleher designed Southwest's operating model to be efficient and drastically different than competitors. He saw his competitors not as other airlines, but as buses. Because of regulation, Southwest was restricted to flying in Texas until 1979, which gave Southwest time to hone its operating process and gain critical mass, expanding to eight Texas cities. From the only Boeing 737 fleet to the multiple, short routes, and the *ten minute turnaround* goal at the gate, Southwest innovated the business process of operating an airline and cut costs as a result. These innovations are internally consistent with the low-cost brand positioning on which Southwest was founded. Growing from one million passengers flown in 1974 to five million in 1977 (when the company IPOed), Southwest built enough scale in Texas to emerge as a brand. During this time period, Southwest earned a relative rate of return of 39%, the highest of any of the brand's phases of growth. Southwest was profitable as of 1973 and continued to be so for 36 years, through 2009.



Pick your competition and enlarge the pie

### Exhibit 34: Southwest Airlines Brand Lifecycle: The Wall Street View



Source: Company data, Credit Suisse estimates.

#### Fedex

Fedex identified a distribution inefficiency in the need for time-sensitive delivery in the United States. of one to two day packages. By picking Memphis as a hub, known for its reliable good weather and lower congestion, Fedex focused its operating system on speed and reliability. Deregulation in 1977 allowed the company to expand its reach and fly larger aircraft.

#### Home Depot

The Home Depot created big-box warehouses that housed 25,000 SKUs of product under one roof, dwarfing local hardware stores' offerings. By keeping overhead low, it offered low prices and incredible selection to do-it-yourselfers and professional contractors, increasing customer convenience. Later, it layered on clinics and other service elements, but the product range and distribution method were key to the brand's emergence.

## Innovation and Inefficiency

#### ESPN

Some brands compete by innovating and tackling inefficiency simultaneously. ESPN combined higher-quality, dedicated, and proprietary sports programming with the new distribution channel of cable TV. As a first mover in cable sports programming, ESPN branded itself as the *first place for sports*. First envisioned as a dedicated sports program for Connecticut teams, father and son team Bill and Scott Rasmussen learned that buying a 24-hour national feed was cheaper than buying a few time slots in the age of cable television. Adjusting their plan, they focused on creating national programming like SportsCenter and acquiring sports rights such as the NCAA and MLB. One early move that caught the public's attention was its round-the-clock basketball coverage of March Madness, including all of the games that the networks were not showing. ESPN's product differentiation, with the top reporters for each sport onboard, was key in the emergence of this brand. Early on-air personalities such as Chris Berman, Bob Ley, Dick Vitale, and Tom Mees distinguished ESPN from its network competitors.



Manage expansion carefully to ensure delivering on the brand promise



Assortment can drive a great brand



Narrow focus works best for new brands

## Gillette

When King C. Gillette patented his safety razor in 1904, which was the first disposable razor on the market, it allowed men to stop sharpening their straight razors and just throw them away. The innovation of the double-edge, thin, stamped steel blade was a significant achievement, as this metal is difficult to sharpen sufficiently. Gillette himself was a tinkerer and long-time inventor, and relished the process. Gillette combined this innovation with automated manufacturing in multiple countries by 1908, building a production scale advantage quickly. When Gillette started, the razors were a significant investment for the average man, at \$5, or more than \$130 in current dollars. However, the convenience overwhelmed the price and Gillette razors and blades became a staple. Along the way, Gillette acquired competitors who sought to mimic his technology with slight modifications, preserving his virtual monopoly in the market.

## First- or Early-Mover Status

As a final note on the emerge phase, being a first mover, while helpful in certain instances, such as Johnson & Johnson, Gillette, ESPN, Disney, and Amazon, was not critical to such iconic brands as Polo Ralph Lauren, Apple and Toyota, who did it better, not first. Being an early mover, however, is a very common path for dominant iconic brands. In a survey of Credit-Suisse analysts, 75% of best-in-class brands were first or early movers in their product/service category.

One advantage of being first or early in a category is that your brand is closely linked with the category itself. This can be a valuable and long-lasting perception for customers to have, especially if they use the brand as a purchase short-cut. If a brand can lock-in a default position in the customer's mind, being first can be a hard nut for competitors to crack.

## Travelodge UK

Travelodge, the U.K. budget hotel chain, used a first-mover advantage to rapidly gain share from small, unbranded, independent inns and hotels. By being the first to provide a consistent budget experience for customers in 1985, the brand became synonymous with the category in the United Kingdom. It currently is the third largest hotel chain, with over 300 locations and has higher gross margins than these independent operators. By keeping its infrastructure efficient, the brand is able to keep costs and prices low. Most locations are roadside ones and 80%-plus of bookings are done online.

If the product or service is an aspirational/image-based purchase, the perception of setting trends and being innovative are key but being "first" is less so. Apple was not the first MP3 player, but it certainly captured the attention of consumers as an "early" player in the market. The claim to be first/early in these industries does not give a brand as much default power as the short-cut brands. Brands must stay current and innovative to maintain the early advantage.

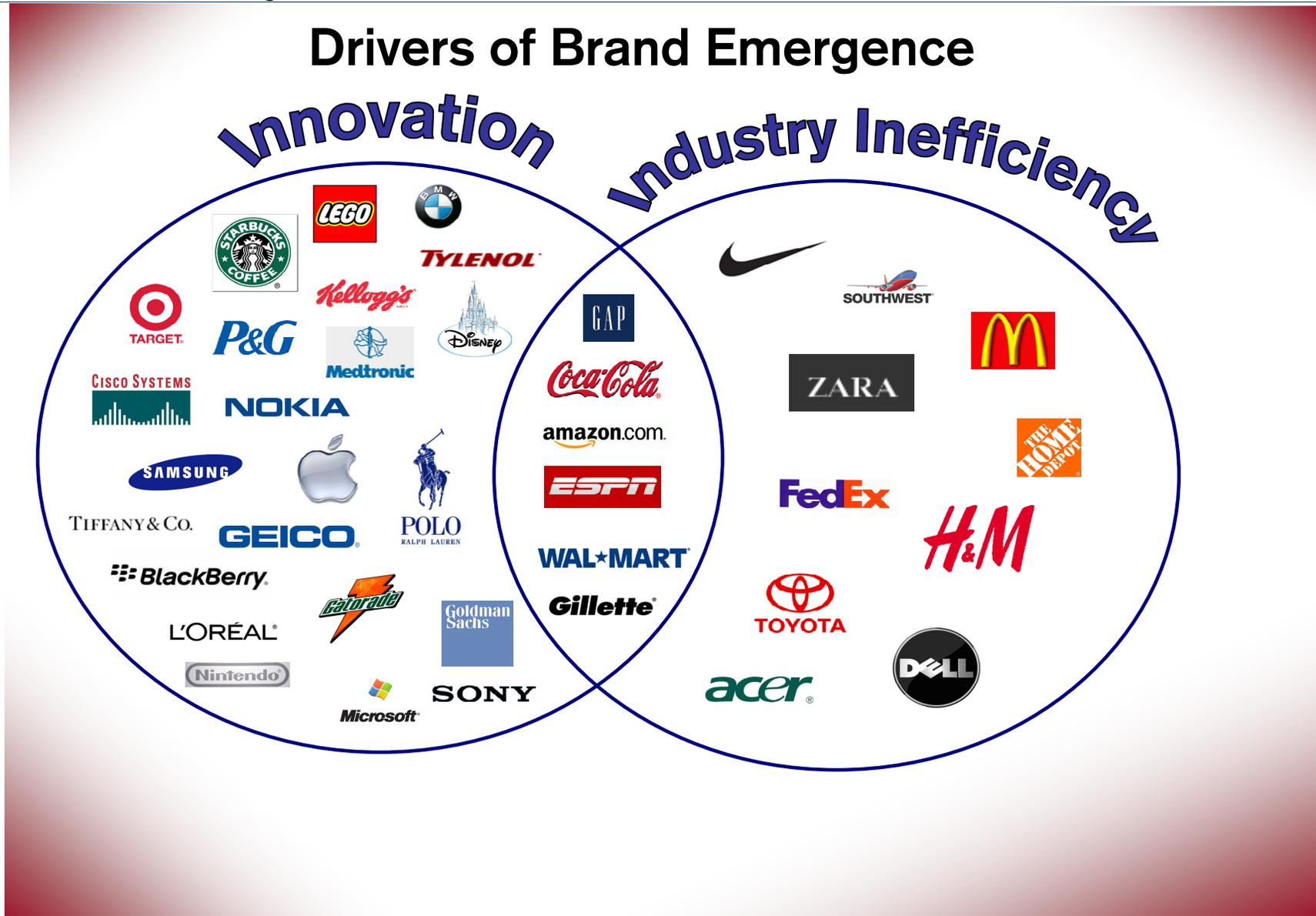
**Gillette®**

Building scale can protect a brand's position

**Travelodge**

Early-mover status and consistent execution conveyed ownership of a category

Exhibit 35: Drivers of Brand Emergence



Source: Company data, Credit Suisse estimates.

**Exhibit 36: Brand Emergence Checklist**

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**Checklist to Emerge:**

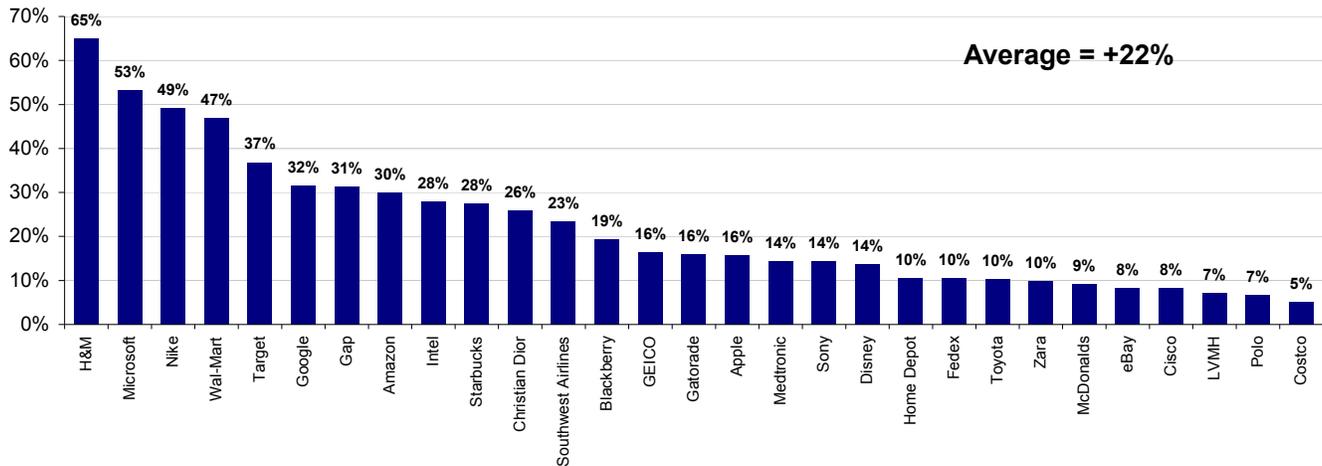
- Brandable Industry
  - New or Underserved Market
  - New Technology
  - Differentiated Product
  - Production Innovation
  - Distribution Innovation
  - Connection with Core Consumer
  - Effective Marketing Strategy as a Brand
  - Authentic Brand Intangibles
  - Sufficient Marketing Investment
  - Reliable Product/Service Quality
  - New Product/Service Category
  - Effective Management & Leadership
  - Robust Sales Growth in Core Market
  - Product Evolution & Investment
- 

*Source: Company data, Credit Suisse estimates.*

# Transform & Proliferate—When Brands Generate Huge Value

**Exhibit 37: Buy Back in For the Transform & Proliferate Phase**

**Average Annual Returns, Transformation & Proliferation Phase**



Source: Company data, Credit Suisse estimates.

After emerging, the brand must make the leap by being validated in the marketplace and proliferating. This phase is key for investors, as this is when, post-IPO, brands see the largest appreciation in stock price, averaging 22% in the brands tracked. In addition, it is the most perilous time for brands, as they maneuver to solidify their brand positioning. Nine factors, some required, some optional, determine whether a brand moves successfully through the transform and proliferate phase.

All brands by this point must possess a viable marketing strategy, reliable quality in their product or service and an effective management and leadership. With these foundations, a brand can then leverage one or more of several other brand-building factors to continue to differentiate itself in a compelling way to customers. These other optional factors include: product innovation, process innovation, sourcing or distribution control, network externalities, unique brand intangibles, or corporate culture. While not all of these are required, most iconic brands use several of them as levers to build and maintain their brand position and strength.

**Exhibit 38: Transform & Proliferate Checklist**

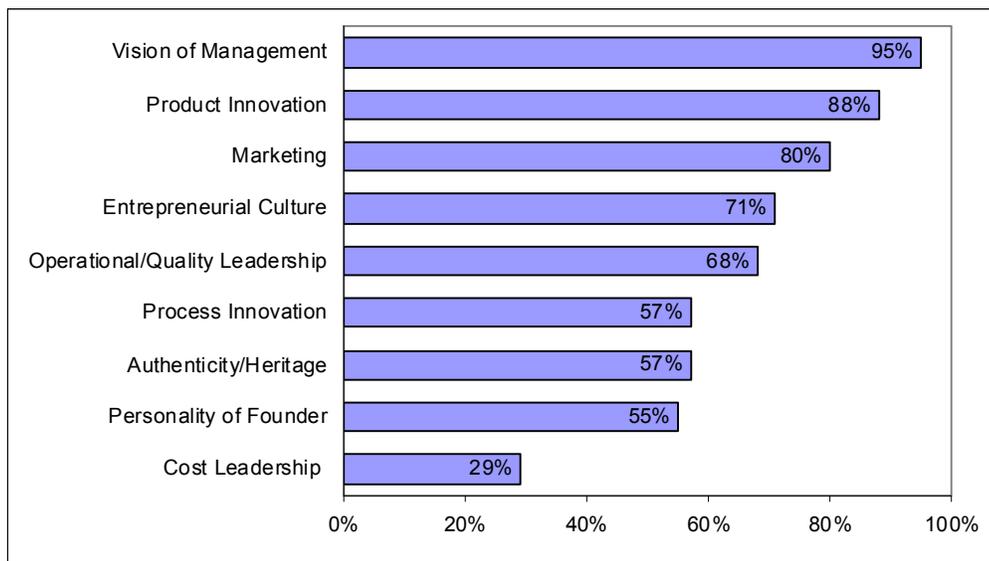
**Checklist to Transform & Proliferate:**

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

Source: Company data, Credit Suisse estimates.

In terms of building great brands, management’s vision and product innovation top the list of success factors in making the leap to greatness for brands, according to Credit Suisse analysts. Marketing strategy was a close third, with 80% of analysts citing it as important to the brand’s transform and proliferate phase.

**Exhibit 39: Credit Suisse Analysts Speak: The Relative Importance of Transform & Proliferate Factors**



Source: Credit Suisse estimates.

**Marketing Strategy**

Marketing strategy is the first required criteria for a brand to make the leap beyond the emerging phase of development. Market strategy can encompass everything from advertising to positioning to pricing to brand architecture. Whether it is an emotional brand

personality, such as Marlboro, or an end-user strategy such as Intel that disintermediates the industry, marketing strategy plays a key role in every brand's validation and expansion.

**Intel**

While Intel was known for its rapid product innovation and its proprietary manufacturing processes, its 1991 Intel Inside cooperative ad campaign, produced internally, catapulted the brand to high-awareness among end-users (consumers) instead of just OEM manufacturers. This positioned the brand to take full advantage of the high-growth 1990s in the PC industry. By branding an "ingredient," Intel succeeded in pulling its product through manufacturers, something only a handful of ingredient brands have ever been able to do. Intel spent more as a percentage of sales on SG&A in 1992 than R&D (17.4% versus 13.3%), which continued through the late 1990s. This investment in brand building paid off as it is one of only two brands to be highlighted (the other being Microsoft) on the exterior of most computers, besides the computer brand itself, indicating its branding power.

The other successful element to Intel's marketing strategy was to begin to name their chips, such as Pentium, instead of using a string of numbers (386, 486, etc.), which were not able to receive trademark protection. In an industry that is invisible to end users and easily copied by competitors, these two elements of Intel's marketing strategy solidified the company's position in the microprocessor industry until the early 2000s.

**Marlboro**

Marlboro built a valuable and powerful brand in cigarettes, even preserving its position as the industry is in decline. Marlboro did not have a straight line path to market prowess, starting its existence as a women's cigarette in the United Kingdom before World War II. When launched in the United States in 1995, the brand was repositioned as an American, macho, independent brand, embodied in various hyper-masculine roles, including a tattooed man, a Navy officer, sports players, and a cowboy, developed by Leo Burnett. With the *Marlboro Country* campaign of 1963, Marlboro created a mythical place as well, focusing on the cowboy. The final benefit for the brand came, ironically, when TV advertising was banned for cigarettes in the United States in 1971. As the Marlboro man was already so recognizable, even when silent, the brand continued to grow share and awareness.

By the 1980s, Marlboro was the best-selling brand of cigarettes in the United States and the world and ranked as one of the top two advertisers in print and outdoor spending. In 1992, it was named the most valuable brand in the world. More recently, with the backlash against the health consequences of cigarettes, the industry has shifted marketing strategies and budgets dramatically from print and outdoor advertising to in-store trade and consumer price promotion offers. In making this shift, it is open to debate whether brands will continue to be as valuable in this industry, as perceived differentiation declines further and price becomes a bigger purchasing factor for consumers.

**Moutai**

Moutai, the dominant leader of sauce-fragranced hard liquor in China with 80% market share, hones its image of luxury and quality, while simultaneously using its power with distributors to create the illusion of scarcity. The official national liquor of China since 1951 and the favored gift of Chinese embassies, this liquor embodies Chinese authenticity and luxury. However, it has less than 10% of the liquor market as a whole, pointing to the next challenge for the brand: how to transform and proliferate into a more flexible brand that can capture more share. International sales are also miniscule, at 3% of revenues, although the brand has been pushing for greater presence in duty-free shops. While the stock has had a dramatic run up in the past three years, more than doubling, the brand could be in the process of hitting the wall.

**Target**

Target started with a conservative and methodical approach to growth in the 1960s and early 1970s, which held the seeds of its future brand strength in marketing strategy. It



Branding an ingredient can work with a focused marketing strategy



Marketing consistency builds lasting, valuable brands



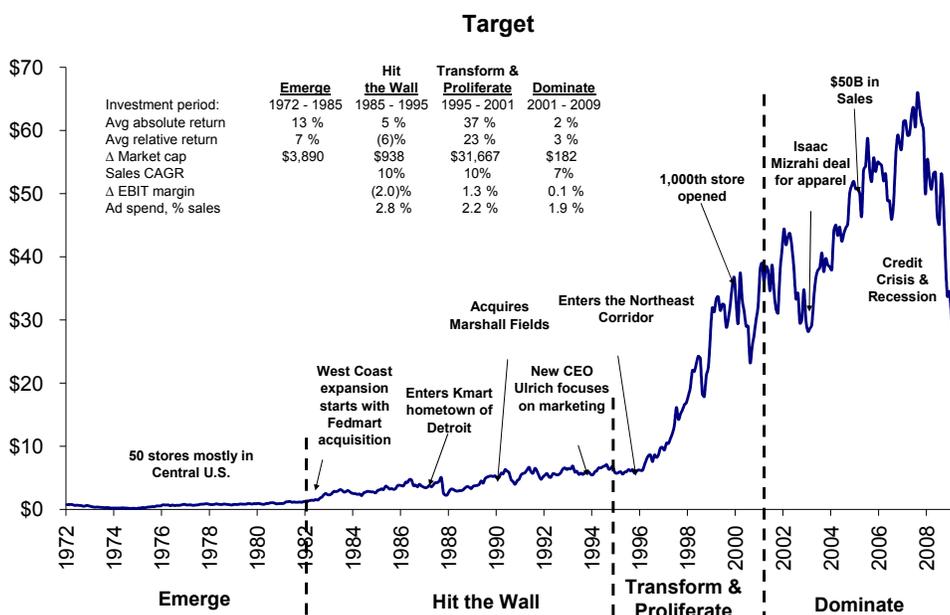
Scarcity, or the illusion of it, backed up by authenticity is a powerful branding combination



Bringing new customers into a market carves off a position for a new brand

started its own in-house advertising department in 1968 and strengthened its apparel offerings in 1969. From the beginning, Target aimed to bring a new, more upscale, customer into the discount channel, creating its own white space. At first, the brand focused on a more contemporary store design, no public address systems or muzak. Then, the brand's success came in the 1980s from its marketing campaigns, proprietary brands and brand personality of "Chez Tar-zhay." It tightly managed its store growth, despite numerous small acquisitions in the 1980s, growing from \$1.1 billion in sales in 1979 to \$9 billion in 1991. During this time, a commercial with DiDi Conn first used the *tar-zhay* pronunciation of the brand's name, later popularized by Oprah Winfrey in the 1990s. The 1980s was also the time when Target broke out of the Midwest, expanding to the West Coast and dominating in Southern California. Target developed its marketing strategy of proprietary brand growth under long-time head of marketing John Pellegrine. Once it had its formula right, it entered the competitive Northeast Corridor market in 1996, which is when its trajectory accelerated, more than doubling sales to \$33 billion in 2001 from \$15 billion in 1995.

**Exhibit 40: Target Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

## Reliable Product/Service Quality

One key role that brands play in the purchasing decision is to let the customer know that what they are buying will meet their expectations of quality. No matter how good the marketing, if a product or service fails to meet or exceed quality expectations, the brand will fade into obscurity.

### Tylenol

Founded as a sterile bandage and suture company over 120 years ago, Johnson & Johnson positioned its brands, such as Tylenol, as products that consumers, and doctors, could trust. Reputation for product quality was paramount in the brand's growth, which was validated by endorsements from doctors. While the acetaminophen formulary was new and gentler on the stomach, it was "the pain reliever that doctor's and pediatrician's recommend most." After five years as a prescription medication, in 1960, Tylenol went over the counter and started telling consumers to "Trust Tylenol."

The brand went through a crisis in 1982 when this trust was imperiled by in-store tampering of its capsules. In Chicago, seven people died as a result of cyanide put into Tylenol capsules. Tylenol is credited with superb handling of this crisis, by issuing a total



Trust, underpinned by quality, is critical to maintaining a brand

recall of their products nationwide within a week (\$100 million in retail value) and then launching new, tamper-proof packaging innovations. While the brand's market share plummeted to 8% from 35% following the poisonings, within a year, its share had rebounded. The brand not only addressed consumers' fears but also used its 2,000-plus sales people to present to doctors and nurses to restore confidence and trust.

### Lego

Privately held and family-run Lego has kept the quality of its products intact since the 1958 patent on its brick design. The founder, a carpenter in Denmark, gave the company its mission, *only the best is good enough*. The company currently owns its production facilities, a strategy from which it briefly departed in 2007 owing to profitability problems, outsourcing some of its electronics parts production. It quickly backpedaled on this decision, and now produces all of the 2,200 possible elements and 55 colors in the Lego range itself. Its production tolerances are tight, with its injection molding machines accurate to two-thousandth of a millimeter (0.002 mm). It claims to have only 18 errors per million, a remarkable quality achievement. And any parent that has assembled a 300-plus piece project with their child has been amazed that all of the required pieces are always included. Furthermore, the company developed a proprietary ABS plastic material for its blocks, that give them clutch power, shine, color stability and resistance to nicking.

### Northwestern Mutual Life

Life insurer Northwestern Mutual Life has a reputation of rock-solid quality, in terms of dividend payout and credit rating. This reputation for financial stability is key in the life insurance business, because if a brand does not have staying power, customers will not trust that they will ever see their policies made good. *The Quiet Company* has been around since 1857 and has been voted the most admired life insurance brand for a staggering 25 years in a row by Fortune Magazine. In the midst of the current financial crisis, Northwestern Mutual has maintained the highest available ratings for insurance financial strength from all four ratings agencies.

The brand achieves this reputation for quality based on a consistent investment strategy and conservative underwriting and pricing policies. Employees are trained on the financial security pyramid to help customers manage their risks in a conservative manner. The starting point is to provide risk protection for early death and disability, which is where customer relationships originate for the brand's life insurance products. This reputation for quality and reliability translates into 96% customer loyalty, driving down customer churn costs for the brand. It also provides steady asset growth, with over \$1 trillion of policies in force.

## Leadership/Management

Leadership is an amorphous term that can mean different things to different people. In the branding context, it means setting a vision and guiding the brand through the potential derailing choices presented as a company grows. What a brand says no to can be as important to its success, which comes from the top. Steve Jobs at Apple and Howard Schultz at Starbucks founded the brands and then were brought back in during times of trouble to revitalize and redirect the brand's trajectory. Leaders, with their vision and communication, bring the brand's organization along the chosen path, or fail to do so, as in the case of Kodak.

### Apple

Steve Jobs was one of three founders of Apple Computer in 1976 and was a leader in pushing for ground-breaking innovation and distinctive design. In 1979, while visiting Xerox PARC research facility, he saw the graphical user interface, which centered around a mouse, and adopted this as Apple's platform for software development. Jobs led the team that developed the Macintosh in 1984, with its anti-establishment ad based on Orwell's *1984*. Despite the Macintosh's success, Jobs was forced to resign from the company in 1985 after a power struggle with new CEO John Sculley. During the next decade, Apple continued to innovate with the Powerbook, which was ground breaking for



Rigorous quality standards can build a lasting reputation and brand



Trust in financial services is a must for a brand



A great CEO can almost embody a brand

laptop computer design. Model proliferation followed with other less successful products, such as the Newton, cameras and TV appliances, none of which were break-out hits. With the rise of Microsoft in the 1990s and its market share gains through cheaper PCs, Apple looked expensive and not as cutting-edge, while the Macintosh platform was not powerful enough.

In 1997, Jobs returned, first as an advisor and then as CEO, and in 1998, Apple returned to profitability with the iMac. Jobs led the company with his vision of break-through technological innovation and his passion for aesthetic design. He became the face of the brand, presenting keynote speeches as well as product introductions, and embodying its anti-establishment corporate culture, going barefoot around the office. With Jobs at the helm, Apple launched the iPod, iTunes store, and the iPhone. None of these products was the first mover in its segment, but all dominated and set the industry's direction once introduced.

**Starbucks**

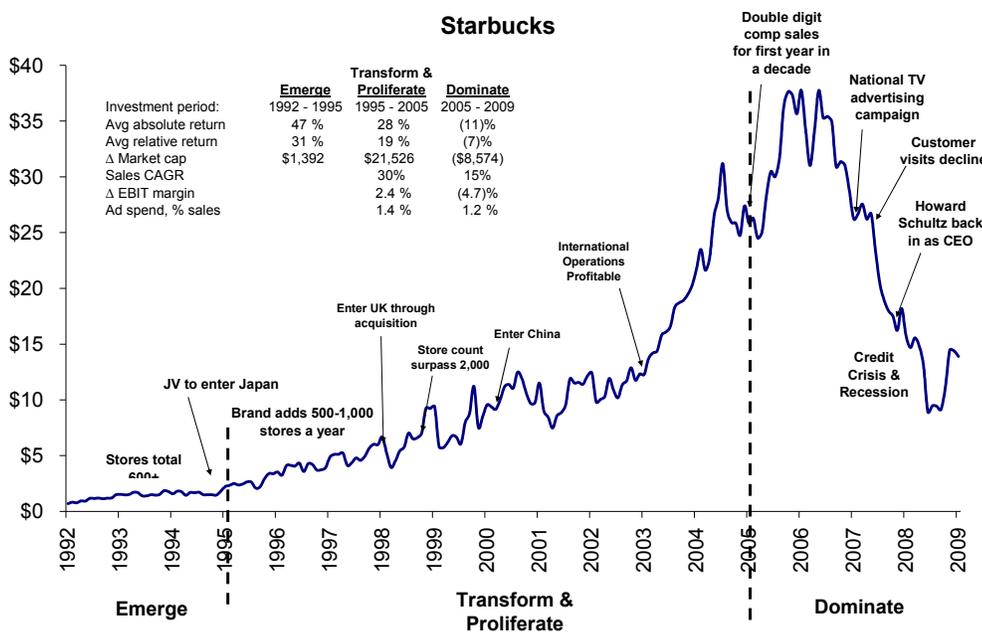
Howard Schultz, CEO from 1987-2000 and most recently brought back by the board to be CEO again in 2008 until the present, led Starbucks from through the brand's emergence (renaming Il Giornale to Starbucks in 1987) through its Proliferation phase, with store growth topping 500-1,000 stores annually from 1996 on, including stunning international growth. A key part of his leadership was the vision of the brand which was rooted in high-quality coffee ("perfectly made beverage") as well as the store experience.



Leaders must keep a brand from losing its focus

Most recent, the board's faith in Schultz's ability to renew Starbucks after too rapid expansion and tough economic times started with him memo to then-CEO Jim Donald in 2007. Schultz highlighted the need for Starbucks to refocus on quality, instead of efficiency, which had been the push for the past several years as the company grew. Schultz's remedy was a laser-like focus on the customer and to increase the passion again. He offered a number of specific recommendations, from grinding coffee again in the stores to making the stores themselves less cookie-cutter. After retaking the helm in January 2008, Schultz has planned to close nearly 1,000 stores in the United States and internationally. Whether this slowing of expansion and refocusing on the customer will give the Starbucks brand the longevity of an iconic brand remains to be seen.

**Exhibit 41: Starbucks Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

**P&G**

P&G's brand management structure was pioneering when the company organized its employees in 1931. By having brand managers as champions and long-term planners, P&G put managing consumer brand equity at the forefront of its management focus. When it went international, it replicated its U.S. corporate structure with a country manager with brand managers beneath them. The company launched an initiative to change to a matrix organization (both brand and geography) by 2005, but this proved to be too much change, too fast for employees and managers resulting in confusion and low morale. So P&G reverted to its previous, tried-and-true brand management structure again.

P&G's management style is also distinctive for its conservativeness and methodical nature. P&G managers take the long-term view in the product development process and continue to tweak the product until it is just right. This patient, deliberative management style of waiting until it is right vs. going to market quickly is key to maintaining quality and pricing-competitiveness of P&G's products.

**Product Innovation**

One way to be a perpetual innovator is consistently to improve your product (the other is to innovate business processes). Brands such as Disney, L'Oreal, Medtronic and Goldman Sachs exemplify this strategy across a range of industries. They have all pushed the envelope in product design and functionality since their inception, and innovation was what differentiated them from their competitors.

**Disney**

When Walt Disney founded his animation company in 1923, he created the first synchronized sound animation cartoon with Mickey Mouse, followed quickly by the first feature-length cartoon, *Snow White and the Seven Dwarfs*. He also innovated with mixing live action, animation and animatronics with *Mary Poppins* in 1964. His theme parks also broke new ground in 1952 by being fun for the whole family, not just the kids. The company continued to update its parks constantly, to make enhancements to the guest's experience. This consistent product innovation led to the branding of Disney entertainment as not only imaginative and family-oriented but truly ground-breaking.

**L'Oreal**

Now a house of over 500 brands worldwide, 23 of which are global, French beauty giant L'Oreal began one hundred years ago with a chemist's new hair color formula. It followed with additional innovations, such as the first sunscreen and the first mass market soap-free shampoo. The company currently has over 2,000 researchers in five global research centers, ten times more people than competitor Revlon. L'Oreal outspends Revlon two to one on R&D as a percentage of sales and continues to grow this spending, compared to a three-year flat budget of Revlon. While L'Oreal's R&D spending is just one-tenth by its advertising spending, it does give the company a competitive edge and is authentic with their heritage of innovation. It has legally protected their innovation, as the company is the top nanotechnology patent holder in the U.S.

**Medtronic**

Medtronic began as a pacemaker manufacturer, first for use in hospitals then implantable on-demand versions. By working closely with doctors, Medtronic identified promising areas of innovation. The company's record on product innovation expanded into managing chronic diseases, such as insulin pumps and neurological devices. During its transform and proliferate phase, R&D spending doubled in 1985-88, reconfirming its innovation focus. It also went to a direct sales force model internationally, which brought it to 120 countries. Medtronic then began an acquisition spree, acquiring close to a dozen medical technology companies, to keep itself on the cutting edge.



A management structure can cultivate multiple layers of brand advocates



A reputation for continuous innovation is invaluable

**L'ORÉAL®**

Outspending competitors on R&D can define a house of brands



Betting on R&D during this critical phase can be a strategic win

### Goldman Sachs

Goldman Sachs began as a partnership back in 1869, but broke through when it pioneered the commercial paper market for entrepreneurs and entered the IPO market with the Sears IPO in 1906. Continuing to innovate into new segments, the company then moved from trading to emphasize investment banking in 1930 under the leadership of Sidney Weinberg, becoming a trusted adviser to companies at all stages of its development and financing needs. The Ford IPO of 1956, where Goldman was the lead underwriter, was the beginning of a period of dominance when Goldman was sought after by companies preparing for an IPO because of the status and trust that the Goldman name implied. Goldman solidified its brand positioning as a trusted, long-term focused advisor in 1974, when the firm pledged not to be a party to advising hostile takeovers, going against the grain of the current rage on Wall Street. More recent, Goldman has thrived on advising companies on mergers and acquisitions, topping the league tables for global M&A volume for the past five years straight. During the recent financial crisis, a flight to quality, in terms of transaction advice, should only accelerate Goldman's dominance of M&A.



Innovation in financial services builds a foundation for growth

## Process Innovation

In addition to product innovation, the other way to be a perpetual innovator is to change the business processes of the industry. Brands such as Southwest, Zara, and Toyota choose to compete as process innovators to eliminate costs, time or waste in their respective businesses.

### Southwest Airlines

Founding Southwest to offer a low-cost alternative to driving in Texas, Herb Kelleher designed Southwest's operating model to be efficient and drastically different than competitors. Starting with the fleet, all Boeing 737s, to the airports served, secondary ones that were less congested and cheaper, to the *point-to-point* routing (versus hub-and-spoke) and the ten minute turnaround goal at the gate, Southwest redesigned the business process of operating an airline. Its customers feel the innovation in the limited snacks onboard, the boarding groups method of loading passengers and the lack of in-flight entertainment. These innovations are internally consistent with the low-cost brand positioning on which Southwest was founded.



Cheaper operating models can define a brand

### Zara

Spanish retailer Zara streamlined the business process in the fashion industry to create fast fashion, the basis for its global brand. The starting premise of the brand's founder, Amancio Ortega, was to listen to the customer instead of trying to predict fashion. To do this, Zara had to be able to quickly design, manufacture and distribute product to its stores in record time. It did so by owning over half of its factories and locating these close to its markets (instead of low-wage far-away countries in Asia). It invested early on in a computerized design system as well as an IT system that linked factories to stores directly. By making these process innovations, Zara reduced the elapsed time from design to store shelf to two to four weeks, compared with an industry average of six months. This had several brand-building and financial, benefits. On the brand-building side, customers perceive the scarcity of products, increasing their desirability and uniqueness. This then increases the frequency of customer visits to Zara. Because of its shorter cycle time, Zara is able to appear to be on target with its fashions, increasing its desirability. On the financial side, the fast fashion innovation leads to fewer, smaller fashion disasters, lowering the percentage of markdowns required. It also increases inventory turns and uses the company's cash more efficiently. International expansion is testing Zara's process innovations currently, as it operates in more remote markets.

ZARA

Building capabilities to respond quickly to trends pays dividends in branding

## Toyota

Toyota designed the Toyota Production System in the 1950s and 1960s to smooth out the car production process, eliminate waste (time, motion and inventory) and increase quality. Now known commonly as *just in time* manufacturing, Toyota's new process was drastically different than the car industry's norm. Each step in the process produces just what is needed for the next step, which significantly reduced the cash in work-in-process inventory. As a result of this process innovation, Toyota car quality became legendary as the company also reduced costly production defects.

When Toyota entered the U.S. market in 1957, its production volumes went up significantly, but it was not until the 1973 oil crisis that U.S. consumers flocked to the brand. As it grew in size, it added supplier flexibility to its production system, enabling it to receive parts just when it needed them from suppliers, again reducing cash needs. It also added a warranty for 36,000 miles or three years in the United States, which helped reinforce the perception of quality.

Based on this platform of quality, Toyota was able to extend its brand first to luxury cars, with the Lexus brand in 1989, then to full-size pick-up trucks in the early 1990s, and the hybrid brand Prius in 1997. Without the reputation for quality, such brand extensions would have failed. The brand gained share in the United States since 2001, with its Corolla and Camry sedans as the backbone of its success. In 2008, Toyota unseated GM as the world's largest car maker with close to 70% customer retention, the highest in the industry. In 2010, a large set of recalls on Toyota vehicles presented a major obstacle for the future of Toyota. It remains to be seen how or if the brand will be able to weather this event.

## Control over Sourcing and Distribution

Power players can compete by closely managing their supply chains and/or distribution channels. Examples of this branding strategy include Coke with its bottlers, McDonald's with its franchisees and Costco and Medco with suppliers. In addition, some of these brands then proceed to compete on value, passing on some of the resulting cost-savings to their customers (e.g., Costco and McDonald's). Others use the control primarily for quality and reliability purposes, such as Coke and Proctor & Gamble.

### Coke

Since its inception, Coke has pioneered distribution innovations, such as the first coin-operated open-top cooler, the precursor to the vending machine in 1929 and the first automated soda fountain dispenser, which mixed the syrup and water to deliver a consistent taste in 1933. These sorts of innovations were key to Coke's emergence, by ensuring uniform quality and increasing distribution points. But the real factor that helped it make the leap was its bottler system.

Coke built its expansion on its 300 bottling partners around the world, the so-called Coca-Cola System, which enabled it to expand rapidly and stay in touch with local markets, especially as it grew overseas. Coke sells the bottlers the concentrate and then the bottlers add the carbonated water and sweeteners, the ratios of which the bottlers can adjust to local preferences. The company bottles/cans the product, sells it, distributes it, and merchandises it in the stores. Coke gives each bottler an exclusive territorial franchise. More recent, Coke has invested directly in its bottlers with minority stakes with the aim to consolidate them into "anchor bottlers." Coke began this process in 1980 and spun off Coca-Cola Enterprises, the vehicle through which this consolidation was being orchestrated in the United States, in 1986. Internationally, bottlers remain largely independent.



Innovative manufacturing processes helped drive brand strength



Distribution control is critical to building a brand

**McDonald's**

McDonald's has pioneered a distribution and financial model that relies heavily on franchisees. However, McDonald's has managed to retain control of its brand and service quality by being the owner of and decision maker on locations. By renting the locations to franchisees (with about a 40% mark-up), McDonald's avoids being held hostage to bad franchisees. The franchisee model has other advantages as well, the largest being as a laboratory for new ideas. Such iconic innovations as the Big Mac, the Egg McMuffin, Filet-o-Fish, and even Ronald McDonald came from franchisees, which behave as the entrepreneurs they are. The 5,000 franchisees worldwide bring a local touch to a large global brand as well, letting it adapt to tastes and cultures.



Franchising can mix off-loading financial risk with tight control of brand consistency

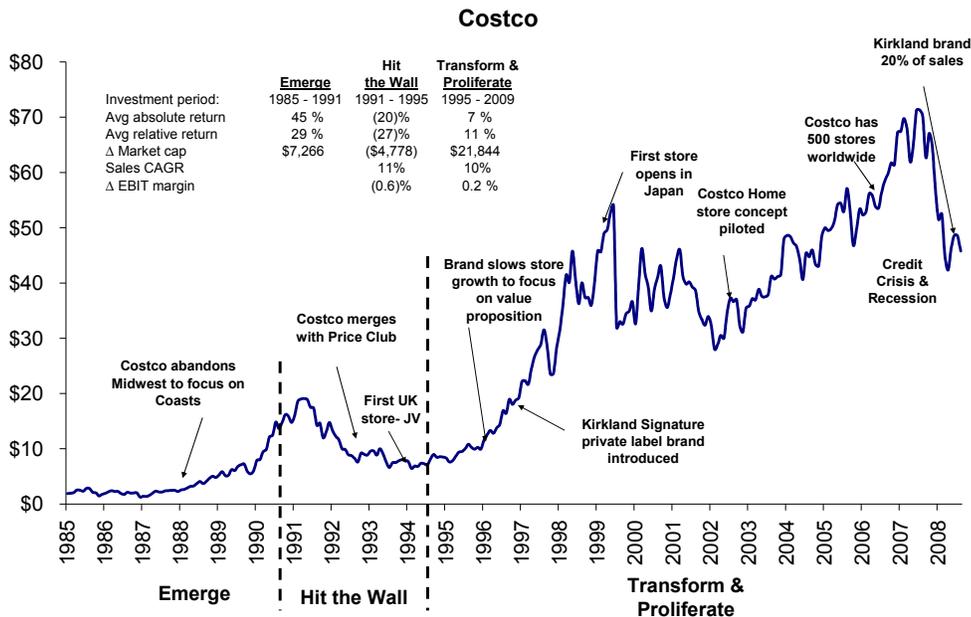
**Costco**

Costco from its inception was designed to be a low-priced way for small business owners and individuals to shop for branded products. By stripping out operating costs, such as stocking and salesperson labor, real estate costs, and advertising, Costco was able to deliver savings to customers. However, its additional insight was to pick one or two brands per product category, the highest quality ones, and negotiate hard on price. The company called this its focused buying strategy, and it increased Costco's power with suppliers. These strategies enabled Costco to offer the best brands at 20-50% less than other channels. More recent, Costco has been building its own store brand, Kirkland, which spans grocery items, hardlines, and softlines. By offering no-hassle returns, Costco lowered the risk for customers to sample the Kirkland brand. The value positioning of the Kirkland brand is clear and consistent to customers.



Narrowing assortment can be a positive point of brand differentiation

**Exhibit 42: Costco Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

**Medco**

Medco was founded in 1983 by identifying a white space of prescriptions by mail, which accounted for only 2% of prescriptions in the United States. Within 10 years, it had 3,000 employers signed up, with 36 million workers. The brand has grown to over 60 million consumers, filled nearly 600 million prescriptions in 2008, and begun to expand internationally through acquisition. Almost half of the company's \$51 billion in revenue is its mail-order business, more than its two closest competitors combined. The remainder of revenue is from prescriptions filled in traditional pharmacies. Medco uses its volume of purchases to demand discounts from pharmaceutical suppliers, a positioning made easier



Adding a new channel can create space for a brand to compete

now that it is independent of Merck (as of 2003). In addition, Medco has built two automatic dispensing pharmacies to further remove costs from the distribution process for mail-order and call center prescription fulfillment, and is continuing to expand this infrastructure. Medco passes on some of these accumulated savings, 20% on average, to employers, who have a high retention rate (96%) with Medco.

The brand's focus on supplier control does have downside risk. There recently has been some controversy about Medco's Prescriber's Choice plan launched in the early 1990s. This program introduced formulary (recommended drugs) that were based on price, negotiated by Medco. If a doctor prescribed a higher-priced drug, Medco would call and ask the doctor if they would like to switch to a lower-priced option, which the doctor would often do. Whether a PBM should be taking this role has been hotly debated. So far, this has not led to any major pharmaceutical company refusing to deal with Medco, a testament to the brand's power in the PBM market.

## Network Externalities

Another type of power player are those brands that leverage their installed customer base or other assets to raise switching costs for their customers and increase loyalty by creating network externalities. Microsoft and Bloomberg are prime examples of the installed base strategy. Google is the scale benefits, as growth reinforces their key operating model of accurate search.

### Microsoft

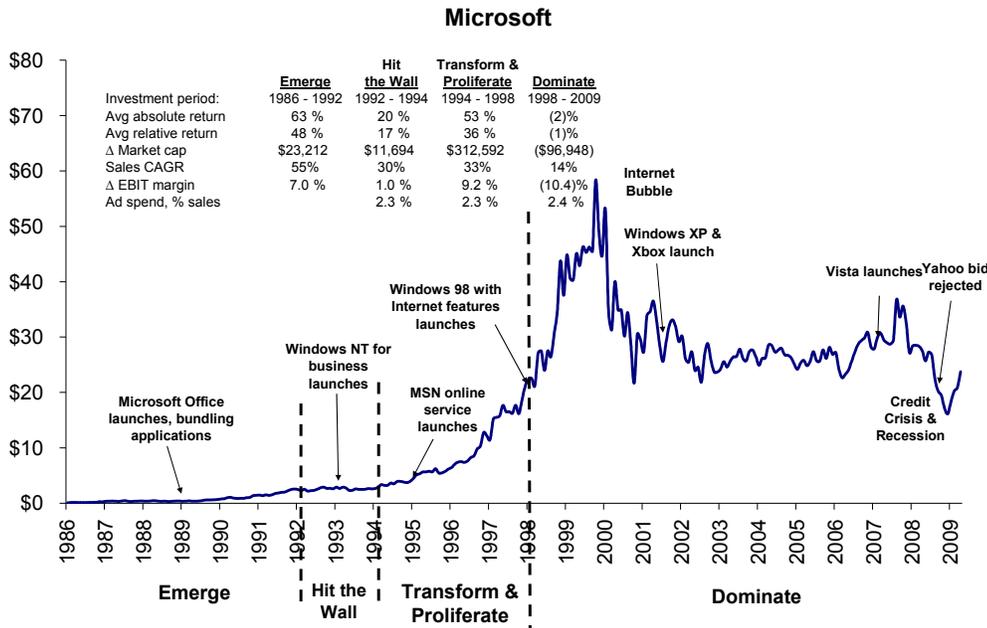
Microsoft's emergence and success in transforming and proliferating rested largely on its ability to quickly create an installed base that would then increase the switching costs for existing customers and increase the incentives for new customers to buy Microsoft's operating system and productivity software. After landing the IBM PC operating system contract in 1981, Microsoft quickly realized the potential of the PC clones and aggressively marketed its MS-DOS program to these manufacturers. It then began selling its Windows version directly to consumers in 1985.

The other strategy, which was more controversial, was the bundling of its productivity software into Microsoft Office. By selling these programs together as a package, Microsoft gained share in the application software segment of the market. Later, with Windows 98 and Internet Explorer, there were legal challenges to Microsoft's allegedly anticompetitive bundling practices. The establishment of an installed base and bundling were key to Microsoft dominating the desktop computer market.



Switching costs can  
entrench a brand

**Exhibit 43: Microsoft Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

**Bloomberg**

The powerhouse business-to-business financial software and information brand reaps the rewards of its net installs of its Bloomberg terminals. Numbering 250,000-plus worldwide, these terminals are the conduit through which professional traders, initially, and more recently lawyers, business people, and individual investors receive and manage data and news. The terminals also provide communication tools (e-mail/messaging), TV, and radio content, and a trading platform. Set up as a prepaid subscription service that is sold as a bundle with no volume discount, the Bloomberg terminal became indispensable to buy-side traders by leveling the playing field of information with the sell-side. Initially based on innovative analytical software which differentiated the brand from established giants such as Dow Jones and Thomson Reuters, Bloomberg now relies as much on its installed base as on innovation. With a huge number of traders trained on the Bloomberg unique keyboard and keystrokes, companies are loath to switch systems because of the steep learning curve. The company even has a policy of letting any user who loses his job keep his Bloomberg for four months free-of-charge, which reduces customer churn. With estimated operating margins of 30%, compared with competitors that are ten percentage points lower, Bloomberg's power player branding strategy is compelling.

**Google**

Starting with a new algorithm, the patented PageRank, which took into account links and referrals to Web sites in search results, Google built a clean, simple, quick-loading search engine that quickly differentiated itself from competitors Alta Vista and Excite. Not only did it yield more relevant results, but it created a scale effect as the Internet grew (and links between Web sites grew in number), causing Google's algorithm to improve exponentially. Its inventory of billions of indexed Web pages also proved a daunting barrier to entry to competitors. Meshing a higher-quality service with an externality that was self reinforcing, Google became the dominant search engine, and officially a verb to describe online search in Webster's dictionary in 2006.

**Unique Brand Intangibles**

While every great brand must have some marketing capabilities, some brands become Aspirational Marketing Machines creating powerful and unique brand intangibles, such as Disney, LVMH, MINI Cooper, Budweiser, and even GEICO. These brands reflect their

**Bloomberg**

Steep learning curves can keep a brand in a strong position



Growth can be self reinforcing to brand business models

customers' values and inspire their customers' dreams. By giving the brand a distinct personality that resonates with the customer and an authenticity that is not easily replicated, some brands use unique brand intangibles to differentiate themselves.

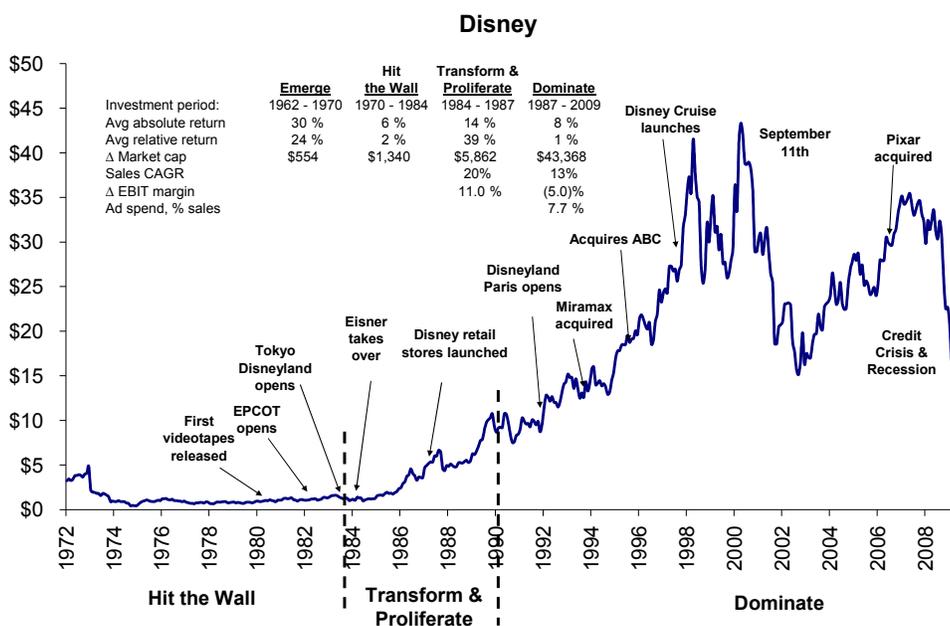
**Disney**

The Disney *magic*, known the world over, relates to the brand's storytelling, creativity, and its ability to awe young children. It also links connotations of wholesome family entertainment to children's fantasy worlds, which differentiates it from competitors. Disney is fairly timeless, which pays dividends when Disney monetizes its library of movies. To preserve this brand image, Disney consistently invests about 7-8% of sales in direct advertising spending, most recently \$2.9 billion or 7.7% of sales in 2008. It also limits the ability of customers to buy its movies, creating scarcity and exclusivity for its older titles, such as the princess movies, releasing only one per year on DVD. The Disney retail chain gives these brand attributes a home in the physical world.



Owning a unique positioning in consumer's minds underpins powerful brands

**Exhibit 44: Disney Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

**LVMH**

LVMH has built a stable of luxury brands based on their individual unique brand intangibles. Whether the brand is a historic (1593 anyone?) or modern brand, LVMH consciously looks for authentic brands with clear brand associations and personalities. The flagship Louis Vuitton brand, 70% of the group's profits in the first half of 2009, has a rich heritage of craftsmanship starting with steamer trunks in the 1850s. Moët & Chandon, founded the previous century, embody champagne and celebration. The company acquired unique fashion and accessories brands, such as Donna Karan, Celine, TAG Heuer, and Marc Jacobs. The commonalities that LVMH looks for when acquiring new brands include: luxury, creativity, innovation, and passion. The company has acquired many new and established brands and integrated them into a corporation as small, autonomous entrepreneurial subsidiaries, preserving their unique natures and cultures, key to keeping the design talent happy. The company also invests heavily in its brands at a corporate level, with marketing and selling expense coming in at 35% of sales consistently in the past three years. These brand intangibles translate into significant financial value for LVMH. Brands are listed on the balance sheet as valued at EUR8.5 billion (40%-plus of market capitalization).



Heritage is a powerful attribute for a brand

### MINI Cooper

Leveraging the heritage of the Cooper brand (a popular British automobile brand from the 1960s), BMW relaunched this brand as the MINI in 2002. The MINI has built brand awareness and personality through atypical advertising, in content and placement, with a strong dose of smart, hip, British humor. It also pioneered a new product category in the process, the premium small car segment, always a powerful way to build a brand. While its ad budget was a fraction of the big auto manufacturers, totaling only \$20-40 million a year for the first several years after its relaunch, the brand stretched the impact of these dollars farther by standing out from the competition. Its cheeky, British humor set the brand apart with tag lines like *Let's Sip Not Guzzle* to emphasize the green-friendly fuel efficiency or *Let's take it off. Let's take it all off*, to launch its convertible model in 2005. It also playfully put actual MINIs in unusual, eye-catching and memorable spots, on a ski lift, in a cage (*Don't feed the MINI*), on top of an SUV, even in a building. The brand relies on outdoor and magazine placement instead of TV, atypical for car brands. All of this built on the foundation of the brand's authentic history as a fuel-efficient British car built for city driving, but with enough horse power to become a racing phenomenon in the late 1960s. Sales, while still a niche brand, have soared especially in the past two years in the United States, where units were 25% of worldwide sales of 232,000, up from just 24,590 units sold in the United States in 2002.



Humor-and resulting free PR- can build a brand's personality

### Budweiser

The Budweiser brand embodies American masculinity with humor and sports linked tightly with the brand. It is accessible and friendly with an authentic heritage, named after a German town in 1876. *The King of Beers* was built through humorous TV advertising campaigns and sponsorships (Monday Night football and NASCAR). The memorable "Whass up?" campaign of 1999-2002 quickly made its way into popular culture, as did the later frog "Bud-Wei-Ser" campaign. AB InBev spent about 15% of sales in 2007 and 2008 on sales and marketing expense. This investment pays off, as Interbrand valued the Budweiser brand at \$11.5 billion in 2008, or about 20% of market capitalization.



Significant marketing spend underpins aspirational brands

### GEICO

GEICO began to transform and proliferate after it was acquired by Warren Buffett in 1996, who increased marketing spend, on TV and direct mail, to generate a unique and memorable brand image. Brand spokes characters led the branding effort. The Gecko, who was introduced in 2000, is humorous but also tightly linked to saving people money. The Caveman of 2004 talked about the ease of GEICO's service ("so easy, a Caveman could do it"). Both were voted favorite advertising icons and made it into the popular culture. The brand's growth simultaneously took off. In 1964, GEICO had one million policy holders. In 2002, it had five million and in 2009, it passed nine million policy holders. The distinctive branding paid off handsomely for GEICO.



Marketing investment can turbocharge brand growth

## Corporate Culture

Aspirational marketing machines can also powerfully affect the company's culture, helping to recruit and retain employees and to boost productivity and morale. The vast majority of great brands have entrepreneurial cultures, which help them to continue to innovate and remain nimble as they age. For this reason, many high-tech firms use this lever too, such as Google and Apple. However, there are exceptions, such as Toyota, Disney, and P&G, which are successful but more conservative and bureaucratic in their cultures.

### Google

Rated as the number one Best Place to Work by *Fortune Magazine* in 2007 and 2008, Google actively manages the corporate environment and culture to compliment its brand. Starting with its headquarters, called The Googleplex, Google deliberately creates a corporate culture to encourage communication and idea sharing among employees and a small company feel. With huddle rooms that group three or four employees together instead of single offices, and weekly TGIF meetings with the founders, where any and all questions are welcome, Google aims to be accessible and democratic. This is consistent with its brand positioning as a democratic and objective search engine (versus paid



When people are key to a brand's success, corporate culture must reflect the brand

advertising rankings). Also, Google's leadership realizes that to make all the hard work and long hours possible, a company has to cultivate some fun and camaraderie for employees, with foosball, pool tables, video games, etc. Google's corporate philosophy of *you can make money without doing evil* is appealing to many young recruits. Last, Google encourages employees to spend 20% of their workweek on something they are passionate about, which fosters creativity and independent thinking. The results of this 20% policy are such significant innovations are Gmail, Google News, and AdSense, clearly building the core of Google's business.

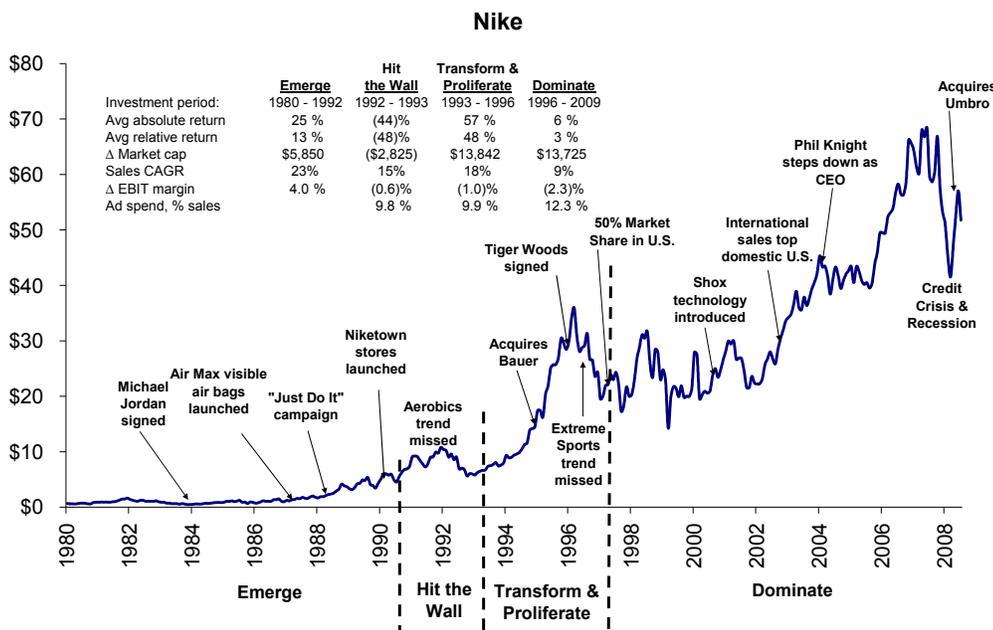
**Nike**

The distinctive culture at Nike headquarters revolves around great athletes and coaches. The names of the buildings include the Mia Hamm Building and the Joe Paterno Child Development Center (named after the Penn State football coach). Nike provides a state-of-the-art employee gym, the Bo Jackson fitness center, which reinforces the brand's motto of *if you have a body, you are an athlete*. It is also a highly competitive culture, sometimes called testosterone-laced. Despite its size, the brand also cultivates an anti-establishment bent, that reflects its marketing strategies and roots as a brand.



Corporate culture attracts the right type of employees to build the brand

**Exhibit 45: Nike Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

**Toyota**

Emerging out of post-war Japan, Toyota emphasized stability, long-term thinking, consensus building, and slow, steady innovation and technology adoption that were common in its national culture. Toyota created new elements that linked closely with its employees, such as continuously solving root problems in the process and developing and empowering people and teams. These enabled Toyota to become more and more efficient and high quality, but effectively manage risk. However, once consensus is reached, the company encourages rapid implementation so that it will not be left behind. This unique combination of attributes was often called *The Toyota Way*, and dovetailed with its uniquely efficient production system.



Culture must work with other brand levers to be effective

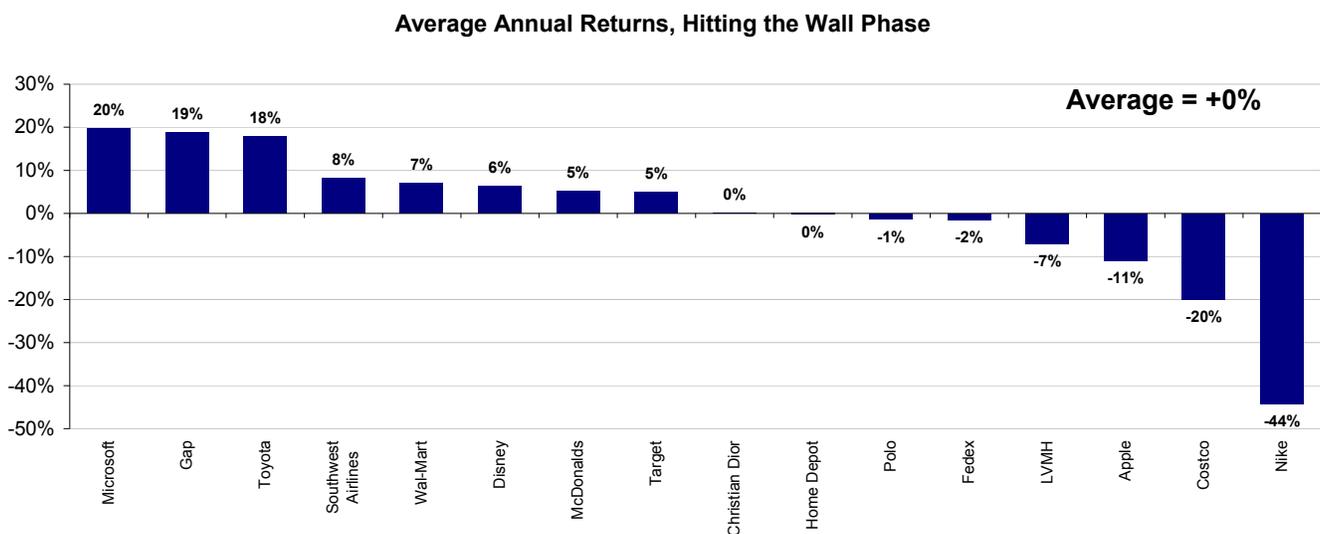
# Hitting the Wall—Why Some Brands Fail to Make the Leap

The reasons brands fail to reach dominant, iconic status mirrors the success factors that built them. For the aspirational marketing machines, they violate the essence or heritage of the brand or they fail to invest in the brand. For the perpetual Innovators, they fail to continue to be cutting edge. For any of them, expanding in the wrong way, either by losing control of distribution, overlicensing, or growing internationally/regionally too aggressively can cause failure through a loss of focus and control of the brand.

1. Ignore a paradigm shift (Blockbuster, MTV, Cingular)
2. Stop innovating (DEC, eBay, Saturn)
3. Violate the essence/heritage of the brand (Reebok, Ann Taylor)
4. Failure to invest in the brand (Columbia Sportswear, Marvel)
5. Wrong kind of expansion (Krispy Kreme, Pierre Cardin)

During this period of struggle, brands on average have zero returns for investors, with considerable variation and significant downside potential. Even great brands such as Nike can average -44% returns during their hit the wall phase.

**Exhibit 46: Avoid Stocks During the Hit the Wall Phase**



Source: Company data, Credit Suisse estimates.

## Ignore a Paradigm Shift

### MTV

MTV is an example of a brand that failed to innovate its product and subsequently lost market share and brand power. Launched in 1981 with the format of music videos and VJs, which consumers and the music industry itself immediately latched onto, MTV successfully reached a young, attractive target market. However, by the mid-1990s, MTV had migrated away from its roots into reality shows, prank shows, and animated cartoons, which together was the majority of its programming. Competitors, in the form of traditional media players and online competitors, simultaneously replicated the product that MTV was creating. With viewership dropping, not enough people want their MTV now.



Did not see the Internet coming

## Blockbuster

The failure to innovate a business process can destroy a brand, such as Blockbuster and the numerous innovations that have caught the company flat-footed. The first change was the DVD which rapidly replaced Blockbuster's VHS-dominated business. Blockbuster turned down a deal that would have extended its existing deal for VHSs to DVDs, providing lower-cost tape/DVD and a rental window before it was available to customers for purchase. Blockbuster had pioneered this VHS revenue sharing deal in which Blockbuster secured a time period during which the movie could be rented, but not purchased in exchange for giving the studios 40% of the rental revenue. Blockbuster turned down this deal extension offered by Warner Bros, opening the door to cheap DVD retail sales, especially at retailers such as Wal-Mart that would use them as loss leaders. Retail sales ate into the rental market, and Blockbuster's revenue was basically flat from \$5 billion in fiscal 2000 to \$5.3 billion in fiscal 2008, but the brand lost over \$4 billion in 2002-04, as it struggled with a changing industry. More recent, Blockbuster was late to see the potential of alternative methods of distribution such as Netflix (rental by mail), Redbox (\$0.99 daily rental kiosks), and online video; the company ended up with mediocre me-too offerings, further eroding its brand.

## Cingular

Formed as a joint venture between SBC Communications and BellSouth in 2000 amid the dot-com crisis, Cingular, the old Cellular One, was a roll-up of over 100 small cellular carriers. Cingular appealed to a young consumer with unique calling plans and hip ads. The only company to offer *rollover* minutes, where unused minutes could be used the following month, Cingular differentiated its service, leading it to become the number two wireless provider in the United States. Then, it merged with AT&T Wireless in 2004, giving a total of 46 million subscribers and building critical scale. However, by 2005, AT&T announced that it was debranding Cingular under the AT&T Wireless brand, backed by \$1 billion in ad spending (which was completed in 2007). This was initiated because the younger customer that Cingular had brought to the table was now migrating from loyalty to a mobile service to loyalty to the phone itself which was a big paradigm shift for the industry, one that is still under way. Older customers, which favored AT&T, remained loyal to this brand, hence the move to rebrand the integrated wireless service. There were also cost-savings associated with doing so and bundling benefits, but had the Cingular brand remained a strong draw to its core customers, more of the brand would exist today rather than just the remnant orange in the AT&T Wireless blue logo.

## Stop Innovating

### DEC

Founded in 1957 and reaching its peak in 1987, minicomputer manufacturer Digital Equipment Corporation (DEC) fell into the classic trap of not innovating aggressively enough for fear of undermining a key product. Initially differentiating itself from IBM, DEC engineered portable, lower-cost machines for laboratories and industrial operations. For over a decade, it set the technological standard for minicomputers, giving it a respected brand name in the professional market. However, in the late 1970s, it failed to innovate and offer a business PC, a segment that it considered to be beneath its technical prowess, (then IBM entered the market). In the late 1980s, it again refused to adjust to the growing popularity of workstations with open systems (UNIX), which eventually replaced minicomputer with proprietary systems, as processing performance improved. New agile competitors such as Sun Microsystems and Silicon Graphics and larger established players such as HP identified and acted on these technological trends faster than DEC. Some attribute this failure to an arrogant engineering-focused (versus customer-focused) corporate culture. Another reason could be DEC's vertical integration, which did not lend itself to open systems *democratic* approach to software. Others point to the unwillingness to innovate its own product (the minicomputer) out of existence, which had customers locked-in to proprietary systems. By 1990, DEC had the lowest revenue per person of any systems company, 50% below HP and 100% below Sun and Silicon Graphics. The company was defunct as of 1998.



Format and delivery changes were ignored



Lost the young, core customer



Did not appreciate the potential of PCs and open systems

**eBay**

As an intermediary creating a marketplace for buyers and sellers of collectibles (initially), eBay needed to build critical mass quickly, but faced a chicken-or-egg problem. No sellers without buyers. No buyers without sellers. So it first tackled the collectibles market, which is inefficient in terms of geographical dispersion and pricing. Plus, collectors are passionate and organically found the marketplace. By 1998, when Meg Whitman joined the company, it had only 300,000 registered users, and 8% of the items sold were Beanie Babies. In the past ten years, the brand added new product categories and markets, with small businesses, new (versus used) merchandise, and internationally, with 30 localized Web sites currently operating. The brand continued to innovate its auction functionality, adding *Buy it Now* as an option and a seller ratings system.

However, in the past three years, the core auction business has been flat, with active users hovering around 84 million for three years in a row. The primary cause of this stagnation has been a lack on innovation. The search functionality on eBay is not as sophisticated as those users are accustomed to on search engines and the check-out is cumbersome. In 2006, eBay tried to increase traffic by launching eBay Express, a traditional Internet retailer, but it did not get traction and was closed in 2008. In addition, Amazon has been making inroads into eBay's market with its third-party seller program. eBay seems to have made a strategic decision to focus on Paypal (online payments business acquired in 2002) at the expense of its auction business, by requiring buyers in certain product categories to use Paypal for their transaction, adding a customer to Paypal, but perhaps at the expense of a satisfied eBay customer.

**Saturn**

Saturn, a recently shuttered autonomous division of GM, launched in 1985 with great promise as a "different kind of car company," but failed to live up to expectations owing to inconsistent innovation and insufficient substance behind the claim to be a different kind of car company. Created in reaction to the Japanese invasion of the U.S. auto market, GM designed Saturn to be completely separate from its parent company, with its own contract with the UAW, entirely new car design (too new, some said, not building on GM's knowledge and experience), and no haggle pricing at its proprietary dealers. The brand combined this business model with patriotic (such songs as *America I Believe in You* accompanied ads) and people-focused marketing. With the first Saturn S-Series hitting dealers in 1990, initial sales were strong through the early 1990s, peaking in 1994 at 280,000-plus units. During this time, the brand received numerous car industry awards, such as *Best Car Value* and ranked number one in new car sales per retailer in 1992. However, the innovation did not continue consistently in the latter half of the 1990s, reflected in industry awards declining followed by sales. Others asked whether a car brand standing for the a differentiated dealer experience was enough to sustain a brand beyond the initial hype and patriotism. Last, the brand suffered from leadership changes in 1998 and 2000, giving a fragmented vision, including adding noncompact models and pricier versions with limited success. By 2003, Saturn had halted production on its core product for two weeks and in 2004 UAW dissolved the labor contract for Saturn. The tenets of the brand's differentiation were collapsing one by one. In October 2009, GM announced, after a failed attempt to sell the brand to Penske, that it had stopped all new Saturn production and would completely shutter the brand in 2010.

**Violate the Heritage of the Brand****Reebok**

After purchasing the U.S. license from British athletic shoe manufacturer Reebok for \$65,000, Paul Fireman introduced three high-end models and had some success. The breakthrough came in 1982 with the Freestyle model, the first athletic shoe aimed at women, which coincided with the aerobics trend in the United States. By bringing in a new customer to the athletic shoe industry, Reebok found a white space to emerge. The Freestyle shoe was as much fashion as function, having soft leather and coming in bright



Rested on the laurels of auctions



Not enough innovation to deliver on a "different kind of car company" brand promise



Migrated away from its core women customers in search for growth

colors such as red, orange, and yellow, a departure in the white shoe industry. The brand experienced rapid growth and soon bought its own production factories in South Korea to lower production costs. Growing from \$12 million in sales in 1983 to \$2.16 billion in 1990, the brand was on a tear. However, this explosive growth would be its undoing, as it had to chase new trends in the early 1990s. First, Reebok tried to position itself as a performance (and men's) brand, with little success, by expanding into basketball, football, and soccer, which caused competitors such as Nike to increase ad spend in these sectors. In 1990, it also went through a corporate reorganization, institutionalizing the straddling of the brand between fashion and performance. It then tried to get endorsements with top athletes in the late 1990s, but struck out. Reebok recently tried to link with hip-hop culture with Jay-Z and other nonathlete-based collections. Reebok also extended its brand into apparel, which helped sales, but failed to keep its heritage in women's footwear authentic. This lack of authenticity and customer focus ultimately led to the decline of the brand.

### Ann Taylor

Founded as an updated classics women's apparel brand in the 1950s in Connecticut, Ann Taylor grew to embody the new career woman in the 1970s and became a national chain. Focusing on suits and separates in the better category, Ann Taylor created a loyal customer base which it monetized with an IPO in 1991. Soon thereafter, the brand departed from its traditional style and lowered the quality of its fabrics and ended its long relationship with the high-end shoe brand Joan & David. With these quality changes, it began to see its brand image quickly erode. Trying to stop the bleeding, management lowered prices 10-15% and founded Ann Taylor LOFT in 1996, a more casual, younger upper moderate chain, which grew quickly. However, the namesake chain has never regained its position in the career apparel sector and continues to struggle.

ANN TAYLOR

Went lower end and lost its core career woman demographic

## Fail to Invest in the Brand

### Columbia Sportswear

Columbia Sportswear rose to prominence in the 1980s by combining a lower-priced outerwear product with a differentiated advertising campaign, called "Tough Mother." The product was innovative with its Interchange System of layers, including GoreTex, but was priced at about half the price of a North Face or Patagonia jacket, finding a white space in the market. The conjunction with its product, the brand ran print and later TV ads that stood out from the typical sportswear ads. Starring its chairwoman, Gert Boyle, and using a humorous slant, the ads reinforced the brand positioning as durable, practical and no-nonsense. By 1994, Columbia Sportswear had double the ad spending as its nearest competitor, with \$6 million or about 2.3% of sales. By this time, sales were \$265 million, up from \$12 million a decade before. The brand began to leverage this brand positioning, trying to outfit consumers head to toe, with a denim line and shoes. In addition, the brand began to grow internationally, from 12% of sales in 1993 to 21% in 1998.



Reduced ad spend deteriorates brand image

However, in the late 1990s, the brand started to reduce advertising spending and instead invest in retail concept shops in department stores to increase distribution. During this time, Columbia searched for growth by acquiring promising, niche brands, including Sorel (2000), Mountain Hardware (2003), and Pacific Trail and Montrail (2006), further distracting from the core brand. By 2004, ad spending had declined to 1.4% of sales and sales soon flattened out. The brand has recently backpedaled, increasing ad spending in 2007 and changing ad agencies. It has also vowed to advertise two new performance features, Omni Shade and Techlite. Whether it will be too little too late for the Columbia Sportswear brand remains to be seen.

### Marvel Comics

Marvel Comics stumbled as financiers paid off leveraged buy-out debt, the comic book market collapsed, and movie licensing deals were sloppily executed in the mid-1990s. But fundamentally, it was because no one in a position of power believed in the power of the Marvel comic book heritage and brand, and did not invest in sustaining it.

Marvel started in 1939 in the height of World War II, creating action heroes battling evil that resonated with consumers. Its modern incarnation came in 1961 when the *Fantastic Four*, *Incredible Hulk*, and *Spiderman* were born, along with merchandising of the characters. Soon, Marvel overtook competitor DC Comics and build a library of over 5,000 characters in the comic book boom of the 1960s. At its peak, Marvel sold 50 million comic books a year in 1968.

Another boom, especially among collectors, occurred in about 1985-1993, which Marvel took full advantage by IPO-ing in 1991. During this time, Marvel switched to self-distribution, which meant that when the music stopped in about 1993, it was stuck with the inventory. In 1993, Marvel tried to make movie deals for its characters, which would come back to haunt the brand as it tried to make the leap in the late 1990s. These forces combined with increased debt taken out by Ron Perelman to create the perfect storm for Marvel. To cut costs and increase cash flow, Marvel hired freelance writers, which lowered the quality of its comics, and customers boycotted in 1996. Then the legal problems started, with questions over rights to characters with founder Stan Lee and ownership battles with Ron Perelman, Carl Icahn, and Toy Biz (a subsidiary) founders Ike Perlmutter and Avi Arad. In 1998, Toy Biz took over Marvel with the approval of the banks and Arad pushed for the brand and movies.

This story has a happy resolution. Spiderman movie rights were resolved in 1999 and Marvel broke through the wall with its X-Man movie a, wild success in the summer of 2000. The company again turned a profit in 2001. Perhaps most importantly, Marvel finally had a brand advocate in Arad, who believed in taking the risk on movies to build the brand. Marvel had 2008 revenue of \$676 million, and Disney announced its intention to acquire the company in August 2009.

## Wrong Kind of Growth

### Krispy Kreme

From its start in 1937, Krispy Kreme grew slowly as a southern U.S. donut chain and was owned by franchisees for nearly two decades. Once it IPOed in 2000, the drive for growth led it to expand rapidly, eventually into Dunkin Donuts territory in the Northeast and even internationally in 2001. This store growth was accompanied by problems with franchisees in Texas, California, and Arizona. Krispy Kreme's cost structure was higher than that of competitors, who did not bake donuts in each store, further exacerbating the economic model. Last, the business model of being overly dependent on donuts (an indulgence) versus coffee (a daily staple), causing Krispy Kreme to hit a wall. It closed 80 stores in 2004-06, losing almost \$200 million in 2005. As of 2009, the chain owned 100 stores out of a total of 500 (including smaller satellite locations).

### Pierre Cardin

Pierre Cardin founded his Paris couture house in 1950 and hit his stride in the 1960s with his ready-to-wear collections, which were in-step with the times. Cardin began licensing his brand for men's shirts and ties, and then took it even further to licensed cars, jets, and even frying pans. In his peak, he had over 800 separate licenses, which brought Cardin over a \$1.0 billion in fees. By putting his name on such a range of products, Cardin diluted the association of his brand with high fashion. The more products he stood for, the weaker the brand became, a testament to remaining focused.



Lowered quality through outsourced writing and illustrating



Expanded into hostile, expensive markets too soon



Never said no to a license agreement

**Exhibit 47: The Red Flags of Brand Failure**

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## Qualitative Factors

- Overdistribution/Channel Stuffing
- Loss of Price Integrity
- Violate the essence/heritage
- Alienate Core Consumer
- Inappropriate Category Extensions
- Product Quality Reductions
- Loss of Control
- Failure to Evolve Product

## Quantitative/Financial Factors

- Insufficient Marketing Spend
- Insufficient SG&A Spend
- Gross Margin Erosion

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Source: Company data, Credit Suisse estimates.

# Breaking through the Wall

If brands succeed in breaking through the wall, it is often a five- to ten-year process of revisiting core brand strategies and adjusting business models, and often increasing marketing spend, to finally overcome this phase.

## Polo Ralph Lauren

From its beginning, Polo Ralph Lauren was based on differentiated product style, first with ties in 1967, but quickly moving into women's clothing four years later. Lauren realized the value in branding the store experience to control how his merchandise was presented to customers, opening his first store in 1971. In 1979, Ralph Lauren launched his first ad campaign, a glossy 20-page spread in magazines that depicted a lifestyle, not a product. The brand extended into home products in 1983 to let customers *live* the Polo Ralph Lauren way, among the first brands to make this category leap.

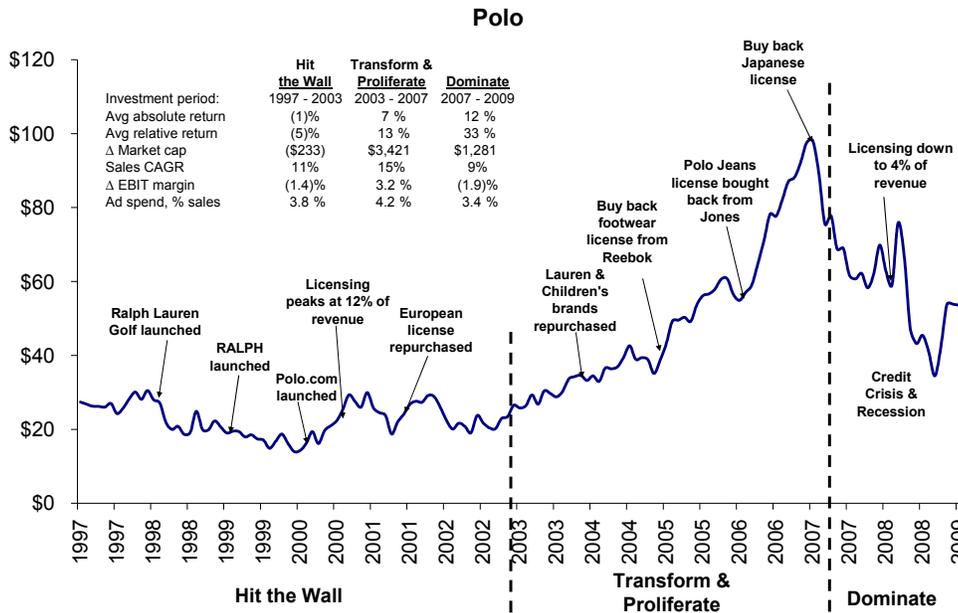
This deliberate, well orchestrated initial marketing strategy was followed by an umbrella brand/sub-brand architecture in the 1990s that included a significant number of licensing agreements. With the Polo Sport line in 1993, the company embarked on a series of sub-brands that moved the brand upscale and down-market successfully. Purple, a higher-priced line, was launched in 1994 and Polo Jeans Co. in 1996. When the company IPOed in 1997, licensing accounted for 10.8% of sales.

Whether it was pressure to grow as a result of becoming a public company or a belief that the company could not successfully enter new markets, price points, or product categories alone, Polo continued an aggressive licensing strategy, peaking at 12.1% of revenues in 2000. In 2001, to regain control of his brand's image and to drive international growth, Ralph Lauren began buying back his licenses. Regaining control of its European license in 2001, Polo expanded distribution 40% the first year alone and within five years grew revenue more than 150%. Other licenses were repurchased, including Lauren and Children's (2004), Ralph Lauren Footwear (2005), Polo Jeans (2006), and the Japanese license (2007). This strategy helped Polo make the leap to grow into a \$5 billion revenue company by 2008. Meanwhile, licensing is just 4.3% of revenues and is done more strategically, such as in eyewear and cosmetics, where scale manufacturing is critical. There are geographies in which the brand is licensed, such as Australia, Korea, and Latin America but the key markets are firmly under corporate control again.



Regained control of brand through license buyback

**Exhibit 48: Ralph Lauren Brand Lifecycle: The Wall Street View**



Source: Company data, Credit Suisse estimates.

**Avon**

Avon was founded and based on the multilevel direct selling model, first primarily with perfumes, and then a broad range of beauty products. The brand flourished and made the leap by 1972, with \$1 billion in sales and an international presence in Europe and Latin America. But the late 1970s and 1980s saw the company lose focus and stray from its core brand strategy of direct selling. In 1979-1988, Avon experienced a lost decade in terms of revenue growth, decreasing and then returning to a flat \$3 billion. The cause of this hitting the wall phase was the shift to more women working in the United States, which undermined the brand's direct selling method, as fewer women were at home during the day and those who would have been reps now had more employment options available. The company lost faith in its model and the growth potential of its beauty brand, and consequently searched for growth through peripheral acquisitions. Tiffany & Co. was acquired in 1979, then Genu (plastic housewares), Family Fashion, James River Traders (apparel), and even magazines. The company even tried its hand at the healthcare business in 1982. All of these acquisitions came with burdensome debt and were jettisoned by 1987, often at a loss.

Avon found its way out of this brand growth predicament through emerging market growth, where women craved the opportunity to work from home and moderately priced beauty products were in demand. In 1990, Avon took advantage of the opening of Eastern Europe and China (where it had to use a retail model until door-to-door selling was legal in 2006) to build its brand's revenue. During this time, the brand invested 2-3% of sales in advertising to revitalize its neglected brand in the United States. By 1997, 65% of sales came from abroad and the company had 2.3 million reps around the world. This doubled again to over 5 million reps currently, with \$8 billion in sales.

**Pampers**

As the first affordable disposable diaper, Pampers, a P&G brand, took six years to develop, with P&G refining the cost structure of the manufacturing process from \$0.10 per diaper down to \$0.055 when it launched in 1962. Eight years after it first launched in select cities, Pampers had 92% market share in the United States. The brand had a good run, building on its first-mover advantage, especially with the high-speed manufacturing process it developed.

AVON

Found new life in emerging markets



Rejuvenated innovation at significant capex cost

P&G perfected the hourglass-shaped diaper, although not a high-speed manufacturing process. With a better fit but a higher price-tag, P&G made the strategic decision to create a new diaper brand, Luvs, to sell this technology. In 1978, came competitor Huggies with the same hourglass shape and tabs. This quickly ended Pampers' enormous market share advantage in the United States. By the early 1980s, Pampers had less than half of the market, but was much larger than Huggies. Pampers initial reaction to this competitive threat was to make some minor tweaks in 1982, which did not have any effect in stopping its market share erosion. In 1984, Pampers overcame its cognitive dissonance about the sunk manufacturing costs and invested \$500 million to revamp over 100 production lines worldwide for hourglass shaped manufacturing. In addition, the brand spent \$225 million in marketing expense to launch *Pampers Ultra* in 1986, nearly eight years after Huggies emerged on the scene. Luvs was dropped to a midtier brand in the 1990s and Pampers regained its dominance, albeit not at 92% market share, as the market leader.

### Virgin

The Virgin Group, a privately held U.K. company, began as a mail-order music catalog in 1970, to take advantage of a new U.K. law that permitted the discounting of records. It added a store in 1971 and continued to focus on the music industry, with a recording studio and record label launched in 1973. From the beginning the brand was anti-establishment, fun, and personified by founder Richard Branson. The brand found its voice when it signed the Sex Pistols in 1976, but really emerged as a legitimate brand when Culture Club signed in 1982. As the brand transformed and proliferated, it took a haphazard approach to new ventures, mostly at the whim of Branson, but with an underlying logic of industries in which the consumer was not being well served, cementing the brand's challenger stance (versus a market leader). The first nonmusic brand extension was to airlines, Virgin Atlantic, which brought the fun and style back to flying and higher levels of service. The brand went international with its Virgin Megastores hitting the United States in 1987.

By 1992, the beginnings of the migration away from the core brand personality were showing, with the sale of Virgin Music to EMI to raise cash for the airline business. Soon thereafter, Virgin launched a series of unrelated noncore businesses, including Virgin Cola (1994), Virgin Direct (financial services, 1995), and Virgin Trains (1997) among others. While the financial implications of these brand extensions would not appear for several more years, the dilution of the brand had begun. In 1998, Virgin started to struggle and shuttered several operating companies, including Virgin Vodka and Virgin Cola and sold Virgin Cinemas. By 2001, owner Richard Branson had lost half his fortune and the brand had hit the wall. Some wondered if it was a reflection of the founder's age and waning relevance to a young audience. Others proffered that by attaching the brand's name to low service, high distrust industries, such as trains and credit cards, the brand had strayed from its core brand promise. Last, others said that the brand had overlicensed its name (Radio, Mobile) and was losing control.

In the past several years, Virgin has attempted to make the leap by refocusing on the brand's roots and personality. Virgin Galactic, a venture started in 2004 to operate commercial space flights, unveiled its first commercial space vessel in late 2009, getting back to the sexy, risk-taking, innovative roots of the brand. It also got back to its core demographic of young, hip consumers with Virgin Active (health clubs) and Virgin Digital (online music). Virgin also found its disrupter role again with 2007 airline battles with British Airways over price fixing and the U.S. Department of Transportation over the launch of a new domestic U.S. low-cost carrier, Virgin America. The 2009 launch of Virgin Bank hopes to rekindle its image as a trustworthy consumer champion (versus hidden fees, etc.). During this period, the group's revenue has increased to \$17 billion from \$7.9 billion in 2003, a sign that the Virgin brand may have found its focus and relevance again in time for its fortieth birthday.

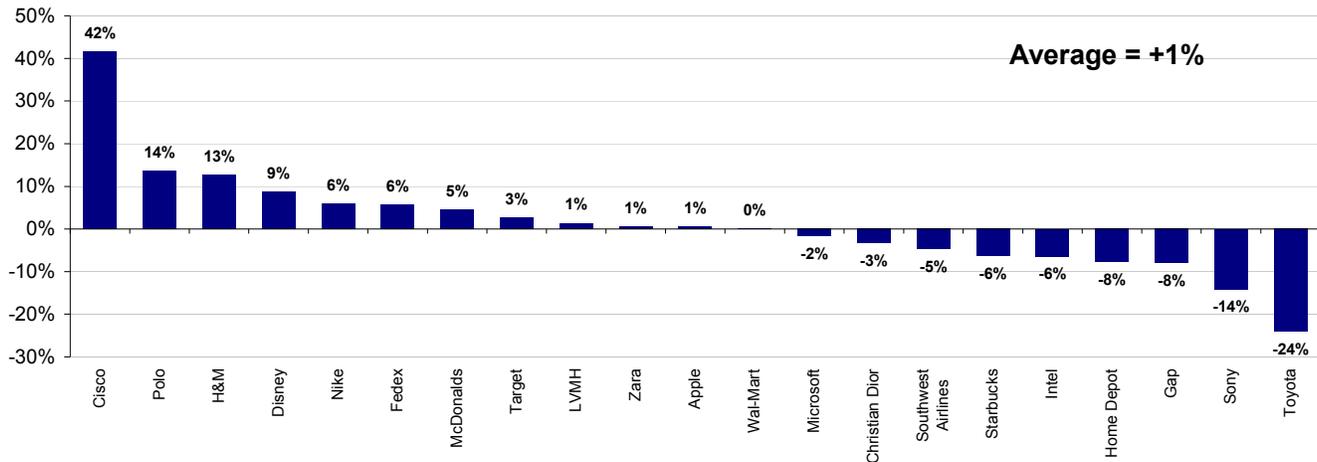


Got away from noncore  
brand extensions

# Achieving Global Iconic Status: Time to Sell the Stock

**Exhibit 49: Cash Out Before the Dominate Phase**

**Average Annual Returns, Domination Phase**



Source: Company data, Credit Suisse estimates.

When exactly a brand enters the dominate phase of development, the goal of any brand, is not always a bright line. However, certain factors must be present to qualify as a dominant, iconic brand. It must be tested in the broader international market through a successful globalization strategy, such as Coke and McDonald's. It must, in the customer's mind, own the category it competes in, such as MP3 players in the case of Apple or family entertainment for Disney. It must have a loyal customer base, such as Nike and Johnson & Johnson. It must have critical scale and market share in the segments it competes in, such as value retailing for Wal-Mart and consumer products for P&G.

**Exhibit 50: Brand Dominance Checklist**

**Checklist to Dominate:**

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

**Exhibit 51: Factors in Establishing Brand's Dominance**

Brand	Globalization	Scale/ Market Share	Own Category/ Mindshare	Loyal Customer Base
McDonald's	√	√	√	√
Nike	√	√	√	√
Disney	√	√	√	√
Coke	√	√	√	√
P&G	√	√	√	√
Wal-mart	√	√	√	√
Gillette	√	√	√	√
Johnson & Johnson	√	√	√	√
Apple	√		√	√
L'Oreal	√	√		√
Toyota	√	√		√
Sony	√	√		√
LVMH	√	√	√	

Source: Company data, Credit Suisse estimates.

The dominate phase is not always a lucrative time to invest in brands.

**Wal-mart**

Founded in Arkansas by Sam Walton in 1962, Wal-Mart established its brand position and business model early, pricing below competitors and owning its distribution center and satellite network as of 1970. It did not charge slotting fees to suppliers, but rather focused on replenishing popular items more quickly. Through store expansion to neighboring states in the Southeast, creating the supercenter format in 1988, and continuing to innovate its efficient distribution processes, Wal-Mart transformed and proliferated by the mid-1990s.

During its dominate phase, Wal-Mart went international, often under a different brand name and with varying models for expansion, from acquisitions (U.K.), to joint ventures (Japan) to franchises (India). While it had mixed success, most notably failing in Germany and South Korea, Wal-Mart currently has about 20% of its sales from its international division. In 1991, Wal-Mart launched its private label store brands, starting with beverages under the *Sam's Choice* name. These brands have grown to be 40% of Wal-Mart's sales. As the employer of 2.1 million people and with nearly 8,000 locations, Wal-Mart has dominant scale. It uses this scale to continue to extract concessions from its suppliers, primarily on how suppliers interact with Wal-Mart's distribution centers. In the early 2000s, it required its top 100 suppliers to begin using RFID chips in their deliveries to better track inventory and aid replenishment, an innovation that met with such success it now has 600 suppliers using the technology. Wal-Mart continues to pass on these savings to its customers, so it can *Save Money. Live Better*, as the slogan says. In the late 1990s, Wal-Mart entered the grocery business to leverage its dominant position to increase its share of wallet of its customers and the frequency of their visits. As a result, over 100 million people visit Wal-Marts every week in the United States alone.

**P&G**

From its origins as a candle and soap maker in 1837, P&G grew with the consumer mass market in the United States and new marketing mediums, such as magazines, radio, and TV, launching the first branded soap with national distribution, Ivory, which the company trademarked in 1879. While first working with distributors to build awareness, P&G recognized the importance of communicating directly with its end user. It had to create large-scale manufacturing plants to drive down costs and reach scale for national distribution. Following Ivory, Crisco was P&G's next brand, which was based on a new technology. This ability to cross product categories marked P&G's emergence as a branded consumer products company.



Scale feeds dominance through supplier power



Institutionalizing brand creation process maintains dominance

Crisco coincided with the company's move to direct distribution in 1910, making P&G the first major company to do so. This change was sparked by a 1909 ruling that manufacturers could not set retail prices for distributors. P&G's new distribution strategy of by-passing entrenched middlemen to smooth inventory and *feel* demand more directly and accurately, caused the company 15 years of sales problems, with sales only regaining their previous level in 1926. But P&G stayed the course and broke through the wall by working with retailers to establish its new business model, which significantly helped P&G's long-term success and dominance. This ability to take the long-term view, continuing to refine ideas and products, would become a defining success factor of the company.

P&G built its renown market research capabilities in the 1920s and created a new corporate structure based on brands rather than geography, as was typical of the time. These two capabilities would distinguish P&G as a multi-brand consumer company. Then came Tide, which was a game changer and led P&G to transform and proliferate. Launched after 15 years of R&D and consumer testing in 1945, Tide was a synthetic soap, a totally new product that worked significantly better than other products and coincided with the growth of automatic washing machines in the United States. By the mid-1950s, Tide had 30%-plus market share and P&G had \$1 billion in sales, with 95 out of 100 American households having at least one P&G product.

Dominance followed, with P&G expanding into new product categories (paper, food, diapers, toothpaste) and new geographies (Europe, Latin America and Asia) in the 1960s and on. Antitrust issues were raised, halting acquisitions for a decade. Throughout this dominant period, P&G's established method for creating, growing and occasionally divesting consumer brands had been *institutionalized* and was repeated with such iconic brands as Crest, Pampers, Folgers, and Charmin (the latter two were acquired and expanded substantially). P&G was the dominant TV advertiser by the end of the 1970s, and sales had risen to \$11 billion with a manufacturing and distribution presence in 22 countries. By 1993, international sales would surpass U.S. sales for the first time in P&G's history.

P&G recently has struggled to maintain its focus on innovation and developing large new brands, as well as staying cost competitive. Its first corporate initiative to do so was the Corporate New Ventures group, which resulted in small wins such as Swiffer, Dryel, and Thermacare. None of these, though, had the potential of a Pampers or Crest. The company's latest approach is to *connect and develop* new brands with partners. On the marketing front, the company instituted value pricing in 1993, lowering prices 10%-plus and eliminating cash discounts and incentives for retailers. National accounts replaced regional ones, to adapt to the rise of Wal-Mart and other national chains. P&G sent collaborative teams to establish mutually beneficial supply chain coordination with these retailers. These policies once again changed the dynamics in the industry. P&G also has been relentless about not getting *fat*, with significant streamlining and reengineering efforts in the early 1990s and 2000s. This combination of initiatives has allowed P&G to maintain its brands' dominance for nearly 50 years.

## Sony

Sony built its brand through innovation and early awareness of the value of a brand, somewhat unique for a Japanese company in the 1950s. Licensing the transistor technology from Bell Labs, Sony made the most commercially successful (not first though) transistor *pocket-sized* radio that it quickly exported to the U.S. market in 1957. Refusing to private label its radio to established U.S. players, Sony intuitively understood that it was building a brand, not a product. The company also chose its brand name, Sony, to easily cross borders, be unique and not be pigeon-holed into any one product category. These marketing strategies were driven by Akio Morita, one of Sony's founders. By the end of the 1960s, Sony had emerged by finding white space in creating the five million unit market for transistor radios.

## SONY

Product design and innovation key to keeping brand leadership reputation

The brand quickly followed up with the Beta video recorder 1975 and the Walkman, the first handheld music player in 1979. While the Beta failed when competing with the VHS standard, it brought Sony into a new market segment. In 1983, Sony successfully created the 3.5-inch minidisk format for camcorders and launched its HandyCam model in 1985. The most successful new segment for Sony was the game console market, which is entered in 1994 with the Playstation. Quickly outselling market-leader Nintendo with its CD-based product, bundling the game Tomb Raider, Sony established a decade long dominance of this product segment, creating an installed base of gamers with over 140 million units sold to date. Sony vertically integrated into content, acquiring CBS Records Group and Columbia Pictures, renaming both with the Sony name. By the mid-1990s, Sony had made the leap to a dominant iconic brand, known for its state-of-the-art electronics.

Building on its success, Sony entered the computer market, with its Viao brand, in 1997, which was a slim and fashionable notebook computer. Sony also worked with potential competitors such as Philips and Ericsson to develop new video recording formats and mobile phones. While Sony's technology was not always adapted (such as the DVD format), the company quickly got on board with the industry's standard and designed state-of-the-art products. Customer loyalty to Sony was high, as was the brand's awareness and connection with the product segments in which it competed.

By the early 2000s, though, Sony's position of dominance was looking more fragile, with agile competitors carving off product segments from Sony, such as MP3 players, flat-screen TVs, and game consoles. Sony did beat rival Toshiba in the development of the Blu-ray DVD standard in 2008, which was quickly adopted by the industry. It remains to be seen whether Sony will be able to remain dominant with hungry competitors, such as Apple, Samsung, Nintendo, and others taking aim at Sony's markets with compelling innovation and attractive, resonating, focused brands.

### McDonalds

McDonald's, arguably the most recognized global brand, has countered the notion that investing in a dominant brand is a recipe for flat returns. Since 2007, McDonald's has had a relative return of 19% annually, far surpassing its peer group of dominant brands which saw low single digit or negative returns.

In the past two decades, the brand has ramped up international expansion to huge new markets such as China, India, and Eastern Europe. It makes efforts to source from local suppliers and is patient in setting up an efficient and high-quality supply chain in new countries. In India, for example, the company took seven years to establish a network of farmers that could supply ingredients, which were new crops for the region, such as iceberg lettuce, to its franchisees. Over half of the brand's outlets currently are international, with an astounding 30,000 restaurants and 5,000 franchisees worldwide.

However, the brand is not flawless, and struggled in 1997-2002. The reason for this period of brand problems was both a loss of focus on its core brand as well as cost cutting, which affected the delivery of the brand promise of McDonald's. During this time, McDonald's corporate organization searched for growth and tried to expand to other partner brands through acquisitions, joint ventures and partnerships. Among these were Chipotle Mexican Grill (1998), Donatos Pizzeria (1999), Boston Market (2000), Pret-a-Manger (2001), and Fazolis (2002). These small U.S. and international chains were seen as opportunities to leverage McDonald's process know-how and brand-building expertise to expand nationally and even internationally. While these partner brands were being grown, the core McDonald's brand was being mismanaged. Franchisees were not pleased with the corporate focus on so many new brands.

Pushing more new domestic McDonald's stores into the market, despite cannibalization complaints by franchisees, McDonald's seemed out of touch with the consumer and the franchisee. The company embarked on a range of cost-cutting initiatives, including changing such sacrosanct policies as stopping the toasting of hamburger buns. The brand



Divested partner brands to focus on international and domestic growth of core brand

tried to grow through hot promotions, such as the Teeny Beanie Baby Happy Meal toy, but put the focus on the toy instead of the food. In short, McDonald's violated numerous tenets of its quality, service, cleanliness, and value (QSC&V) philosophy. As a result, the brand lost market share domestically and had six straight quarters of earnings declines in 2001-02.

By 2002, McDonald's realized that it needed to refocus on the core brand and began divesting its Partner Brands. By 2007, all of the aforementioned brands had been sold or IPO-ed. The company reinvested in the core brand with the most comprehensive redesign of McDonald's global packaging. It also refurbished many restaurants. It reignited the innovation engine, most prominently with the McCafe concept, an Australian idea for higher-end coffee. McCafe is now in over 7,000, or 50% of, U.S. locations, and is set to roll out to 85% of locations. This concept is a close extension of the core brand (fast, quality and value versus Starbucks). It is also a frequent, often daily purchase, and brings in adults, which compliments McDonald's traditional target of families with kids. The company has seen same store sales rise, despite—or perhaps because of—the weak economy, especially internationally, in the past year.

# Brand Failures

Brands can fail during any of the previous five phases of development. Some fads do not become brands after emerging. Some promising brands fail as they try to become larger and farther reaching in the transform and proliferate phase. Dominant brands can fail as well, despite their brand's power.

## When Emerging Brands Stumble

Some brands never progress beyond the emerging phase. Remember People Express, a contemporary of Southwest? Or ReplayTV in the DVR industry? The overhyped fad of Crocs? There are several reasons for failure to move from emerge to transform and proliferate, including the following.

1. Not knowing when to say no (Crocs).
1. Stop innovating, leaving competitors an opening (ReplayTV).
2. Failure to make the transition from product to brand (Palm).
3. Balancing founder/entrepreneurial leadership with seasoned management team (Webvan).
4. Nonstrategic acquisitions that distract from brand development (People Express).

### Not Knowing When to Say No: Crocs

Crocs emerged at a boat show in 2002, where the light-weight, odor, and microbial resistant shoes sold out quickly at \$30 a pair, which was cheaper than most boat shoes. The company made many of the right moves early on. They bought their manufacturer and supplier of Croslite resin, Foam Creations, in 2004, giving it control over its point of differentiation. It also hired a professional manager, Ron Snyder, in 2005, who led the charge to grow and increase the flexibility and responsiveness of its manufacturing operation. The brand moved some overseas to China, Romania, and other countries and got lead times down to two to four weeks by 2006. Crocs resisted pressure from large national retailers to raised prices, believing that the \$30 price level was key to the brand's positioning. By year-end 2006, revenues were above \$100 million, and Crocs were being sold in eight countries.

Then, the company IPOed in early 2007, and the Croc fad took off, selling in 27,000-plus retailers around the globe. However, the brand did not maintain a disciplined distribution strategy, which was its undoing. Retailers, not wanting to be left out of the fad, placed phantom orders for more than they could sell. Crocs produced frantically to these substantially elevated levels, but missed the end of the summer selling season. Its inventory in warehouses went up over 200% from a year earlier. The stock price plummeted as a result, despite revenues rising to \$847 million. By 2008, Crocs appeared in Costco to clear through the excess inventory, and revenues for the brand declined to \$722 million. The company is now searching for revenue growth through acquisitions (Tagger, Bite Footwear, Ocean Minded) and product category extensions to other Croc products (purses, kneepads, etc.). The stock is down to under \$3 a share and Snyder has left the company.

### Stop Innovating: ReplayTV

ReplayTV was the first mover in the digital video recorder (DVR) market. It launched its hardware product in 1999, a few months before rival TiVo. ReplayTV's technology had different features and pricing strategy than TiVo. Replay's "QuickSkip" feature was the most controversial (and popular), allowing viewers to skip 30-second increments, coincidentally the same length as most advertisements. Replay sold its hardware outright, for about \$700 initially, while TiVo had a lower price point of about \$500-plus a monthly (or lifetime) subscription fee. ReplayTV also added a feature called *Send Show*, which allowed users to exchange content directly with one another, trying to help the company



Not managing distribution and production effectively



Did not keep up with competitors in innovating

build a network effect. SONICblue bought ReplayTV in 2001 and quickly had to deal with a lawsuit from the TV networks. The networks alleged that ReplayTV's *Quick Skip* undermined the free TV model and that the *Send Show* feature violated copyright rules about premium content. While the lawsuit was tied up, ReplayTV was losing the battle to Tivo, which continued to drop prices and whose technology let the DVR recommend content to users based on the other content they watched. DirecTV entered the DVR space in 2001 with the help of Microsoft and RCA by launching UltimateTV. By 2003, SONICblue filed for bankruptcy and was taken over by Japanese high-end electronics manufacturer D&M Holdings, which also owned The Boston Sound and Denon brands. In 2007, the brand was sold to DirecTV and no longer sells hardware.

#### Fail to Transition from Product to Brand: Palm

Other brands, such as Palm, failed to move from a product to a brand as they Emerged, suffering from a lack of continued innovation beyond the first couple of products. Founded in 1996 to develop hand-writing recognition software, later named *Graffiti*, Palm was the first entrant into a white space of portable digital assistants (PDAs). Following the launch of the Palm Pilot, the founders sold out to 3M and then left the company as they perceived that they did not have enough control. They formed a rival firm, Handspring. This left Palm adrift and without its source of innovation, as well as a new competitor. Palm continued to refine the product with the Palm V in 1999, but the Graffiti software was cumbersome. The company IPOed in 2000, but lost 90% of its IPO value shortly thereafter. A marketing push in 2000 could not stop the company's revenue from shrinking. With this, they cut back on R&D spending, from \$160 million in 2001 to about \$70 million by 2003. The founders bought back Palm in 2003 and formed Palm, Inc. With its source of innovation back in place, Palm did have some success in the Treo, the first smartphone, but was quickly outmaneuvered by competitors such as Motorola and Nokia which had WiFi and 3G capabilities. Instead of owning the category of personal, portable multi-application communication devices, Palm continued to struggle with its brand and products, pigeon-holed into its Graffiti software.

#### Management Team: Webvan

Founded by Louis Borders (of Borders Books fame) in 1999 at the height of the dot-com boom, Webvan was one of the first online-only grocery delivery businesses, and perhaps the most spectacular dot-com disaster financially. The company began operations in Northern California, promising a 30-minute delivery window. Webvan hired former Fedex drivers, among others, to help it efficiently deliver the groceries from its warehouse. The trouble began, though, when former Andersen consultant CEO George Shaheen, encouraged by investors Goldman Sachs, Yahoo and others, began to aggressively build out Webvan's infrastructure. With no grocery industry experience himself or on his management team, Shaheen plunged ahead with a plan for 26 automated warehouses, at \$30 million a piece. Shaheen did not focus on making each warehouse and market profitable before expanding to additional ones. And warehouses reported high levels of spoilage and significant overcapacity. Shaheen was pushed out in April 2001, and Webvan ran out of cash by the end of 2001 and became dot-com road kill.

#### Nonstrategic Acquisitions: People Express

People Express, a close-follower of Southwest in the no-frills airline segment, began its brand emergence with promise, launching service in 1981, a baby of de-regulation in the airline industry. It was based out of Newark and had a simple fare structure, all economy class, which was purchased onboard the flight. A key aspect of its strategy was to make its employees feel like owners- and shun unions- by granting them stock in the company (it IPOed in 1980), one of the first to do so. By 1984, the airline had more than \$2 billion in revenue with virtually no advertising.

However, People Express chased the wrong kind of growth. It acquired several companies, including Frontier Airlines, early in its history, which directly contradicted the model of low fares and non-union workforce on which People Express was founded. As a result of these acquisitions, the brand was briefly the U.S.'s fifth largest airline. It also got away from its



Pigeon-holed into a fleeting product success



Lack of grocery experience doomed this online delivery service



Acquiring ill-fitting companies ended this pioneering airline

successful operational model by changing its pricing structure to include business class and going to longer, even international, flights. As a result, the company had a large debt burden, an uneconomical cost structure and brand confusion with its customers. It was purchased by Texas Air in 1987 and ceased to exist as a brand.

## When Dominant Brands Fade

There are several reasons once-dominant brands decline from a seemingly unstoppable position. The first is that they stop innovating, a common reason for failure of brands throughout their lifecycle. Dominant brands are especially prone to this because of their seemingly secure position as market leaders, as well as the struggle between brand consistency and adaptability. The second possible reason for a brand to fade over time is that the quality of their product or service declines, disappointing customers and tarnishing the brand. A third potential reason is a loss of focus, either because of acquisitions, non-core expansion or other reasons. Finally, financial mismanagement can hollow out a branded company.

### Stop Innovating/Bureaucratic: Kodak

George Fisher, a superstar at Motorola, was brought into Kodak in 1993 to turn around the 100-plus year old brand and transform it into a digital imaging company. While he had some initial successes in divesting noncore businesses and performed substantial cutbacks and layoffs, he did not succeed in migrating the company to become a digital imaging giant. The two fundamental problems were (1) a failure to view the digital imaging industry as a razor business (versus a blade business, as traditional instant imaging had been), where the profits lie in the hardware and (2) a cultural fear of cannibalizing the existing business and therefore not innovating fast enough. Both of these problems point to a failure of leadership and vision from the top. Fisher hired new top management almost immediately, but he could not successfully lead the middle managers to change their mindset about digital imaging. Despite 10 years and \$5 billion in R&D on digital imaging technology, and by most accounts very good camera technology, Kodak failed to continue its dominance in the imaging industry. Fisher was out in 2000, but Kodak was the long-term casualty of this failure. Most recently, Kodak announced that it would stop producing its iconic Kodachrome color film in 2009 from a lack of demand from professional and amateur photographers.

### Quality Declines: General Motors

From a dominant position of over 50% market share of the U.S. car market to a 2008 market share of 20%, lower than Toyota for the first time, and bankruptcy, GM's fall from brand dominance was multi-faceted. But the factor that started the brand's death spiral was the decline in quality in order to compete on price with the Japanese imports in the 1970s and 1980s. Weighted down with union concessions from the 1950s, GM had to churn out cars to cover these high fixed costs, which meant that GM produced too many cars and had to have fleet sales to clear inventory, which lowered the resale value of GM cars. This then drove prices lower, pricing \$3,000-10,000 below a Toyota, and quality dropped as a result. Foreign competition, bureaucratic culture, complacency, and regulation (CAFÉ standards) all played a role as well, but had GM found a way to maintain its quality, it might have kept its brand dominance.

### Lose Focus: Sears

The largest U.S. retailer from the 1950s until the 1980s, Sears grew from its roots as a mail order catalog serving rural communities to a store-based retailer with its own well established stores brands (Craftsman tools, DieHard batteries, Kenmore appliances). However, Sears took its eye off the ball in the 1980s when it tried to become a conglomerate. The company expanded into real estate (Coldwell Banker in 1981), brokerage (Dean Witter in 1981), computers (Prodigy in 1984), and credit cards (Discover in 1985). While it divested these businesses in the 1990s, Sears was distracted from its core retail business during a time of great change in retailing, when specialty stores were emerging and discounters, such as Wal-Mart and Target, were building scale. Instead of



Missed the digital revolution



Dropped product quality to increase volume at the brand's expense



Expanded into noncore businesses, which distracted the brand

focusing on protecting its retail brand, Sears was busy expanding into peripheral businesses. Declining profitability led to a takeover by Kmart in 2005. The result of this brand erosion is that its market position decline to fourth in U.S. retailing in 2008.

### **Financial Mismanagement: TWA**

The airline linked to Charles Lindbergh and Howard Hughes and known for its dominance of the European routes from the U.S. in the 1970s (passing Pan Am in 1969), TWA was an iconic travel brand, linked with glamour, adventure and service. It achieved its peak in 1988 when it had 50%+ market share of the trans-Atlantic traffic. From this dominant market position, TWA shrank over the next decade to eventually be acquired by American Airlines in 2001 in a desperate situation. The primary cause for the brand's decline was financial mismanagement by corporate raider Carl Icahn, who thought he could "shrink this airline to profitability." After acquiring TWA in 1985, he initially tried to grow by acquiring Ozark Airlines in 1986 and building scale in St. Louis. But after taking TWA private in 1988 and weighing down the airline with \$540 million in debt, he cut costs and salaries, trying to extract enough savings to cover the interest payments on the debt he took on. He also sold the most profitable London routes in 1991 and lucrative gates, which undermined TWA's core service and brand reputation as well as reducing its operating scale internationally. TWA filed for bankruptcy in 1992 and again in 1995. The airline then tried unsuccessfully to focus on domestic U.S. routes in the late 1990s. The brand was finally sold for parts to American Airlines in 2001, who quickly wound down the brand.



Debt burden forced sale of key assets

# Brand Reinvention: Often a Great Investment Opportunity

Brands can be down but maybe not out, a position in the brand lifecycle which is highly investable. The key is to have an opening for the brand that allows for its Reinvention. What makes a brand reinvention possible? There are four paths that brands can take to find new life:

1. Going back to brand's essence
2. Forgoing industry
3. New product category
4. New geography

Once a brand identifies its way back into customers' hearts and minds (and wallets), it must then succeed with the factors listed above for the transform and proliferate, the re-entry point for brands. While it may have an established track record to build on (such as innovation with Apple) and brand intangibles (such as Coach), it also has to counter any negative associations customers retain from its fall from grace. A brand usually does this by going back to its essence (which it may have gotten away from as it struggled) and executing on its promise to customers.

## Back to Brand's Essence: Nintendo

Nintendo started in the mid-1800s in Japan as a playing card company and created the first cards targeted at kids specifically, with Mickey Mouse on the front. The company grew into a games and toys company in the 1960s and 1970s and then built its electronic toys focus, including the first Game and Watch handheld game player in 1980, a market Nintendo continued to own throughout the next few decades virtually uninterrupted with its Game Boy models. The arcade game market was the next one Nintendo entered, but its first attempt was a flop called Radarscope. Then, a young R&D employee named Shigeru Miyamoto invented the Donkey Kong game that made Nintendo a household name in the U.S. arcade market in 1981. Donkey Kong gave video games its first compelling character in Mario, who would continue to appear in Nintendo games. It also gave a new type of movement in the games themselves which differentiated Donkey Kong from competitors. But by the mid-1980s, the U.S. arcade market declined from a lack of new games. Through exclusive contracts with independent third-party game developers in Japan, Nintendo branched out into the home market and was the dominant system in the U.S., with its Nintendo Entertainment System (NES), with the first lock-out chip to protect against unauthorized games.

However, Sony was developing an entirely new kind of home console system based on CDs, which gave much more memory, enabling more complicated game-play and more sophisticated graphics. Tomb Raider was the game that put the Sony Playstation on the map. Playstation largely replaced the NES in the early 1990s for about a decade. The CD-based games also changed the business power dynamics in the video game market, with significantly longer development times and higher investment required, leading to large players like Electronic Arts instead of the smaller ones Nintendo controlled in Japan. Hardcore gamers migrated to the Playstation and became more and more of an installed base for Sony, with the ever-more complicated controller, cryptic buttons and key-patterns helping to keep them loyal.

After a failure of the Nintendo Game Cube, Nintendo went back to its roots with Miyamoto's help. It focused on the whole family, instead of the gamer community, to broaden the demographic target. And, perhaps most significantly, Nintendo simplified the controller to a "wand" that was very intuitive to use. In 2005, the Nintendo Wii, named to be inclusive, was an instant hit when it launched. By 2007, it sold more units than the Xbox (Microsoft's console) and Playstation 3 combined in the U.S. market, marking the first time that Nintendo held the lead since NES.



Got back to core customers of the whole family with a simpler, intuitive wand

### Back to Brand's Essence: Pringle's of Scotland

A nearly 200-year-old brand that started by manufacturing hosiery and underwear, Pringle's of Scotland was based on authentic an heritage of high-quality knitwear (a term it coined in 1905) including the original design for argyle. The brand entered the fashion world in the 1930s with the twin set, worn by movie stars and socialites both in Europe and the U.S. through the 1950s. The brand even set up a Pringle's Bar in Harvey Nichols in 1953 with a rainbow of twin sets, a must have item.

As fashion moved on to other looks, Pringle's became a staid, conservative brand in the 1960s and 1970s. The brand tried to rejuvenate itself in 1981 with a sponsorship of golfer Nick Faldo, but this only succeeded in pigeon-holing the brand more narrowly into a golf and leisure brand. A second attempt was made to broaden the reach of the brand by opening company-owned retail stores in the U.S. and Japan in the early 1990s, but because of too rapid expansion, the brand converted the stores to franchises. The rise of the pound drove export prices higher, and the brand incurred substantial losses in the late 1990s, culminating in the brand's sale to S.C. Fang, a Hong Kong textile tycoon.

The change in ownership, while bemoaned by the local U.K. press, proved a turning point for the brand with a return to innovation and glamour. Fang brought in CEO Kim Winser and Designer Stuart Stockdale to do the turnaround. Reigning in international licenses and redirecting the creative towards a fashionable and sexy image using models like Heidi Klum and Sophie Dahl, but remaining true to its brand identity of luxury knitwear. Sales rebounded, peaking in 2006 at £25.7 million. Around this time, Winser and Stockdale both left, and the brand was in flux. Douglas Fang took over as CEO and Claire Waight Keller was brought in as Creative Director from Gucci. She pursued a haute couture, edgier image than previously, changing the face of Pringle from Klum and Dahl to British actress Tilda Swinton and Freja Beha Erichsen. While this was true to the British character of the brand, the sexy, glamorous dimensions were somewhat abandoned. They also launched a lower priced contemporary line called "Pringle 1815 Scotland" in 2007 in an attempt to broaden the brand's reach. While sales have lagged recently (£17.7 million in 2008), the brand is still trying to solidify its reinvention as a fashion brand.

### Forgiving Industry: Coach

If a brand operates in a forgiving industry, this makes for a much easier reinvention. Forgiving industries include those based on intangibles or innovation (fashion or beauty products) rather than on reputation or trust/safety (pharmaceuticals or investment advice). However, when a brand is based on unique brand intangibles, it's more likely to require a reinvention of the brand's image/personality instead of a just a great new product or service.

Coach began as a small leather goods brand that used baseball leather to make sturdy, classic items in 1941. When Bonnie Cashin joined in 1962 as a designer, the brand introduced handbags with an American style that was more classic than other 1960s styles. Driving the brand sensibility for ten years, Cashin developed the brand's silver toggle clasp and the open-top style of bag that became a mainstay of the brand.

In the later 1970s and 1980s, the brand became staid, with products in the navy, brown and black color range with dowdy designs. Sara Lee bought the company, which had \$19 million in revenue, in 1985 and it continued to grow slowly. Sara Lee did encourage Coach to move production overseas to lower-cost, more flexible suppliers. However, the food conglomerate did not manage the brand particularly well and sales peaked in 1995 at \$540 million and then began to decline. New CEO Lew Frankfort knew he had to do something dramatic to revitalize the brand. He hired Reed Krakoff as a new Creative Director, a key move for a brand competing as an aspirational/intangibles player. Krakoff added fun, fresh and modern to the well-established brand attributes of American, high-quality and affordable that the brand already embodied. CEO Frankfort also identified a white space in the handbag market for \$250-300 status bags, priced lower than designer bags and created an aspirational middle class handbag category.



Returning to its fashionable roots

COACH

Created a new price point that built on the brand's heritage

Sara Lee spun off Coach in an IPO in 2000, when the brand had finally regained its revenue level of 1995 (\$549 million), but the stock didn't take off until 2003. Revenues grew dramatically from \$0.7 billion in 2002 to \$3.1 billion in 2008. The creative team was functioning cohesively, coming out with 12 collections a year, up from 4 to increase the frequency of customer visits to its growing number of stores. By 2008, Coach had a 22% share of the U.S. handbag market, double its nearest competitor, Louis Vuitton. Various licensing agreements for watches, sunglasses, footwear and even office furniture were added to the mix, extending the brand to more categories. On the cost-side, one of the legacies of the Sara Lee ownership was that Coach did 75%-plus of its manufacturing overseas, freeing up cash to invest in extensive brand-building advertising campaigns (\$47 million in 2007).

The test of Coach's reinvention will be how successfully it can grow internationally. The brand has met with good success in Asia, where it has opened 15 stores in China and bought back its Japanese subsidiary, where it is the number two handbag brand. The company has set a goal of getting 35% of its revenues from international sales by 2010, which would put it on track to be a dominant global handbag brand.

### **New Product Category: Apple**

When Apple first emerged as a PC and operating system brand, it had a reputation for product innovation, aesthetic design and anti-establishment culture. After the brand's success with the Macintosh in 1984 and the Powerbook laptop in 1991, it struggled to find a path to growth through innovation in the early 1990s. It tried the Newton PDA as well as cameras and TV appliances, none of which grabbed consumers. The brand languished while Microsoft grew in power with its Windows operating system.

Then, in 1997, Steve Jobs returned as CEO of the company. He led the company in a different direction, overseeing the development of the iPod. Launching the iPod in 2001, Apple re-positioned itself as a consumer electronics brand instead of just a PC maker. Simultaneously, Apple built its Apple stores retail distribution channel, connecting the brand directly to the end-user. Adding iTunes in 2003, which was the first successful and sustainable music downloading model, Apple put itself at the nexus of music, technology and handheld products. The iPhone followed, capping the brand's ownership of this segment. Combining this with its distinctive advertising campaigns, Apple successfully reinvented as a hip, distinctive consumer electronics brand.

### **New Geography: Pantene**

Pantene was a brand that P&G acquired as a small part of the acquisition of Richardson-Vicks in 1985. Launched in 1945, the brand was a niche higher-end brand of shampoo distributed through professional salons and up-market drug stores. P&G saw the potential to bring it to the masses by infusing with its BC-18 conditioning technology. The question was how to go about "restaging" the brand. The company chose Taiwan because, while Pantene had been an international brand, it had not been sold in Asia and lacked any baggage for consumers and retailers.

The local brand manager scoured the globe for elements to include in Pantene's positioning. He drew from France's campaign for *shine outside/strength inside* and combined this with the health positioning in the United States, which appealed to the local consumer. P&G also linked the brand's name to the vitamin (B-5) in the shampoo, terming it *Pantene Pro-V*. It created advertising images with shiny straight hair to accompany the repositioning effort. Re-launching in 1990 in Taiwan, the brand quickly spread to other countries in East Asia and surpassed market share targets. Then, with this established success, Pantene was brought back to the United States in 1992, where it quickly established a dominant market share position which is still enjoys today as a mass beauty brand.



Defined, then dominated,  
new product categories



Went to Asia to innovate a  
reinvention of the brand

### New Geography: Esprit

Esprit was a quintessential California-born brand, started out of the back of Susie and Doug Tomkins VW bus in 1968, as the Plain Jane Dress Company. Targeting teenage girls with babydoll dresses and clothing with a European flare, the brand personality was young, sporty, bold, self-confident and natural. Having emerged by 1978 with \$100 million in sales through department stores, Esprit then became a fashion phenomenon in the 1980s. Esprit Kids was launched in 1981, and the brand brought the shop-in-shop concept to its marketing operations. It hit its peak in about 1986 with more than \$800 million in sales and went international to Hong Kong (1983), Singapore (1985) and Germany (1986), followed by other European and Asian countries.

The brand began to lose momentum in the United States after the divorce of the founders in 1989, as well as the rise of the lots of competitors in specialty retailing in the United States. The company began licensing in 1991 to supplement the retail revenue, branching out into eyewear, timepieces, socks and tights, and even bed and bath products. In East Asia, however, the brand continued to thrive. Esprit Asia, a distribution-only business run by Michael Ying, IPOed on the Hong Kong stock exchange in 1993. In 1996, Susie Tompkins wanted out and sold the European and Asian operations to Esprit Asia while the U.S. operations were sold to private equity investors. During the 1990s, the majority of Esprit's retail store growth came in the Pacific Rim, driven by Esprit Asia.

During the late 1990s, Asia and Europe were defining the brand and leading the growth in stores and revenue. Germany and Hong Kong, especially, were crucial for the brand's reinvention and growth. In Europe, the brand followed a franchise model, growing to more than 1,000 franchised locations by 2008. In Asia and the United States, the stores were company-owned and operated, totaling more than 700 today. One of the key moves Michael Ying made was to consolidate all trademarks, licenses and the U.S. operations in 2002, forming Esprit Holdings operating out of Hong Kong. In 2004-08, worldwide revenue more than doubled to HK\$37 billion.



Europe and Asia allowed the brand to refocus itself successfully

# Brands in Healthcare

Before we look at tomorrow's great brands in detail, we wanted to first point your attention to a particularly intriguing brand dynamic that is currently playing out in the healthcare industry. Within pharmaceuticals, we note that brands tend to be hard to come by, however the OTC market and emerging markets are providing a platform for brands to develop. In healthcare services, the role of brands is growing, particularly in Europe

## Global Pharmaceuticals

### US ad spend is high but brands are short live

The pharmaceutical industry is one of the largest users of advertising in the US. At peak in 2006/07, Nielsen estimates that the industry spent \$5.4bn on direct-to-consumer (DTC) advertising. In 2008, pharma ranked second in ad spend behind automotive manufacturers. Drug brands such as Viagra (erectile dysfunction), Lipitor (cholesterol lowering) and Nexium (acid stomach) became household names in the US during the last decade, boosted by multi-billion dollar advertising budgets.

However, brands in the pharmaceutical industry are short-lived. Drug patents last an average of 20 years, of which 10 years is required for development to get the drug on the market. This gives products an average of 10 years to be commercialized before patent expiry. After this time, for most products, multi-source generic players enter the market and the branded company's market share is eroded by over 90% in the first year post-patent expiry. This rapid erosion is deliberately engineered within the US drug reimbursement system. Pharmacists are financially rewarded by health insurers and the government for substituting branded drug for generic alternatives when a patient arrives with a prescription.

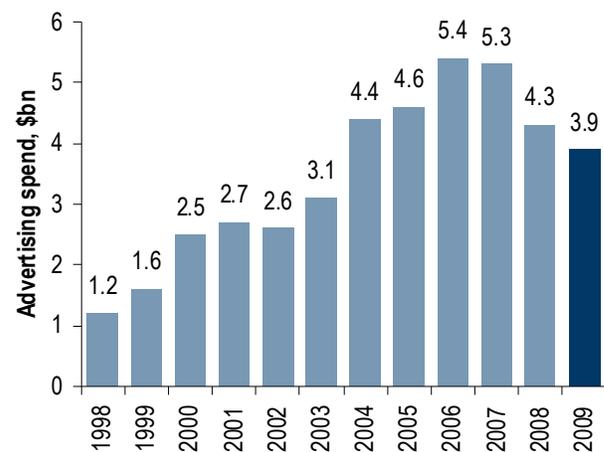
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Figure 52: Top 10 industries by US ad spend, 2008

Product category, \$m	2008	2007	% change
Automotive manufacturers	10,016	11,854	-16%
<b>Pharmaceuticals</b>	<b>4,344</b>	<b>5,325</b>	<b>-18%</b>
Auto dealerships - local	4,198	4,605	-9%
Fastfood restaurants	4,081	3,933	4%
Department stores	3,891	3,994	-3%
Mobile telephone services	3,431	3,732	-8%
Cinema/Movies	3,322	3,751	-11%
Direct response products	2,577	2,359	9%
Restaurants	1,619	1,619	0%
Furniture stores	1,581	1,636	-3%
<b>Top 10 categories</b>	<b>39,090</b>	<b>42,808</b>	<b>-9%</b>

Source: Nielsen estimates, excludes internet and B2B

Figure 53: Pharma US DTC spend over time



Source: Nielsen estimates, excludes internet and B2B

### Ex-US brands are limited by a ban on advertising

In contrast, outside the US and New Zealand, most governments prevent the pharmaceutical industry from advertising directly to consumers (as opposed to doctors). In these markets, where the state is responsible for the majority of drug spending, governments believe that DTC advertising drives up prescription drugs costs, threatening the sustainability of universal access, national health care services. By limiting DTC advertising, the hope is that the decision on drug selection remains with the treating physician, allowing the use of more, older generic drugs and fewer expensive brands.

## Longer-term pharma brands may start to emerge

Over the next five years, five of the world's current top 10 drugs will lose patent protection. Effectively, these brands will disappear overnight. Given this significant loss of revenue, the pharmaceutical industry is looking for new business opportunities to support earnings.

**We believe that two key areas being adopted by many industry players could lead to more sustainable brand value in pharma:**

### 1. Over-The-Counter Medicines.

When a drug reaches the end of its patent life, the manufacturer has the right to apply to sell the drug over-the-counter (OTC) in pharmacies without a prescription. This can garner an additional three years of exclusivity from competition. The switch decision is taken by the drug regulator based on the healthcare benefit of making the product more widely available. Unsurprisingly, the safety profile of the product is a critical element of the decision as products can be less well monitored in an OTC environment. Other key factors are the ability to self diagnose and the risk of the treatment masking symptoms of a more serious condition.

The main pharma players have been focussed on OTC opportunities to effectively extend the lifecycles of drugs, but the commercial impact of switches has been limited by an unwillingness of regulators to allow conversions to OTC. Good examples of global switches have been the low dose PPIs for heart burn such as Prilosec, smoking cessation products (Nicorette family) and more recently Alli for obesity. In Europe, where the regulators are more relaxed about switches we have also seen Zovirax for herpes. With a dearth of pipeline products, and having spent billions of dollars building a consumer brand, Pharma is redoubling their interest in targeting the more sustainable revenue and earnings from OTC drugs. Major products that we believe have OTC potential include Prevacid and Nexium (acid stomach), triptans (migraine) and Lipitor (cholesterol lowering).

**Figure 54: Top 10 US OTC medicine brands**

Rank	Brand	Company	Indication
1	Tylenol	J&J	pain
2	Advil	Pfizer Wyeth	pain
3	Mucinex	Reckitt Benckiser	cough/cold
4	Prilosec	P&G	acid stomach
5	Zyrtec	J&J	allergy
6	Claritin	Schering Plough	allergy
7	Aleve	Bayer	pain
8	Alli	GSK	weight loss
9	Excedrin	Novartis	pain
10	Asprin	Bayer	pain

Source: GSK Consumer Markets Day, May 2009

### 2. Emerging markets.

As GDP growth drives an increase in healthcare spend, emerging markets (EM) are becoming increasingly important drivers of Pharma industry revenue and earnings. We estimate that EM will grow from a \$100bn drug market in 2008 to \$400bn in 2020. In these markets, the substitution of generics for branded drugs on patent expiry is significantly less established partly because these are largely self pay markets. Furthermore, the historic variable quality of locally-produced generic medicines also means that consumer remain more loyal to brands (although quality issues are now much less prevalent). As a consequence, drugs brands may have a greater long-term sustainability in the medium-term.

## European Healthcare Services

### Increased Competition Leading to an Increase in Brand Awareness and Importance

Increasing competition for patients in healthcare services is causing the importance of brands to ascend. Public care providers in many EU countries remain incoherently branded - many relying on a dominant local position and physician referrals to attract patients. However, four things are promoting change which should emphasize the role of brands, in our view:

- (1) **Patient choice** – it is becoming *de rigour* to offer citizens a choice of provider (i.e. public or privately-run) regardless of their ability to pay. This is now common across Scandinavia, the UK, France and Germany. Branding aids consumer decision-making.
- (2) **Public budget pressures** – although the majority of acute services across the EU are reimbursed (i.e. they are not out-of-pocket) this proportion may decline in the face of funding constraints. Competition for non-reimbursed services is often more intense, typified today by dentistry, vision correction, cosmetic surgery and fertility, for example.
- (3) **Declining information asymmetry** – the internet has given rise to 'expert patients' and implies incumbents should find it harder to meet expectations.
- (4) **Cross-border elective services** – in theory the EU Services Directive could promote the development of cross-border choice, funded by the patient's home government.

### Competition for patients is the key ad spend driver

In Figure 55, we show the amount of advertising spend in different segments of the UK health system, while Figure 56 shows our subjective ranking of brand strength for select companies. Arguably the best-known private healthcare brand is insurer Bupa. Founded in 1947, Bupa pre-dates the NHS by one year and has ~40% share of the private insurance market. Annual ad spend per covered life is significantly higher than ad spend per hospital visit – as a physician's referral will likely influence an individual's hospital choice, versus a more financially-driven decision for corporates and consumers to buy supplementary insurance.

**Figure 55: Advertising intensity reflects competition for patients**

UK Private Health Insurers (2006)	Competition
Covered lives (mn)	6.4
Ad spend (£ mn)	26
% sales	0.8
Spend per life (£)	4.1
<b>UK private hospital (GHG - 2009)</b>	
Annual patient visits (mn)	1.3
Ad spend (£ mn)	3–4
% sales	0.4–0.5
Spend per visit (£)	2.4–3.2
<b>UK public health system (F2009)</b>	
Population (mn)	61.3
Ad spend (£ mn)	56
% NHS budget	0.1
Spend per person (£)	0.9

Source: Hansard, Company data, Datamonitor, Credit Suisse estimates

**Figure 56: Relative brand strength does not always correlate to ad spend (UK)**

Organisation	Annual ad spend, £ mn	Notes
	56	Default provider of 'free' healthcare; all services have been widely branded since 1999
	10-15	Largest private insurer; 'Bupa' is the generic name for private insurance across the UK since foundation in 1947
	~0	Famous for celebrity rehab; often in the media
	3-5	Relies on physician referrals but we believe public awareness is generally low
	~0	Physician-owned hospitals; Unusual business model and physical architecture has created national media interest

Source: Credit Suisse estimates

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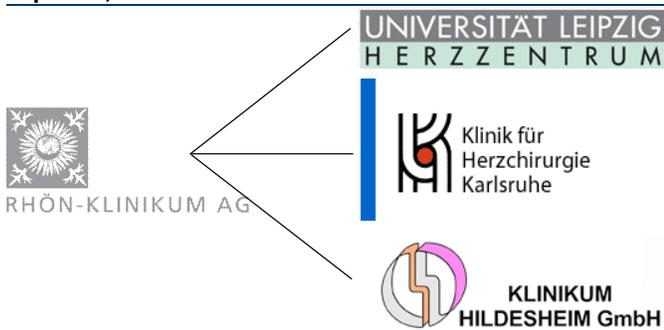
**Components of a good healthcare brand**

Branding allows healthcare operators to communicate the type of services offered (surgery, rehab, etc), waiting times, allusions to quality (morbidity and infection rates, in addition to ‘hotel services’) and, if necessary, pricing. Due to increasing transparency in many EU countries, public operators are starting to disclose outcome data by facility, a key point of differentiation from the private industry.

**Two approaches to brand building**

German hospital operators Rhoen Klinikum and Helios (part of Fresenius SE) provide a good case study of two differing branding regimes (Figure 57 and Figure 58). The former prefers to brand its facilities locally whilst the latter believes its sources of differentiation should be widely broadcast. Other EU operators have harmonised branding across their networks even internationally (notably Bupa, Générale de Santé and Capio), while a few follow Rhoen’s approach (ie. HCA’s six hospitals in London are all separately-branded).

**Figure 57: Rhoen Klinikum promotes its hospitals as separate, local entities...**



Source: Company data, Credit Suisse

**Figure 58: ...whereas all of Fresenius’ Helios hospitals are clearly branded as being part of a wider group**



Source: Company data, Credit Suisse

**Emerging brands are tied to industry consolidation.** As industry fragmentation remains high across the EU, significant brands remain in short supply. That said, a number of consolidators have come to our attention in recent years (Figure 59) and we expect further activity to increase awareness. Media coverage of Circle Health has been intense in 2009-10, driven by interest in its physician-ownership model and the engagement of high-profile architects to design new facilities, although the company operates just 4-5 facilities today we believe that it represents an interesting brand story in the making.

**Figure 59: Emerging brands are following industry consolidation, we believe**

Brand	Description	Founded
 vitalia	French hospital consolidator	2006
 LABCO Quality Diagnostics	European lab consolidator	2002
 Circle	UK physician-owned hospital network	2004
 Virgin	Reported by <i>The Telegraph</i> to be considering healthcare investments (4-Feb-09)	1972

Source: Company data, Credit Suisse estimates

## Brands of Tomorrow

We have created a portfolio of 24 next great brand stocks (plus three private company picks), identified by our framework and analysts as stocks likely to outperform over the next three to five years as they grow in size, scale, and brand equity with consumers. Credit Suisse has created a Delta One basket that tracks an equal-weighted investment in the stocks (Ticker: CSGLBRND).

### Exhibit 60: 27 Exciting Brands of Tomorrow

Brand	Ticker	Region	Description
Alibaba.com Limited	1688.HK	NJA	Vast Chinese Business-to-Business eCommerce site poised to leverage its first mover advantage (and memorable name) as it shifts its model from subscription- to transaction-based.
Almarai	2280.SE	EMEA	Deeply tied to and rooted in the culture in which it thrives, Almarai, a Middle Eastern dairy brand, is expanding its footprint into Egypt and baby food.
Amazon	AMZN	US	Positioned to leverage its scale, infrastructure, and first mover advantage to grow its mind share and take advantage of the secular eCommerce tailwind.
Apple	AAPL	US	Known for aspirational, consumer-friendly innovation, positioned to proliferate in new markets for smartphones, tablets, PCs, as well as internationally.
BIM	BIMAS.IS	EMEA	Unique Turkish discount food retailer recognized for value and consistency expanding into the Middle East and North Africa.
Capitec	CPIJ.J	EMEA	An innovative South African retail bank with aggressive plans to increase presence in more affluent areas and gain an edge through pricing.
China Merchants Bank	3968.HK	NJA	Deregulation and increasing borrowing by the Chinese consumer should allow this trusted retail bank to increase product penetration in the marketplace.
Comac	Private	NJA	Poised to take advantage of the captive Chinese airline market, this startup aircraft brand is developing a 150-seat airliner to compete directly with Boeing's 737 and Airbus' A320.
Enfamil	MJN	US	High-quality baby formula Enfamil brand with global reach, leveraging worldwide trend away from breast feeding.
Facebook	Private	US	International growth, mobile devices, and advertising revenues offer profitable upside for this rapidly growing social media site.
Hyundai Motor	005380.KS	NJA	Korean car brand repositioning its image toward "affordable luxury", poised to take advantage of Toyota's missteps and accelerate US market share gains.
Indian Hotels	IHTL.BO	NJA	Upscale Indian hotel brands represent a unique play on domestic India tourism growth as well as international expansion.
Julius Baer	BAER1.VX	Europe	Emerging from the recent financial tumult, Julius Baer has realigned its structure and strategy to return to its original model focused on passion, transparency, and tradition.
Li Ning	2331.HK	NJA	The most recognized Chinese domestic athletic footwear brand founded by a Chinese Olympic legend with further upside in China and abroad.
Mahindra & Mahindra	MAHM.BO	NJA	A very affordable, compact and stylish Indian truck and tractor brand well positioned in India and other emerging markets, attempting to break into the US market.
MercadoLibre	MELI	Lat Am	Highly recognized first mover, well-positioned for growth in the online consumer marketplace in Latin America.
Mercedes-Benz	DAIGN.DE	Europe	Legendary brand reinvigorating its image by moving more toward younger, more stylish, and eco-friendly products.
Polo Ralph Lauren	RL	US	A transcendent classical American brand that can continue to leverage itself into Europe, Asia, and new product categories such as handbags.
Sonova Holding	SOON.S	Europe	High end, high quality European hearing aid brand known for its discrete products well positioned to take advantage of aging population.
Swatch	UHR.VX	Europe	Following a successful repositioning, luxury brand Omega exudes longevity, expertise, and reliability in an industry marked with change and consolidation.
Tiffany & Co.	TIF	US	Iconic American brand with an aspirational yet attainable image that is poised for increased penetration in China and Europe.
Tingyi	0322.HK	NJA	Well-known, market leading Chinese instant noodle maker with scale advantages that is also making inroads into fast growing ready-to-drink beverage market.
Trader Joe's	Private	US	Significant growth opportunities for this food retailer focusing on specialty niche private label products.
Tsingtao Brewery H	0168.HK	NJA	Known for quality, consistency, and taste, aspirational beer brand well positioned in the large, growing, and consolidating Chinese beer market.
Under Armour	UA	US	Authentic performance sports brand rapidly growing into new product categories, sports, channels, and regions.
Uniqlo	9983	Japan	Dominant Japanese basics apparel brand with a scalable retail model that is poised for massive expansion in China.
Yakult Honsha	2267	Japan	A Japanese maker of probiotic drinks, which stands to benefit as the emphasis on health and wellness grows in the Americas and Asia.

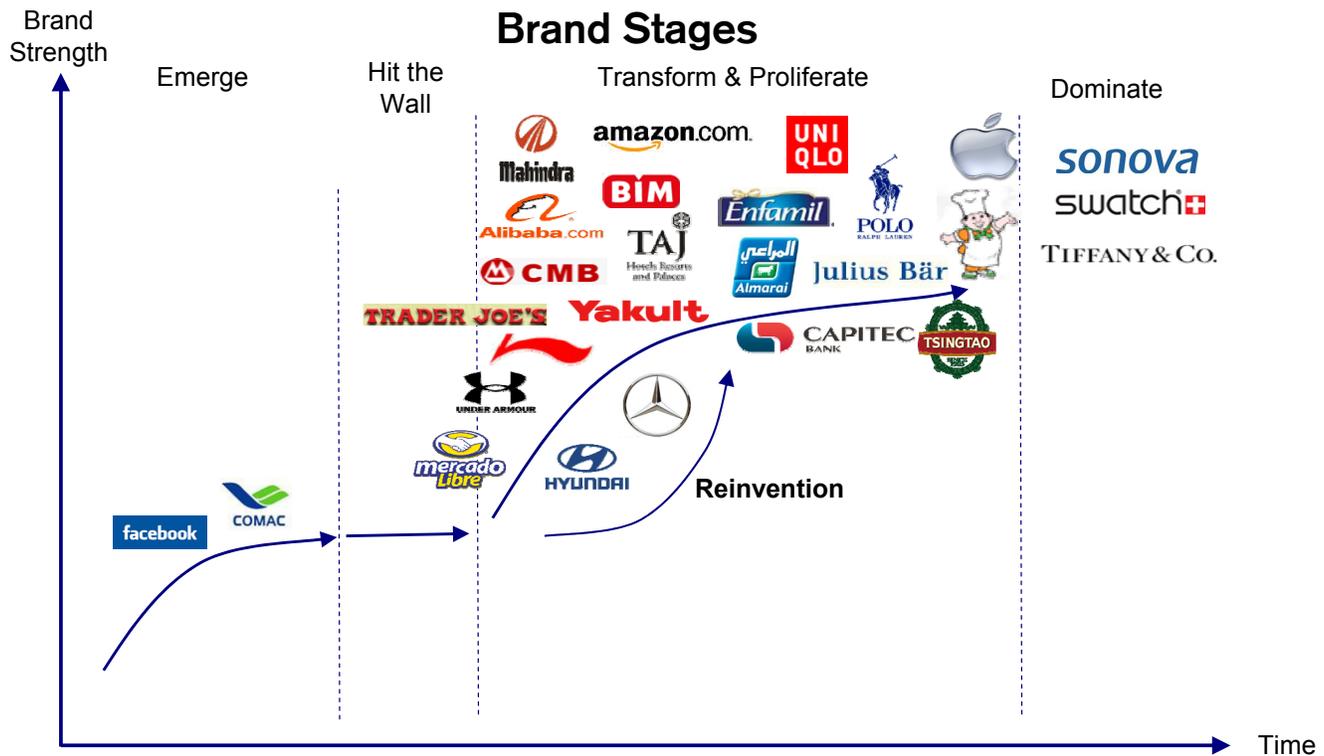
Source: Company data, Credit Suisse estimates

**Exhibit 61: A Balanced Portfolio of High Potential Brand Stocks across Markets**



Source: Company data, Credit Suisse estimates

**Exhibit 62: A Balanced Portfolio of Brand Stocks Across the Various Development Phases**



Source: Company data, Credit Suisse estimates.

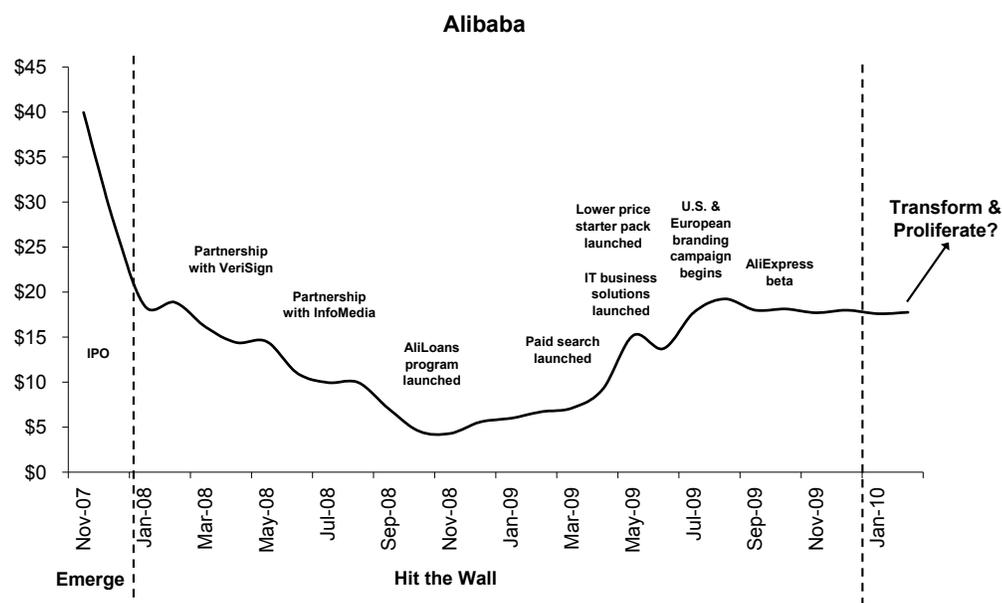
# Alibaba.com Limited (1688.HK): China's B2B Online Marketplace

## Exhibit 63: Alibaba Stock Price History

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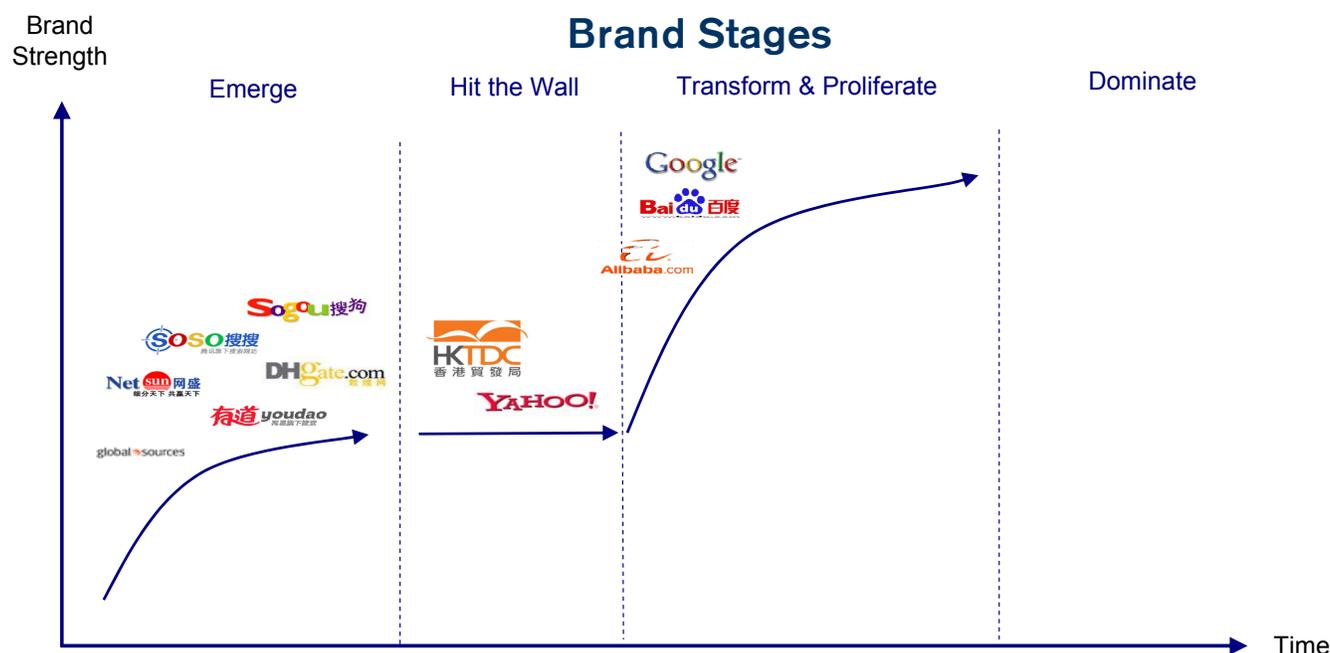
Source: Company data, Credit Suisse estimates.

## Investment Summary

- **Unique Brand Story.** Alibaba is a hybrid model—part search engine part ecommerce company—that dominates the nascent B2B online industry both within China and among international SMEs (small and medium-sized enterprises). Their model is currently transforming and proliferating from a subscription-based marketing service/directory to a transaction and VAS-based marketplace. The biggest strength of the brand is the integrity of its supplier database. Built over 10 years and authenticated through VeriSign and user ratings, Alibaba's database is viewed as more trustworthy than search engines and its sister company payments brand, AliPay, is more trusted than bank credit cards online, as AliPay escrow payment methodology provides extra buyer protection. This augurs well for the brand as it seeks to proliferate in the next five years.
- **Brand Opportunity.** Building on this established trust, Alibaba's big opportunities involve monetizing its registered users and traffic. As the brand moves to charging for VAS, in addition to its subscription-based model, including paid search, Alibaba should be able to increase the adoption of paying membership from its current 1%. The addressable market in China is huge and growing, as SMEs are more likely to trade online versus offline, especially compared to larger companies. China's Internet penetration will continue to rise from its current 30%—another plus for Alibaba. The third prong of its future growth is maximizing international marketplace transactions, including India and the United States, in which the brand invested \$30 million in an overseas marketing program in 2009.
- **Market Perception.** While some critics see Alibaba as an inch deep and a mile wide with only limited success at monetizing their traffic and user-base, we believe that the trust the brand has accrued will allow it to ramp up revenues. With its focus moving from building user numbers to getting users to adopt a wider range of VAS, Alibaba will transform and proliferate in the next five years.

- Valuation.** Alibaba subscription business model provides visible and sustainable free cash flow stream. Due to its unique business model, cash-based earnings are the preferred financial measurement for Alibaba.com. Alibaba's 2010 FCF yield at 3.7% is higher than Tencent at 3.4% and Baidu at 2.1%. Our DCF target price is set at HK\$25.0, implying 43.0x cash-based P/E in 2010 and 27.6x cash-based P/E in 2010 and 1.38x cash-based PEG in 2010. Trading at 30x 2010E cash-based P/E and 0.9x 2010E cash-based PEG, Alibaba is rated as OUTPERFORM. We believe Alibaba.com high multiple is justified by the new growth drivers and its hybrid business model of search engine/e-commerce marketplace.

**Exhibit 64: Chinese B2B Search & eCommerce Industry Competitive Brandscape**



Source: Company data, Credit Suisse estimates.

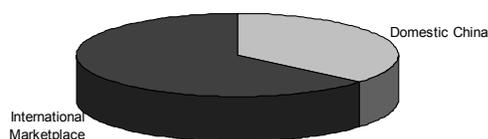
## Brand Overview

Alibaba was founded in 1999 by Jack Ma as an online bulletin board for businesses to post buy/sell trade leads within China. It focused on small to medium-sized enterprises (SMEs) as customers, striving to “open sesame” to the Chinese market for international and domestic Chinese trade. The company operates two separate marketplaces, one for international customers and one for strictly Chinese domestic transactions. With 45 million registered users and 6,000 product categories across over 40 industry verticals, these marketplaces already command four times the market share as their nearest competitor in China.

While initially Alibaba was a marketing vehicle for suppliers to showcase their products and get leads, in the past two years it has begun its transformation into a true marketplace where transactions are negotiated and consummated. The international marketplace has led the way, comprising 60%-plus of revenues owing to higher adoption rate of value-added services (VAS) and more transactions per user. Its international proliferation has also been concurrent with this transformation to a marketplace. It expanded into India through a joint venture with InfoMedia in 2008, and now India makes up more than 10% of its international traffic. In 2009, the brand invested \$30 million in a U.S. advertising push targeting entrepreneurs looking to source in China.

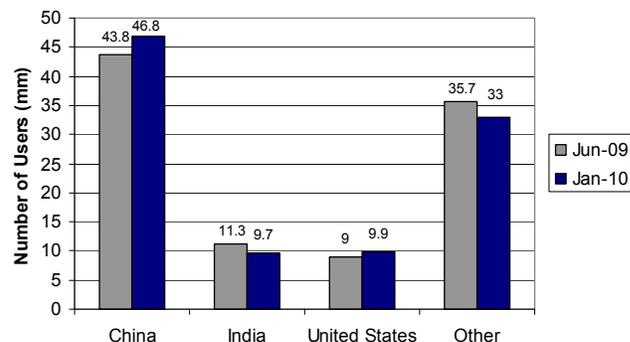
While still a relatively small company (US\$500 million in estimated 2009 revenues), its gross margins have averaged 86% in the past three years with about half of that falling to the bottom line, except in 2009 with the overseas marketing program and switch to paid search and lower-priced starter kits. Even with these investments, net income was still 24% in 2009.

**Exhibit 65: Alibaba Revenue Mix (2009)**



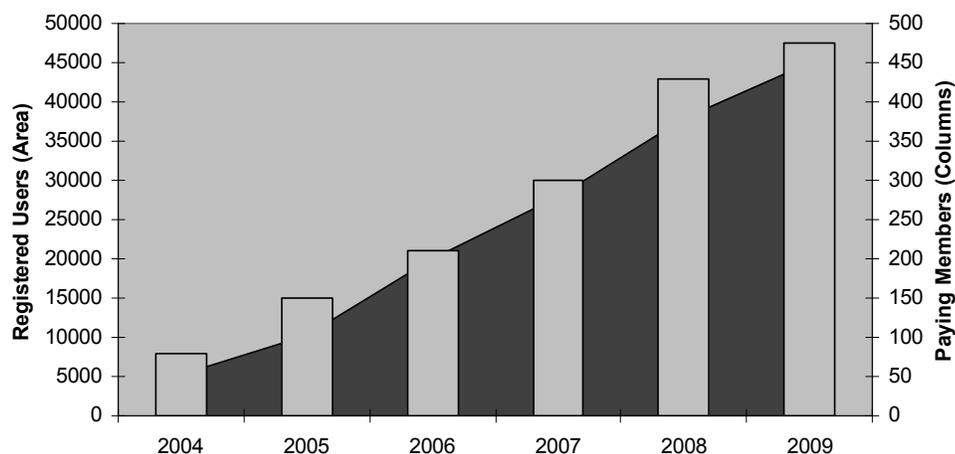
Source: Company data, Credit Suisse estimates.

**Exhibit 66: Alibaba International User Mix (2009 vs 2010)**

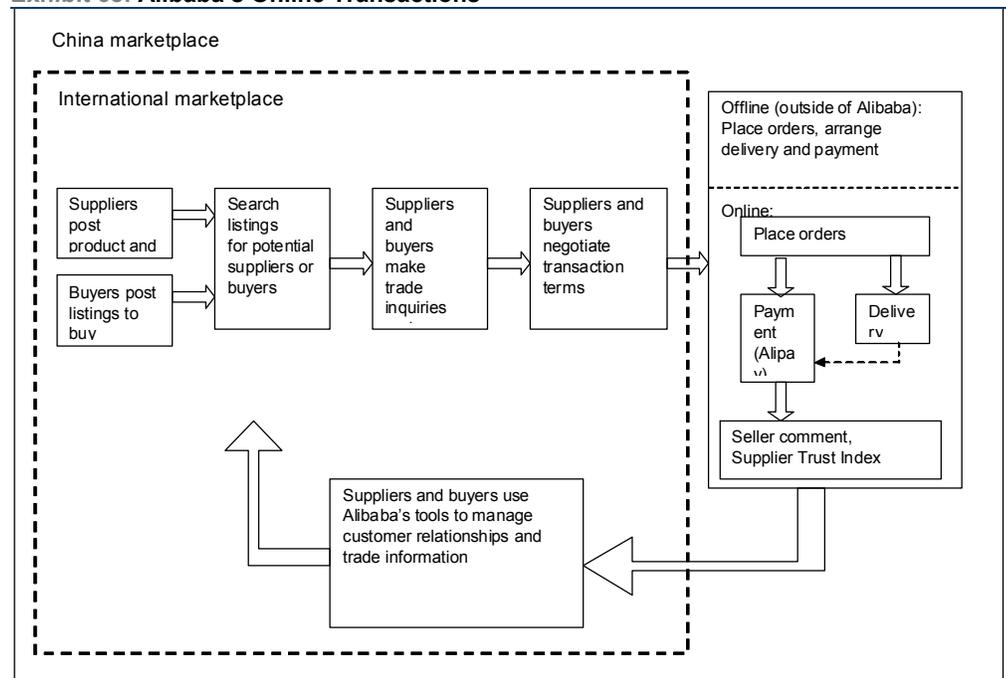


Source: Company data, Credit Suisse estimates.

**Exhibit 67: Growth of Registered Users and Paid Subscribers (Thousands)**



Source: Company data, Credit Suisse estimates.

**Exhibit 68: Alibaba's Online Transactions**

Source: Company data, Credit Suisse estimates

## Brand Development State: Transform & Proliferate

Building on the trust of users, Alibaba is moving to transform and proliferate through monetizing its rapidly growing user base with VAS and investing in international expansion.

**Exhibit 69: Alibaba Has Completed the Brand Emergence Phase, and Now Is at a Point of Inflection in the Transform and Proliferate Phase**

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Value-Added Services Adoption

While Alibaba has struggled to monetize its user base, the adoption of VAS is ready to take off, especially with the lower-priced starter pack launched in 2009 and the rumored fee introduction for existing free VAS such as Mobile CTP, Winport and AliLoans. While

offerings have been limited to date (e.g., Traffic Analyzer, Virtual Showroom), the potential for invoicing, tracking, and other valuable yet-to-be-developed services is tremendous in a market like China. The other big push is for paid search, called Ali Advance, which was launched in 2009 and already has 40% of Baidu's online marketing customers. We believe Alibaba will have an impressive 6% of paid search by 2012.

### India as Next Big Thing

With its 2008 partnership with InfoMedia, an Indian B2B media network, Alibaba opened its marketplace to Indian SMEs. Just over one year later, India comprises 11% of Alibaba's international marketplace's registered users, behind the U.S. at 16%.

### Resumption of Chinese Export Growth

The second half of 2008 and 2009 were devastating to Chinese exporters, as the world financial crisis turned their businesses on their heads. When exports resume their growth, Alibaba will benefit in facilitating these transactions.

### China Internet Penetration

While China's 300 million Internet users are equal to the entire population of the U.S., the country's Internet penetration is only 30%, holding huge upside as more people go online domestically.

### International Transactions

The beta test of AliExpress launched in 3Q09 in the international marketplace enabled transactions using AliPay. The initial results are promising, as our tracking shows the product listing tripled three months after beta testing.

## Major Catalysts

We believe the three key catalysts for Alibaba stock over the next five years are as follows:

- **Value-Added Services.** As Alibaba finds what its SME customers are willing to pay for in terms of VAS, it could successfully monetize its 45 million registered users at a much higher rate than the 1% rate today. Offerings such as AliLoans (domestic China only), paid search and theoretically invoicing and tracking could add substantially to Alibaba's topline growth.
- **India Penetration.** The partnership with InfoMedia is in its infancy and could add significant growth to Alibaba's international marketplace growth in the coming years. Already, India comprises 11% of the registered users on the international marketplace, second only to the United States at 16%.
- **Chinese Economic and Export Growth.** As exports recover after the financial crisis, the SMEs that Alibaba serves will be stronger and more aggressive in the marketing spending.

## Key Risks

### Slowdown in the Chinese and Global Economy

If the Chinese and global economy were to slow down or be hit with rapid inflation, this could negatively impact Alibaba's customer base and their ability to pay for VAS and advertising.

### Regulation of E-commerce in China

Any additional regulations, such as those for online payments that are expected in 2010, could hurt Alibaba's business. New competitors, especially more conservative offline players, could emerge once the rules are in place, mitigating the risk of change in the legal landscape.

## Search Engines Strengthen

Search engines are not the only starting point for Internet users in China, unlike the U.S. and European markets. Branded sites typically get less than 30% of their traffic from search engines, primarily because users do not trust the results they get back from search. However, search engines such as Baidu have been rising recently in their Alexa rankings and have had good success at monetizing their growing traffic. This could threaten Alibaba's role as a hybrid search engine/marketplace.

## Vertical Niche Marketplaces

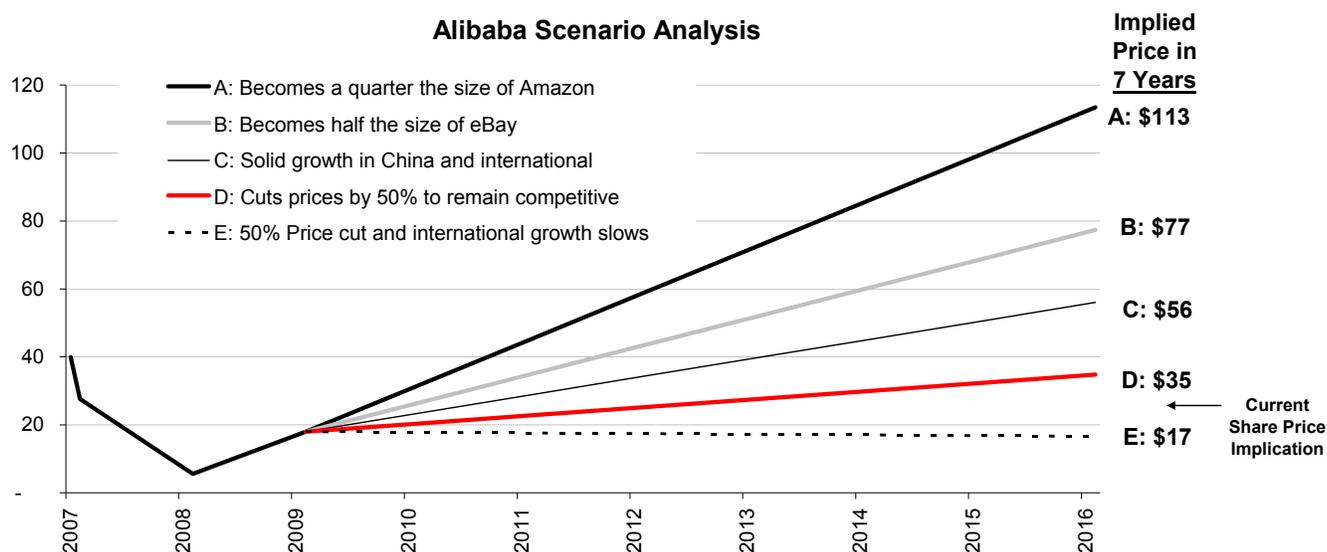
Alibaba's 6,000 product categories and 40-plus industry verticals are vulnerable to a focused competitor cherry-picking profitable niches and serving those customers' specific needs better. For instance, one competitor, Netsun, operates three vertical B2B portals in petrochemicals, pharmaceuticals and textiles. While today it does not appear to be a direct threat to Alibaba, because of the low rate of cross-selling and seeming lack of scalability, it could eventually undermine Alibaba's model.

## Valuation

Alibaba subscription business model provides visible and sustainable free cash flow stream. Due to its unique business model, cash-based earnings are the preferred financial measurement for Alibaba.com. Alibaba's 2010 FCF yield at 3.7% is higher than Tencent at 3.4% and Baidu at 2.1%. Our DCF target price is set at HK\$25.0, implying 43.0x cash-based P/E in 2010 and 27.6x cash-based P/E in 2010 and 1.38x cash-based PEG in 2010. Trading at 30x 2010E cash-based P/E and 0.9x 2010E cash-based PEG, Alibaba is rated as OUTPERFORM. We believe Alibaba.com high multiple is justified by the new growth drivers and its hybrid business model of search engine/e-commerce marketplace.

## Financial Statements and Comparable Valuation

### Exhibit 70: Current Share Price Embeds Conservative Growth Expectations



	2009E	2016 Scenario Analysis				
		A	B	C	D	E
Sales	3,920	40,000	27,000	19,400	15,642	9,000
Growth CAGR	-	39%	32%	26%	22%	13%
EBIT margin	28%	57%	57%	57%	51%	51%
Interest expense (income)	(106)	(486)	(486)	(486)	(350)	(200)
Tax rate	17%	28%	28%	28%	28%	28%
Sharecount	5,068	5,191	5,191	5,191	5,191	5,191
<b>EPS</b>	<b>\$0.20</b>	<b>\$3.24</b>	<b>\$2.21</b>	<b>\$1.60</b>	<b>\$1.16</b>	<b>\$0.67</b>
Growth CAGR	-	49%	41%	35%	29%	19%
P/E Multiple	89	35	35	35	30	25
<b>Implied Price, 2016E</b>		<b>\$113</b>	<b>\$77</b>	<b>\$56</b>	<b>\$35</b>	<b>\$17</b>
Implied 7-yr return		556%	347%	224%	101%	-4%
CAGR		31%	24%	18%	10%	-1%

Source: Company data, Credit Suisse estimates.

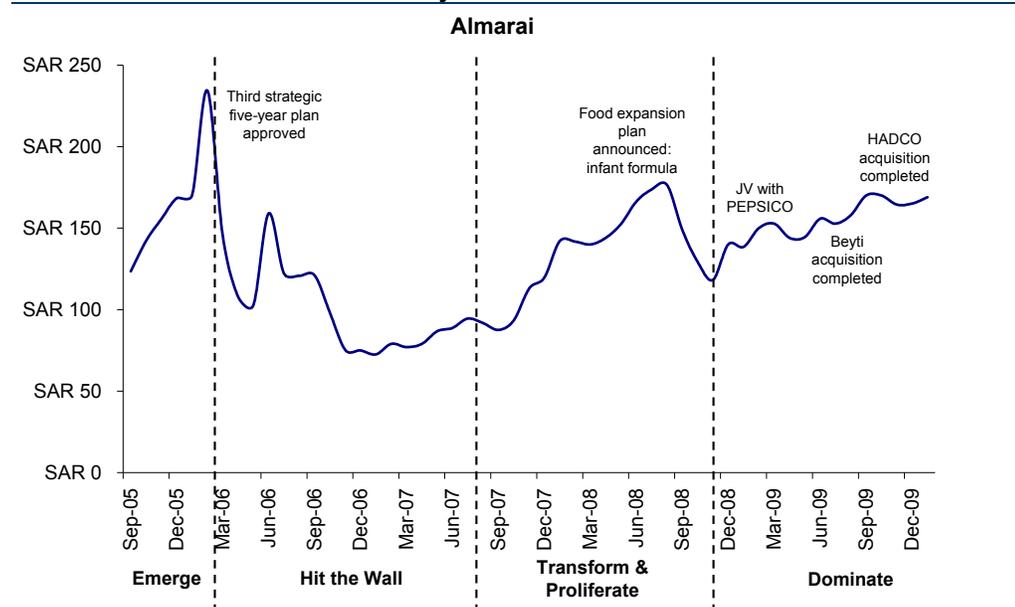
### Exhibit 71: Alibaba Trades at a Premium to the Group on 2010 Estimates

Company	Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009 Stock Perf	2008 Stock Perf	EPS				P/E CY08	P/E CY09	P/E CY10	3-Yr Avg P/E	EV-to-Sales
										FY07	FY08	FY09E	FY10E					
Ali Baba	1688-HK	17.30	\$11,474	-	\$440	48%	-	222%	-80%	0.04	0.24	0.20	0.32	72.7	85.2	54.9	-	-
Google	GOOG	540.64	\$171,027	\$144,931	\$23,326	36%	21%	102%	-56%	12.78	23.20	27.37	31.41	23.3	19.8	17.2	20.0	6.2
Global Sources	GSOL	6.47	\$286	-	\$208	13%	-	26%	-81%	0.61	0.51	0.33	0.48	12.7	19.6	13.6	13.0	-
Baidu	BIDU-US	492.70	\$16,943	-	\$462	38%	34%	215%	-67%	1.70	6.26	9.41	13.83	78.7	52.4	35.6	36.8	-
eBay	EBAY	22.67	\$29,320	\$23,204	\$8,727	17%	13%	69%	-58%	0.10	1.58	1.67	1.83	14.3	13.6	12.4	13.5	2.7
Amazon	AMZN	117.33	\$51,642	\$47,221	\$24,509	5%	29%	162%	-45%	0.87	2.04	2.91	3.80	57.5	40.3	30.9	39.6	1.9
Average						26%	24%	133%	-64%					43.2	38.5	27.4	24.6	3.6

Source: Company data, Credit Suisse estimates.

# Almarai Co (2280.SE): A Danone in the Making

Exhibit 72: Almarai Stock Price History



Source: Credit Suisse.

## Investment Summary

- Unique Brand Story.** Almarai has created significant brand value in the dairy segment and has proven its reliability and success. The company's products are consumed daily; therefore, they are tested daily and must have a flawless track record, as any defect could significantly tarnish the brand. The company's cold distribution chain has allowed it successfully to transport dairy products over long distances in an incredibly warm climate, which has led to great success in Saudi Arabia and allowed it to expand outside of the Kingdom of Saudi Arabia (KSA) to the Gulf Cooperation Council (GCC) with similar success. In a hostile Middle Eastern environment, this asset allows the company to sustain a competitive advantage
- Brand Opportunity.** We like Almarai's strategy of establishing a dairy footprint across the MENA region by acquiring established and operationally well placed distribution chains in demographically attractive opportunities. We see significant opportunity for Almarai to continue to expand its businesses into new regions and tranches with its recent move into Egypt and toward baby food.
- Market Perception.** Almarai is the third most popular Arab brand, behind Jazeera and Emirates (Forbes). Brand strength is traditionally measured in terms of price premiums for product, but we believe that is half the story for Almarai.
- Valuation.** Almarai trades at 15.9 times our 2010 EPS estimate, a 23.4% discount to its peers. Our conservative 2010-11 EPS growth estimate for Almarai is 9.5% versus 7.7% for its peers.

Digvijay Singh

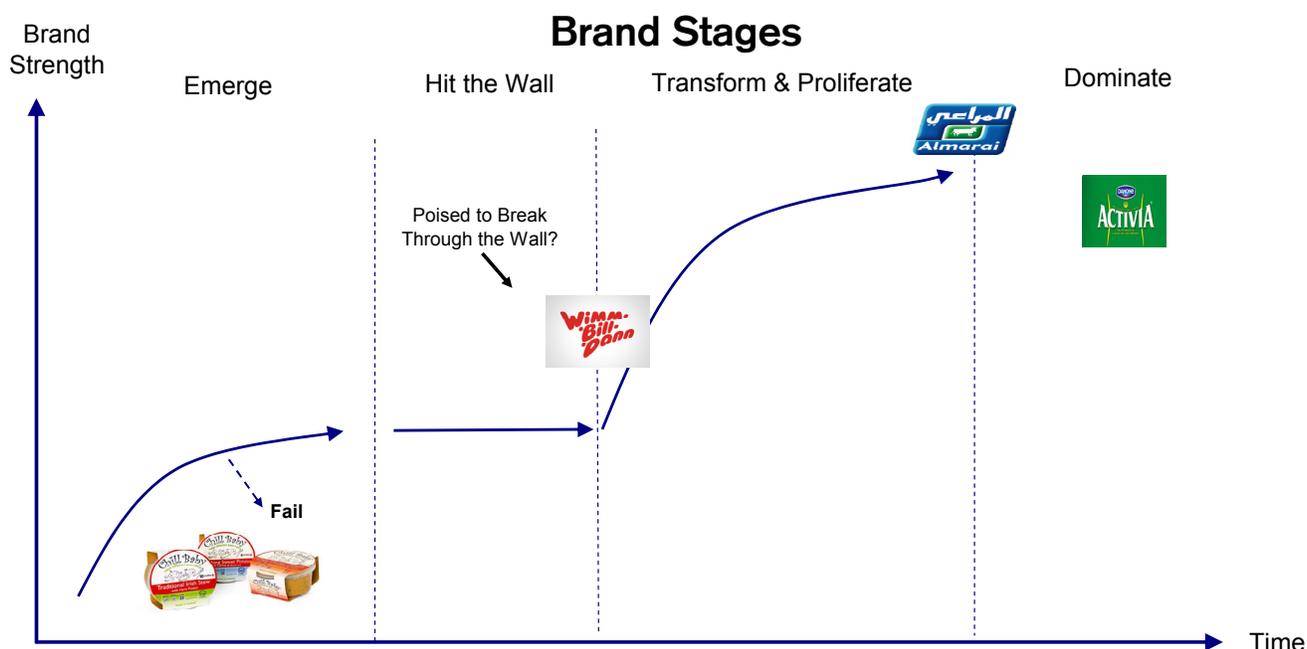
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**Exhibit 73: Almarai and the Dairy Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

## Brand Overview

Almarai was founded in 1976 as a fresh milk processor and a producer of laban (yogurt drink); the company then expanded into dairy farms, food processing, cheese, and now into agriculture and infant foods. Therefore, the company has grown upstream and downstream to become one of the largest—if not the largest—vertically integrated dairy companies in the world. It is the first dairy farm in the world to gain ISO 9002 accreditation.

### So What Is Special About Serving Fresh Milk Everyday?

Serving fresh milk everyday may seem trivial a task; however, in an arid geography such as that of Saudi Arabia, where temperatures soar to 50 degrees Celsius (122 degrees Fahrenheit) and more in the summer, developing a cold distribution chain throughout the country and consistently serving a quality product is a huge challenge.

### A Milk Company and a Pan Arab Brand

Saudi Arabia receives visits from millions of devout Muslim pilgrims for the holy pilgrimage to Mecca and Medina every year. Charitable donations often take the form of food and milk; Almarai's milk is actively utilized for such donations. Therefore, we believe the brand will strongly resonate as a pious and pure brand of milk across the globe, not just in Saudi Arabia.

### About Values, Not Exclusivity

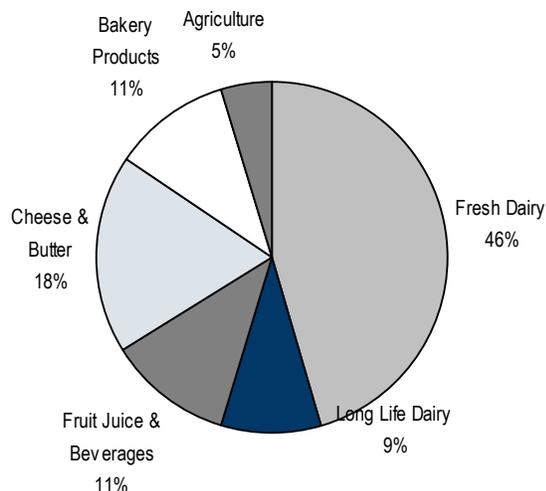
A typical brand strength assessment is in the form of price premiums paid for an equivalent product. While Almarai's milk is sold at a premium (c 25%, which is a large premium in consumer staples) to recombined milk, the company focuses on volume rather than exorbitant price premiums, as its mission is more rooted in welfare.

### Is it More or Less Challenging to Be a Brand in Consumer Staples?

The challenge of being a brand in consumer staples is that the brand is tested on its value everyday, and a customer could make a decision to switch to other brands daily. Furthermore, as a food product, if Almarai fails in quality and provides an unsuitable product, the result could be serious to the consumer's health. To guarantee a high-quality

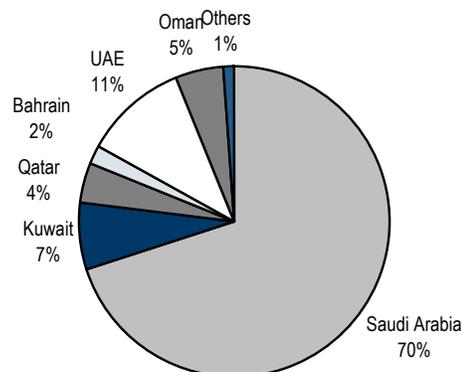
product without fail, Almarai has to control all aspects of the value chain, from the fodder that the cows consume to the distribution warehouses and vehicles. Therefore, we argue that it is more of a challenge to become and maintain a high-quality brand in consumer staples.

**Exhibit 74: Revenue Breakup (2010)**



Source: Company data, Credit Suisse estimates.

**Exhibit 75: Geographic Breakdown (2010)**



Source: Company data, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

**Exhibit 76: Almarai Completed the Brand Emergence Phase and is currently in a Transform and Proliferate stage as it extends its brand into new segments and regions**

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

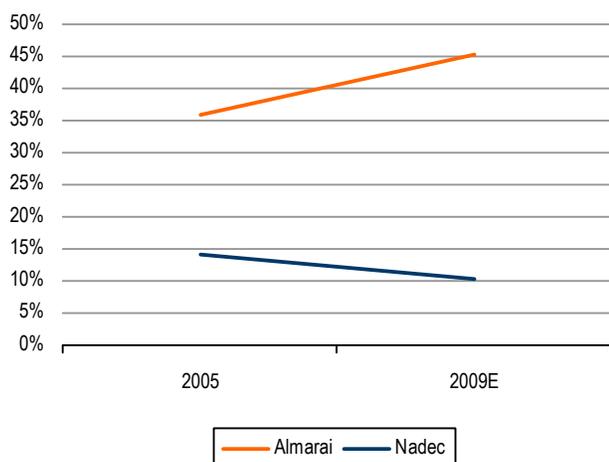
Source: Company data, Credit Suisse estimates.

**While Almarai has achieved dominance within the dairy segment in Saudi Arabia, the company is in the process of transforming itself as it enters into the baby food market and Egypt.** Over the past 20-plus years, Almarai has grown its market share throughout dairy. Almarai perfected the appropriate technology to transport dairy and other food products throughout a warm climate. Furthermore, the brand has become integrated in Muslim culture, playing to the needs and tastes of its main consumer. The brand has consistently gained market share, and we believe it will continue to proliferate as it enters new tranches, such as baby food.

**Market Share Trends Tell the Following Story (Compared With the Largest or Next Largest Market Participant)**

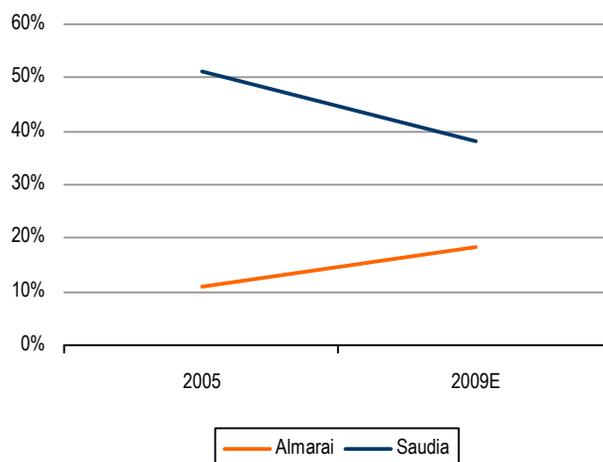
- Almarai has consistently gained market share over domestic Saudi incumbents in categories in which it has operational edge, which is to be expected. (See Exhibit 77.)
- The company has gained market share in categories in which there was potential for cheaper imports to gain market dominance. (See Exhibit 78.)
- The company has dominated the market in new categories in which it had no traditional operating experience. (See Exhibit 79.)
- It has done so against internationally renowned brands by adapting to local customer flavors and by having a pulse on consumer tastes. (See Exhibit 80.)

**Exhibit 77: GCC Market Share: Fresh Milk**



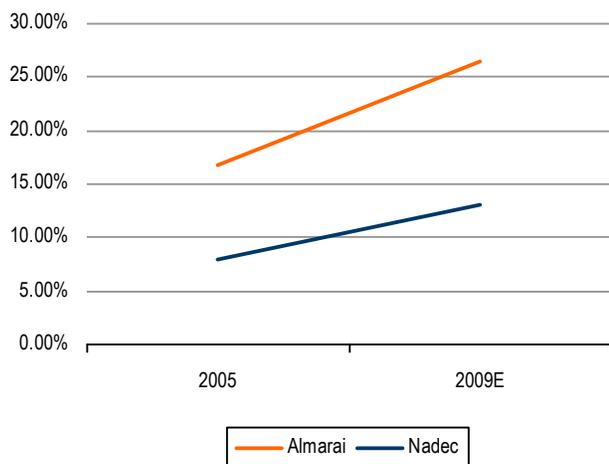
Source: Company data, Credit Suisse estimates.

**Exhibit 78: GCC Market Share: Plain UHT Milk**



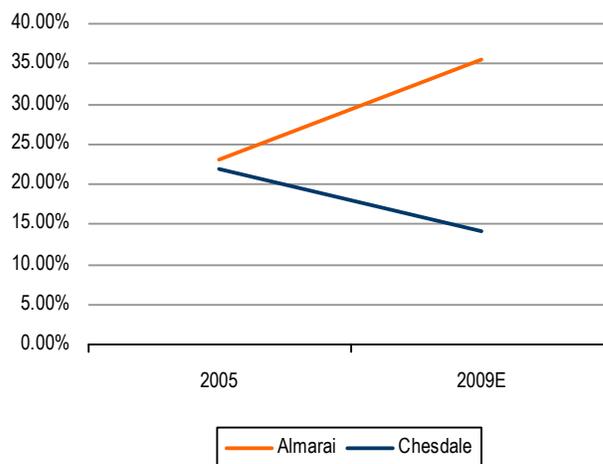
Source: Company data, Credit Suisse estimates.

**Exhibit 79: GCC Market Share: Fresh Juice**



Source: Company data, Credit Suisse estimates.

**Exhibit 80: GCC Market Share: Cheese Slices**



Source: Company data, Credit Suisse estimates.

### Acquisition Strategy: Targeted and Deliberate

Almarai has pursued a strategy of select acquisitions over the past few years, from which the company will benefit, in our view. Almarai has witnessed significant growth in recent years, a process that has been facilitated by the company's desire to acquire companies in new regions or product lines.

The company recently acquired Hadco and Beyti, allowing it easier entry into new markets such as poultry and Egypt, respectively. We view the joint venture with Pepsico (PEP) of strategic importance to Almarai's long-term growth opportunity. We outline the key benefits of each of these acquisitions.

**Hadco:** We believe that Almarai's agreement with Hadco, an agricultural and poultry company, will prove to be beneficial to the company for the following reasons.

- It positions Almarai as the prime vehicle for execution of the Saudi food security program.
- Hadco provides Almarai with exposure to an attractive food segment via poultry.
- The cash component is a low 1.75% of acquisition value (excluding transaction costs); therefore, the acquisition does not compromise other expansion prospects.
- The land asset alone could account for roughly 72% of the deal's value; therefore, we view the price paid for acquisition as reasonable for Almarai's shareholders.

**Beyti:** Only a month after the Hadco acquisition, Almarai announced the finalization of the Beyti acquisition, which we believe will be a positive for the following reasons.

- The demographics and population pyramid in Egypt make for an attractive market for consumer staples (72.5 million as per the 2006 census, of which 21% are younger than ten years old).
- Distribution chain challenges allow for the creation of market-entry barriers. A tie up with PEPSICO and the acquisition of an incumbent premium brand helps immensely in that regard.
- Egypt is primarily a long-life milk market; attractive and untapped opportunities exist in the premium fresh milk segment.
- Midterm scaling up opportunities exist to cater to Egyptian and Libyan markets.
- The location (next to Alexandria canal) is a key asset in terms of water resources, which would be crucial to any production ramp-up.
- The deal's value is at a least a roughly 5% discount to the replacement value of the assets.
- Current capacity utilization is close to 40%, which represents low-hanging fruit.

**PEPSICO Joint Venture:** Lastly, Almarai engaged in a joint venture with PEPSICO that we believe will be instrumental in giving Almarai access to its significant distribution chain outside of the Gulf Cooperation Council (GCC) and to PEPSICO's tremendous marketing effort. There are several synergies that we believe we can expect from the Almarai/PEPSICO joint venture.

- PEPSICO has been able to establish a market-leading presence in fresh fruit juices in the United States and the United Kingdom and Almarai would benefit from the R&D synergies as this is among the fastest growing categories for Almarai.
- Almarai has much to gain from the product inventory of PEPSICO, not just in the beverages segment, but also in foods.

- PEPSICO's distribution chain outside the GCC markets would be an immense value add value for Almarai.

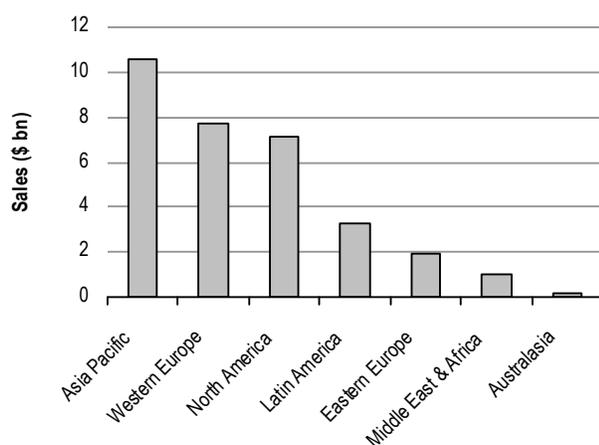
## Growth Strategies & Opportunities

### Baby Food: Sizing the Middle East

The Middle East and Africa baby food market is among the fastest growing globally, with long-term growth rates in excess of 10% for 1998-2008. (Refer to our note titled *Infant Formula: Can a Local Producer Dominate International Incumbents?*, dated August 11, 2009). Middle East and Africa region is positioned as one of the most attractive markets for new local entrants for two main reasons.

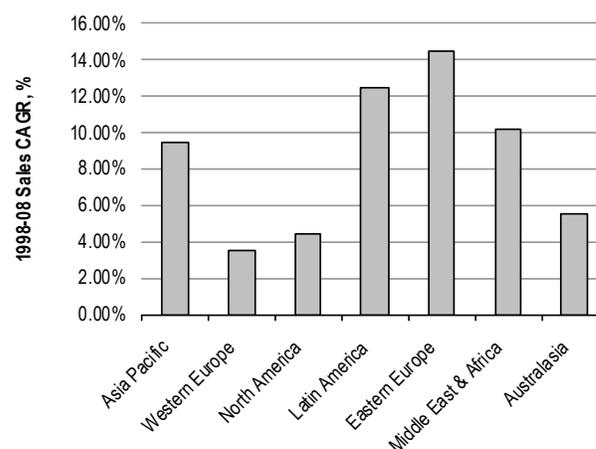
- Given its relatively small size (\$1 billion), we believe it will only attract a passive market presence from global majors.
- The category growth rate allows for new market entrants to establish beachheads in market share in traditional categories, such as formula milk.

**Figure 81: Regional Breakdown of Retail Sales (USD in Billions)**



Source: Company data, Credit Suisse estimates.

**Figure 82: Regional Sales Long-Term Growth Rates (1998-2008)**



Source: Company data, Credit Suisse estimates.

### Almarai Is Poised for Dominance in the Baby Food Segment

- **Strong local distribution outreach.** Almarai services 42,000 outlets daily and has a best-in-class cold distribution chain for dairy in KSA. Its core market synergies in KSA and Pepsico's distribution network in Egypt offer attractive opportunities to establish beachheads in these markets in baby food segment.
- **Local growth and beachhead via presence in traditional categories is vital.** The local market growth and basic product penetration is essential to obtain the beachhead necessary for survival. Therefore, we view Almarai's decision to target baby milk (the largest category, at around 67% of sales) as a positive.
- **Brand equity is of utmost importance.** Product brand equity is essential for new market entrants. Almarai has been the forebearer of quality fresh milk for over 20 years, is a top-three Arab brand (in a recent Forbes poll), and is among the strongest emerging market brands globally. Therefore, it is well positioned for the category in terms of brand equity. In addition, being present in the fresh milk category positions it well to enter the formula milk market.

- **The importance of being local.** The importance of being local and the ability to tap into local tastes cannot be overstated. As for Almarai, even in categories outside of baby foods in KSA, in categories in which foreign companies would be expected strongly to compete, such as cheese slices, Almarai has grown market share to 35.6% in 2008 from 23% in 2005. The competitors in this category are Kraft (KFT), Happy Cow, Lavachequirit, and Chesdale, among others. This has primarily been made possible via introduction of local flavors. Therefore, we believe that Almarai should be able to push for market share in baby milk categories via local product customization

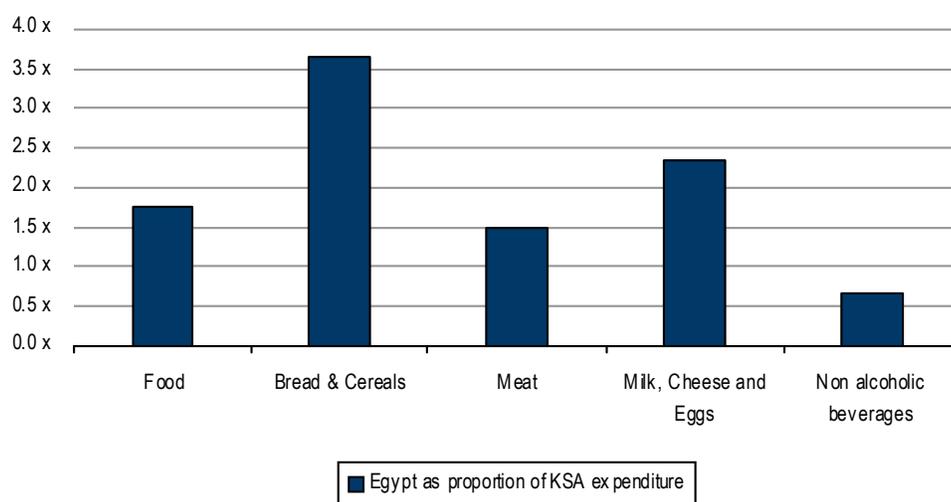
### Egypt: An Attractive Demographic Market

Egypt is an attractive market on account of aggregate consumption and demographic structure. We believe that Almarai will be able to replicate its success in Saudi Arabia into Egypt across major product categories on the back of Pepsico's distribution chain and Almarai's execution experience.

We believe that Egypt is likely to become a key geographical market for Almarai, offering up to 25% contribution to bottom line within the next five years. While competition in Egypt will be intense, we believe that Almarai will corner valuable market share owing to superior product quality.

- The demographics and population pyramid in Egypt make for an attractive market for consumer staples (72.5 million as per the 2006 census, of which 21% are younger than ten years old, against 35 million for GCC).
- The aggregate consumption (in absolute terms) is larger than that of KSA, Almarai's core market.

### Exhibit 83: Egypt as Proportion of KSA Expenditure



Source: Company data, Credit Suisse estimates

- Distribution chain challenges allow for the creation of market-entry barriers. A tie-up with Pepsico and the acquisition of an incumbent premium brand (Beyti) will help immensely to establish a footprint.

### The Saudi Food Security Vehicle

**Current Agricultural Cultivation in KSA Is Environmentally Unsustainable.** The Saudi government intends to phase out wheat production in the country, as the depletion of underground aquifers (fossilized) is unsustainable on account of the limited and nonreplenishable nature of these water reserves. Refer to our note titled *Sunny Short to*

*Medium Term Outlook, but Clouds Appear on the Horizon*, dated August 4, 2008, in which we highlighted the gravity of the situation.

**The Kingdom Is Searching for Food Security Abroad.** The government is seeking to secure offshore sources of food and has established a Saudi Company for Agricultural Investment and Animal Production (SCAIAP), (owned by the General Investment Fund). The current investment outlay is SAR 3 billion; We believe that the most favorable route would be the establishment of quasi-equity vehicles, funded by cheap financing from the government, establishing ownership of foreign assets. In our assumptions, we forecast a vehicle funded with 3% cost of debt and 50% government equity ownership.

**Hadco-Almarai Is a Leading Private Contender for Investment Vehicle Partnership.** Hadco is already cultivating 22,830 acres (9,238 hectares) of farmland in northern Sudan that it has secured on a 48-year lease at a cost of \$45.3 million. Hadco currently manages 35,000 hectares of land in Saudi Arabia, of which we believe at least one-half is actively cultivated. Therefore, among private-sector Saudi companies, Hadco is one of the most prominent agricultural operator with proven expertise in managing large-scale farm cultivation of basic crops.

Thus the Almarai Hadco combined entity is the most serious contender for public private partnership programs for overseas farm cultivation as it has a proven greenfield expertise.

**Large Fund Injection Needed for Full Domestic Substitution.** If we take Hadco's deal with Sudan as a benchmark, the funds required just for land acquisition to cultivate the estimated 1.3 million tonnes per annum of Saudi wheat demand would be roughly SAR 9.5 billion. This is with the cheap cost of land at SAR 18,350 per hectare. If land acquisition were in areas such as Pakistan, the cost could jump to as much as SAR 17 billion. This is without the needed investment in equipment, ancillary facilities, and a supply chain network, which could push the costs up by 20-40%. We assumed a fairly low level of agricultural yield, at 2.5 tons per hectare.

**Figure 84: Land Acquisition Cost: Wheat Cultivation**

Cost (SAR/Hectare)	Wheat Yield (Tonne/Hectare)				
	2.5	4	6	8	10
16,515	8,588	5,367	3,578	2,684	2,147
17,983	9,351	5,844	3,896	2,922	2,338
18,350	9,542	5,964	3,976	2,982	2,386
25,690	13,359	8,349	5,566	4,175	3,340
33,030	17,176	10,735	7,157	5,367	4,294
40,370	20,992	13,120	8,747	6,560	5,248

Source: Credit Suisse estimates.

**Value Creation for Almarai.** While achievement of a 13.9% ROIC (our current 2010 assumption for Almarai) in these markets may be challenging, with a cost of capital at roughly 3%, we believe the value creation for Almarai could be roughly SAR 3.3 billion (9% ROIC), with the allocation of only SAR 3 billion worth of funds. This would translate to SAR 29 per share. If the funding for Almarai was higher (we expect SAR 9 billion in three to four years) the value creation could be higher.

**Figure 85: Almarai Value Creation (SAR Billion)**

Cost of Financing		ROIC Achieved in Joint Venture				
		5%	7%	9%	11%	13%
1%	1%	3.8	6.8	9.8	12.8	15.8
	2%	1.9	3.4	4.9	6.4	7.9
	3%	1.3	2.3	3.3	4.3	5.3
	4%	0.9	1.7	2.4	3.2	3.9
	5%	0.8	1.4	2.0	2.6	3.2

Source: Credit Suisse estimates.

## Major Catalysts

- Establishment of a technology joint venture in milk formula segment would be attractive as it would reduce product development lifecycle.
- Establishment of dairy farms in Egypt would be a step towards introducing fresh milk and a positive midterm catalyst

## Key Risks

### Large Payout Ratios

The company offers high payout ratios (45%), which can be seen as a cash drain. However, the cost of debt remains low and this mitigates the impact in the short term.

### Risk of Epidemics

Large cow herds can be a risk in the event of an epidemic, but insurance, isolated locations, dry climate, and preventative measures serve to mitigate this risk. Furthermore, as the company develops overseas farms, the concentration risk becomes progressively reduced.

### Egyptian Expansion

Egyptian expansion will need cash outlays and will be a fairly tough market from which to extract high margins. However the large size of the market and the massive underpenetration of fresh milk will allow for an optimum price volume combination target, which would maintain the IRR in Egypt at a similar level to that of other investments of Almarai.

## Valuation

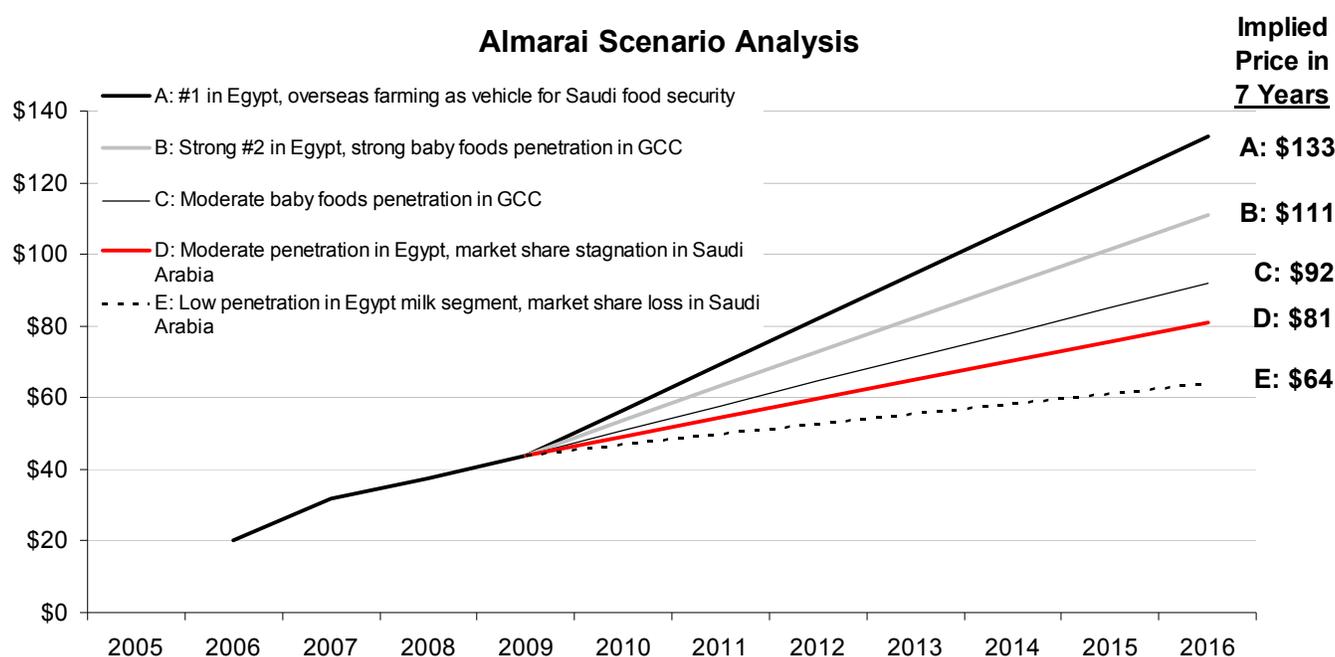
Almarai trades at a 15.9 times our 2010 EPS estimate, a 23.4% discount to its peers. Our conservative 2010-11 EPS growth estimate for Almarai is 9.5% versus 7.7% for its peers. We believe that Almarai deserves a valuation premium (even when adjusted for one-year growth) to the OECD comparables owing to the following.

- The demographics at play in GCC and MENA markets, with a large young population (e.g., roughly 65% of Saudi population is younger than 24 years old and growing in excess of 2.5%), providing attractive long-term dynamics for staples consumption compared with mature OECD markets.
- Almarai is a strong Arab brand (number three on Forbes poll, 2006) and well acknowledged for its product quality. Owing to the customary rituals of donating food items (including milk products) during Haj pilgrimage, the Almarai brand name extends well beyond the GCC and MENA regions. We believe that the Saudi origination of Almarai products will allow the company to command a pricing premium in all MENA markets. Almarai has consistently gained market share from its competitors in the fresh dairy segment.
- The price compression that dairy has been subjected to on account of retail concentration in OECD markets is virtually absent in most MENA markets. For example, Savola (2050.SE) the largest retailer in Saudi Arabia, has a less than 15% market share in a highly fragmented market.
- Almarai runs among the largest-scale dairy farms, not just in MENA but globally. Therefore, it is well positioned to scale operations and to become the dominant dairy aggregator in the MENA markets. Its operations are state of the art and completely mechanized, the company has a solid management team, and a great track record.

- Almarai has agreed upon the financing commitments with local banks to finance near term growth and we do not believe it to be a constraint. Furthermore, there are no specific binding debt covenants (as informed by the company). We believe that the company will continue to enjoy a fairly low cost of capital with respect to its regional and OECD competitors.

## Financial Statements and Comparable Valuation

**Exhibit 86: Current Share Price Embeds Conservative Growth Expectations**



	2009A	A	B	C	D	E
Almarai Sales	1,587	4,500	4,000	3,800	3,600	3,400
Growth CAGR	-	16%	14%	13%	12%	11%
EBIT margin	22%	22%	22%	22%	22%	22%
Interest other expense	40	40	40	40	40	40
Tax rate	3%	5%	5%	5%	5%	5%
Sharecount	115	115	115	115	115	115
<b>EPS</b>	<b>\$2.62</b>	<b>\$7.85</b>	<b>\$6.94</b>	<b>\$6.58</b>	<b>\$6.21</b>	<b>\$5.85</b>
Growth CAGR	-	17%	15%	14%	13%	12%
P/E Multiple	17	17	16	14	13	11
<b>Implied Price, 2016E</b>		<b>\$133</b>	<b>\$111</b>	<b>\$92</b>	<b>\$81</b>	<b>\$64</b>
Implied 7-yr return CAGR		194%	144%	103%	78%	42%
		17%	14%	11%	9%	5%
Discount rate		12%	12%	12%	12%	12%
<b>NPV</b>		<b>\$59</b>	<b>\$49</b>	<b>\$41</b>	<b>\$36</b>	<b>\$28</b>

Source: Company data, Credit Suisse estimates.

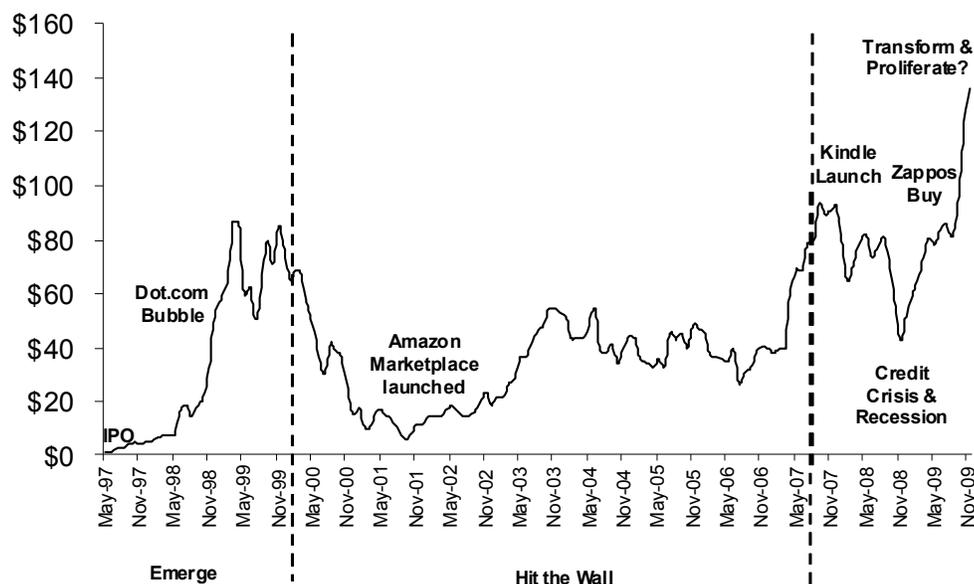
**Exhibit 87: Almarai Trades at a Discount to the Group Despite Above Average Growth Prospects**

Company	Ticker	Current price(\$)	Market cap (\$ mil)	EV (\$ million)	2010E Sales (\$)	EBIT Margin (%)	P/E		
							2009	2010	2011
Nestle	NESN.VX	46.64	179582.12	186166.88	97135.62	13%	17.63	16.29	14.66
Danone	DANO.PA	56.83	34877.77	42529.45	22128.7	16%	16.33	15.28	13.93
Bright Dairy & Food Co.,Ltd	600597.SS	1.41	1469.35	1515.68	1304.99	2%	78.09	75.05	71.26
China Mengniu Dairy	2319.HK	3.12	5421.11	5091.61	4083.11	4%	43.65	35.29	27.36
Dairy Farm International	DAIR.SI	6.37	8584.86	8493.81	7985.18	5%	27.53	24.86	21.99
Dean Foods Company	DF	17.8	3258.57	7374.68	11975.23	0%	10.77	11.13	
Wimm-Bill-Dann Foods	WBD.N	20.41	3592.16	3959.72	2330.63	11%	41.85	21.33	18.1
Almarai Co	2280.SE	44.8	5151.93	5930.28	1838.71	21%	17.62	15.86	14.49

Source: Company data, Credit Suisse estimates.

# Amazon.com Inc. (AMZN): Scale and Share in E-Commerce

Exhibit 88: AMZN Stock Price History



Source: Company data, Credit Suisse estimates.

## Investment Summary

- **Unique Brand Story.** AMZN has authentic heritage as the first online bookseller and has successfully extended its proliferation into other product categories, including electronics, other media categories, and apparel and shoes (with its acquisition of Zappos). Throughout its 15-year brand history, AMZN has relentlessly focused on service, price, and selection, while emphasizing innovation in designing its technology and infrastructure platform.
- **Brand Opportunity.** AMZN has the opportunity to build share and scale in this tumultuous retail environment, by grabbing market share from weaker online and offline players and by benefiting from increased e-commerce penetration. In addition, AMZN is positioning itself in the digital media space, with its market-leading Kindle device, which could be a bulwark against the growing threat of the transition of media from physical to digital format.
- **Market Perception.** While some see the threat of digital distribution of media as an existential threat to AMZN, we believe that through the Kindle and other innovative methods of distribution, AMZN will continue to maintain and build its presence in media sales and electronics.
- **Valuation.** While we believe in AMZN's long-term growth prospects, we believe that its current valuation is above our comfort level; therefore, we have a \$130 target price on the company. This implies that AMZN can trade at a 34x P/E and a 17.9x P/FCF multiple based on our 2010 forecasts. While we consider AMZN a core holding, we maintain our Neutral rating, given its full valuation.

Spencer Wang

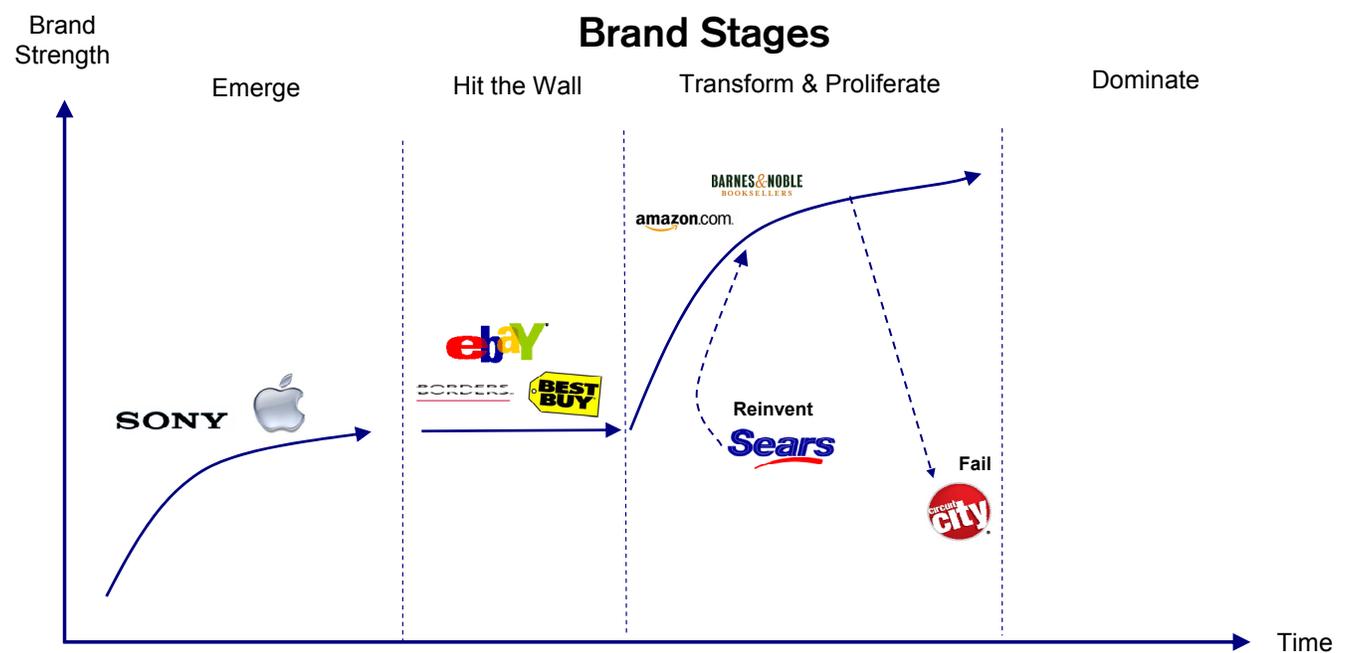
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Kenneth Sena

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**Exhibit 89: Media, Electronics, and eBook Industry Competitive Brandscape**


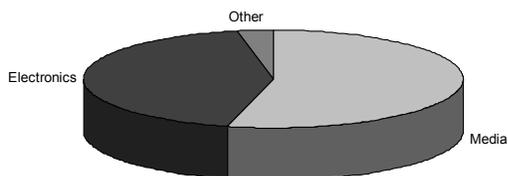
Source: Company data, Credit Suisse estimates.

## Brand Overview

AMZN was launched in 1995 (and had its IPO in 1997), as the world's first online bookstore; it was the darling of the Internet boom. The company took a cautious route compared with that of most of its flame-out peers by growing steadily and reaching profitability six years after its launch. Moving from books to CDs/DVDs and then software and other sectors, AMZN proved that it could sell across product categories. AMZN differentiated itself, and continues to do so, by providing unparalleled customer service and by innovating in terms of user interface and functionality. Ideas such as *one-click* ordering, customer reviews, and affiliate programs were first introduced by AMZN.

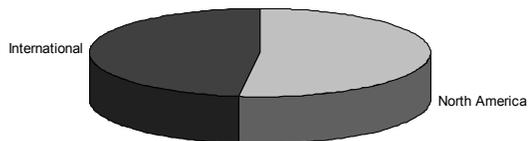
The brand currently is the leading e-commerce Web site, with \$19.2 billion in 2008 revenues, split almost evenly between the media (54% in third quarter 2009) and electronics segments, and between North American sales (52% in third quarter 2009) and international (the latter grew ten percentage points faster than North America). The acquisition of Zappos and the two-year old franchise of the Kindle could prove to be catalysts for five-year growth plans.

**Exhibit 90: AMZN Business Mix (Third Quarter 2009)**



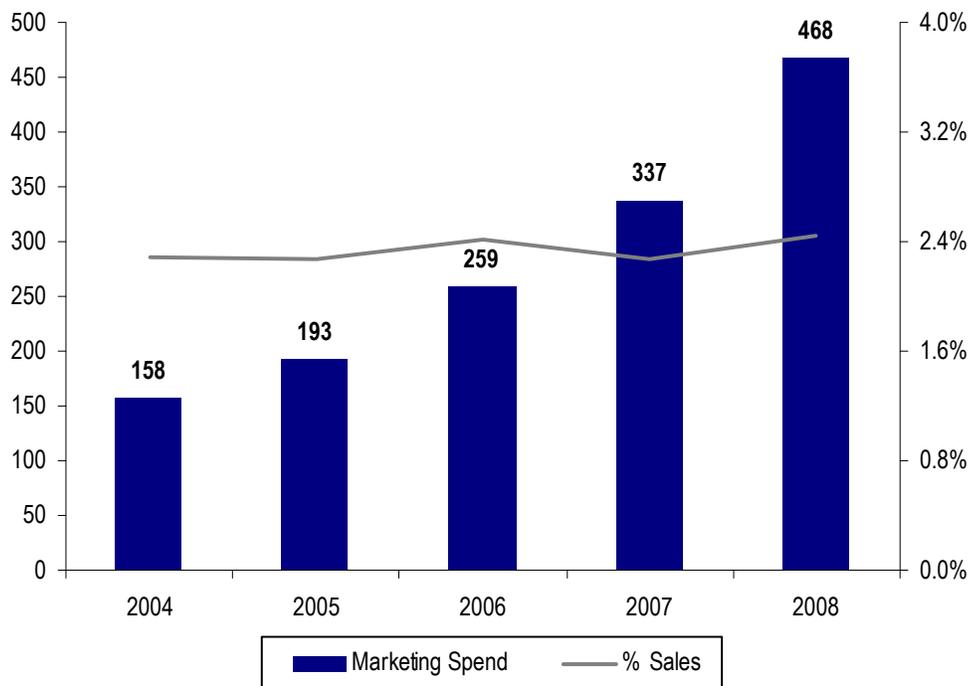
Source: Company data, Credit Suisse estimates.

**Exhibit 91: AMZN Geographic Mix (Third Quarter 2009)**



Source: Company data, Credit Suisse estimates.

**Exhibit 92: Management Continues Heavily to Invest Behind the AMZN Brand**



Source: Company data, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

In the United States especially, AMZN is a behemoth of e-commerce. To fully transform and proliferate the brand, additional product categories and international growth must continue. As a power player, AMZN will leverage its market position and scale to further build market share, as e-commerce increases its global penetration.

### Exhibit 93: AMZN Completed Brand Emergence Phase, Has Made Significant Progress in the Transform and Proliferate Phase, but Is not Yet in the Dominance Phase

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Scale Wins

AMZN should continue to build market share and to leverage its distribution, mindshare, and technology spend advantages to build scale, especially in this time of weakness for competitors, online and offline.

### Third-Party Sellers

Third-party sellers, introduced in 2006, have provided coverage and depth of inventory that AMZN itself cannot offer, leading customers to start their product search at AMZN as a default. Proving an engine of growth in the past two years, third-party sellers should continue to provide upside potential to AMZN.

### International Growth

Growing at ten percentage points higher than North American sales in the third quarter of 2009, international markets should allow AMZN to proliferate its model and approach global dominance in the next five to ten years.

### The Kindle Upside

While the Kindle will not be a game changer in terms of revenue and profit potential for AMZN, it could prove to have defensive benefits, as books are increasingly digitized.

## Major Catalysts

We believe the three key catalysts for AMZN stock over the next five years are the following.

- **New product categories.** AMZN will continue to expand into new product categories, starting with apparel and shoes, with its acquisition of Zappos.
- **Increased e-commerce penetration of retail sales.** AMZN should continue to benefit as e-commerce increases its share of retail sales, especially in the segments in which AMZN is a major player—media and electronics.
- **International growth.** While international sales currently make up 48% of AMZN's sales, there is significant upside potential in continued expansion within its current markets—the United Kingdom, Germany, Japan, France, and China—and to new markets.

## Key Risks

### The Digitization of Media

AMZN's sales could be at risk, with books, music, DVDs, and other media moving to digital formats. While the costs of distributing digitally versus physically are lower, whether AMZN will be the beneficiary (versus the publisher/content owner) remains to be seen.

### The Rise of Search

A vast majority of customers start their Internet purchase process at a search engine. AMZN's competitive advantage of being top-of-mind for many consumers will be diluted, as the brand will appear in a list of results rather than the customer starting at AMZN's Web site. While AMZN is well positioned to offer great service and selection, and as a result may be clicked on more often than other choices, it poses a threat to AMZN's e-commerce dominance.

### Apple's Tablet

We do not believe investors should underestimate Apple's (AAPL) ability to design and market a winning consumer electronics product. We believe the Apple iPad could threaten the Kindle's business and build on AAPL's success with the iTunes store to take market share from AMZN.

### Google Books

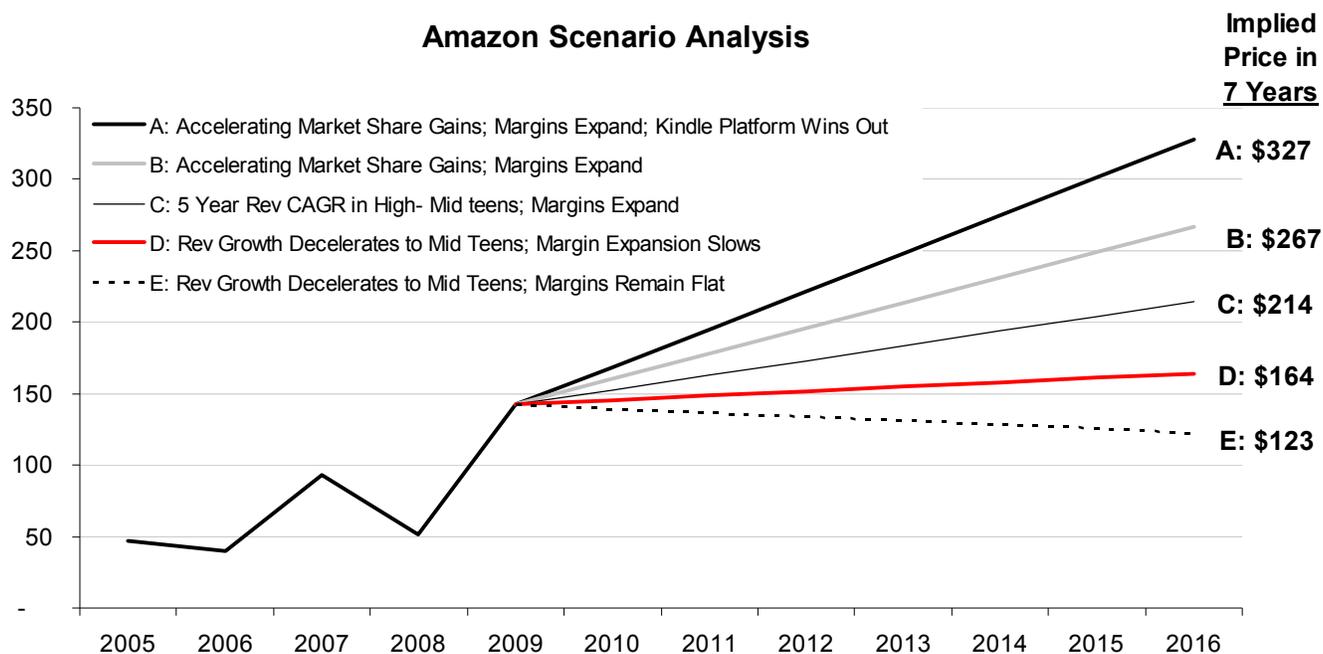
Google's (GOOG) democratic/open-source approach to digitizing libraries' books could threaten AMZN's lead in the Kindle market and pass the control back to publishers.

## Valuation

While we believe in AMZN's long-term growth prospects, we believe that its current valuation is above our comfort level; therefore, we have a \$130 target price on the company. This implies that AMZN can trade at a 34x P/E and a 17.9x P/FCF multiple based on our 2010 forecasts. While we consider AMZN a core holding, we maintain our Neutral rating, given its full valuation.

## Financial Statements and Comparable Valuation

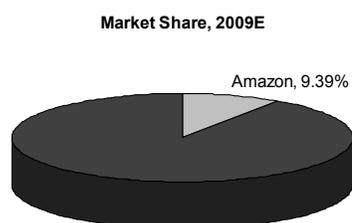
Exhibit 94: Current Stock Price Embeds Conservative Growth Expectations



	2009E	2016 Scenario Analysis				
		A	B	C	D	E
Amazon sales	24,039	77,937	75,448	72,958	67,979	63,001
Growth CAGR	-	18%	18%	17%	16%	15%
EBIT margin	4.3%	6.3%	5.8%	5.3%	4.8%	4.3%
Interest other expense	(98)	(498)	(498)	(498)	(498)	(498)
Tax rate	25%	23%	24%	25%	26%	27%
Sharecount	440	467	467	467	467	467
<b>EPS</b>	<b>\$1.93</b>	<b>\$8.94</b>	<b>\$7.95</b>	<b>\$7.03</b>	<b>\$5.97</b>	<b>\$5.03</b>
Growth CAGR	-	24%	22%	20%	17%	15%
P/E Multiple	61	37	34	31	27	24
<b>Implied Price, 2016E</b>		<b>\$327</b>	<b>\$267</b>	<b>\$214</b>	<b>\$164</b>	<b>\$123</b>
Implied 7-yr return		177%	126%	82%	39%	4%
CAGR		16%	12%	9%	5%	1%

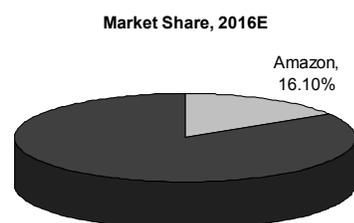
Source: Company data, Credit Suisse estimates.

### Exhibit 95: AMZN Represents 9% of the Roughly \$255 Billion Global E-Commerce Market



Source: Company data, Credit Suisse estimates.

### Exhibit 96: Our Base Case Assumes an Increase to 16% Market Share by 2016



Source: Company data, Credit Suisse estimates.

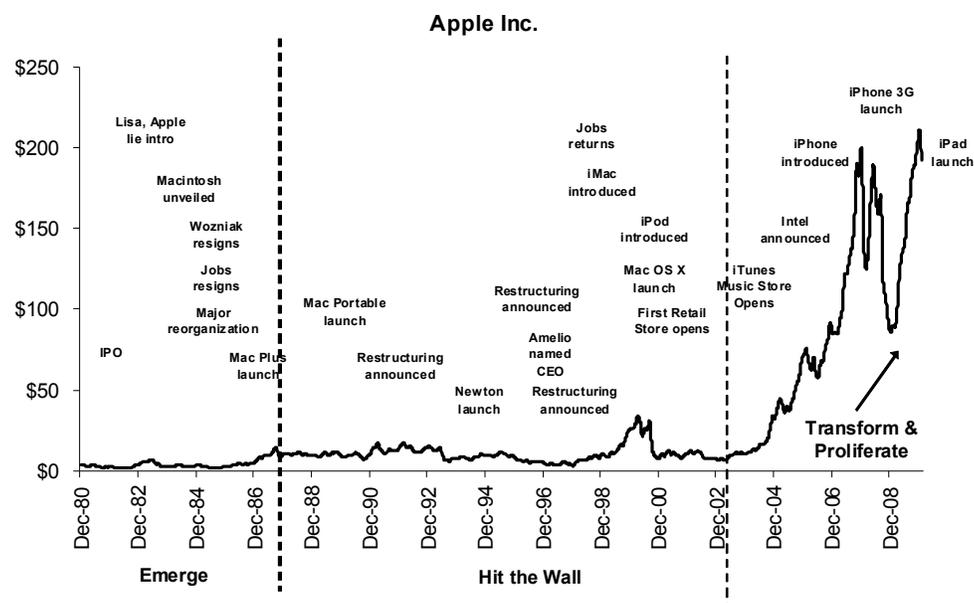
### Exhibit 97: AMZN Trades at a Premium to the Group Owing to Above-Average Growth Prospects

Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009	2008	EPS				P/E	P/E	P/E	3-Yr	EV-to-Sales		
							Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	Avg P/E			
<b>Amazon</b>	<b>AMZN</b>	<b>118.01</b>	<b>\$52,179</b>	<b>\$46,270</b>	<b>\$24,509</b>	<b>5%</b>	<b>29%</b>	<b>162%</b>	<b>-45%</b>	<b>0.87</b>	<b>2.04</b>	<b>2.91</b>	<b>3.80</b>	<b>57.8</b>	<b>40.6</b>	<b>31.0</b>	<b>39.6</b>	<b>1.9</b>	
Wal-mart	WMT	53.83	\$203,806	\$239,706	\$405,046	6%	11%	-5%	18%	3.00	3.66	3.99	4.38	14.7	13.5	12.3	13.6	0.6	
Target	TGT	50.64	\$38,159	\$57,014	\$64,948	7%	13%	40%	-31%	3.43	2.86	3.22	3.64	17.7	15.7	13.9	13.4	0.9	
Family Dollar	FDO	32.36	\$4,494	\$4,300	\$7,401	6%	13%	7%	36%	1.62	2.07	2.29	2.56	15.6	14.1	12.6	13.6	0.6	
BJ's	BJ	35.60	\$2,017	\$2,104	\$10,027	2%	10%	-5%	1%	1.47	2.23	2.50	2.71	16.0	14.2	13.2	15.1	0.2	
Costco	COST	60.79	\$26,860	\$25,521	\$71,422	3%	14%	13%	-25%	2.37	2.57	2.91	3.22	23.7	20.9	18.9	18.3	0.4	
Average							5%	15%	35%	-8%					24.3	19.8	17.0	18.9	0.8

Source: Company data, Credit Suisse estimates.

# Apple Inc. (AAPL): Dominant Brand with Room for Growth

Exhibit 98: AAPL Stock Price History



Source: FactSet, Credit Suisse estimates

## Investment Summary

AAPL is the seventh largest personal computer vendor in the world, but its remarkably successful media player and mobile phone businesses have made it a brand leader in consumer electronics. After years of anemic growth, the company has been able to regain market share and mind share with its wildly successful iPod digital music players and has extended this into the PC and smartphone markets. If the company is able to gain a dominant position in the smartphone market, sales could more than double and EPS could near \$25 over the next seven years (with earnings of over \$32 marking the upper end of our scenario analysis).

- Unique Brand Story.** AAPL has always enjoyed strong brand recognition, but the company recently has made great strides in transforming and proliferating this brand beyond the niche Mac segment of the PC market. The company has a simplified product line and a unique marketing and advertising approach that have enabled it to capture significant mind share. AAPL already possesses many of the characteristics of a dominant brand, with its loyal customer base, focused leadership, and significant cash flow generation, and we believe the company is set to expand the remaining two—robust international presence and dominant market share—in the coming years. In particular, we believe AAPL is leveraging its dominant iTunes and App Store platforms across multiple segments of consumer electronics with the iPod, iPhone and iPad to capture a much larger profit pool in coming years. In addition, we believe the “halo effect” from the success of these platforms will continue to drive growth in the company’s Mac business.
- Brand Opportunity.** AAPL’s brand is greater than its market share in many cases; and we believe that there are significant growth opportunities. The company has yet to capture significant market share abroad, with the exception of the iPod line. However, this may be changing, as AAPL continues to add international iPhone carriers. In addition, the iPad and a increasing international Mac strength could provide significant market expansion opportunities for AAPL.

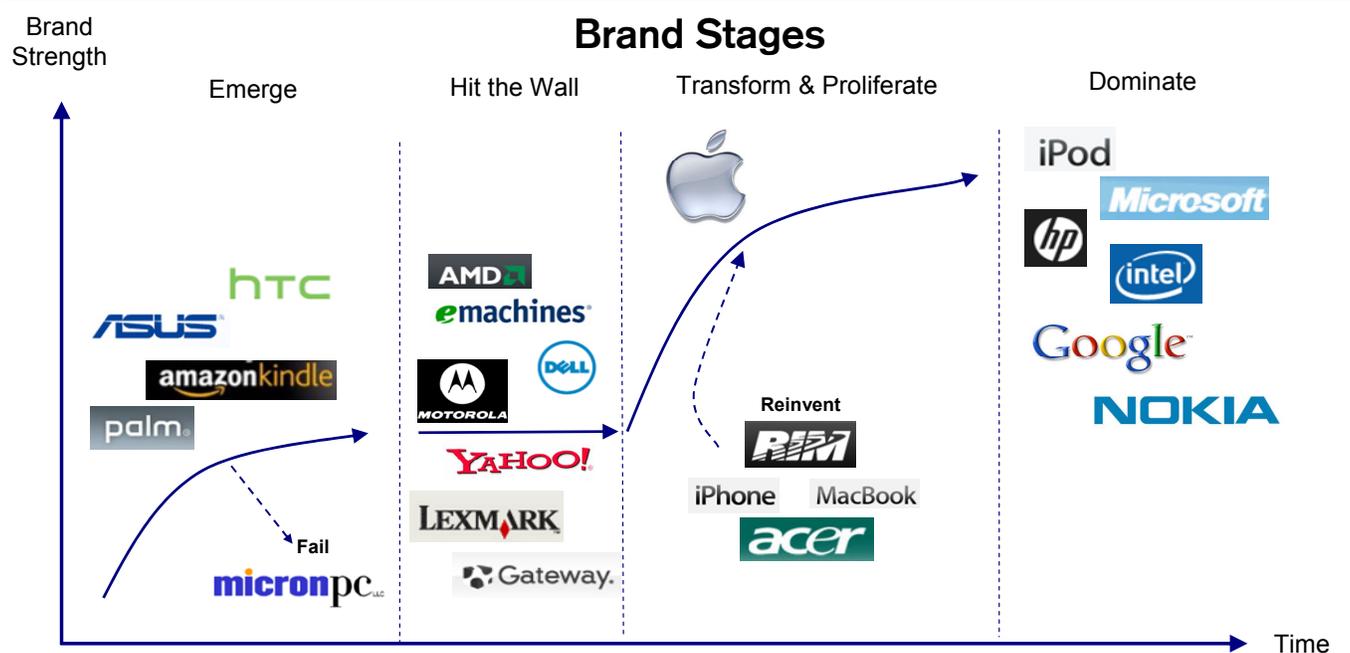
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- Market Perception.** While most investors are positive on AAPL's long-term prospects, we believe many have been reducing positions in recent weeks for various reasons: (1) disappointment over the iPad's features; (2) concern over AAPL's lack of a Verizon (VZ) partnership; (3) a view that there are limited near-term catalysts; and (4) a general reduction of technology portfolio weightings. We believe that this weakness provides an attractive buying opportunity. While the iPad was missing some key features (multitasking, flash support, and a camera), we still believe that it will provide a healthy boost to profits. In addition, although the lack of a VZ partnership for the iPhone may be somewhat of a disappointment, this was not factored in to our estimates and we see continued upside potential from international iPhone shipments, Mac market shares expansion, and continued margin and average selling price strength. Furthermore, we do believe VZ will begin selling the iPhone in 2011.
- Valuation.** The stock currently trades at 16.2 times our calendar 2010 EPS estimate, versus a five-year average multiple of 24.9 times. Net cash per share is \$43.29, including long-term investments (\$26.96 excluding long-term investments). Excluding this cash and associated interest (assuming a 1% rate), AAPL currently trades at 14.2 times our 2010 ex-cash EPS estimate. Our 12-month target price is \$275. In this report, we provide a long-term scenario analysis of various brand proliferation scenarios for AAPL (Exhibit 109). While we recognize it is quite difficult to forecast earnings seven years into the future for any technology company, and for AAPL in particular, we believe this provides a useful framework for understanding the company's long-term potential. In this analysis, we assume AAPL will gain a dominant share of the smartphone market; we conservatively assume that the company remains a niche player in Macs and in portable media devices. This base-case scenario assumes that the company is able to generate EBIT margins of 34% (on a cash basis) in 2016, which drives average annual EPS growth of 14%. Assuming a P/E multiple of 20 times, we believe that AAPL could appreciate by more than 155% to nearly \$499 in the next seven years [note discounted share price in line with our current target], which represents average annual growth of 14%. We reiterate our Outperform rating.

**Exhibit 99: AAPL Global Competitive Brandscape**


## Brand Overview

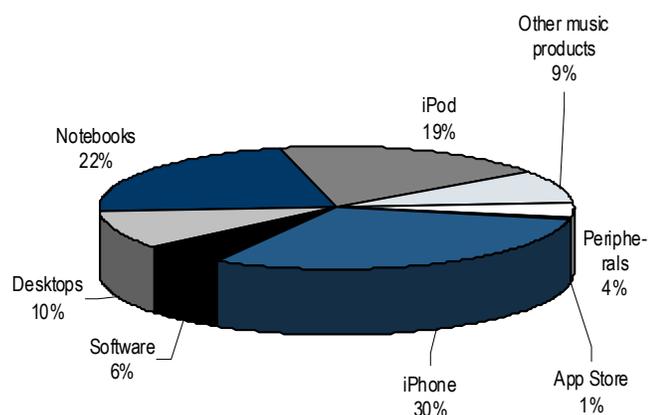
AAPL was founded on April 1, 1976, by Steve Jobs, Steve Wozniak, and Ronald Wayne. Wayne sold his 10% stake back to Jobs and Wozniak a few weeks later for \$800. The company went on to become one of the first companies to commercialize the personal computer. AAPL's business expanded tremendously over the past 34 years, and the company now designs, manufactures, and markets personal computers, portable digital music players, and mobile phones, and sells a variety of related software, services, peripherals, and networking solutions. The company sells its products through its online stores, its network of AAPL and third-party retail stores, its direct salesforce, and third-party wholesalers, resellers and value-added resellers. It targets the education, consumer, creative professional, business, and government segments of the market. AAPL is headquartered in Cupertino, California, and has a manufacturing facility in Cork, Ireland. The company employs approximately 34,300 worldwide.

### Exhibit 100: The Evolution of the Apple Logo

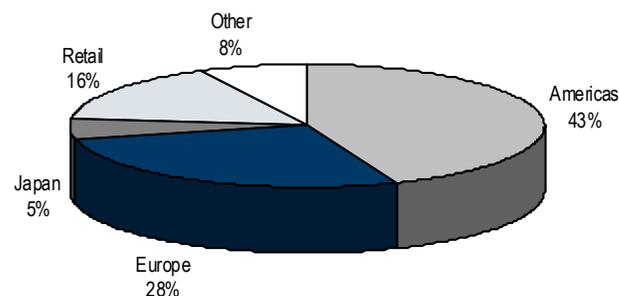


Source: biztoolbelt.com.

Since Steve Jobs' return to Apple in 1996, Apple has undergone a massive transformation. Arriving at the company when it was facing extinction, Mr. Jobs first struck a deal with Microsoft (MSFT) that would ensure continued development of Office for the Mac, as Mr. Jobs realized the need for improved application development around the platform. Also, he shepherded the introduction of Mac OS X, which actually came from the OS developed at his previous company, NeXT. OS X was widely regarded as a remarkably developer-friendly operating system (OS), which helped drive renewed interest in the Mac platform. On the product side, Mr. Jobs streamlined the company's then countless and confusing Mac SKUs into a simple four-family product portfolio. This dramatically lowered inventory and drove material improvements in working capital management. Most important, in 2001, Mr. Jobs took a big gamble with the launch of the iPod MP3 player by bucking the industry trend toward ever smaller form factors and introducing an HDD-based device capable of holding an entire music library. The iPod eventually led to the massive resurgence in the company's revenue and profit streams from 2002 onward. The iPod was followed by the launch of the iTunes Music Store, and Apple soon transformed the market for digital media content sales. After dominating the MP3 player market, Apple released the iPhone in 2007, leveraging the success of iTunes and the iPod. Eventually, the App Store was launched for the iPhone and iPod product lines, and Apple had secured its place as a leading smartphone vendor in 2008. Finally, Apple is attempting to further extend its OS X, iTunes and App Store platforms with the recent introduction of the iPad, a tablet-based media device.

**Exhibit 101: AAPL Business Mix**

Source: Company data, Credit Suisse estimates.

**Exhibit 102: AAPL Geographic Mix**

Source: Company data.

## Major Catalysts

We believe 2010 will be a year full of positive catalysts for Apple. Additional content and carrier partners for the iPad should be announced in the coming months, further fueling the device's appeal. In addition, we expect increasingly encouraging data on consumer demand for iPhones and Macs to emerge as we progress through 2010. Beyond 2010, we believe Apple will continue to drive the profit pool around its OS X, iTunes and App Store platforms, as it leverages a common R&D and branding pool deeper into the global consumer electronics industry.

## Valuation

The stock currently trades at 16.2 times our calendar 2010 EPS estimate, versus a five-year average multiple of 24.9 times. Net cash per share is \$43.29, including long-term investments (\$26.96 excluding long-term investments). Excluding this cash and associated interest (assuming a 1% rate), AAPL currently trades at 14.2 times our 2010 ex-cash EPS estimate. Our 12-month target price is \$275. In this report, we provide a long-term scenario analysis of various brand proliferation scenarios for AAPL (Exhibit 109). While we recognize it is quite difficult to forecast earnings seven years into the future for any technology company, and for AAPL in particular, we believe this provides a useful framework for understanding the company's long-term potential. In this analysis, we assume AAPL will gain a dominant share of the smartphone market; we conservatively assume that the company remains a niche player in Macs and in portable media devices. This base-case scenario assumes that the company is able to generate EBIT margins of 34% (on a cash basis) in 2016, which drives average annual EPS growth of 14%. Assuming a P/E multiple of 20 times, we believe that AAPL could appreciate by more than 155% to nearly \$499 in the next seven years [note discounted share price in line with our current target], which represents average annual growth of 14%. We reiterate our Outperform rating.

## Brand Development State: Transform & Proliferate

AAPL is one of the few companies that has gone through all four stages of brand development and, despite nearly failing in the 1990s, the company transformed and proliferated. AAPL is viewed as one of the most innovative companies in the technology industry and its products are renowned for their industrial design and ease of use. While AAPL is one of the most recognizable brands in the world, it is only "dominant" in the MP3 player market. AAPL is in the earlier stages of transformation and proliferation in the PC

and smartphone categories. In addition, the recent iPad launch could create a new market opportunity in media devices. As a result, AAPL's market share and international presence in these categories leave lots of room for the company to become an even more dominant brand. Indeed, the avenues of growth that we see for the brand have warranted its inclusion in this emerging brands report.

### Exhibit 103: AAPL Could Become a More Dominant Brand If It Builds Out Its Market Share and International Presence

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
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#### Checklist to Dominate:

- Robust International Presence
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- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Credit Suisse.

AAPL possesses many of the attributes of a dominant brand, with a few notable exceptions. The company's unique marketing strategy and continued innovation has enabled it to create a mystique around the company and its products that is difficult to duplicate. The company has a loyal customer base and remains deeply focused on maintaining and expanding its brand. At the same time, AAPL has not abandoned its roots and remains committed to serving not only consumers, but also the education market and creative professionals. Most important, the company's products are all based on a common set of platforms (OS X, iTunes and the App Store), which enables it to leverage a common R&D and marketing pool. This not only produces significant operating leverage, but it has also allowed Apple to launch innovative technologies more quickly than its more fragmented competitors.

Despite AAPL's transformation, a significant international presence is something that has always eluded the company and the company's market share in Macs and mobile phones remains relatively low. Nevertheless, this may be changing. The success of the iPod and the iTunes/App Store platforms has reignited interest in AAPL and made it one of the most recognized brands in the world. Although the company's overall international exposure remains lower than its peers and its share of the worldwide PC market is lower still, we believe that AAPL has a significant opportunity to replicate its U.S. success in other regions. Indeed, AAPL could continue to expand its iPhone share abroad through the addition of multiple international carriers. In addition, most of the company's retail expansion plans now focus on international locations. Similar to in the United States, retail stores abroad could play an important role in generating interest in the brand and Apple's technology. This is particularly important for the Mac side of the business.

## Growth Strategies & Opportunities

### Expanding the Content/Compute Platforms into New Profit Pools

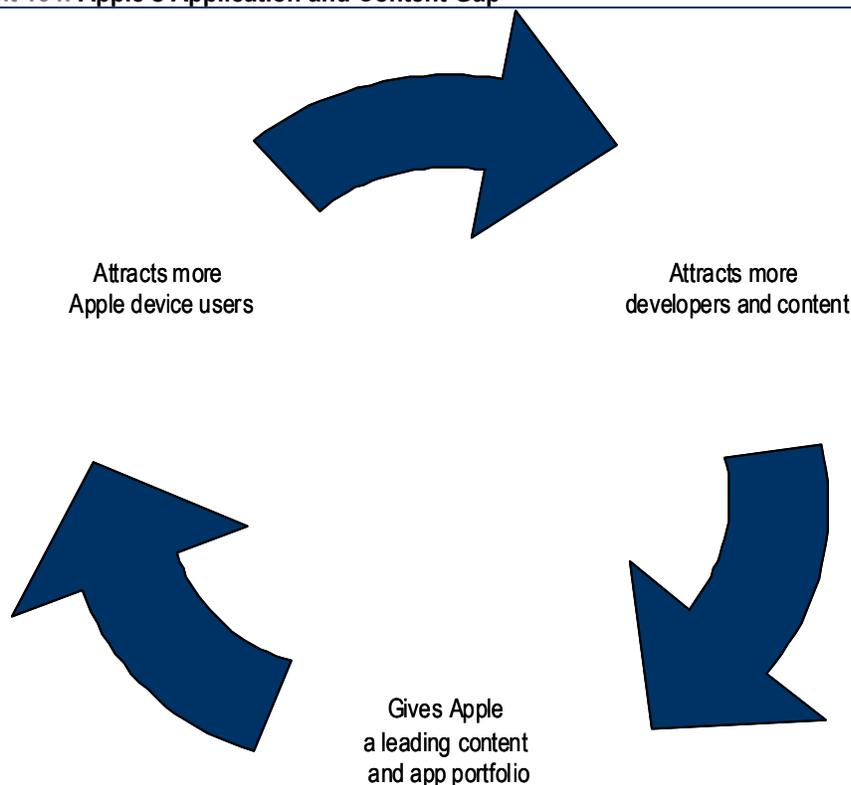
While Apple has expanded beyond its Mac roots and into multiple new product segments over the past decade, the reality is that the company has maintained a relatively simple platform approach. All of the company's core product lines are based on a variant of its core OS X software, including the iPod Touch, the iPhone, the Mac and now the iPad. This

has provided each of these products with a similar user interface, and most important, it is providing developers with a similar programming interface for multiple devices. In addition, Apple has leveraged its successful iTunes Music Store across these devices, providing a large installed base of users for its content partners and making its overall platform even stickier for its users. Moreover, the company is now leveraging the remarkably successful App Store across the iPhone, iPod and iPad product lines. This has provided the company with a large portfolio of applications that are entirely different from the traditional “packaged apps” available in the PC industry. This simple integration of OS X, iTunes and the App Store is creating a unique source of competitive advantage for Apple in multiple segments of the consumer electronics industry. Most important, the company’s substantial first mover advantage on the multimedia and mobile apps markets is generating substantial switching costs for its customers. The good news is that Apple’s loyal installed base seems to be more than willing to lock themselves into these platforms with steady content and hardware purchases.

When looking at Apple from this platform perspective, it becomes clear that the company is focusing its R&D and marketing dollars into one content and computing ecosystem. The devices that attach to this ecosystem are merely delivery vehicles for these platforms. As the installed base for these devices grow, the platform becomes increasingly attractive for developers and content providers. This leads to a greater content and application gap versus would-be competitors, and this in turn, generates more demand for Apple devices. This virtuous cycle provides Apple with significant barriers to entry for its key markets, and the focused R&D and marketing investments provide it with surprisingly strong leverage potential.

**Exhibit 104: Apple’s Application and Content Gap**

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Source: Credit Suisse.

This suggests that Apple's iPhone, iPod Touch, and the recently announced iPad do not represent entirely new product categories. Instead, each represents a device that delivers Apple's platform to a distinct market segment. Interestingly, this simple strategy is all delivered under one, increasingly pervasive brand umbrella.

### **Macs: Windows Switching Costs Are Falling, though Pricing Remains the Barrier**

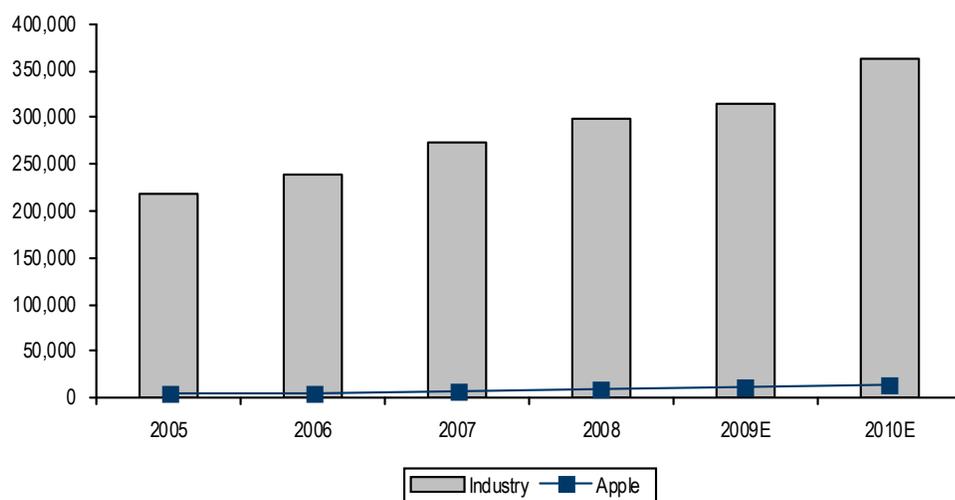
As any follower of computer history would know, the closed systems approach AAPL followed in its early years forced its Mac business into a niche market position as MSFT capitalized on the rise of industry standard hardware in the 1980s. While the Mac platform continued to receive accolades from critics during this period, many consumers feared that they would face application compatibility and usability issues if they were to switch to a Mac from a Windows PC. These switching costs, coupled with the Mac's premium pricing, appeared destined to limit AAPL's future growth and profit potential. AAPL's management team was clearly aware of the switching costs that prevented it from gaining market share in Macs and over the past decade, AAPL has actively courted Mac developers, invested heavily in branding campaigns, and offered Windows converts in-depth Mac training. Nevertheless, these efforts seemed to have little impact for many years. This all changed in 2005, when AAPL announced its intent to switch to the Intel platform from the IBM PowerPC architecture. By switching to Intel, AAPL embraced the industry standard hardware that it had railed against for most of its existence. This enabled AAPL to court a wider array of PC-centric software developers, to keep up with the rapid technical advances of the x86 platform, and to tap into Intel's massive economies of scale. This also allowed AAPL to launch Boot Camp in 2006. Boot Camp was a software utility that allowed Mac users to run the Windows operating system on Mac hardware. This functionality was later followed up with support for Windows through third-party virtualization software. The fact that AAPL now technically and legally supported the use of Windows on its platform was nothing short of revolutionary at the time. While we believe that AAPL would prefer that consumers adopt its hardware and software, Boot Camp and third-party virtualization software provide a direct boost to AAPL's capability to sell its highly profitable Mac systems into the massive PC installed base. In addition, with the Mac OS already installed, a Mac running Windows can be seen as an important Trojan horse for the Mac platform. This dramatic change provided a critical boost for Mac market share.

In addition to these factors, the agnostic nature of the Internet and Internet-centric computing is also removing key barriers for Mac adoption. As consumers become increasingly accustomed to using Internet- or "cloud"-based applications, the underlying OS choice becomes less meaningful. As the Mac platform becomes increasingly easy for new users to adopt, Apple's design and software advantages become a more meaningful driver of customer decisions. We believe all these factors bode well for the future market share potential of the Mac platform.

With that said, the key barrier to AAPL's potential market share is its pricing strategy, particularly in the consumer segment. AAPL has stubbornly refused to follow the steady pricing declines of its Wintel competitors, and as a result, their products are still largely confined to the premium segments of the market. Indeed, AAPL's notebook prices bottom out at \$999, which is far higher than the average industry ASP of \$707. This premium price keeps Apple from the highest volume segments of the market. For instance, the \$499-799 price band represents more than 53% of all consumer notebook units. While AAPL could easily leverage lower-cost components to profitably attack these segments of the market, we believe the company fears that its "luxury" brand in PCs could be tarnished. This is in stark contrast to the company's mass market approach in its other product segments. If AAPL chooses to remain in the premium segments of the market, its market share can still expand, but in the end, the Mac business may remain a highly-profitable niche market product.

**Exhibit 105: The Key Barrier to AAPL's Potential Market Share Is Its Pricing Strategy**

Worldwide PC units in 000s



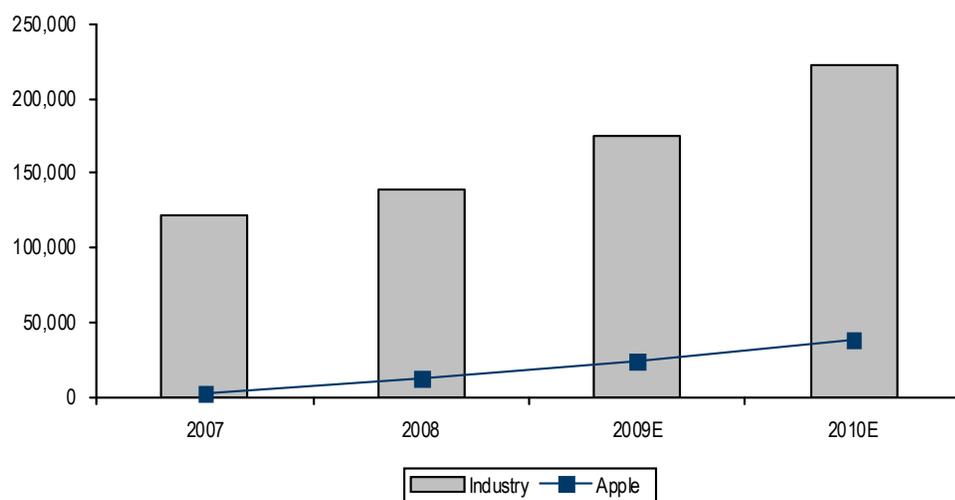
Source: Gartner Personal Computer Quarterly Statistics Worldwide Database, November 2009. Credit Suisse estimates for 2009-2010 and Apple.

**The iPhone: Leveraging the OS X Compute Experience for Mobile Devices**

Although Apple had no experience in mobile telephony when it launched the iPhone in 2007, we believe the company's significant iTunes installed base and highly-refined OS X software provided it with a fairly substantial advantage in the growing smartphone category. As others attempted to build content platforms and advanced operating systems from scratch, Apple leveraged the device-agnostic platforms it had developed over the prior decade. Interestingly, despite these clear advantages, the company did not rest on its laurels. AAPL lured developers to create unique software applications for the device by refining the developer-friendly OS X operating system and launching the revolutionary App Store. The prices for these mobile applications range from \$0 to \$75 a pop, and Apple is offering mobile advertising solutions to help developers monetize the free apps. As new iPhone users continue to invest in these apps and other iTunes content, we contend that AAPL is once again building material switching costs into its model. (as it did with iTunes content and the iPod). Since the launch of the App Store in mid-2008, Apple now offers 150,000 applications and users have downloaded over 3 billion apps. It is safe to say that this is now the fastest growing application platform in the history of the computing industry. Handset manufacturers, Google, and even the mobile carriers are rushing to mimic Apple's unique approach to this market. Nevertheless, Apple's first mover advantage is substantial, and the company's platform is quickly becoming a de facto industry standard.

**Exhibit 106: Apple's First Mover Advantage in Smartphones is Substantial**

Worldwide smartphone units in 000s



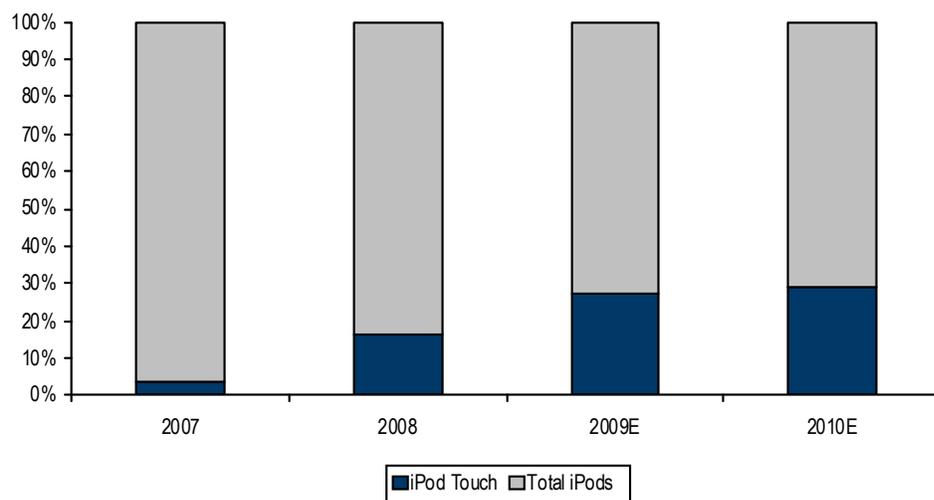
Source: Company data, Credit Suisse estimates.

**The iPod Touch: Media, Apps and the Internet in the Palm of Your Hand**

While we have noted that the iPod business is now facing secular decline as consumers opt for smartphones with MP3 capabilities, the iPod Touch has been a remarkably notable exception to this trend. By leveraging its OS X, iTunes and App Store platforms for the iPod Touch, Apple has captured a mobile computing market opportunity that many never knew existed. Indeed, users of the iPod Touch are typically consumers that don't want an iPhone, but want to utilize the content from Apple's iTunes and App Store. We estimate this device has quickly grown from 5.1 million units in its first year of availability to nearly 19.4 million units in calendar 2009. We expect this growth to continue, and the rich ASPs and margins from this product should serve as a unique buffer for the secular shift from iPods to smartphones.

**Exhibit 107: The iPod Touch Should Provide a Buffer for the Secular Shift to****Smartphones**

% of total iPod units



Source: Company data, Credit Suisse estimates.

## The iPad: Apps, Media and the Internet for the Mass Market

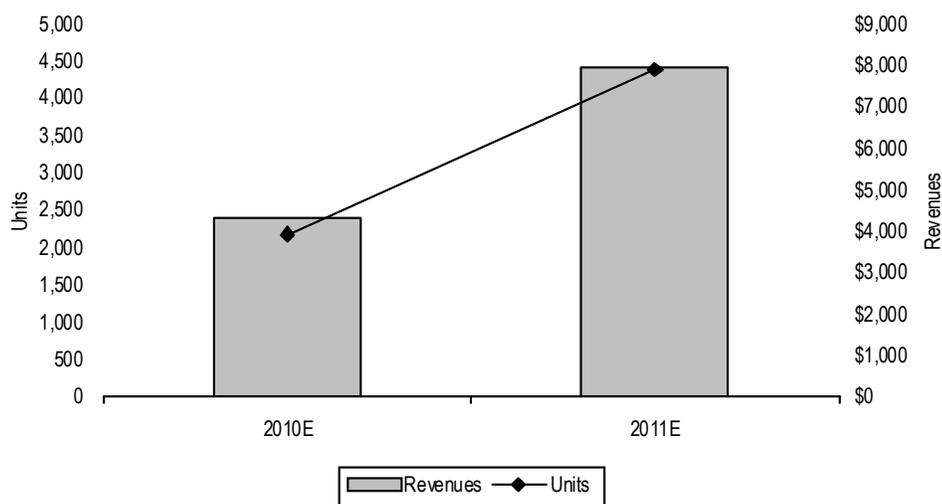
As we noted above, AAPL has been reluctant to enter the low-cost notebook fray, and the netbook market in particular. AAPL does not necessarily fill this hole with the iPad, and we believe that there is room for further discounting on the MacBook line. Nevertheless, in the context of the App Store and iTunes platforms, we believe the iPad fills a critical and potentially lucrative market opportunity.

The iPad adds to the iPod Touch's functionality with a larger screen, a more powerful processor, and optional 3G connectivity. While these additional features may excite consumers, they should have an even more pronounced effect on the AAPL ecosystem. Developers have flocked to the App Store, with over 140,000 apps available; this has driven over 3 billion downloads in just over 18 months. The more powerful features on the iPad should enable far richer apps, further stimulating downloads, and attracting even more developers. This virtuous cycle continues to work in AAPL's favor, and it is becoming difficult for any would-be competitor to catch up. On the iTunes side, content providers can now take advantage of a much larger screen, which is particularly important for e-reading and movies.

From an economic perspective, we believe this device is clearly additive to AAPL. There currently is a price band gap between AAPL's high-end iPod Touch (\$399) and its low-end MacBook (\$999). The iPad now offers price points within this price band, and it should attract incremental demand from portable gamers, e-reading enthusiasts, and casual PC users. In particular, for low-end notebook users that tend to use their devices only for Web browsing, multimedia viewing, and e-mail, we believe the iPad is an adequate substitute for a general purpose computer (plus users get seamless access to AAPL's core platforms). As a result, we believe the iPad is generally additive to the overall financial model, with minimal cannibalization. Most important, it now provides Apple with a product for the highest volume price band of the portable computing market.

### Exhibit 108: The iPad Should Be Generally Additive to the Overall Financial Model

Revenues in millions, units in 000s



Source: Credit Suisse estimates.

## Key Risks

### Component Prices and Shortages

Like most IT hardware vendors, AAPL could be affected by the component environment. If the company is unable to secure components, this could have an impact on the product availability and result in lost sales or a slower-than-expected sales ramp-up. In addition, volatility in component pricing and availability could result in higher product costs. Although AAPL has long-term agreements in place to help mitigate some of these risks, volatility in the component environment could pose a risk to our estimates.

### Executive Changes Could Result in Stock Price Volatility

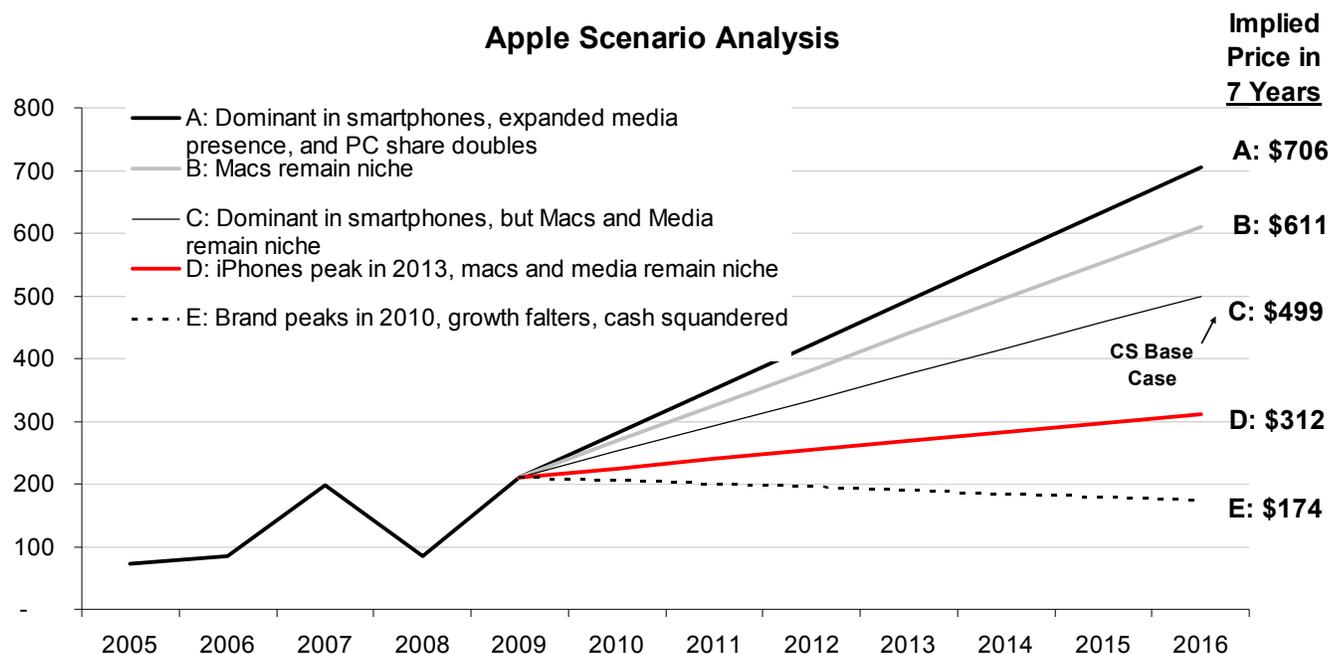
The significant appreciation in AAPL's stock price and its unusually successful profit expansion over the past six years has led investors to attach a significant value to the leadership of Steve Jobs. On the flip side, the past health issues of the iconic CEO and the reality that he will one day have to choose a successor has produced considerable anxiety among investors. Although the company has yet to publicly announce a succession plan, Mr. Jobs' leave of absence in 2009 gave investors greater confidence in the depth of the company's management bench and Tim Cook's ability to manage the day-to-day operations of the company. Nevertheless, executive changes could pose a downside risk for long-term investors.

### Premium Price Strategy Could Limit Market Share Gains

AAPL has employed a premium-price strategy that helped establish it as one of the most innovative companies in the technology industry. Nevertheless, this strategy has kept the company out of the mass market, particularly in Macs. AAPL has been successful at driving growth and capturing market share in the premium price bands of the market, but these premium price bands appear to be shrinking. Therefore, AAPL may need to enter some of the lower-priced categories of the PC market if its market share gains are to continue. If the premium price bands shrink at a faster rate than we anticipate and the company does not expand into other segments of the market, our estimates could be at risk.

## Financial Statements and Comparable Valuation

**Exhibit 109: Our Base-Case Scenario Assumes AAPL's Stock Price Could Reach \$499 in Seven Years**



		<b>2016 Scenario Analysis</b>					
		<b>2009A</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>
Apple Sales (cash value)	46,708	120,000	111,107	96,107	71,107	59,000	
Growth CAGR	-	14%	102%	98%	89%	84%	
EBIT margin	29%	35%	36%	34%	32%	26%	
Interest other expense	201	201	201	201	201	201	
Tax rate	31%	30%	30%	30%	30%	30%	
Sharecount	912	912	912	912	912	912	
<b>EPS</b>	<b>\$10.25</b>	<b>\$32.10</b>	<b>\$30.56</b>	<b>\$24.94</b>	<b>\$17.32</b>	<b>\$11.63</b>	
Growth CAGR	-	18%	17%	14%	8%	2%	
P/E Multiple	19	22	20	20	18	15	
<b>Implied Price, 2016E</b>		<b>\$706</b>	<b>\$611</b>	<b>\$499</b>	<b>\$312</b>	<b>\$174</b>	
Implied 7-yr return		261%	213%	155%	59%	-11%	
CAGR		20%	18%	14%	7%	-2%	

Source: Company data, Credit Suisse estimates.

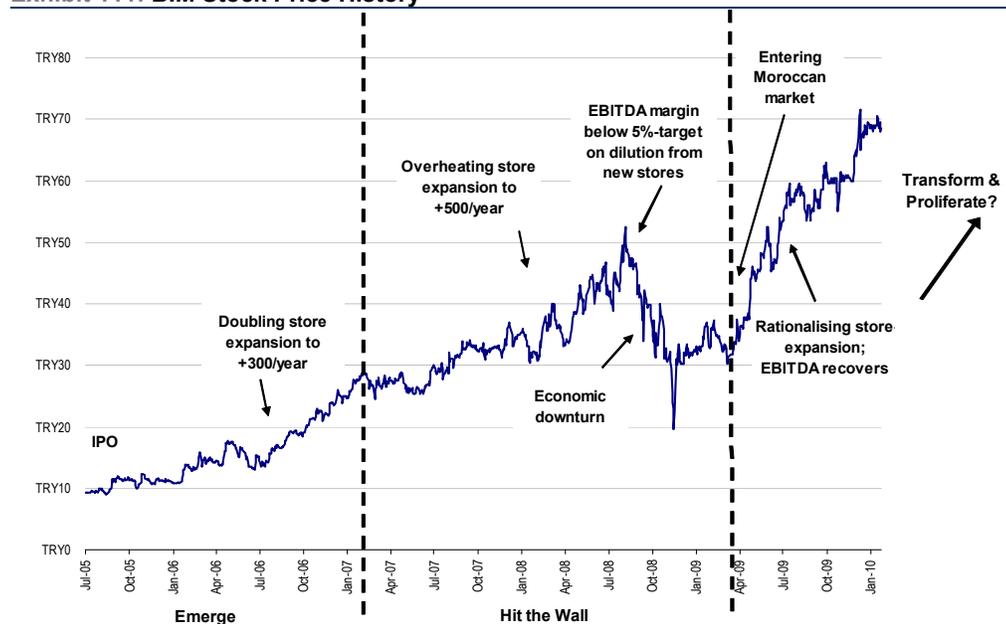
**Exhibit 110: AAPL Trades at a Premium to Its Peers Owing to Its Significant Growth Prospects**

Company	Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009 Stock Perf	2008 Stock Perf	EPS				P/E CY08	P/E CY09	P/E CY10	3-Yr Avg P/E	EV-to-Sales
										FY07	FY08	FY09E	FY10E					
Apple Inc.	AAPL	208.20	\$190,511	\$161,976	\$36,286	22%	19%	0%	-57%	3.94	6.29	7.88	9.53	33.1	26.4	21.9	22.4	4.5
Dell Inc.	DELL	14.42	\$28,382	\$20,882	\$61,101	5%	12%	1%	-58%	1.26	1.35	1.03	1.25	10.7	14.0	11.6	11.7	0.3
Hewlett-Packard	CHPO	51.09	\$123,467	\$125,838	\$114,068	9%	-	1%	-28%	2.46	3.85	4.34	4.76	13.3	11.8	10.7	-	1.1
Microsoft Corp.	MSFT	30.08	\$272,207	\$248,309	\$58,437	34%	11%	0%	-45%	1.52	1.70	1.84	2.10	17.7	16.3	14.3	12.8	4.2
Nokia Corp.	NOK	12.89	\$48,198	\$74,519		6%	-	1%	-59%	2.38	1.98	0.86	1.02	6.5	15.0	12.6	-	-
Research In Motion	RIMM	64.51	\$35,493	\$35,372	\$9,624	23%	20%	-5%	-64%	1.52	3.43	4.35	5.04	18.8	14.8	12.8	18.2	3.7
SanDisk Corp.	SNDK	29.05	\$6,664		\$3,351	-10%	-	1%	-71%	0.31	(2.13)	1.33	1.53	(13.6)	21.8	19.0	-	-
Sony Corp.	SNE	34.12	\$33,367	\$35,910	\$77,068	-2%	-	15%	-60%	1.88	(1.01)	(0.91)	1.37	(33.8)	(37.6)	24.9	-	0.5
Average						11%	15%	2%	-55%					6.6	10.3	16.0	16.3	1.8

Source: Company data, Credit Suisse estimates.

# BIM (BIMAS.IS): Turkey's Price Leader Taking the Next Step

Exhibit 111: BIM Stock Price History



Source: Company data, © Datastream International Limited ALL RIGHTS RESERVED.

## Investment Summary

- Unique Brand Story.** BIM's pure hard-discount neighborhood retailer model combines a resilient business with affordable growth opportunity. Stores are located on secondary streets, providing (1) cost efficiency (roll-out per store of around US\$80,000) and (2) growth flexibility, given rising scarcity of leasable space in high-income crowded cities. BIM's low-cost model enables the company to fund its growth 100% from internal cash. Despite the aggressive roll-outs of the past three years, the company is running at US\$90 million net cash as of end-September 2009 (around 2.6% of market capitalization, adjusted for interim dividends).

While BIM's 2,640 stores make it the largest retailer by store count in Turkey, the company slightly lags the leader competition in terms of physical space (and domestic revenues), as it restricts itself with smaller-than-300 square meter stores to ensure (1) roll-out flexibility, (2) headcount savings, and (3) distribution efficiency, with concentrated product assortments in each store. Despite the rapid growth of modern retailers, traditional food retailers (mom-and-pop stores, open bazaars, small corner stores) command to 66% of the food trade in Turkey as of 2009 (Source: Credit Suisse forecasts based on Turkish Council of Shopping Centres and Retailers—AMPD). We see BIM's low-cost orientation as the closest model to capture traffic from unorganized channels into modern retailing. Our base-case scenario, which conservatively assumes that BIM will slow store additions, forecasts that the company will reach 4,585 stores in Turkey at year-end 2016, following a 17% sales CAGR from 2009 (excluding any contribution from the newly established Moroccan operations).

- Brand Opportunity.** With its limited advertising budget, it takes time for consumers to recognize BIM's core pricing edge. Although the company has proved its strong presence in Turkey's largest cities, there is room for better brand recognition in the

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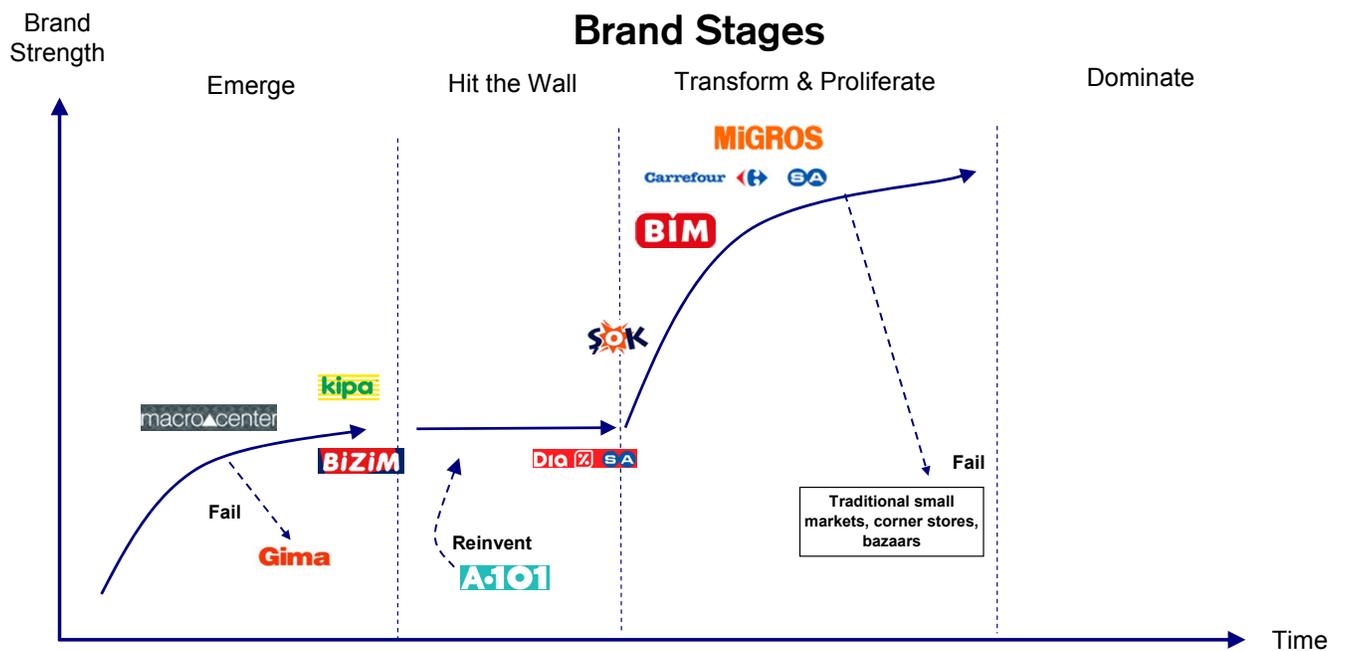
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newly entered cities and districts; management recently started testing nationwide TV advertisements to accelerate this recognition. The first foreign BIM store was opened in Morocco in the second quarter of 2009. We believe that the model has the potential to enjoy successful penetrations in other MENA regions over the next five years.

- **Market Perception.** Opening stores in secondary markets and keeping the store decoration costs at minimum have led BIM's brand name to be associated as a store for low-income individuals. We believe that this was a false initial perception and that there is scope to transform it into a store with the lowest price of the comparable quality. The company's new test concept, in which stores are doubled in size (600–700 square meters) and accompanied with a small parking place outside, has the potential to accelerate this transition, in our view. In addition, the recent start of TV advertisements will likely help the change the misperception.
- **Valuation.** BIM's 2010 P/E multiple of 21 is a 48% premium to global food retailers under Credit Suisse coverage. We continue to justify this premium with BIM's (1) midcycle 32% EPS growth in 2007-2012 against 15% for peers and (2) higher cash flow visibility through its simple balance sheet, with virtually no financial debt or forex risks.

Exhibit 112: Turkish Food Retailers: Brand Stages



Source: Company data, Credit Suisse estimates

## Brand Overview

BIM is often referred to as the Turkish ALDI (recently retired CEO Jos Simons worked for ALDI prior to his job at BIM). The company is a hard-discount retailer that aims to provide high-quality food and basic consumer goods at the lowest possible price. The company achieves this by focusing on a limited assortment of approximately 600 articles, preferring private labels. The company's business plan revolves around carrying a high number of private labels and a high volume of each item.

BIM began as a hard-discount market chain in 1995 with 21 stores, which soon spread across Turkey. The company currently has 2,640 stores in Turkey and recently extended into Morocco, where it had 26 stores as of January 2010.

To keep costs low, BIM adheres to a strict list of principles.

- BIM places the customer first and claims to care for customer benefits over short-term profits.
- BIM offers the highest-quality products at the lowest price.
- BIM stores are decorated without excessive costs.
- BIM arranges exclusive production of high-quality goods.
- BIM employs the minimum number of personnel that will ensure that operations are run efficiently.
- BIM customers pay for the product themselves and not the fancy packaging or the brand.
- BIM presents its products in its own boxes to avoid additional expenses.
- BIM locations are those with the most agreeable rents and are central to their customers.
- BIM avoids excessive advertising.
- Despite the highly scale-oriented nature of the industry, BIM avoids acquisitions to ensure that qualities of the *BIM culture* remain intact.

BIM is particular in its close control of the operational logistics. The company operates in 27 regions, each with a distribution center of around 10,000-15,000 square meters. In addition, BIM owns the trucks that service the stores from these 27 regional warehouses.

### **Branding Efforts**

**Commitment to price leadership.** Low price for the same quality sits at the heart of BIM's branding strategy and is secured by a virtuous cycle: the company has a long-term EBITDA margin target of 5% and all operating expenditure to sales improvement is invested back into the lower shelf prices (i.e., lower gross margin) to stimulate demand and higher revenues in return to provide incremental operating leverage and further operating expenditure to sales savings.

**Shifting from branded products to private labels to ensure pricing strength.** BIM currently maintains a roughly 10% shelf-price differential with the soft-discount food retailers and up to 40% differential with the mid- to high-end multiformats. In an attempt to increase the relative price gap with competing brands, BIM has been gradually shifting to private labels from branded products, which are remarkably cheaper than their branded counterparts, but capable of earning even slightly higher mark-ups owing to their significant cost advantage.

**Increasing the awareness?** BIM has a tight advertising budget and stores are generally left alone to build their own shopper awareness recognition. This strategy helps cost synergies and the efficient run of the virtuous cycle; however, it requires a longer duration to establish the recognition of price leadership in newly entered districts. Growing scale of operations provides flexibility for more aggressive promotion of the pricing edge and satisfactory product quality. Recent TV advertisements highlighting BIM as the *wise way of shopping* form a move in this direction and, we believe, offer an opportunity to tap the less-penetrated mid- to high-income level.

**Penetration.** Despite management's incentive to test a broader advertisement budget, network expansion continues to be the leading self-promotion vehicle. Almost 100% of the revenues currently are generated in the Turkish market. In our view, the newly begun Morocco operations prove that management aims to replicate the success in nearby regions elsewhere, particularly in MENA, where the competition from large multinationals is a remote threat.

## Brand Development State: Transform & Proliferate

BIM successfully emerged as Turkey's first hard-discount neighborhood food retailer over the past 15 years. It has reached comparable revenues with its acquisitive multiformat competitors in the domestic market. Taking into account the brand's current limited access to the mid- to high-income population, small foreign presence, and room for better operating leverage (around 10% operating expenditure to sales, from current 13%), we believe that the brand has the potential to be a dominant retailer in MENA.

### Exhibit 113: BIM Has Made Progress in the Transform and Proliferate Stage, But Has Potential to Be a Dominant Player in Its Core Markets (Turkey and MENA)

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Penetration/Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

### Success in Morocco Is Key for the Pace of International Expansion

BIM is testing its ability to replicate its successful brand creation in Turkey in other close regions, having opened its first store in Morocco in April 2009. Management has a particular focus on MENA. We believe that this is partially for the purpose of avoiding competition from global multiformat players, which will more likely prioritize Eastern Europe for growing emerging markets exposure.

BIM's store expansion in Morocco in the first year of operations (26 stores) was a bit slower than the initial guidance of 40 stores. The pace of growth in the early stage does not indicate to us a trend for the midterm; we believe that gradual recognition of the BIM brand name in the country will accelerate the brand awareness and the supply of leasable store space after a critical mass of store count is reached.

While we do not fully subscribe, BIM management believes that it should first feel confident with the success of its Moroccan franchise before engaging in further foreign penetration. With a cautious three-year capital expenditure plan of US\$20million to breakeven (versus current net cash of US\$90 million), BIM's next foreign penetration could be in 2012. Out of likely tier-II markets, the roughly 74 million population in Egypt is one of the most attractive entry points in MENA, and could double BIM's addressable market in Turkey.

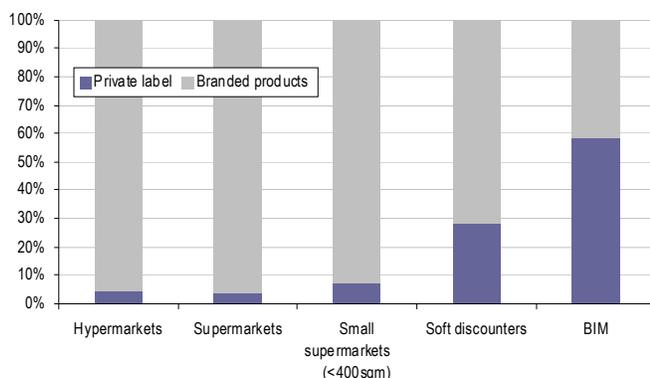
## Growth Strategies & Opportunities

### Recognition of Private Labels

BIM's revenue share of private labels is the highest compared with that of other food retailers in Turkey; management believes that there is potential to increase the private label share to roughly 90% from the current 58%. These brands are not advertised on television and are rarely mentioned in an occasional newspaper advertisement, which

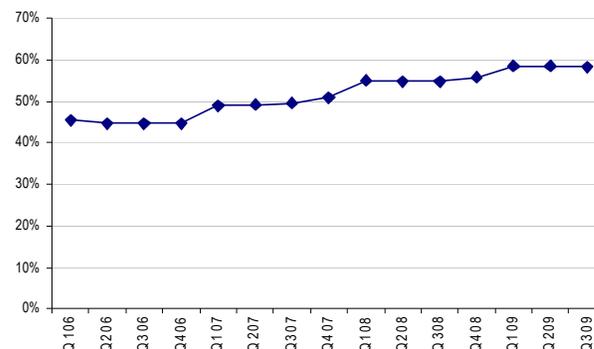
usually highlights the competitive prices in large-ticket items to draw customer traffic. Given the current low marketing spend on private label merchandise, we believe the superior price and quality of BIM's private label basket is poised to enjoy a long learning curve from shoppers over the next five years.

**Exhibit 114: BIM Has Stronger PL Mix versus Local Peers**



Source: Company data, Credit Suisse estimates.

**Exhibit 115: BIM Maintains PL Focus**



Source: Company data, Credit Suisse estimates.

### Growing Scale; Confidence for Higher Ad Budgets

As a part of its low-cost model, BIM has kept its advertisement spending at 0.35-0.50% of sales over the past three years. Based on our projections, the retailer's strong growth momentum will bring this ratio to below 0.30% in the next four to five years. At such a scale, the company will likely find ample room to fund the fixed-cost nationwide advertisements to invest in the brand and to reinforce consumer awareness.

### High Bargaining Power from Concentrated Suppliers

BIM ranks the second among Turkish food retailers in terms of domestic revenues (as of the first nine months of 2009). Nevertheless, its low number of product assortments yields a concentrated supplier base, which makes it one of the largest procurers of mainstream food brands. We believe that BIM's growing scale and increasing private label concentration will continue to allow for stronger bargaining power ahead of suppliers. This will help to reinvest in the low-cost qualities of the model.

## Major Catalysts

- Larger stores outer zones.** Opening larger stores is at the experimental stage. The key idea behind this format is to move some of the concentrated store locations to outer districts, and thus to enjoy greater flexibility in finding new store locations while preventing cannibalization of the nearby stores. These larger stores are accompanied by small parking lots; however, rent per square meter costs are generally lower. (In some cases BIM owns the property, given larger square meter requirement.) We believe that larger stores with parking lots will help to move the shopper mix toward the mid- to high-income population with bigger basket sizes. Potential penetration to the high-income segment would be a great contributor to BIM's operating leverage theme, in our opinion.
- Penetration to new income segments and foreign markets.** Having reached 2,640 stores, BIM has broadly completed its physical presence in Turkey's major cities. Although the proportion of Turkish households that have visited a BIM store has improved to 50%-plus, we observe its lowest-price positioning keeps the addressable market to the small-basket shoppers. In addition to the opportunity of penetrating the high-income class, BIM has the potential to replicate its low-cost model in MENA over the next five to ten years.

- Draft retail law: an opportunity or a threat?** The Turkish government has been working on a new retail draft law for the past five years (at least), yet the final draft, which envisaged some restrictions to store roll-out criteria, working hours of organized retailers, and their payable terms with the suppliers, has never passed the final stage owing to severe criticism from some members of Parliament and industry players. However, there is chance for an amended version to be ratified in the next three years. Details are pending, but earlier drafts tended to leave BIM's small square meter stores out of the definition of *modern retailers*. Although the ambiguity remains, if new store openings are indeed hindered by the draft or if BIM's small stores are left outside of potential restrictions (a lower chance, in our view), BIM's already established store network in crowded cities and districts would be a relative positive for capturing the traffic from unorganized channels to modern retailers.

## Key Risks

### Cannibalization

Following accelerated store roll-outs in the second half of 2008, the company for the first time mentioned the *cannibalization effect* of nearby stores in densely populated cities. BIM has churned away from aggressive store adds since then; however, competing soft-discounters still look aggressively to expand their networks. We estimate organized food retailers in Turkey are looking to add roughly 16% store-space growth in 2010. We doubt the demand for modern food trade will be able consistently to meet such an aggressive supply over the next five years. If the supply-demand gap sustains, it could weigh on sales efficiencies and consequently on the operating leverage of organized retailers.

### Revival of the Only Competitor?

Since BIM's emergence, a local chain, A101, has been the closest model to replicate BIM's 100% hard-discount stores. After one to one and one-half years of silence, a local newspaper reported that a new local group injected US\$50 million into A101 to revive the growth plans, with ambitions to reach a 1,500 store network in three years in Turkey (*Daily Hurriyet*, December 22, 2009). We continue to believe that this is an aggressive target, but progress in this direction could add to the cannibalization downside risks for BIM.

### Deviation from Disciplined Managerial Approach

We attribute BIM's successful track record in Turkey mostly to management's highly disciplined operational approach, the most remarkable ones being (1) a lean management style, by which every regional head is authorized to decide opening new stores; (2) closing unprofitable stores after a test period; (3) strictly limiting product assortments in stores to 600 SKUs to avoid distribution cost inefficiencies; (4) keeping the recent advertising appetite within boundaries to ensure that shelf prices maintain as the key advertising article; (5) employing only leased stores; and (6) never opening stores on the main streets, despite more attractive pedestrian traffic. These items constitute the core values of the BIM culture and should remain in place regardless of management reshuffles (including the recent retirement of the former CEO for the board of directors seat).

### Slow Expansion Abroad

The miss in Moroccan store count target in the first year of operations is not a midterm concern to us. However, a sustained lag in store expansion would defer the break-even stage and delay the penetration of the BIM brand in other close markets, as the success in Morocco seems to be a major benchmark for management to enter other markets.

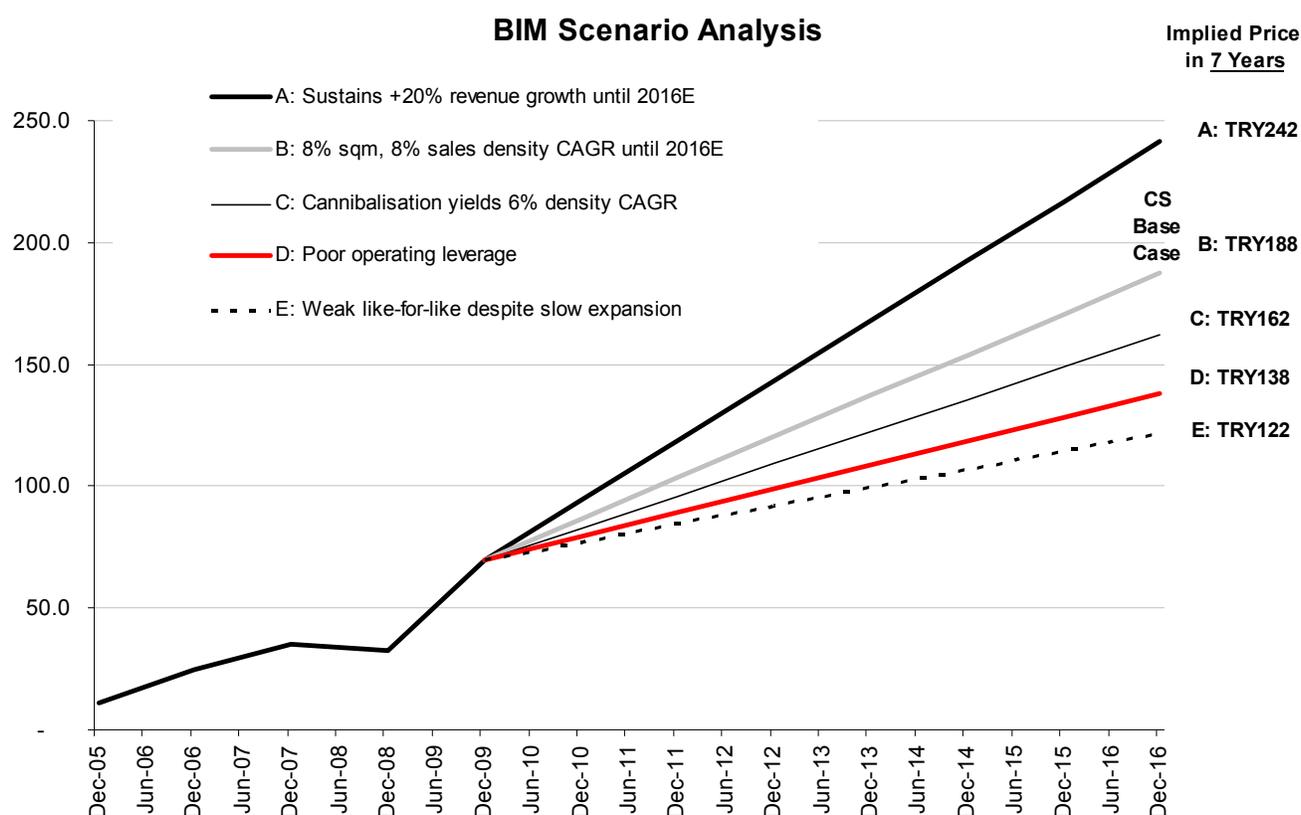
## Valuation

We continue to value BIM via a DCF analysis to better capture its superior growth profile. In addition, the company's business model allows for strong free cash flows from working capital while aggressively growing the network.

BIM's 2010 P/E multiple of 21 is a 48% premium to global food retailers under Credit Suisse coverage. We continue to justify this premium with BIM's (1) midcycle 32% EPS growth in 2007-2012 against 15% for peers and (2) higher cash flow visibility through its simple balance sheet, with virtually no financial debt or forex risks.

## Financial Statements and Comparable Valuation

**Exhibit 116: Current Stock Price Embeds Conservative Growth Expectations**

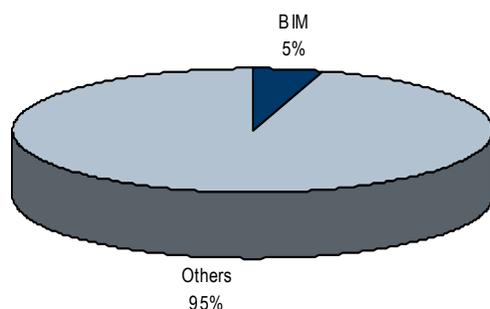


	2009E	2016 Scenario Analysis				
		A	B	C	D	E
BIM sales	5,300	19,000	15,589	14,000	13,000	12,000
Growth CAGR	-	20%	17%	15%	14%	12%
EBIT margin	4.7%	4.6%	4.5%	4.5%	4.3%	4.3%
Interest other income	9	43	41	39	37	35
Tax rate	20%	20%	20%	20%	20%	20%
Sharecount	75.9	75.9	75.9	75.9	75.9	75.9
<b>EPS</b>	<b>TRY2.72</b>	<b>TRY9.66</b>	<b>TRY7.82</b>	<b>TRY7.05</b>	<b>TRY6.28</b>	<b>TRY5.81</b>
Growth CAGR	-	20%	16%	15%	13%	11%
P/E Multiple	25	25	24	23	22	21
<b>Implied Price, 2016E</b>		<b>TRY241.61</b>	<b>TRY187.70</b>	<b>TRY162.16</b>	<b>TRY138.19</b>	<b>TRY121.95</b>
Implied 7-yr return		255%	176%	138%	103%	79%
CAGR		20%	16%	13%	11%	9%

Source: Company data, Credit Suisse estimates.

### Exhibit 117: BIM Represents 5% of the \$69 Billion Turkish Food Market

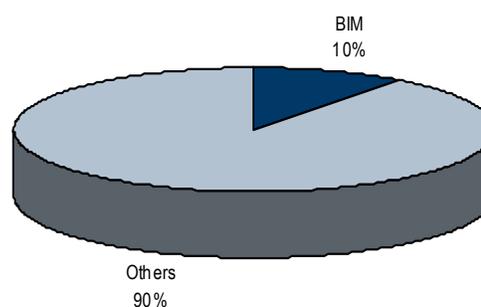
BIM: Revenue market share in Turkey's food trade  
2009E



Source: Company data, AMPD, Credit Suisse estimates.

### Exhibit 118: Our Base Case Assumes an Increase to 10% Market Share by 2016

BIM: Revenue market share in Turkey's food trade  
2016E



Source: Company data, AMPD, Credit Suisse estimates.

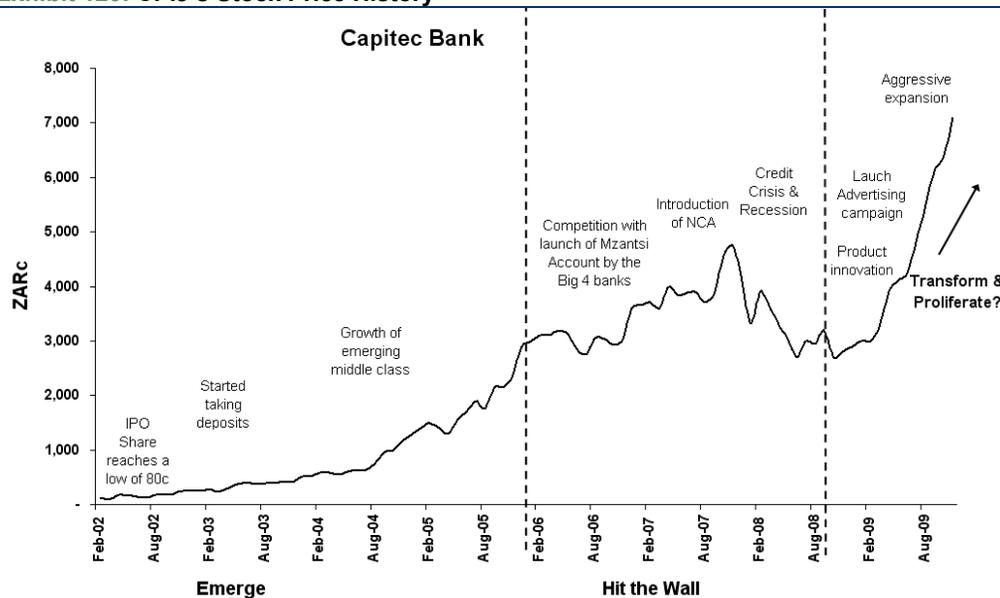
### Exhibit 119: BIM Trades at a Premium to the Group Owing to Above Average Growth Prospects

Ticker	Curr	Price	Mkt Cap	Enterprise Value	Sales FY10E	EBIT Margin	12M Stock Perf	EPS				P/E FY08	P/E FY09E	P/E FY10E	3-Yr Avg P/E	EV/Sales FY10E	5-year EPS CAGR	
								FY07	FY08	FY09E	FY10E							
Ahold	AHLN.AS	Eu	9.02	11,266	11,313	28,676	5.0%	-1%	0.52	0.70	0.76	0.80	12.9	11.9	11.3	12.0	39%	na
Carrefour	CARR.PA	Eu	33.73	23,956	33,194	90,713	2.7%	22%	2.52	2.22	1.82	2.07	15.2	18.5	16.3	16.7	37%	-6%
Casino Guichard	CASP.PA	Eu	57.48	6,453	12,997	27,549	4.5%	10%	4.34	4.29	4.42	4.56	13.4	13.0	12.6	13.0	47%	-2%
Colruyt	COLR.BR	Eu	174.75	5,857	5,531	6,770	6.7%	-1%	7.94	8.87	9.56	10.02	19.7	18.3	17.4	18.5	82%	10%
Delhaize	DELB.BR	Eu	54.51	5,498	7,928	19,608	4.8%	11%	4.43	4.78	4.60	4.68	11.4	11.9	11.6	11.6	40%	5%
Metro	MEOG.F	Eu	39.36	12,861	22,309	68,378	3.0%	40%	2.79	3.05	2.57	3.14	12.9	15.3	12.5	13.6	33%	1%
Morrison (William)	MRW.L	p	292.1	7,638	8,280	15,546	5.2%	11%	0.08	0.14	0.16	0.20	20.9	18.3	14.6	17.9	53%	19%
Sainsbury	SBRY.L	p	319.1	5,818	7,489	20,024	3.4%	-4%	0.14	0.19	0.21	0.24	16.8	15.2	13.3	15.1	37%	23%
Tesco	TSCO.L	p	410.75	32,474	42,074	59,079	6.2%	12%	0.21	0.25	0.27	0.29	16.4	15.2	14.2	15.3	71%	13%
Wal-Mart Stores, I	WMT	US\$	52.97	217,601	258,642	409,589	5.8%	14%	na	na	63%	na						
Costco Wholesale	COST	US\$	58.52	26,679	25,233	76,697	2.8%	36%	na	na	33%	na						
Walmart	WALMEX	US\$	4.31	36,199	35,290	22,441	8.2%	117%	na	na	157%	23%						
Soriana	SORIANA	US\$	2.47	4,445	5,041	7,809	5.1%	53%	na	0.15	na	na	16.5	na	na	na	65%	25%
Spar Group	SPPJ.J	R	72.6	12,402	11,988	32,730	3.3%	32%	2.98	3.90	4.30	4.55	18.6	16.9	16.0	17.2	37%	na
Grupo Famsa	GFAMSA	US\$	2.13	704	1,272	1,247	5.6%	377%	na	na	102%	na						
X5 Retail Group	PJPQ.L	US\$	30	8,147	9,759	11,469	6.4%	329%	0.75	-7.87	0.73	1.25	nm	41.1	24.0	32.5	85%	52%
Seventh Continent	SCON.RT	US\$	7.9	593	1,176	1,578	6.4%	32%	1.32	-1.28	0.12	0.79	nm	65.8	10.0	37.9	75%	15%
Magnit	MGNT.RT	US\$	66	5,872	6,355	7,486	7.1%	355%	1.35	2.26	3.05	4.37	29.2	21.6	15.1	22.0	85%	na
<b>BIM</b>	<b>BIMAS.IS</b>	<b>TRY</b>	<b>68</b>	<b>5,161</b>	<b>5,013</b>	<b>6,418</b>	<b>4.5%</b>	<b>106%</b>	<b>1.43</b>	<b>1.50</b>	<b>2.72</b>	<b>3.16</b>	<b>45.3</b>	<b>25.0</b>	<b>21.5</b>	<b>30.6</b>	<b>78%</b>	<b>32%</b>
<b>Average</b>							<b>5.1%</b>						<b>21.8</b>	<b>14.5</b>		<b>63%</b>	<b>15%</b>	

Source: Company data, © Datastream International Limited ALL RIGHTS RESERVED; Credit Suisse estimates.

# Capitec Bank (CPIJ.J): Challenging Established Banks

Exhibit 120: CPIJ's Stock Price History



Source: Company data, Credit Suisse Standard Securities estimates.

## Investment Summary

- Unique Brand Story.** CPIJ's low-cost banking model will continue to attract more customers that are price sensitive and looking for better-value alternatives. The bank offers a highly attractive savings rate and low transaction fees owing to its lean cost structure.
- Brand Opportunity.** CPIJ plans to open 40 branches in fiscal 2010, which will increase its network to over 400 in total across South Africa. Management expects to obtain better retail locations, as the current market downturn has resulted in increased availability of space. CPIJ also plans to move to more affluent areas to attract middle income earners, a market that is traditionally the preserve of the big four. The bank introduced more long-dated, high-value loans to attract the middle to upper income earners (recently launched 48 months R100,000 loans). In the first half of 2010, CPIJ had 2.1 million active clients; management is confident that by fiscal 2010, the company will have 2.5 million customers, and targets 5 million customers in 2016/2017.
- As long as CPIJ is able to manage the impairments risk, we believe that the company will continue to produce earnings growth. CPIJ consistently revises its credit scoring criteria to manage its risk exposure. CPIJ limits its exposure in sectors that are currently under severe pressure, such as Mining and Automotive, by declining loans to potential clients employed in these high-risk sectors. CPIJ's exposure in these sectors currently is less than 7% and CPIJ has good exposure in government with 45% of the bank's clients employed as civil servants, which lowers the risk of nonperforming loans due to retrenchments.
- Market Perception.** Although CPIJ is attracting clients from the big four banks through its low pricing, growth remains in the underbanked market, in our view. According to industry research, it is estimated that only 63% of South Africa's adult population is banked clients—5% of these have home loans and 3% have personal loans. Also, a

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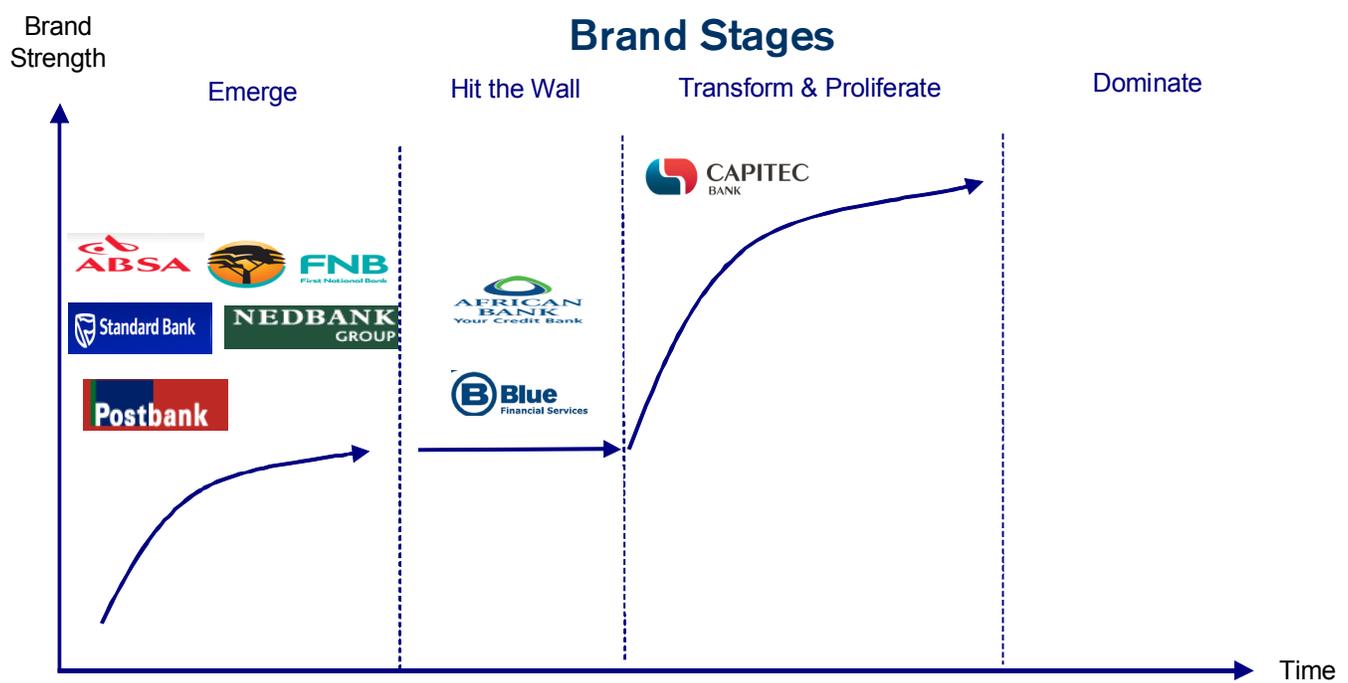
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number of clients see bank accounts as a way to receive their salaries and are not taking advantage of other bank products. Therefore, we believe that there is still potential for growth in the mass market, as more people become aware of other banking services.

- **Valuation.** We believe that taking the long-term view is warranted for a compelling brand story in a growth phase. Our seven-year target price is 7 times our EPS estimate of R19.13, which embeds R17.7 billion in gross loans and a 26% net interest margin, and would drive a 6% CAGR return over the next 7 years.

#### Exhibit 121: South African Banking Industry and Its Competitiveness in the Unsecured Lending Space



Source: Credit Suisse Standard Securities estimates.

## Brand Overview

CPIJ is a retail bank in South Africa, which focuses on providing accessible and affordable banking services to clients via the innovative use of technology, in a manner which is convenient and personalized. It offers loans, savings accounts, and transactions through branches, cards, Internet, ATMs, or partners. CPIJ currently has 371 branches and approximately 3,400 employees.

### Retail Bank Not a Micro Lender

Management has always had a vision for CPIJ to be more of a retail bank than a micro lender, providing a full range of banking solutions to a wide range of private clients. This vision is being pushed to the fore to a much greater degree, as competitors in this market are faced with declining earnings and are cutting costs to protect profitability. With competitors cutting back, CPIJ is building its infrastructure to accommodate more clients and continues to provide unsophisticated products at the lowest prices in the market.

### Simplified, Accessible, Low-Cost and Convenient Banking

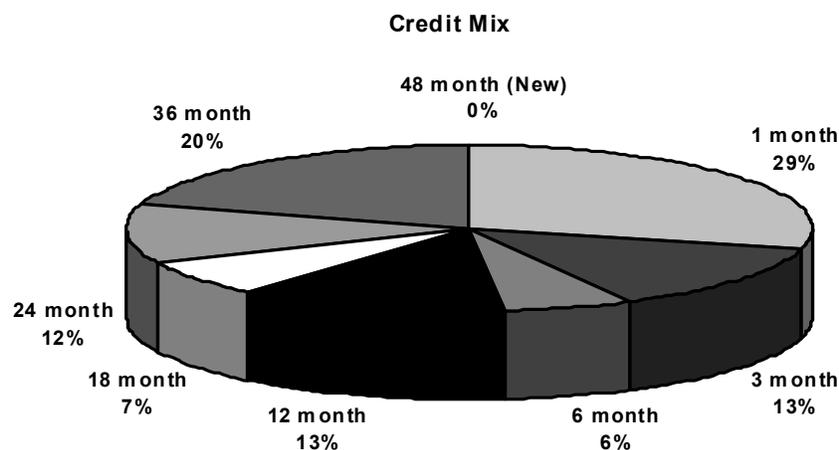
CPIJ provides simplified and affordable retail banking services through the use of technology. The application process for savings accounts and personal loans is paperless and takes minutes to complete. Credit checks prior to granting of loans are performed electronically. CPIJ offers only one facility to clients, the Global One Bank Account, which acts as a transaction account, savings account, and provides access to credit products

with real-time access to funds. The real-time capability means that clients' needs are met immediately when they enter the branch. On a busy day, management indicated that CPIJ is able to process around 5,000 transactions in one hour. Management believes that through the use of technology, CPIJ will continue to provide simple and convenient banking to a wide range of clients across different income groups. Convenience is further enhanced with extended banking hours that are from 08:00 to 17:00 on weekdays and 08:00 to 13:00 on Saturdays in its entire branch network.

### Use of Technology to Launch Innovative Products

CPIJ launched a new product in July 2009, a loan that can be activated via cellphone SMS. The 30-day loan can be activated from anywhere at anytime simply by sending an SMS with the amount required. Once approved, the loan immediately is available in the client's account. In fiscal 2009, CPIJ introduced Internet banking and cellphone SMS update functionality. More than 60,000 clients sign up each month for the SMS update, which is the automatic SMS notification of all the debits and credits going through one's account, allowing clients to monitor all the activities on their accounts as they occur. CPIJ introduced a secure Internet banking functionality by which a user is required to enter a unique user identity, password, and token code for added security. It eliminates the risk of sensitive information, typically sent via cellular networks, from being intercepted, which could compromise the account security. Tokens are issued at CPIJ branches during registration for a once-off fee of R125.

### Exhibit 122: CPIJ Loan Products



Source: Company data, Credit Suisse Standard Securities estimates.

### CPIJ's Core Principles

Since its inception, CPIJ has operated under four core principles.

- **Affordability.** CPIJ's fees and interest rates charged on its products are significantly lower compared with those of its peers.
- **Accessibility.** CPIJ has a broad and diversified network of branches.
- **Convenience.** Customers have access to hundreds of retailers and ATMs.
- **Simplicity.** Customer transactions are quick and simple; customers never are asked to fill out forms—in fact, the branches are paperless.

## Branding Efforts

In November 2007, CPIJ embarked on a formal and independent research project to ascertain consumer perceptions regarding its brand and offer. The company launched its first television and print campaign in February 2007, which has dramatically increased market awareness of the Capitec brand and its suite of products. As a result, CPIJ has a customer base of 2.1 million, which is up approximately 74% over the past two years. Despite recent turmoil in the banking community, CPIJ continued to grow, which speaks volumes to the business model. Since the branding efforts commenced, CPIJ has received notable accolades such as, third in *The Sunday Times Top 100 Companies* and first in *The Financial Mail Top 200 Companies*.

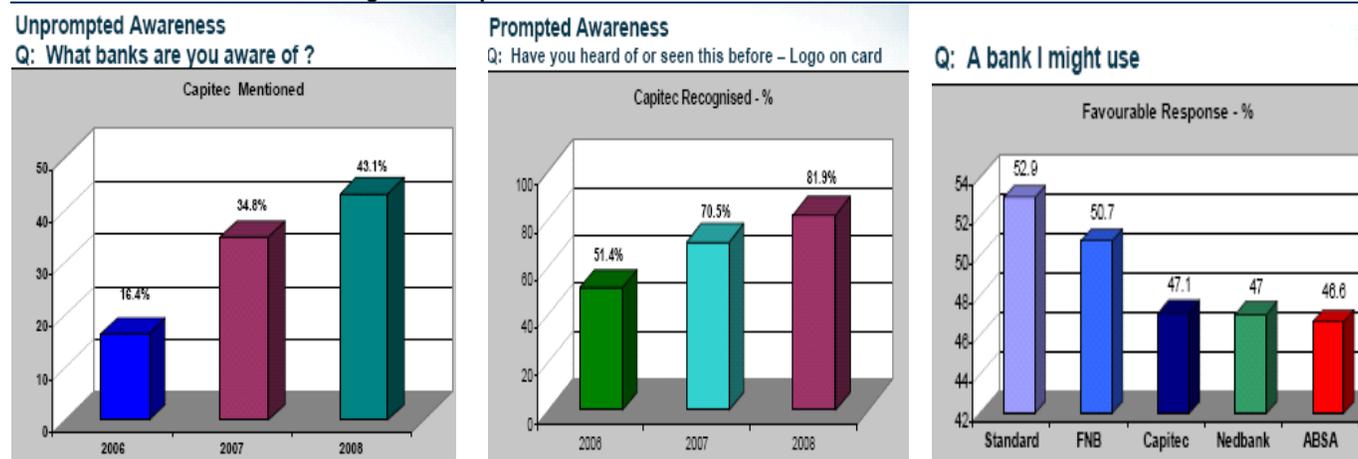
CPIJ's sole mission is to create an innovative alternative to traditional banking. The company plans on changing everything that is accepted, but disappointing to clients about the banking process. Since its inception, CPIJ has redefined the way retail banking is accessed in South Africa and has challenged the conventional way of delivering value to customers. CPIJ's goal is fundamentally to change consumers' banking experiences. It intends to do so by the following.

- Adding product offerings with easy access to products and services.
- Differentiating its position in the marketplace.
- Making things easier for customers through service.

## Increase Brand Awareness

Management embarked on aggressive advertising campaign to increase CPIJ's brand awareness. In July 2009, CPIJ rolled out its updated logo and pay-off line as part of a branding exercise. The bank participated in one of South Africa's most popular soap operas, *Generations*, as part of its drive to improve its brand awareness. In Exhibit 123 are the results of survey conducted to assess its brand recognition.

### Exhibit 123: CPIJ's Brand Recognition Improved



Source: Company data.

## Brand Development State: Transform & Proliferate

CPIJ emerged as a microlender in 2001, during the days when small banks such as Saambou were going under. It has since been successful in providing loans to the previously unbanked market in South Africa.

## Exhibit 124: CPIJ is adjusting its successful business model toward a more affluent consumer base in order to increase market share

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Credit Suisse Standard Securities estimates.

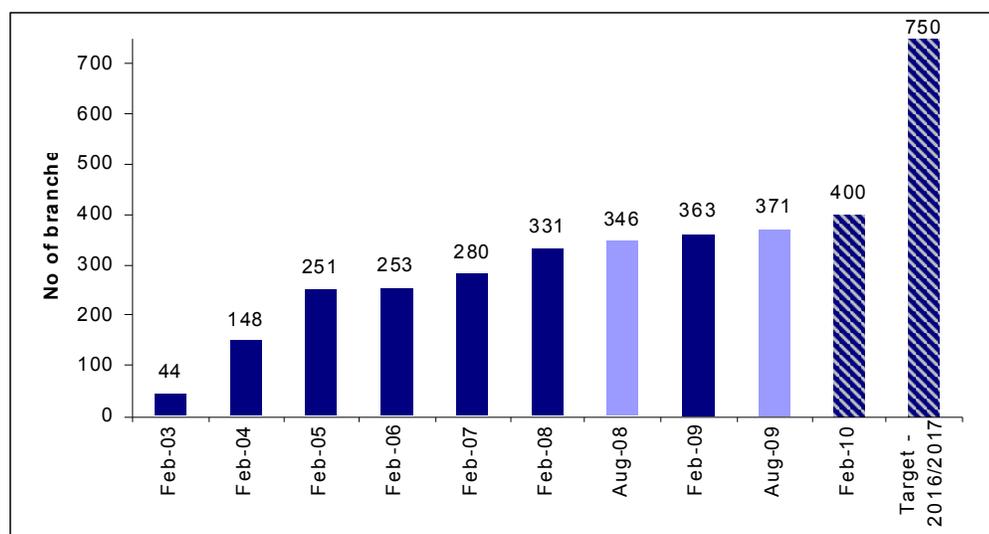
CPIJ has always been perceived as a microlender for the poor. Management is working hard to change this perception and emphasizes that CPIJ is a retail bank offering a full range of banking solutions to all (not just the low end). The bank has embarked on a number of branding and marketing initiatives to attract a wide range of clients. It launched a new logo with the pay-off line *Simplicity is the new sophistication*. This refers to its offer of a simple and affordable banking to its clients through its Global One Account. The bank continues to grow and attract a wider range of clients, including middle and upper income groups.

## Growth Strategies & Opportunities

In South Africa, many people are not part of the banking system. Only 63% of the adult population is banked clients, 3% of which have personal loans. CPIJ is also tapping into the middle income

### Increase Branch Network in More Affluent Areas

CPIJ plans to open 40 branches in fiscal 2010, which will increase its branches to over 400 in total across South Africa. Management expects to obtain better retail locations owing to market downturn and as CPIJ plans to move to more affluent areas to attract middle income earners. The current financial crisis has resulted in availability of space in areas in which this was previously limited. Of the 40 branches to be opened, 10 will be in suburban malls, which are upper market areas. Management believes that CPIJ will be able to increase its market share by providing a more transparent and cheaper banking alternative to that offered by the big four banks in South Africa.

**Exhibit 125: CPIJ Branches Continue to Grow**

Source: Company data, Credit Suisse Standard Securities estimates.

**Competitive Pricing Is Attracting Customers**

The level of bank charges and the competitiveness of fees between banks has been the subject of many debates and recent investigation by the competition authorities. CPIJ charges fixed fees per transaction and management believes that these are less than one-half those of the big four banks, as per Exhibit 126.

CPIJ believes that the price sensitivity of consumers in recent economic times is resulting in a number of clients choosing CPIJ as a cheaper alternative.

**Exhibit 126: CPIJ Charges Lower Than Traditional Banks**

Typical bank costs				
Transactions	Number of transactions	Other bank	Capitec Bank	YOU SAVE
ATM withdrawals	3	19.50	9.00	10.50
Stop orders and debit orders	4	24.00	10.00	14.00
Balance enquiries	2	5.00	FREE	5.00
Statements	2	8.00	4.00	4.00
Interaccount transfers	2	13.00	5.00	8.00
Monthly administration	1	41.00	4.00	37.00
Debit card purchases	2	3.80	FREE	3.80
<b>Total per month</b>	<b>16</b>	<b>114.30</b>	<b>32.00</b>	<b>86.30</b>
<b>Total per year</b>	<b>193</b>	<b>1 419.60</b>	<b>384.00</b>	<b>1 035.60</b>

Source: Capitec Bank March 2009.

**Use of Technology to Launch Innovative Products**

CPIJ launched a new product in July 2009, a loan that can be activated via cellphone SMS. The 30-day loan can be activated from anywhere at anytime simply by sending an SMS with the amount required. Once approved, the loan immediately is available in the client's account. In fiscal 2009, CPIJ introduced Internet banking and cellphone SMS update functionality. More than 60,000 clients sign up each month for the SMS update,

which is the automatic SMS notification of all the debits and credits going through one's account, allowing clients to monitor all the activities on their accounts as they occur. CPIJ introduced a secure Internet banking functionality, by which a user is required to enter a unique user identity, password, and token code for added security. It eliminates the risk of sensitive information, typically sent via cellular networks, from being intercepted, which could compromise the account's security. Tokens are issued at CPIJ branches during registration for a once-off fee of R125. CPIJ expects to release 20-25% capacity from the use of this service.

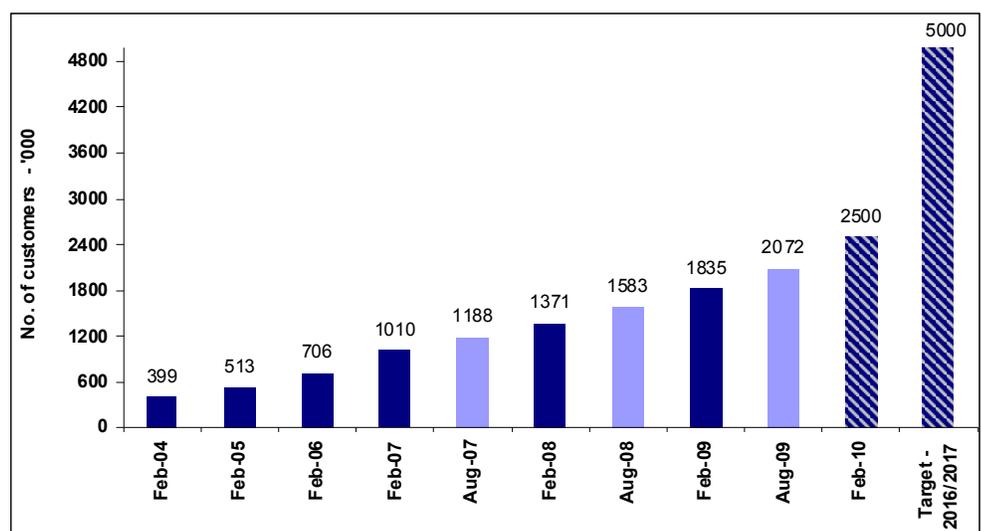
### Product Extension Aimed at Attracting Higher Income Earners

In November 2009, CPIJ launched a high-value, long-dated loan targeted more at the less risky middle to upper income consumer. The loan amount is R100,000 over a 48-month period. Although long-dated loans are at lower margins, CPIJ plans to increase the profitability through increased volumes.

### Increase Number of Clients

In the first half of 2010, CPIJ reported a record 2,072 million clients and management is confident that by fiscal 2010 CPIJ will have 2.5 million customers, and targets 5 million customers in 2016/2017. Compared with its closest competitor in the market, the Mzansi Account, which is a low-cost banking alternative launched in 2006 by the big four banks and Post Bank, currently has six million clients (split among these five banks). With 2.1 million clients, CPIJ surpassed the Mzansi account, which averages 1.2 million for each bank (assuming an equal split).

**Exhibit 127: CPIJ Number of Customer Continues to Grow**



Source: Company data, Credit Suisse Standard Securities estimates.

*Management experience makes a difference.* The CPIJ management team has significant experience in the mass market and extensive know-how of the microlending business. Part of the senior management started working at CPIJ since its formation in 2001. We believe that management has a deep understanding of the company's business and market, and should be able to handle any competition and other challenges well.

**Exhibit 128: CPIJ Continues to Grow**

Bank	Number of branches						
	2003	2004	2005	2006	2007	2008	2009
Standard Bank Group	911	975	984	951	1,103	1,106	1,105
Absa Group	668	675	718	759	1,011	1,192	1,081
FirstRand Group			667	690	688	712	687
Nedbank		848	581	583	612	590	576
Abil					550	478	419
Capitec	265	251	253	280	331	363	371

Bank	Number of ATMs						
	2003	2004	2005	2006	2007	2008	2009
Standard Bank Group	3,316	3,603	4,131	4,538	4,916	5,174	5,421
Absa Group	4,502	5,078	5,835	7,053	8,524	9,104	9,211
FirstRand Group			3,718	4,185	4,561	4,800	5,311
Nedbank		1,227	1,174	1,283	1,694	1,818	1,795
Abil							
Capitec	75	180	210	407	765	939	1,053

Bank	Number of customers (in millions)						
	2003	2004	2005	2006	2007	2008	2009
Absa Group	6.2	7.0	7.7	8.4	9.6	10.7	11.0
FirstRand Group					6.8	11.5	11.7
Nedbank		3.6	3.5	4.0	4.4	4.9	5.2
Abil						1.7	1.8
Capitec	0.4	0.5	0.7	1.0	1.4	1.8	2.1

**SA Credit Active consumers according to the National Credit Regulator**

**18.0**

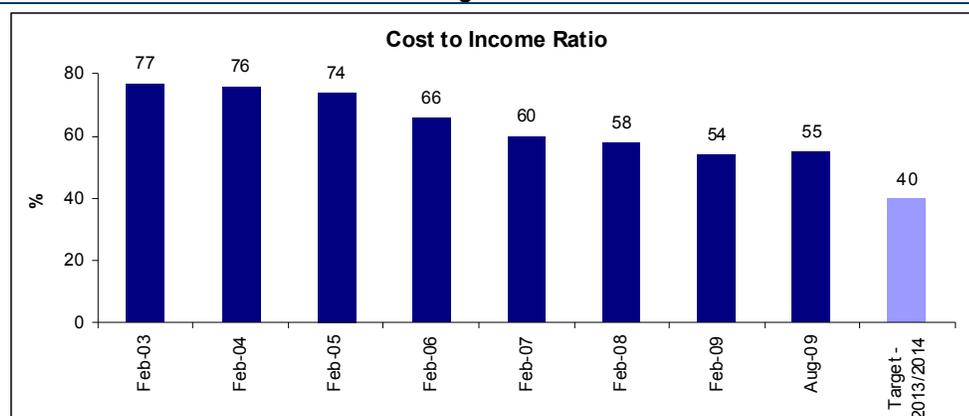
Source: Company data

CPI ATMs include its own and partnership ones

For Absa, branch numbers are for "number of staffed outlets" and ATMs include non-Absa owned and subsidiary ATMs.

**Cost Containment Is Key**

CPIJ plans to reduce its cost to income ratio to 40% by fiscal 2013/2014 from 55% in the first half of 2010. Despite the growth in branch network and related costs, CPIJ has been able to reduce the cost to income ratio, as noted in Exhibit 129, to 55% in the first half of 2010 from 77% in fiscal 2003.

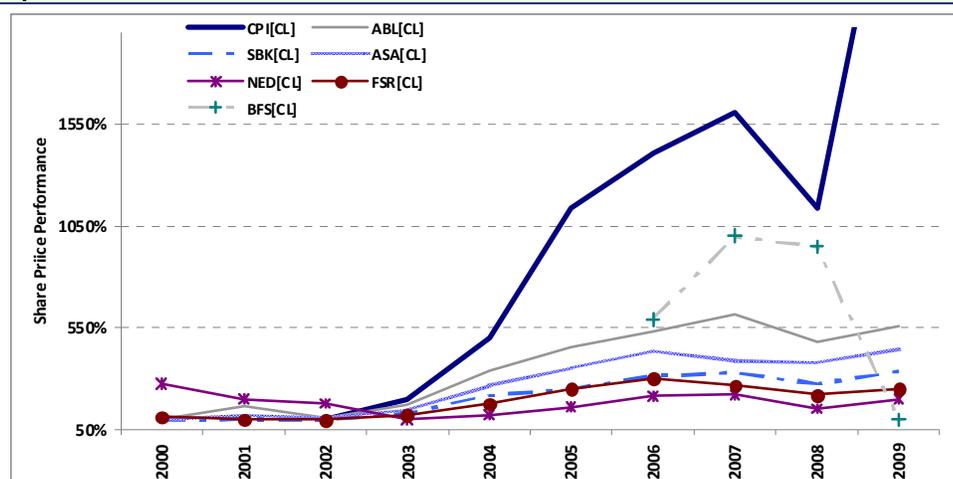
**Exhibit 129: CPIJ Cost to Income Declining**

Source: Company data, Credit Suisse Standard Securities estimates.

- The incremental investment in infrastructure should be minimal, as CPIJ drives to open smaller branches with centralized bank office function. Each branch operates with only about ten staff members. Clients per branch have increased to 5,585 in the first half of 2010 from 2,044 in fiscal 2005. CPIJ expects to release 20-25% capacity using SMS loans when clients apply for loans without visiting the branch.
- CPIJ is embarking on the use of education to encourage electronic banking in order to reduce costs. Of CPIJ's clients, 99% still use cash withdrawals on a regular basis, and only 16% use debit cards. This results in increased costs for CPIJ; therefore, the company continues to embark on education programs and communication to encourage clients to pay electronically and to use cards, which will drive costs down.

## Stock Performance versus Peer Group

### Exhibit 130: CPIJ Outperformed Other South African Banks as It Continued to Deliver Impressive Results



Source: I-Net.

## Major Catalysts

The key catalysts for CPIJ over the next five years are the following.

- *Increase market share in middle to upper income customer base.* Success in opening branches in affluent areas will be positive for CPIJ in attracting higher net worth clients.
- *Product launches.* New products to attract customers, such as extending the SMS loans from accessing only the one month loans to include other products.
- *Reduction in nonperforming loans.* CPIJ's strategies to reduce impairments and lowering the bank's risk will be key to its profitability.

## Key Risks

- *Slow economic recovery may negatively affect demand for credit.* Our economists projects modest economic growth for South Africa in 2010. Real GDP growth is forecast at 2.7%, which puts South Africa in the slowest six of the mainstream emerging markets. Industrial production growth appears to have decisively troughed, but the overall level remains depressed at volumes more consistent with 2004. High levels of inflation with electricity price hikes may have a negative impact on CPIJ's client base, resulting in increased nonperforming loans.

- *Increased competition from the bigger banks.* As CPIJ moves more aggressively to compete in more affluent areas that are currently serviced by the traditional banks and offers more long-dated, high-value loans to attract the middle to upper income earners (launched 48 months R100,000 loan), the company will face increased competition from the bigger banks. In November 2009, First National Banks (FNB) announced the launch of FNB EasyPlan network of branches, which appears to be aimed at what CPIJ currently is offering. The FNB EasyPlan offers the following.
  - It is aimed at people earning less than R100,000 (CPIJ has no ceiling, its offering is open to everyone).
  - It is paperless banking and loans are granted within ten minutes, CPIJ also claims to have a turnaround of ten minutes, and biometric system results in paperless transacting.
  - It offers extended operating hours (open 12 hours) at three EasyPlan branches (CPIJ minimum hours 08:00 to 17:00 and can also open from 07:00 to 19:00).
  - EasyPlan claims to be the most affordable banking format in the market, with monthly fee of at R3.95, while CPIJ charges R4.00.

Although at this stage we are not convinced that the FNB EasyPlan will be able to compete effectively with CPIJ owing to the costs involved, clearly the bigger banks are implementing plans to defend their market shares.

- *Negative impact of rising unemployment on nonperforming loans.* According to the National Credit Regulator, consumer credit quality continues to deteriorate. High levels of unemployment and reduced working time have a negative impact on nonperforming loans. According to the National Credit Regulator in South Africa, 8.1 million consumers (or over 45% of the total credit active consumers) currently have impaired credit. *CPIJ consistently revises its credit scoring criteria to manage its risk exposure in the current economic environment.* CPIJ limits its exposure in sectors that are currently under severe pressure, such as mining and automotive, by declining loans by potential clients employed in these high-risk sectors. CPIJ's exposure in these sectors currently is less than 7%. *CPIJ has good exposure to government, with government employed clients making up 45% of its clients, which lowers the risk of nonperforming loans due to retrenchments.*

## Valuation

We value CPIJ using three different methodologies: HOLT®, relative P/E, and P/B. To determine our fair value and target price, we use a weighted average of these three techniques. The Credit Suisse HOLT® methodology is our primary valuation technique; therefore, it carries the most weight at 50%, while the remaining two valuations carry equal weights of 25% each.

**Exhibit 131: CPIJ Valuation Summary**

Valuation Method	Fair Value	Weighting	Weighted Fair Value	Weighted Target Price
HOLT®	R91.00	50.0%		
P/E Relative Value	R66.00	25.0%		
Price to Book	R44.00	25.0%		
<b>Average</b>	<b>R67.00</b>	<b>100.0%</b>	<b>R73.00</b>	<b>R90.00</b>
<b>Share Price</b>	<b>19-Feb-10</b>		<b>R81.00</b>	
<b>Potential Upside/(Downside)</b>				<b>11%</b>
Dividends				1.90
Total Return				91.90
<b>Total Return %</b>				<b>13.5%</b>
			<b>Feb-10</b>	<b>Feb-11</b>
<b>Current P/E</b>			<b>16.5</b>	<b>11.6</b>
<b>Target Price Implied P.E</b>			<b>18.4</b>	<b>12.9</b>

Source: Credit Suisse Standard Securities estimates; HOLT ValueSearch™, I-Net.

**Discount Rates Used in Our Valuations**

HOLT®. Discount rate used is the market-derived *real* cost of equity of 7.8%

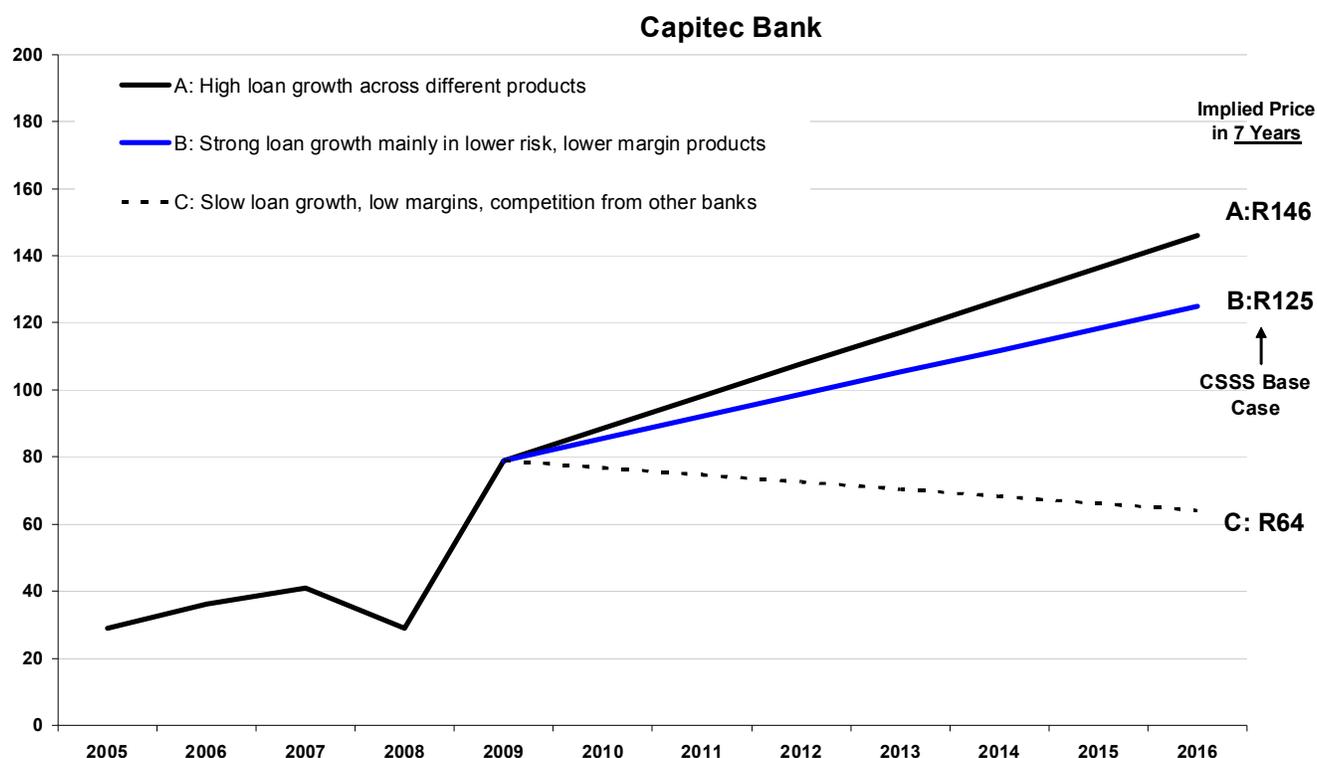
**Relative Valuations**

We performed relative valuations using a long-term median P/E multiple of 12.9, a P/B multiple of 2.7 for the peer group, and our forecast earnings and equity.

# Financial Statements and Comparable Valuation

## Scenario Analysis

Exhibit 132: CPIJ Growth Even at Low Margins Will Be Profitable



### Capitec Bank Scenarios

	2009
Gross Loans	3,223
Growth CAGR	
Net Interest Margin	29%
Cost to Income ratio	54%
Net Interest Income	943
Growth CAGR	
Non-Interest Income	1,201
Growth CAGR	
Impairments provision	468
Growth CAGR	
Total Operating Costs	1,237
Growth CAGR	
Sharecount	83
<b>EPS</b>	<b>R 5.31</b>
Growth CAGR	
P/E Multiple	15
<b>Implied Price, 2016E</b>	
Implied 7-yr return	
CAGR	

### 2016E Scenario Analysis

	A	B	C
Gross Loans	18,821	17,679	6,908
Growth CAGR	29%	28%	12%
Net Interest Margin	28%	26%	15%
Cost to Income ratio	40%	40%	48%
Net Interest Income	5,288	4,629	1,009
Growth CAGR	28%	26%	1%
Non-Interest Income	5,011	4,581	3,341
Growth CAGR	23%	21%	16%
Impairments provision	2,070	1,945	622
Growth CAGR	24%	23%	4%
Total Operating Costs	4,151	3,674	2,075
Growth CAGR	19%	17%	8%
Sharecount	83	83	83
<b>EPS</b>	<b>R 35.20</b>	<b>R 19.13</b>	<b>R 13.70</b>
Growth CAGR	31%	20%	14%
P/E Multiple	4	7	5
<b>Implied Price, 2016E</b>	<b>R 146.00</b>	<b>R 125.00</b>	<b>R 64.00</b>
Implied 7-yr return	80%	54%	-21%
CAGR	9%	6%	-3%

Source: Company data, Credit Suisse Standard Securities estimates.

## We Compare CPIJ with other South African Banks

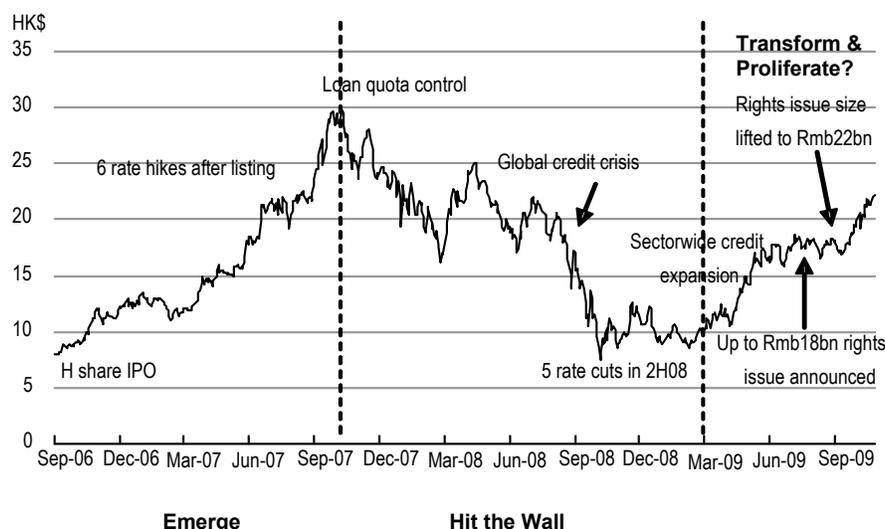
## Exhibit 133: CPIJ Trades at a Premium to South African Banks Owing to Its Higher Growth Prospects

TICKER	CAP (Rm)	Close	I-Net Consensus [cps]				Growth - Financial Year			Growth - Calendar Year			P/E Calendarised		
			2009	2010	2011	2012	2010	2011	2012	2010	2011	%ch	2010	2011	
SBK	169,152	108.55	756.9	973.0	1286.5	-	28.6%	32.2%	-	973.0	1286.5	32.2%	11.2	8.4	
FSR	102,836	18.24	133.1	149.7	197.8	245.2	12.5%	32.1%	24.0%	172.8	220.6	27.6%	10.6	8.3	
ASA	95,960	133.61	1072.0	1354.9	1704.8	-	26.4%	25.8%	-	1354.9	1704.8	25.8%	9.9	7.8	
NED	61,398	123.10	992.3	1204.0	1651.8	-	21.3%	37.2%	-	1204.0	1651.8	37.2%	10.2	7.5	
<b>RMH</b>	<b>36,394</b>	<b>30.10</b>	<b>219.3</b>	<b>272.0</b>	<b>346.2</b>	<b>451.2</b>	<b>24.0%</b>	<b>27.3%</b>	<b>30.3%</b>	<b>307.6</b>	<b>396.6</b>	<b>28.9%</b>	<b>9.8</b>	<b>7.6</b>	
<b>ABL</b>	<b>24,527</b>	<b>30.5</b>	<b>225.1</b>	<b>283.5</b>	<b>381.0</b>	<b>438.5</b>	<b>25.9%</b>	<b>34.4%</b>	<b>15.1%</b>	<b>307.9</b>	<b>395.4</b>	<b>28.4%</b>	<b>9.9</b>	<b>7.7</b>	
<b>INL</b>	<b>41,295</b>	<b>57.08</b>	<b>572.4</b>	<b>543.4</b>	<b>674.0</b>	<b>899.5</b>	<b>-5.1%</b>	<b>24.0%</b>	<b>33.5%</b>	<b>641.4</b>	<b>843.1</b>	<b>31.5%</b>	<b>8.9</b>	<b>6.8</b>	
CPI	6,722	81.00	359.0	490.0	639.0	858.0	36.5%	30.4%	34.3%	614.2	821.5	33.8%	13.2	9.9	
<b>538,284</b>							<b>21.4%</b>	<b>30.7%</b>	<b>15.0%</b>				<b>30.3%</b>	<b>10.4</b>	<b>8.0</b>
TICKER	CAP (Rm)	Close	CSSS [cps]				Growth - Financial Year			Growth - Calendar Year			P/E Calendarised		
			2009	2010	2011	2012	2010	2011	2012	2010	2011	%ch	2010	2011	
SBK	169,152	108.55	725.0	964.0	1,248.0	-	33.0%	29.5%	-	964.0	1248.0	29.5%	11.3	8.7	
FSR	102,836	18.24	133.1	148.0	192.0	239.0	11.2%	29.7%	24.5%	169.1	214.6	26.9%	10.8	8.5	
ASA	95,960	133.61	1,072.0	1,367.0	1,702.0	-	27.5%	24.5%	-	1367.0	1702.0	24.5%	9.8	7.9	
NED	61,398	123.10	965.0	1,208.0	1,640.0	-	25.2%	35.8%	-	1208.0	1640.0	35.8%	10.2	7.5	
<b>RMH</b>	<b>36,394</b>	<b>30.10</b>	<b>219.3</b>	<b>272.0</b>	<b>346.2</b>	<b>451.2</b>	<b>24.0%</b>	<b>27.3%</b>	<b>30.3%</b>	<b>307.6</b>	<b>396.6</b>	<b>28.9%</b>	<b>9.8</b>	<b>7.6</b>	
<b>ABL</b>	<b>24,527</b>	<b>30.50</b>	<b>225.1</b>	<b>283.5</b>	<b>381.0</b>	<b>438.5</b>	<b>25.9%</b>	<b>34.4%</b>	<b>15.1%</b>	<b>307.9</b>	<b>395.4</b>	<b>28.4%</b>	<b>9.9</b>	<b>7.7</b>	
<b>INL</b>	<b>41,295</b>	<b>57.08</b>	<b>572.4</b>	<b>543.4</b>	<b>674.0</b>	<b>899.5</b>	<b>-5.1%</b>	<b>24.0%</b>	<b>33.5%</b>	<b>641.4</b>	<b>843.1</b>	<b>31.5%</b>	<b>8.9</b>	<b>6.8</b>	
CPI	6,722	81.00	359.0	490.0	700.0	910.0	36.5%	42.9%	30.0%	665.0	875.0	31.6%	12.2	9.3	
<b>538,284</b>							<b>23.1%</b>	<b>29.2%</b>	<b>15.1%</b>				<b>28.9%</b>	<b>10.5</b>	<b>8.1</b>
TICKER	CAP (Rm)	Close	CSSS / Consensus				Growth - Financial Year			Growth - Calendar Year			P/E Calendarised		
			2009	2010	2011	2012	2010	2011	2012	2010	2011	%ch	2010	2011	
SBK	169,152	108.55	-4.2%	-0.9%	-3.0%	-	4.4%	-2.8%	-	-0.9%	-3.0%	-	0.9%	3.1%	
FSR	102,836	18.24	0.0%	-1.1%	-2.9%	-2.5%	-1.3%	-2.4%	0.5%	-2.1%	-2.7%	-	2.2%	2.8%	
ASA	95,960	133.61	0.0%	0.9%	-0.2%	-	1.1%	-1.3%	-	0.9%	-0.2%	-	-0.9%	0.2%	
NED	61,398	123.10	-2.8%	0.3%	-0.7%	-	3.8%	-1.4%	-	0.3%	-0.7%	-	-0.3%	0.7%	
<b>RMH</b>	<b>36,394</b>	<b>30.10</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>-</b>	<b>0.0%</b>	<b>0.0%</b>	
<b>ABL</b>	<b>24,527</b>	<b>30.50</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>-</b>	<b>0.0%</b>	<b>0.0%</b>	
<b>INL</b>	<b>41,295</b>	<b>57.08</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>-</b>	<b>0.0%</b>	<b>0.0%</b>	
CPI	6,722	81.00	0.0%	0.0%	9.5%	6.1%	0.0%	12.4%	-4.3%	8.3%	6.5%	-	-7.6%	-6.1%	
<b>538,284</b>			<b>-2.1%</b>	<b>-0.4%</b>	<b>-2.0%</b>	<b>-0.6%</b>	<b>2.2%</b>	<b>-2.2%</b>	<b>0.1%</b>	<b>-0.6%</b>	<b>-2.0%</b>	<b>0.0%</b>	<b>0.6%</b>	<b>2.0%</b>	

Source: Credit Suisse Standard Securities estimates, I-Net.

# China Merchants Bank-H (3968.HK): Strongest Retail Bank Franchise

Exhibit 134: China Merchants Stock Price History



Source: Company data, Credit Suisse estimates.

## Investment Summary

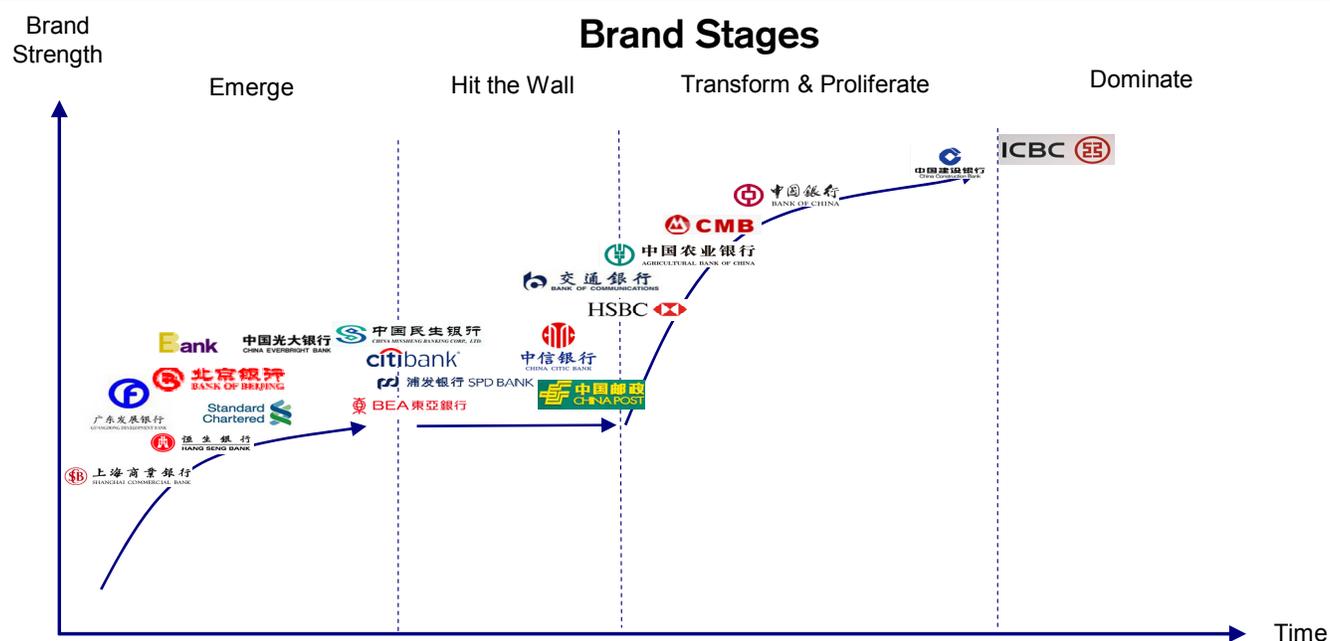
- Unique Brand Story.** China Merchants Bank (CMB) has made a significant effort to establish its retail brand, which is manifested in its superior balance sheet growth relative to its peers. On the retail side, we believe the bank is underpenetrated and should be able to grow at a much faster rate with the onset of Chinese deregulation. We believe deregulation, coupled with increasing leverage of the Chinese consumer, and CMB's strong franchise, should make it the preeminent retail bank in the country.

**Strong Macro Backdrop.** China provides the best macro environment in Asia for banks despite the expected soft patch. Aggressive fiscal stimulus and monetary policy have underpinned growth. The Chinese consumer currently has low leverage (retail loan to GDP ratio of only 10%). In the next five to ten years, as consumers' purchasing power increases, we believe they will borrow more, and leverage will increase.

- Brand Opportunity.** With CMB's consumer and mortgage competition being quite low, we believe deregulation should be a positive catalyst, allowing the bank to differentiate itself more easily.
- Market Perception.** We view CMB as the best run bank in the industry. Despite a recent misstep with an ill-timed acquisition in Hong Kong, we have confidence in the management team's ability to reach CMB's full penetration potential.

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**Exhibit 135: China Merchants Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

## Brand Overview

CMB was formed in 1987 and represented the first commercial bank entirely owned by corporate legal entities. In 2002, the company became listed on the Shanghai Stock Exchange and in 2006 became listed on the Hong Kong Stock Exchange. The company is the sixth largest commercial bank in China based on total assets and has over 600 offices in China. In 2007, the company broadened its global footprint, becoming the first Chinese bank to receive a banking license in the United States. CMB currently has 44 branches, 623 sub-branches, one credit card center, one credit loan center for small businesses, and 1,567 self-service banking centers in China, as well as one branch and representative office in New York.

CMB specializes in three businesses: retail banking, corporate banking, and the treasury business. Approximately 50% of its operating income is from corporate banking, roughly one-third comes from its retail banking segment, and the remainder is derived from its treasury business and other activities. The company's corporate banking segment specializes in lending and deposit taking activities, structured products, and syndicated loans, among other services. CMB's foray into retail banking is most notably marked by its unique *All-in-one Card* campaign launched in 1995. The retail business offers a diverse range of products and services to a wide variety of clients. As of June 30, 2009, CMB had issued more than 28.85 million credit cards. The treasury business consists of interbank, capital markets, and proprietary trading activities. Other sources of operating income include insurance underwriting, investment properties, in addition to interest in jointly controlled entities.

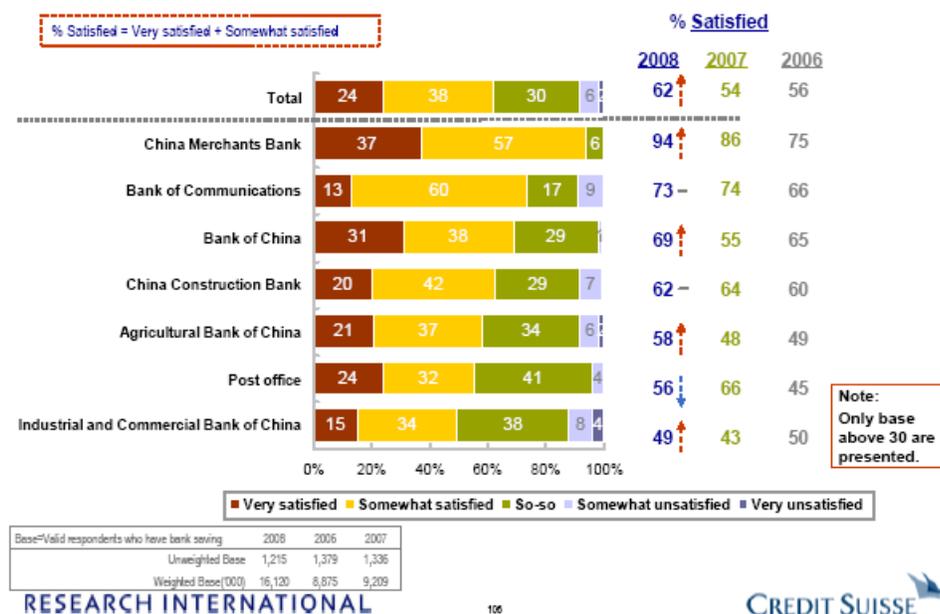
### CMB a Star in Customer Satisfaction

We perform a proprietary survey on China's financial services industry on an annual basis. Our most recent survey (December 2008) indicated a continued lag in second-tier joint stock bank retail franchises, with CMB being a strong exception. While most retail banks hardly made an impact in our survey, CMB did exceptionally well, with 94% of respondents expressing satisfaction with its bank services, up from 86% in 2007. This has been an

exceptional bank that scores well in our survey through increased customer gains and noted improvements in customer satisfaction, which should, in turn, enhance customer retention.

**Figure 136: CMB Continues to Score Exceptionally Well on Customer Satisfaction;  
Agricultural Bank of China and Bank of China Have Also Done Well**

### Satisfaction to the bank service – by bank



Source: Research International, Credit Suisse estimates.

### Competitive Environment

The China Construction Bank (CCB) and the Post Office gained more customers in our 2008 survey, but their service levels did not appear to have caught up. Both showed slipping levels of customer satisfaction, especially the Post Office. Last, the Industrial and Commercial Bank of China (ICBC), although it has seen a weakened customer penetration, managed to improve its customer satisfaction. ICBC, as the largest bank, especially in urban China, continued to have the lowest customer satisfaction levels compared with its peers, according to our survey. This could reflect the challenges all large banks face in terms of improving efficiency and overall quality control. We believe that there is also a tendency for larger banks in China to rely on and leverage more of their extensive distribution channel as its competitive strength, which makes improving service quality a less strategic focus. In general, we find banks with a greater focus on target market and strategy tend to score better on customer satisfaction.

Our 2008 survey found that awareness of foreign banks has been reduced. About 62% of respondents could not name any foreign banks that operate or have branches in China. This ratio increased from 55% in 2007. The reduced awareness was seen across the board for most foreign banks. This is likely a reflection of foreign banks' relatively slower expansion in China, as they face increasing operational challenges at home.

**Figure 137: ICBC Is Still Considered the Main Bank, but the Landscape Is Looking More Competitive**



Source: Research International, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

**Figure 138: China Merchants Completed the Brand Emergence Phase, Has Made Significant Progress in the Transform & Proliferate Phase, but Remains Far from Approaching the Dominance Phase**

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Mortgage Growth

As Chinese consumers increase leverage, growth in mortgages should be a major source of upside potential for CMB. Home ownership currently is at 70% of the Chinese population. However, we believe that roughly 30% is public housing and that private home ownership is only 40% of the population. As living standards across the country improve, private home ownership should rise, leading to strong mortgage growth. Currently 50% of

home buyers make their purchases using all cash. We believe this could increase three- to four-fold over the next five to ten years (in-line with our expected increase in retail loans to GDP, to 30-40% in the long term from 10% currently).

### **Franchise Remains Solid and Should Be Best Positioned for a Recovery in the Private Sector in China**

CMB's strong franchise has supported balance-sheet growth that is superior to that of its peers, and we believe it should continue to do so. Retail deposits account for 40% of its deposit funding and have grown at a fast rate, enabling the bank's strong balance sheet expansion. The bank's strong retail franchise helps to secure better fee income momentum. This, along with limited currency risk, gives CMB extra edge in delivering growth, in our view. In the coming three years, we expect a robust macro growth environment to support a 28% CAGR in CMB's outstanding loans. CMB's focused retail banking strategy reflects a steady increase in retail deposits share.

### **Robust Fee Income Growth**

CMB also delivered consistently stronger fee income growth than its major peers. As the leading player in the credit card market, CMB has a fairly diversified fee income base. To a large degree, a favorable market environment has helped to drive up fees. The trends that we have repeatedly seen across Chinese banks are (1) stronger agency fees owing to the underwriting of corporate commercial papers since mid-2005, (2) the commencement of charging management fees on lower balance accounts that raise settlement fees and (3) an overall higher fund transfer volume thanks to the strong equity and property markets, and expectations of further renminbi appreciation.

## **Major Catalysts**

- **Deregulation.** Benchmark lending and deposit rates currently are mandated by the authorities in China. Our recent discussions with them did not give us any indication that liberalizing the rates is high on their agenda. Nevertheless, when banks will be allowed to set their own rates, this should typically lead to competition for the best-quality customers (and for cheaper transaction deposits), resulting in margin pressure for some time until a dynamic equilibrium is achieved again. Because CMB's competition in the consumer and mortgage markets is so low, we believe deregulation should be a positive for it. The bank should be able to differentiate itself more easily and to build a new market in private banking.
- **Increasing leverage.** On a loan-to-GDP basis, penetration of consumer and mortgage lending in China is low. This is owing to the high household savings rate and fairly nascent lending products in these segments. As China's economy matures, the driver will shift from investment to consumption. The government is making efforts to boost consumption and to reduce the tendency of its population to save. This should increase the proportion of consumer and mortgage loans, as seen in more developed markets. China has only 36% contribution from consumption compared with 55-60% on average for other Asian economies; including other emerging markets. This is the long-term story in China, and banks can participate by catering to the demand for consumer and mortgage loans, which will help mitigate the loss of market share on corporate lending to some extent. CMB should be a key beneficiary of this trend, given its focus on the consumer market.

## **Key Risks**

### **CMB's Continual Expansion in the Retail Banking Business Limits Room for Stricter Expense Control**

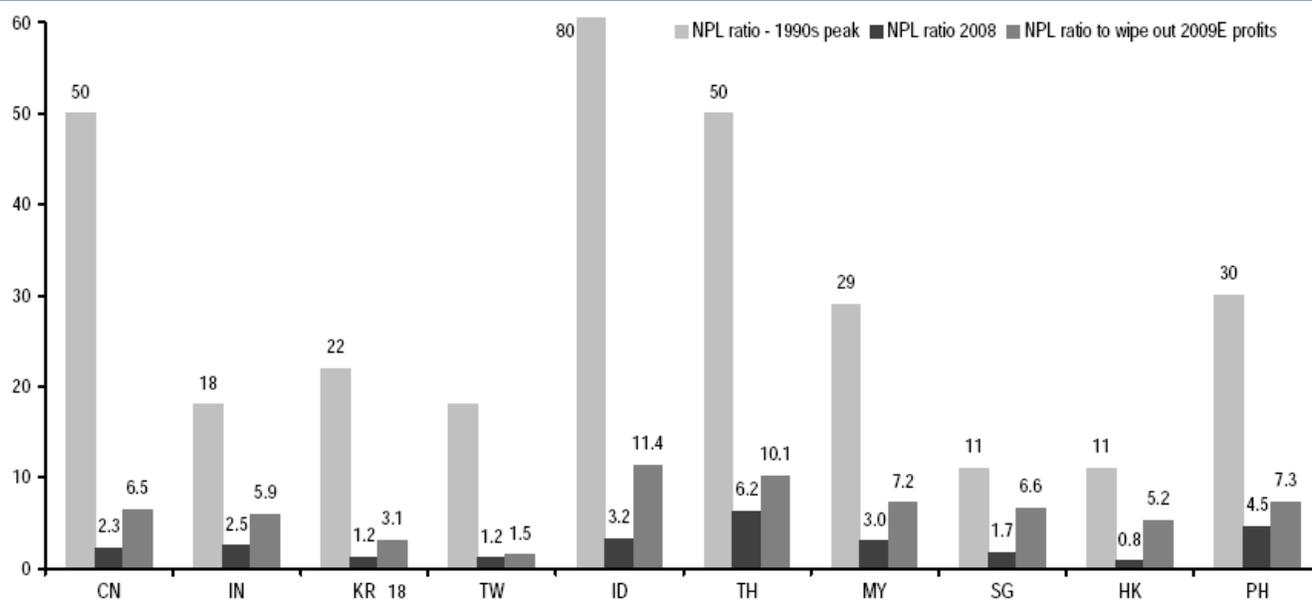
CMB, with its strategy to continue expanding branch network and investing in retail banking franchise, sees limited room for cost savings, particularly compared with other banks. However, this should be expected by the market.

The key risks from our perspective for Chinese banks are (1) asset quality problems arising from quick loan growth, (2) the effect on margins once the lending and deposit rates are liberalized, and (3) disintermediation.

### Rapid Credit Expansion

Scorching loan growth will most likely lead to some adverse selection of borrowers and asset quality issues with a lag, which is reflected in our banking pressure index (a leading indicator), and it is likely to become a problem in 2011 or later, once infrastructure projects come on stream. One more angle on asset quality: China has a fairly large cushion on rising nonperforming loans, given its superior profitability. Therefore, it needs the nonperforming loan ratio to rise to 6.5% (from 2.3% as of 2008) for 2009 profits to be wiped out. In our view, asset quality deterioration remains an earnings risk in China, not a capital or solvency risk, and even such an earnings risk is fairly small.

**Figure 139: Asian Banks: Nonperforming Loans Ratio Require to Wipe Out Profits (Percent of Loans)**



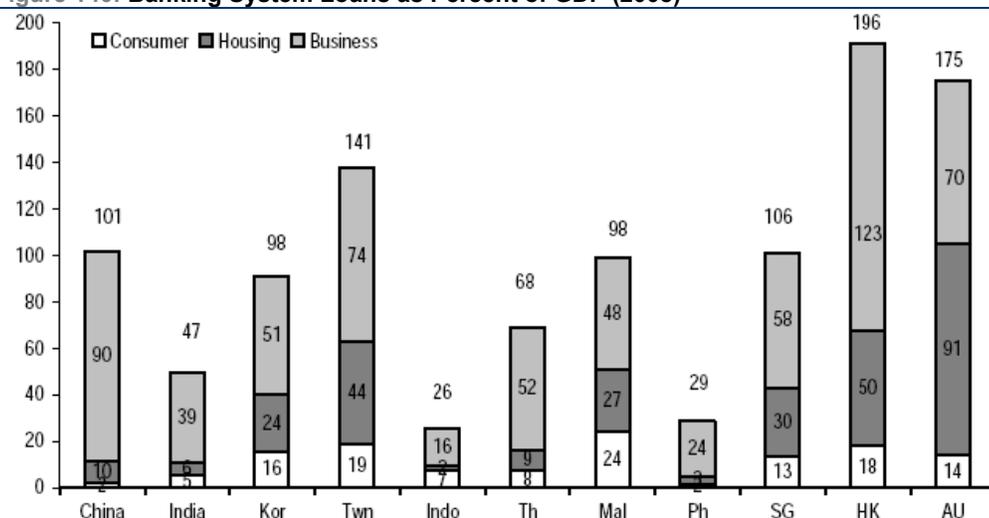
Source: Credit Suisse estimates (aggregated for CS Universe).

### Liberalization of Lending and Deposit Rates

Benchmark lending and deposit rates currently are mandated by the authorities in China. Our discussions with them did not give us any indication that liberalizing the rates is high on their agenda. Nevertheless, when banks will be allowed to set their own rates, this should lead to competition for the best-quality customers (and for cheaper transaction deposits), resulting in margin pressure until a dynamic equilibrium is again achieved. Smaller banks are likely to be squeezed more relative to the large banks. Independent market-driven rates would reveal the true credit risk management ability of banks, as they would need to learn to price risk properly.

### Disintermediation

China intends to develop capital markets as an alternative source of funding for borrowers and providing an alternative investment avenue for households, banks, and insurance companies. Loan penetration is not low in China, but most corporate funding (as of now) is being met by banks, but would lose some market share to the bond markets. We believe that the pace of loss of market share will depend on three factors: (1) progress in the development of bond market infrastructure, such as the legal framework, standardized documentation, the transparent mechanism for price discovery, and trading; (2) the emergence of quality players, including issuers that can obtain a good rating and investors with the ability to buy varying risks and tenors; and (3) intermediaries that can facilitate the structuring, issuance, syndication, and trading of bonds.

**Figure 140: Banking System Loans as Percent of GDP (2008)**

Source: CEIC, Credit Suisse estimates.

## Valuation

CMB currently trades at 15.5 times our 2010 EPS estimate and 3.0 times our 2010 book value estimate, with our 2010 return on equity estimate of 21.2%. We expect CMB's margin to improve through 2011 from the cyclical trough recorded in the second quarter of 2009, as the massive liquidity through aggressive monetary easing and fiscal stimulus suppressed yield and spreads. Therefore, return on equity in 2011 is likely to represent a normalized profitability in the midterm. Based on our 2011 return on equity estimate of 22.7%, our target price for CMB, based on Gordon growth model (cost of equity at 11.4%; risk-free rate at 4%, market risk premium at 6%, beta at 1.23, and terminal growth rate of 5%), is HK\$20.07, implying 2.77 times book value.

While we believe that CMB currently trades at the fair value based on the midterm profitability, the profitability is based on current business mix (retail loans account for 32% of total loans). Below we lay out our estimates of potential changes in return on equity if the retail banking business were to increase its share of its total business. Fair value should rise along with the increase of retail banking business.

**Figure 141: Dupont Analysis**

% to average assets	2009E	2010E	2011E (Share of Retail Banking Business)			
			Base (32%)	40%	50%	60%
Net interest income	2.21%	2.46%	2.65%	2.90%	3.00%	3.10%
Non-interest income	0.62%	0.59%	0.58%	0.67%	0.77%	0.87%
Total revenue	2.83%	3.05%	3.23%	3.57%	3.77%	3.97%
Operating expenses	-1.45%	-1.38%	-1.33%	-1.52%	-1.66%	-1.78%
Pre-provision profits	1.39%	1.67%	1.90%	2.05%	2.11%	2.18%
Provisions	-0.21%	-0.22%	-0.38%	-0.40%	-0.35%	-0.30%
Pretax profits	1.18%	1.45%	1.52%	1.65%	1.76%	1.88%
Tax	-0.25%	-0.32%	-0.33%	-0.33%	-0.33%	-0.33%
<b>ROAA</b>	<b>0.94%</b>	<b>1.13%</b>	<b>1.19%</b>	<b>1.32%</b>	<b>1.43%</b>	<b>1.55%</b>
Leverage (x)	21.5	20.6	19.1	19.1	19.1	19.1
<b>ROAE</b>	<b>20.1%</b>	<b>23.3%</b>	<b>22.7%</b>	<b>25.2%</b>	<b>27.2%</b>	<b>29.5%</b>

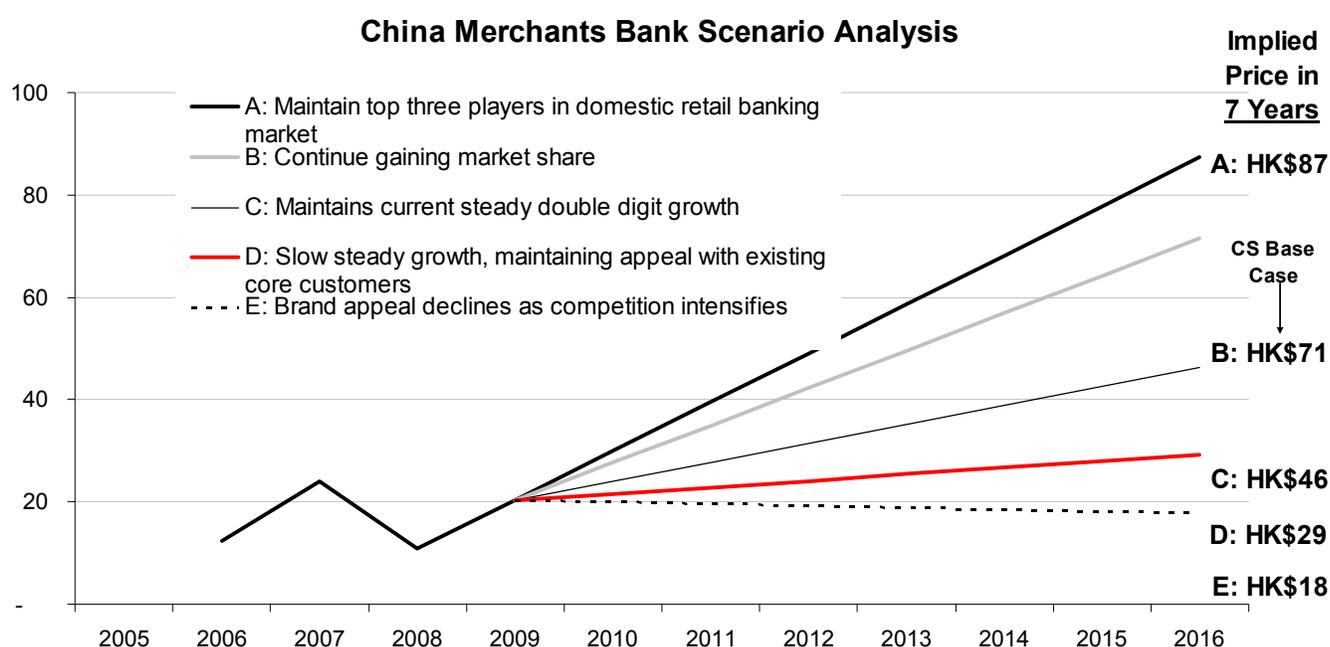
Source: Company data, Credit Suisse estimates.

**Figure 142: Target Value Based on Percent of Retail Banking Business**

	2011E (share of retail banking business)			
	Base (32%)	40%	50%	60%
<b>ROE</b>	<b>22.7%</b>	<b>25.2%</b>	<b>27.2%</b>	<b>29.5%</b>
COE	11.4%			
Rf	4%			
Rm	6%			
beta	1.23			
g	5%			
<b>Implied PBV</b>	<b>2.77</b>	<b>3.16</b>	<b>3.48</b>	<b>3.84</b>
<b>Target value (HK\$)</b>	<b>20.07</b>	<b>22.96</b>	<b>25.26</b>	<b>27.87</b>

Source: Company data, Credit Suisse estimates.

## Financial Statements and Comparable Valuation

**Figure 143: Current Stock Price Embeds Conservative Growth Expectations**

	2009E	2016 Scenario Analysis				
		A	B	C	D	E
CMB RWAs (Rmb bn)	1,174	7,367	5,598	4,207	3,123	2,288
Growth CAGR	-	30%	25%	20%	15%	10%
PPOP margin	2.14%	2.50%	2.40%	2.30%	2.20%	2.10%
Impairment charges	4	59	42	29	20	14
Tax rate	21%	21%	21%	21%	21%	21%
Sharecount	19	26	21	21	21	21
<b>EPS (Rmb)</b>	<b>0.89</b>	<b>3.85</b>	<b>3.50</b>	<b>2.55</b>	<b>1.83</b>	<b>1.30</b>
Growth CAGR	-	23%	22%	16%	11%	6%
P/E Multiple	18	20	18	16	14	12
<b>Implied Price, 2016E (HK\$)</b>		<b>87.3</b>	<b>71.5</b>	<b>46.3</b>	<b>29.1</b>	<b>17.7</b>
Implied 7-yr return CAGR		391%	302%	160%	64%	-1%
		26%	22%	15%	7%	0%

Source: Company data, Credit Suisse estimates.

Figure 144: China Merchants Comp Valuation

	Ticker	Ticker	Price (HK\$)	Market Cap (US\$m)	Deposits (FY10E) (Rmb bn)	Market Cap to Deposits	PPOP/Shr (FY10E) (Rmb)	BVPS		PB FY10E	ROE FY10E	EPS (Rmb)				P/E FY09	P/E FY10
								P/POP FY10E	(FY10E) (Rmb)			FY09E	FY10E	FY11E	FY12E		
<b>China Merchants Bank</b>	<b>3968.HK</b>	<b>3968.HK</b>	<b>17.80</b>	<b>\$49,827</b>	<b>2,028</b>	<b>16.8%</b>	<b>1.83</b>	<b>8.6</b>	<b>6.39</b>	<b>2.45</b>	<b>21.2%</b>	<b>0.89</b>	<b>1.24</b>	<b>1.57</b>	<b>1.94</b>	<b>17.7</b>	<b>10.0</b>
ICBC	1398.HK	1398.HK	5.48	\$267,998	11,537	15.9%	0.73	6.6	2.33	2.08	22.5%	0.40	0.49	0.53	0.57	12.1	9.1
China Construction Bank	0939.HK	0939.HK	5.86	\$192,779	9,322	14.1%	0.90	5.7	2.62	1.97	24.3%	0.48	0.61	0.67	0.72	10.7	7.7
Bank of China	3988.HK	3988.HK	3.67	\$136,397	7,593	12.3%	0.61	5.3	2.22	1.46	17.9%	0.33	0.38	0.41	0.42	9.9	7.8
Bank of Communications	3328.HK	3328.HK	7.52	\$53,944	2,909	12.7%	1.29	5.1	3.92	1.69	20.8%	0.56	0.76	0.87	0.95	11.8	7.6
China CITIC Bank	0998.HK	0998.HK	5.19	\$29,661	1,513	13.4%	0.83	5.5	3.17	1.44	17.1%	0.40	0.51	0.56	0.62	11.6	8.1
China Minsheng Banking Corp.	1988.HK	1988.HK	7.64	\$24,902	1,374	12.4%	1.07	6.3	4.36	1.54	14.4%	0.54	0.60	0.67	0.73	12.4	10.1
Average						13.9%		6.2		1.80	19.7%					12.3	8.6

Source: Company data, Credit Suisse estimates.

# Commercial Aircraft Corporation of China, Ltd (COMAC; Private): A Threat to the Boeing/Airbus Duopoly

Exhibit 145: COMAC's C919



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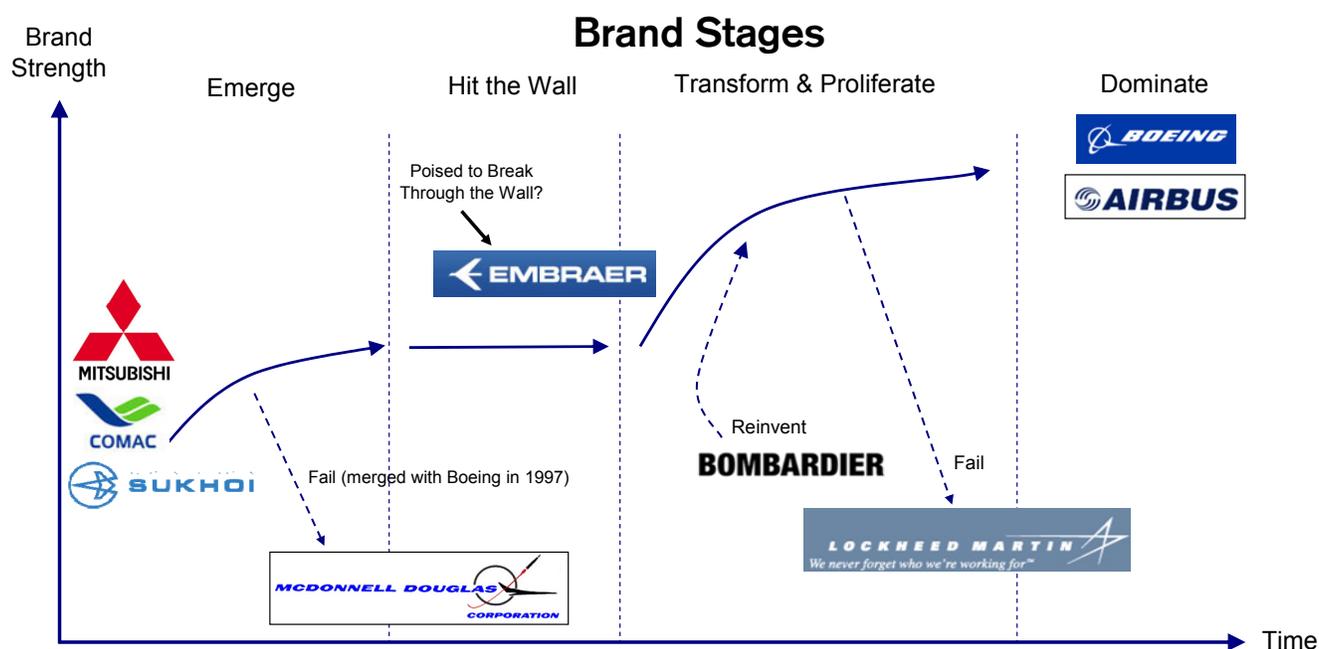
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Source: Flightglobal.

## Investment Summary

- Unique Brand Story.** Commercial Aircraft Corporation of China, Limited (COMAC) is a government-backed aerospace manufacturer established in 2008. COMAC is entering the competitive narrowbody market, intending to target the Boeing 737 and Airbus A320, to bring market penetration to China to become competitive on a domestic front. COMAC aims to work directly with overseas suppliers to attain engines, parts, and avionic systems at more competitive price points.
- Brand Opportunity.** The C919 represents China's attempt to break into the highest volume segment of the large commercial jet market and split the Boeing (BA) and Airbus duopoly. China has the second largest civil aviation market in the world, after the United States. The country's fleet comprises nearly 1,200 aircraft and is rapidly growing.
- Market Perception.** The market and COMAC's competitors are not dismissing China's plans to enter the narrowbody aircraft market. Boeing and Airbus are expected to re-engine the B737 and A320 to satisfy the requests of customers for progressively more fuel-efficient aircraft. The C919 is being designed and constructed completely in China; COMAC projects approximately 2,000 of the aircraft will be constructed over the next 20 years. According to Safran (SAF.PA), assuming COMAC can live up to its plans, it has the chance to acquire a 10% share of the market.

## Exhibit 146: Large Jet Industry Competitive Brandscape



Source: Company data, Credit Suisse estimates.

## Brand Overview

The C919 program is being spearheaded by COMAC and is developed and designed as China's attempt to build a narrowbody aircraft to compete with BA and Airbus. The government-backed aerospace manufacturer was established in 2008 to strengthen China as an aircraft manufacturer. Similar to the origins of Airbus four decades ago, COMAC is backed by the domestic government, including the Shanghai municipal government and the Chinese government. However, unlike Airbus then, COMAC was not established through relationships with companies that possessed ample experience designing and developing commercial aircraft.

### COMAC's First Aircraft

COMAC's first (and current) aircraft attempt is the ARJ-21, a twin engine regional airliner that began development in March 2002. The ARJ-21 is expected to be delivered to customers in late 2010, six months later than the targeted time table at the time of its first flight in November 2008. The two years of flight testing will extend the development period to eight years, the same period COMAC anticipates for the C919. The government-led consortium plans to manufacture 11 ARJ-21 aircraft in 2010 and projects to manufacture 30 per year by 2015. There are those that believe COMAC lacks the reputation needed to be a dominant player. With the ARJ-21 still in testing, COMAC has no track record to demonstrate its commitment to quality, reliability, and safety. However, the development and manufacturing of the ARJ-21 should provide valuable lessons for the C919.

### The C919 Aircraft

The C919 represents China's attempt to break into the highest-volume segment of the large commercial jet market and split the BA and Airbus duopoly. Plans to launch the C919 began with a development phase that started in March 2003. The C919 program was approved in March 2007 and COMAC was established in May 2008. China has a developmental budget of US\$4.5 billion for the C919 through the domestic government consortium. The possibility exists for the government to step in and subsidize the aircraft to establish the country's position in the global industry. This would allow COMAC to deliver significantly lower prices to its customers and gain market share from BA and

Airbus. However, it must be noted neither the ARJ-21 nor the C919 complies with the 1992 U.S.-European Union pact limiting government subsidies. This may bring about trade dispute issues when marketed to other portions of the world, as it has been a long-standing controversy between BA and Airbus. Government subsidies have led to unfair pricing power and competition concerns.

**Exhibit 147: Bull and Bear Case for the COMAC C919**



<b>C919 Bull Case</b>	<b>C919 Bear Case</b>
<ul style="list-style-type: none"> <li>• Development budget of \$4.5 billion and backed by the government of China; government owns most of the airlines and will probably order them to buy the C919</li> <li>• GE and Snecma will provide engine and nacelle - world's first integrated propulsion system with advanced inlet configuration - traditionally designed separately, this is the first time both are designed by one team</li> <li>• Construction of final-assembly plant is underway and is expected to open in 2012; will become the main manufacturing base for the C919</li> <li>• Boeing projects air travel in China will experience the most robust growth out of any market, growing annually at 6.9% through 2028 (world average is 4.9%); China has the 2nd largest aviation market after the U.S. and is comprised of ~1,200 planes</li> </ul>	<ul style="list-style-type: none"> <li>• COMAC has never delivered a single airliner and is still struggling with the slow development of its prior undertaking, the ARJ21 (launched in 2006, aims to deliver in 2010)</li> <li>• First engine to test in early 2013; COMAC is projecting the first flight in 2014, if there are issues with the engine this could be pushed back significantly</li> <li>• China is providing domestic manufacturers priority in supplying products to COMAC; however due to low-tech practices, domestically China can only supply 25% of parts needed for C919</li> <li>• COMAC is turning to new, lightweight carbon composites in place of steel for the plane's construction to gain the 12% to 15% in fuel efficiency however, Boeing has had difficulty in bringing its first composite plane, the 787 Dreamliner, to market and test flights have been repeatedly canceled with delays coming from structural flaws</li> </ul>

Source: Company data, Credit Suisse estimates.

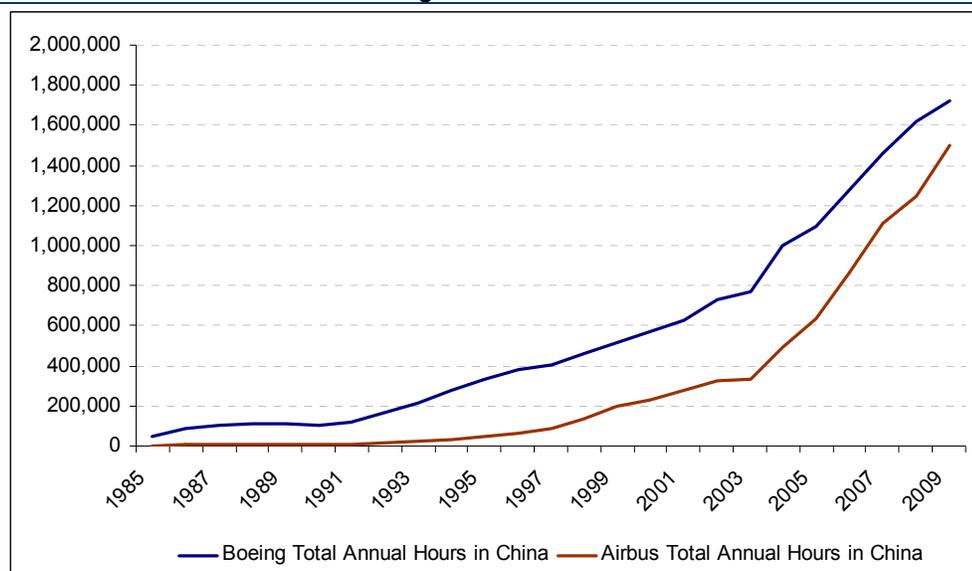
China has the second largest civil aviation market in the world after the United States. The country's fleet comprises nearly 1,200 aircraft and is rapidly growing. BA forecasts that the country will need 3,770 narrowbody aircraft for domestic routes over the next 20 years. At current list prices, this equates to \$400 billion worth of aircraft. On a global front, BA places the 20-year demand for narrowbody aircraft, such as the C919, Airbus A320 and Boeing 737, at nearly 19,500 platforms, translating to a value of \$1.4 trillion.

In 2008, BA and Airbus delivered 676 single-aisle aircraft compared with 182 twin-aisle ones. At the Singapore Air Show in February 2010, COMAC announced it is seeking to

acquire 100 orders of the C919 in 2010. COMAC expects to attain the orders from domestic customers, according to Yuan Wenfeng, the deputy general manager at COMAC. COMAC expects to complete the first preliminary design of the aircraft by year-end 2010. Furthermore, airlines tend to purchase the same fleet of planes for life-cycle, overhaul, servicing, and retrofitting purposes, eliminating the need for many carriers to switch to the C919 in the near future, as they have already locked in deliveries.

As shown in Exhibit 148, we believe aircraft utilization (hours and cycles) will continue to grow and will create ample opportunity for COMAC to build a domestic platform to succeed.

**Exhibit 148: BA and Airbus Annual Flight Hours in China**



Source: Company data, Ascend.

It is clear that history may be repeating itself with the competitive threat of the C919. The 1986 Northwest Airlines order for 100 A320 aircraft changed the aircraft manufacturer game, as competition between BA and Airbus intensified. Airbus' presence in the U.S. market became prevalent; we see COMAC attempting to follow in the footsteps of Airbus.

**Exhibit 149: The C919**



Source: Flightglobal.

### Will COMAC Follow the Airbus Example?

In 1973, the large jet market consisted of three players—BA (58% market share), McDonnell Douglas (29% market share), and Lockheed (LMT) (13% market share). Then Airbus, a consortium of European aviation companies, came together in an effort to compete with the United States. Similar to the COMAC story, Airbus was originally formed by a government initiative by Germany, France, and the United Kingdom to develop an aircraft so that the region would not be reliant on international aircraft manufacturers.

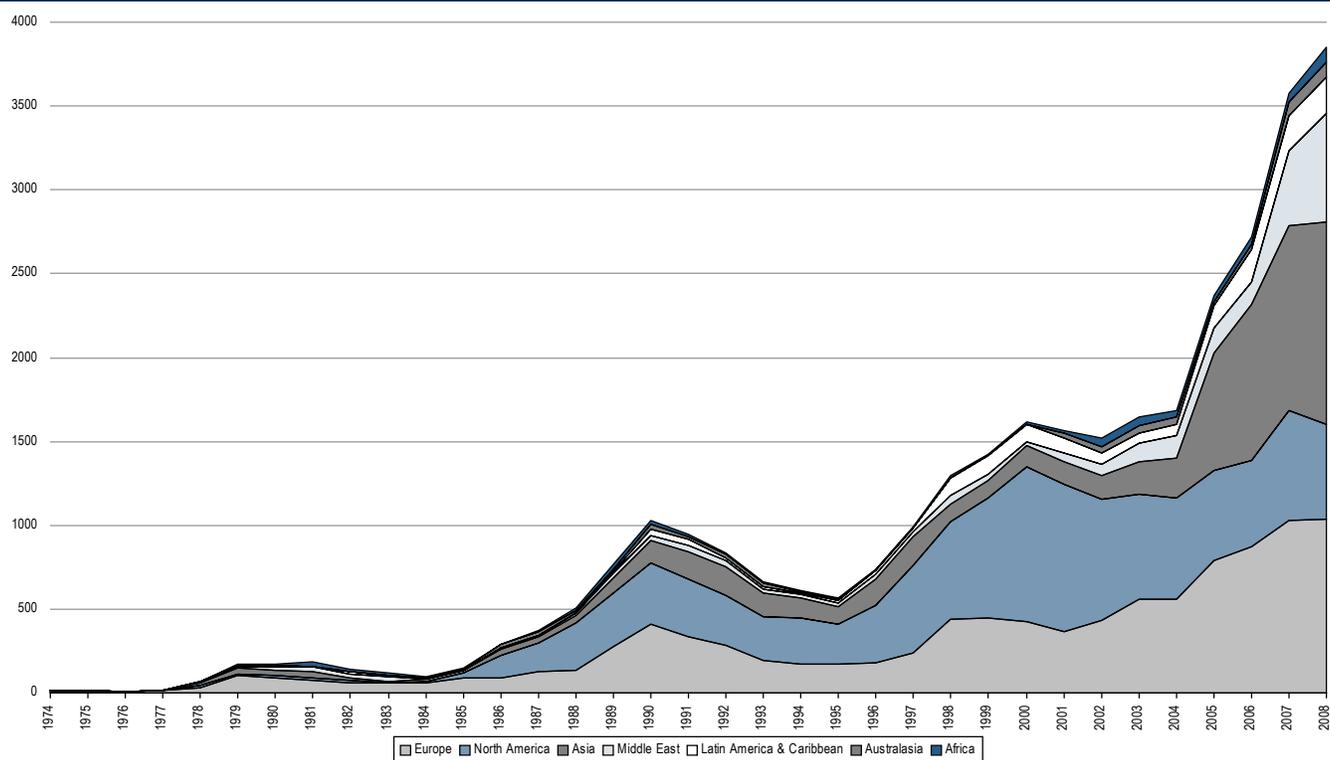
Airbus saw an opportunity to create an aircraft to compete with U.S. players by utilizing European suppliers and developers.

Airbus' first aircraft was the A300, twin-engined aircraft. France manufactured the flight control, cockpit and fuselage section, while Germany made the spoilers and flaps, and Spain produced the horizontal tailplane, although at the time Spain was not a full partner. Rolls Royce (RR.L) manufactured the engines, but suffered difficulties and delays in getting off the ground. The entire process spanned seven years, with the signing of a memorandum of understanding in 1967, the first flight of the A300 in 1972, and the aircraft entering service in 1974.

The A300's success initially was poor, as Airbus did not have a dominant name in the market and was a newcomer to an already established industry with high barriers to entry. Airbus went on a robust marketing campaign, targeting airlines in the United States and Asia. By 1979, Airbus had acquired 256 orders for A300s and was in the process of launching the more advanced A310. Airbus sealed its presence as a competitive aircraft manufacturer that posed a threat to its U.S. rivals in 1981 with the launch of the A320.

Prior to the first flight of the A320, the aircraft had over 400 orders versus 15 orders for the A300 in 1972. Airbus built its market share to 50% today from 1.5% of large aircraft (greater than 100 seats) deliveries in 1974 in its duopoly with BA. Airbus is constantly in competition with BA for aircraft orders. Assuming COMAC experiences a similar background from inception to global recognition, we believe it will take at least a decade for the C919 to become a competitive market player among large aircraft manufacturers.

**Exhibit 150: Airbus Backlog by Region**  
number of aircraft (LHS)



Source: Ascend.

### Airbus and BA Backlogs for Chinese Airlines

Exhibit 151 shows the current BA and Airbus backlog attributable to Chinese airlines. Chinese airlines currently account for 625 aircraft in the backlog, which represents 9.1% of the total backlog. Almost 80% of the backlog attributable to Chinese airlines is for narrowbody aircraft, the portion of the market that the C919 will be attacking.

**Exhibit 151: BA and Airbus Backlog for Chinese Airlines***number of aircraft*

Operator	737 (NG)	777	787	A319	A320	A321	A330	A380	Total
AerDragon Aviation Partners					8				8
Air China	43	15	15		22	10	21		126
China Aviation Supplies					98				98
China Cargo Airlines		6							6
China Eastern Airlines	8		15		46				69
China Southern Airlines	57	6	10		19	17	10	5	124
Deer Air				1					1
Hainan Airlines	14		8	10	13		7		52
Juneyao Airlines					8				8
Shandong Airlines	3								3
Shanghai Airlines	3		9			8			20
Shenzhen Airlines					31				31
Sichuan Airlines				2	10	5	6		23
Spring Airlines					7				7
Xiamen Airlines	49								49
<b>Grand Total</b>	<b>177</b>	<b>27</b>	<b>57</b>	<b>13</b>	<b>262</b>	<b>40</b>	<b>44</b>	<b>5</b>	<b>625</b>

Source: Ascend.

## Brand Development State: Emerging

**Exhibit 152: As China Remains in Planning stages For C919, the Brand Is Emerging, but We Believe It Will Have Strong Customer Base from China****Checklist to Emerge:**

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

**Checklist to Transform & Proliferate:**

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

**Checklist to Dominate:**

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

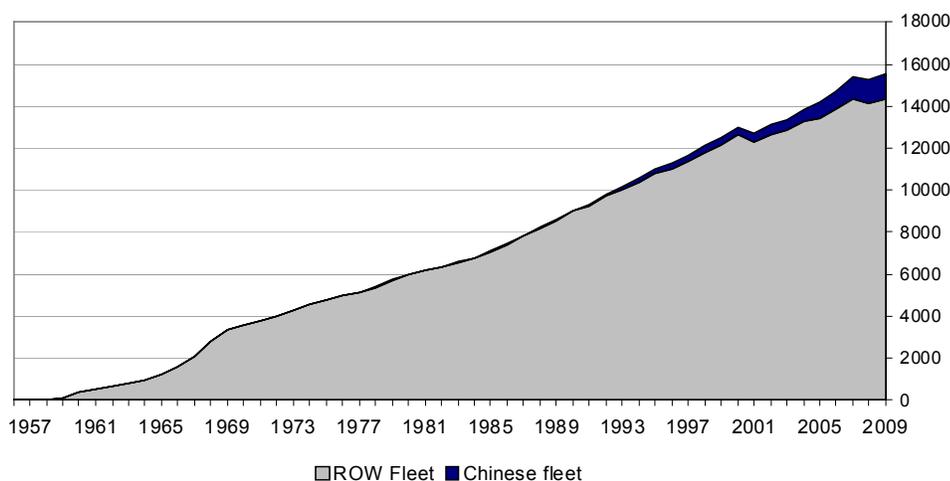
## Growth Strategies & Opportunities

**Strength and Opportunity in the Chinese Market**

Despite the global nature of the industry, a captive marketplace is key to the successful launch of a new product, to stimulate initial demand and to establish a fleet with sufficient critical mass to hone the support infrastructure.

What is good for China is that the captive market is sizeable. Over the past 20 years, Chinese airlines have ordered a rising portion of the industry's annual deliveries. The Chinese fleet currently numbers 1,264 large jets, or 8.8% of the 15,575 in the active (nonstored) fleet. Furthermore, Chinese aircraft orders have been increasing as a percentage of the total, as shown in Exhibit 153.

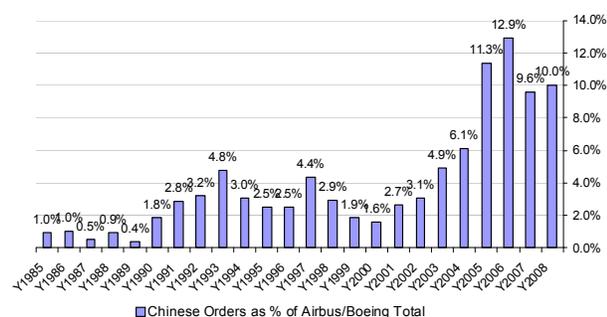
**Exhibit 153: Global Fleet, Separating China and Rest of World (1956–Present)**



Source: Ascend, Credit Suisse estimates.

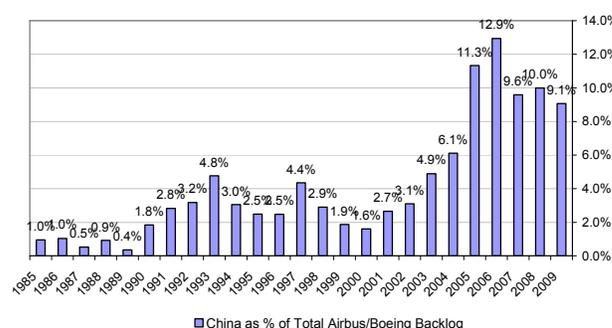
China currently has 1,054 single-aisle aircraft in its fleet, and another 489 units on order, with 64% of these from the Airbus A320 family. Airbus established a production line in China to attract orders. In recent years, industrial cooperation has become a necessary means to close marketing relationships. Given the sizeable backlog, we expect that China will receive roughly 100 deliveries of Airbus and BA aircraft (combined) for each of the next few years.

**Exhibit 154: China Aircraft Orders, Percent of Global Total**



Source: Company data, Credit Suisse estimates.

**Exhibit 155: China Aircraft Backlog, Percent of Global Total**



Source: Company data, Credit Suisse estimates.

We can envision a scenario in which this market is split into thirds rather than halves, with the C919 taking the third spot. Sticking with the 100-unit per annum quantity, it would be some time before COMAC would be able to exceed deliveries of 33 units per year.

Therefore, the Chinese market should supply more than enough demand to launch successfully the C919 and fill the first several years of production slots without eliminating Airbus and BA from the market. In the long term, a different scenario could arise if Chinese airlines begin to seek commonality with the 919. Still, China will want to export the aircraft as soon as possible and establish itself as a true global supplier in this market. Therefore, some capacity will be diverted to export sales as soon as the market becomes interested in the aircraft.

**China's Growing Role in Aviation**

As previously mentioned, industrial cooperation between China, BA, and Airbus has allowed BA and Airbus to gain market share in China, while bringing a piece of the

production process to Chinese suppliers. Chinese companies have been suppliers to BA and Airbus, allowing the companies access to lower labor and structural costs while giving the suppliers exposure to aircraft technology and innovation.

In 1999, Airbus surpassed BA for the first time in the number of orders. BA responded by partnering with East Asia; by outsourcing a portion of the production and design to East Asia, BA was rewarded with a number of contracts for new aircrafts.

Airbus chose a different strategy and kept its manufacturing in house. However, the company was forced to revisit this strategy when it struggled to gain incremental sales in Asia. In late 2005, Airbus reversed its tactic and implemented a requirement that major suppliers outsource a portion of work to Asian countries as part of its *global action plan*. As a result of this action plan, China and Airbus agreed to establish an assembly line in China. With this agreement (of which BA has a similar agreement with Japanese industrial companies), the incumbent companies virtually handed over much of the knowledge and tools to their suppliers.

On June 23, 2009, the first A320 was assembled in China. At that time, Airbus made up 40% of the Chinese aviation market, a market experiencing double digit growth. The notion that China would remain content in its role as only a supplier to such a large growth market has been short lived.

#### **A Potential Threat to the A320 and B737?**

The introduction of the C919 to the marketplace could have a potentially detrimental impact on BA and Airbus. At the minimum, we expect the Chinese market for BA and Airbus narrowbody aircraft demand to eventually lose steam. According to Airbus' 20-year outlook, this market represents 13.1% of demand for large aircraft. We expect China to build a competitive product that can be sold globally, especially if it finds viable partners and suppliers, which we see China experiencing no issue with as it becomes a major aircraft player around the world. COMAC expects to announce launch customers in the first half of 2010; we see this as a negative catalyst for BA and Airbus.

BA and Airbus are not dismissive of China's plans to enter into the competition for narrowbody aircraft. Airbus noted the market is filled with unexpected difficulties and delays and believes for China to achieve its goal of being a global aviation player it will take more than a decade based on precedent.

BA and Airbus will also undergo the possibility of re-engining to remain competitive with the development of the C919. According to Air Insight, a 2010 re-engining of the A320 and Boeing 737 is virtually a certainty, as the two manufactures must take on a potentially higher capacity aircraft in the C919. As a result of the impending re-engining, BA's and Airbus' market share in the 100-200 seat category market, which currently is at 88%, could fall to as low as 40% in competition with new aircraft manufacturers. BA believes a re-engined 737 would cost 20-30% of a full development product. BA and Airbus will take steps to begin re-engining soon as COMAC projects the first flight of the C919 will occur in 2014, with deliveries expected in 2016. The C919 is being completely designed and constructed in China and COMAC projects approximately 2,000 of the aircraft will be constructed over the next 20 years. According to SAF, assuming COMAC can live up to its plans, it has the chance to acquire a 10% share of the market.

The C919 competes with the Airbus A320 and Boeing 737 for market share as summarized in Exhibit 156.

**Exhibit 156: Narrowbody Aircraft Comparison**

Aircraft	Aircraft Manufacturer	Seating Capacity	Range	Engine Manufacturer	Orders	Variants
<b>C919</b>	<b>COMAC</b>	<b>168-190 passengers</b>	<b>2,200 to 3,000 nautical miles</b>	<b>Safran Group and GE Aircraft Engines</b>	<b>100 <sup>(1)</sup></b>	<b>Smaller (130 seat) and Larger (190 seat)</b>
A320	Airbus	150 passengers	2,900 nautical miles	CFM International and International Aero Engines	159	A320-100, A320-200
B737	Boeing	85-189 passengers	1,540 to 5,510 nautical miles	Pratt & Whitney JT8D, CFM International 56-3 and 56-7 Series	2,063	Nine variants with the -600, -700, -800 and -900 currently in production

(1) Per COMAC's Deputy General Manager of Program Management, Yuan Wenfeng, COMAC expects to receive approximately 100 orders for the C919 by the end of calendar year 2010 and expects most contracts to come from Chinese (domestic) customers.

Source: Company estimates.

**Engine Platform Awarded and Suppliers Selected**

COMAC awarded Snecma (Safran SA), the General Electric (GE) venture, a \$10 billion deal to supply engines for the C919 in December 2009. The 50/50 joint venture between Snecma and GE is the world's largest commercial aircraft engine manufacturer and is currently the sole western supplier for the C919. The two renewed their partnership in 2008 through 2040. The CFM LEAP-X engine will power the C919 and will provide the GE the opportunity to partner with COMAC and to gain significant moment and market share in the Chinese aircraft market. The partnership won over other engine suppliers, including RR and Pratt & Whitney.

According to CFM, the LEAP-X1 will run on 16% less fuel and have 16% fewer CO2 emissions than other CFM engines. The Chinese have chosen a complete integrated propulsion system for the C919. The LEAP-X was formally announced in 2008 and has a new centerline engine that will enhance overall performance and capability. CFM will continue development in 2010 and currently is in its second phase of testing. CFM plans to conduct full-scale endurance testing on the resin transfer molding composite fan with the first full engine going into test in early 2013. The engine will be provided in partnership with Nexcelle, the nacelle and thrust reverser and will form a complete integrated propulsion system solution for the Chinese. Nexcelle was formed in 2008 as a 50/50 joint venture between GE's Middle River Aircraft Systems and SAF's Aircelle.

Ron Klapproth, the program manager for the LEAP-X, claimed the integrated propulsion system for China's C919 will represent "a new frontier for the industry." The engine and nacelle usually have been designed separately. Designing these together will bring about improvements including weight, noise, and fuel burn. Along with these added incentives, COMAC believes it can ultimately bring the C919 down in price level than the \$50 million range that BA and Airbus charge for their planes.

COMAC has stated domestic manufacturers will have priority in supplying products for the C919. COMAC will only send request for proposals to international suppliers when the parts or components cannot be manufactured by domestic players. Owing to the country's low-tech history and background, it is believed domestic producers can only supply 25% of the parts and components needed for the C919. While this development is potentially a major negative for the aircraft suppliers and manufacturers, it may be a positive for Western suppliers that have key technologies that the Chinese are not yet capable of supplying, most notably engines and avionics.

**Major Catalysts**

While we believe that COMAC has been somewhat aggressive in its time line, the following are key dates to which the company has pointed.

- 2010: COMAC is hoping to acquire 100 orders of the C919 during 2010
- End of 2010: first preliminary design of the C919 is expected to be complete
- 2014: first flight

- 2016: entry into service
- By 2030, COMAC expects to build about 2,000 C919s

## Key Risks

### Aggressive Time Line

One of the largest risks that we currently see to the C919 lies in the aggressive time line that COMAC has set. Launching the new aircraft in 2016 is an ambitious schedule, and we believe that this time line might be compromised if COMAC were to encounter unexpected obstacles. In recent years, BA and Airbus have encountered problems launching new aircraft, in the B787 and A380, respectively.

### Use of Carbon Composite

COMAC is turning to new, lightweight carbon composites in place of steel for the plane's construction to gain the 12-15% in fuel efficiency improvement. However, BA has had difficulty in bringing its first composite plane, the 787 Dreamliner, to market and test flights have been repeatedly delayed by structural flaws. BA finally flew the 787 for the first time on December 15, 2009.

### Customer Market

While the biggest struggle for newcomers in the aircraft market has been early adoption, as proving its success and safety will take time, we do not expect this to be a problem for the C919, as we expect the government will place orders and likely allocate them to state-owned carriers such as Air China, China Southern, and China Eastern Airlines.

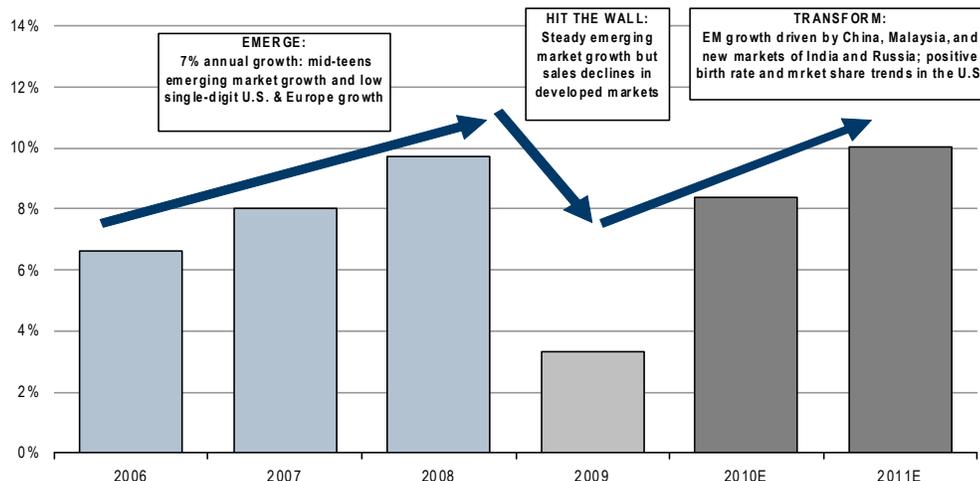
### Capital Commitment

The necessary capital that is required for a new aircraft to launch is immense; however, we believe that the Chinese government will support this venture through the finish line, making it less of a risk for the C919.

# Enfamil: A Brand That Translates to Any Language

Enfamil is a brand within Mead Johnson Nutrition Co. (MJN)

Exhibit 157: MJN Sales Growth History (Excluding Currency)



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story – Global Growth Opportunity.** Mead Johnson Nutrition Co. (MJN) with its flagship Enfamil brand has the highest exposure to the rapid growth emerging markets in Asia and Latin America of any U.S. food brand making it the best long-term growth story in the package food group. Sales in MJN's emerging markets were up double digits in the midst of the global economic recession of 2009, which we believe can accelerate in coming years as the global economy rebounds, MJN continues to grow distribution, and enters new markets. The crown jewel is MJN's China business, which accounts for 14% of company sales and has been growing 20-30% for the past decade. We expect this rate to continue, as MJN has expanded into 109 new cities in China in the past year, helping MJN accelerate growth in the coming years.
- Expansion Opportunity into New Markets.** While MJN has the highest emerging market exposure of any company that we follow, there are a few large and growing markets for MJN to add to its territory. The most important opportunities are Russia and India, where MJN recently started to make inroads. Both of these countries have specific cultural and distribution challenges, but we are confident that MJN will be able to leverage the great success it has had in China, Malaysia, and Mexico in these countries as well.
- Rebounding U.S. Business.** The pronounced consumer weakness in the U.S. and a key new product innovation by a competitor caught MJN flat footed in 2009; sales declined and MJN lost market share in the United States. MJN has fought back with a new product of its own, Enfamil Premium, and increased direct-to-consumer marketing in the past months—market share losses and sales trends are improving. Enfamil still resonates with consumers, and we expect only slight market share losses in the first

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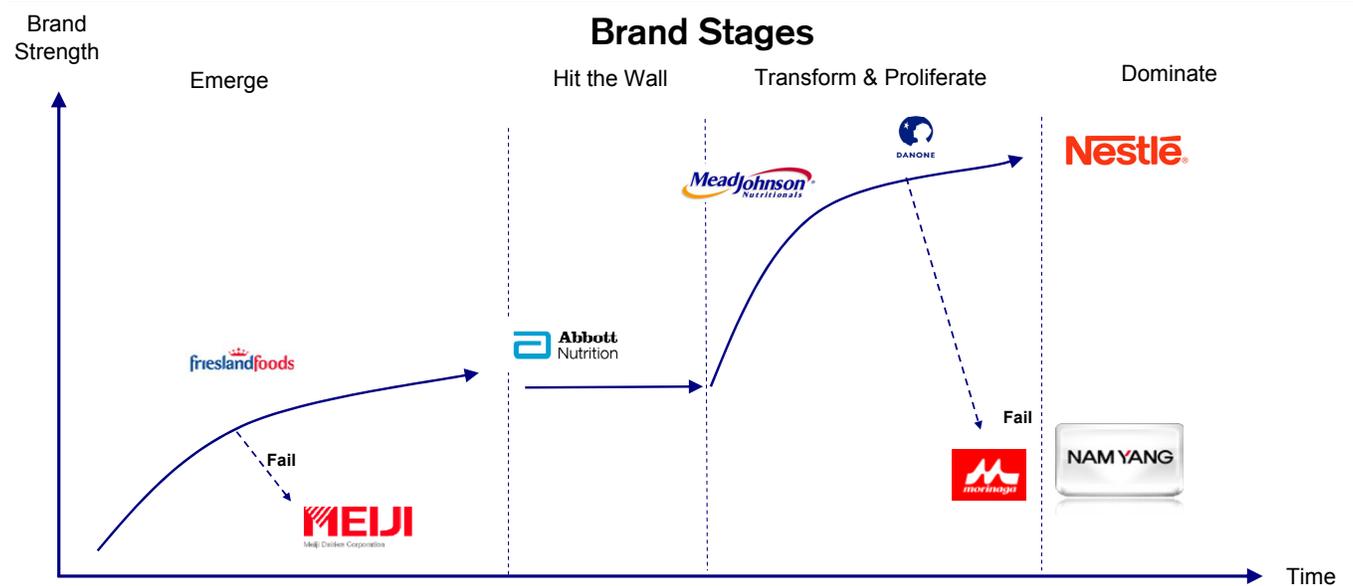
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quarter of 2010 and market share gains by the second half of 2010. We see signs of a bottom of U.S. birth rates likely owing to improved consumer sentiment and look to turn positive in 2010.

- **Valuation.** MJN trades at a 25% premium to the packaged food group based on our 2010 EPS estimate of \$2.45. We believe the high sales growth and margins warrants such a valuation premium.

#### Exhibit 158: Global Pediatric Nutrition Competitive Brandscape



Source: Company data, Credit Suisse estimates.

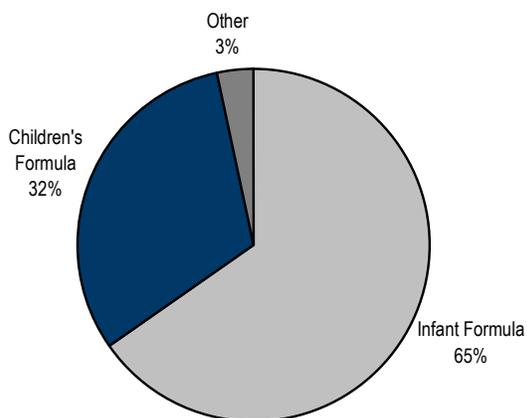
## Brand Overview

MJN was founded in 1905 and released its first product, Dextri-Maltrose, in 1911. Dextri-Maltrose was the first clinically supported and physician-recommended infant formula in the United States. In 1959, MJN developed Enfamil, which was the company's first product modeled after the nutritional structure of breast milk. MJN was acquired in 1967 by Bristol-Myers Squibb (BMY) and was taken public in February 2009.

**Appetite for growth.** MJN's historical approach to geographic expansion has been conservative and disciplined. Rather than entering a region with the entire product portfolio in every major city, MJN makes inroads in just a few markets with a limited product portfolio. MJN expanded into India and additional cities in China and Russia in 2008 using a similar approach. While under the umbrella of BMY, MJN was forced to adopt the conservative expansion approach of its parent. This ensures that losses are minimal in the first few years (\$1-2 million) and breakeven is reached within three to five years.

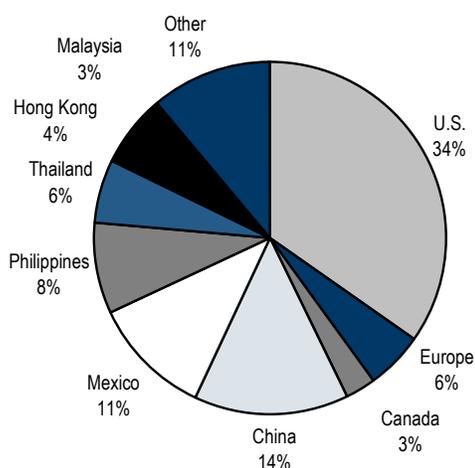
MJN hopes to be more aggressive in its expansion plans to ratchet up growth. We believe MJN could be successful with a more aggressive approach to expansion. MJN's long history of successful geographic expansion and experience analyzing the demographic profile of a country or region will help to ensure the company will enter geographies for which the return potential is high and with products that fit the market.

**Exhibit 159: MJN Business Mix 2009**



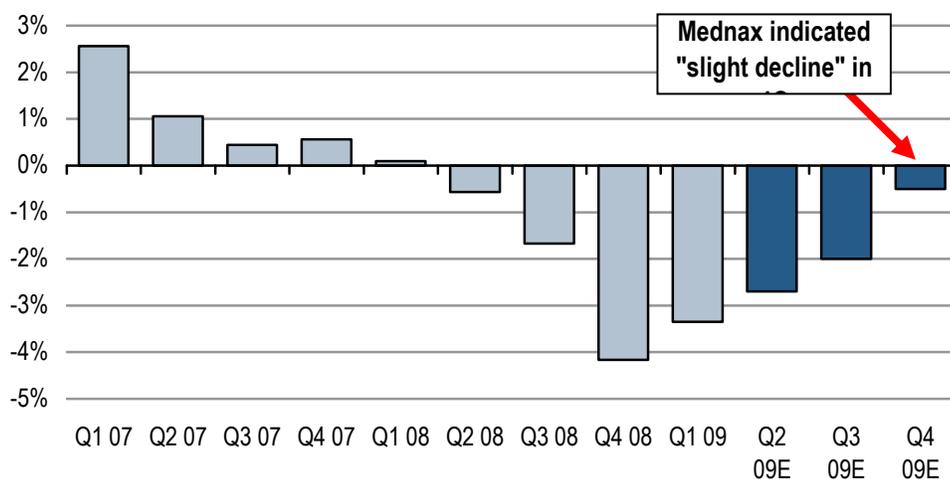
Source: Company data, Credit Suisse estimates.

**Exhibit 160: MJN Geographic Mix 2009**



Source: Company data, Credit Suisse estimates.

**Exhibit 161: U.S. Birth Rate Trends Showing Signs of Improvement**



Source: Company data, Credit Suisse estimates.

## Brand Development State: Transform and Proliferate

MJN has shown how to take a Western brand that is synonymous with quality and innovation and translate it to new and growing foreign markets. The Enfamil brand is already in many key markets such as China, Mexico, and Brazil, but MJN is far from capturing the full distribution opportunity with which it is presented and has the ability to take its extensive demographic and cultural knowledge into its key new opportunities of India and Russia.

## **Exhibit 162: MJN Needs to Continue to Expand Distribution in Its Current Markets in Asia and Latin America and Expand into New Fast-Growing Emerging Markets in Which It Does Not Have Presence, Specifically India and Russia**

### **Checklist to Emerge:**

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### **Checklist to Transform & Proliferate:**

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### **Checklist to Dominate:**

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## **Growth Strategies & Opportunities**

### **New U.S. Management Structure and Marketing Investments**

After a poor 2009, MJN management reorganized its North America segment, with a new head of U.S. operations and a new head of the U.S. salesforce. Both of these managers are from outside of the company and draw from experience at preeminent consumer products companies. MJN is increasing its market spending in the United States and diverting some of its spending from the healthcare professional channel to direct-to-consumer marketing, such as the Internet and television. This will be the first time that MJN has used television to market Enfamil in the United States.

### **China's One Child Policy a Long-term Opportunity**

The Chinese government's choice of slowing population growth through its one child policy amplifies the importance of the financial success of that child and the income available for pediatric nutrition products. In many households across China, two parents and two grandparents funnel their income down to just one child increasing the spending power of the parents. In addition, Chinese parents use every resource at their disposal to give their child the most advantages early in life, including infant formula, which is proven to improve brain and eye development.

### **Entry into India and Russia**

We are a few years from seeing a positive impact from the company's recent inroads into India and Russia, but we believe that there are significant opportunities in both of these markets. While Russia and India are very large markets, they have significant room to grow consumption. The average U.S. child consumes about 105 pounds of formula per year, while children in India and Russia consume only 11 and 30 pounds per year, respectively. As the middle class and incomes in India and Russia grow, formula consumption will as well.

Exhibit 163: Key Birth and Consumption Fundamentals

	2009E Births (millions)	Per Capita Consumption (lbs per year)
<b>U.S.</b>	<b>4.3</b>	<b>106</b>
<b>China</b>	<b>18.5</b>	<b>26</b>
<b>India</b>	<b>25.1</b>	<b>11</b>
Indonesia	4.5	48
Philippines	2.5	46
Malaysia	0.6	60
France	0.8	95
Spain	0.4	100
<b>Russia</b>	<b>1.6</b>	<b>30</b>

Source: U.S. Census Bureau.

## Major Catalysts

We believe the three key catalysts for MJN over the next five years are the following.

- Bottoming of U.S. formula market and MJN's market share.** The U.S. infant formula market has been surprisingly weak during the economic recession of 2008-09 with midsingle digit declines in the U.S. birth rate and in infant formula consumption. In recent months, we have heard positive commentary from prenatal and newborn healthcare provider, Mednax, of improving birth trends in the company's hospitals, giving us confidence that formula consumption will improve in 2010. MJN's sales were especially weak in 2010, as they were out innovated by their main competitor in the U.S., Abbott (ABT), which released a key new product featuring probiotics on which MJN was also working. MJN's internal market share metrics continue to show market share losses, but at an improving rate on the back of its new product "Enfamil Premium" in late-2009.
- Positive contribution from new territories.** In late 2008/early 2009, MJN started to lay the groundwork for operations in India and Russia. MJN management sees these two countries as the most important expansion opportunities for the future. While under the BMY umbrella, MJN was forced to take a conservative approach entering new markets, often taking six to seven years before making an impact. As an independent company, management intends on leveraging the insights gained from China, Mexico, and Malaysia to allow for expansion in half the time.
- Likely takeout candidate.** MJN's emerging market business in Asia and Latin America is appealing for many food companies in the United States and Europe. We rank the most likely bidders in the following order: Nestle (NESN.VX), Danone (DANO.PA), and Heinz (HNZ). All three of these names have stated an interest in expanding their health and wellness and pediatric nutrition businesses. We expect MJN would fetch 14.5 times EBITDA, which would imply a bid of \$55 per share.

## Key Risks

### Cost Inflation

Dairy, MJN's largest input cost at 25% of cost of goods sold, was a key driver of the nearly 300 basis points of gross margin expansion that the company experienced in 2009. Cutbacks by dairy producers in the United States and abroad pushed dairy prices higher in late 2009; MJN expects dairy prices to be up 30% in 2010. MJN has the highest gross margins of any company that we cover at 65%, which means it only has to increase prices 2.5% to offset the 8.0% inflation to cost of goods sold from dairy.

### Out Innovated by Competition

MJN's disappointing performance in its U.S. business after getting beat to market by its main competitor shows how important innovation is to the pediatric nutrition category. MJN believes that it lost three points of market share to ABT when it beat MJN in introducing a product featuring prebiotics by nearly a year. It is clear from MJN's recent presentations by management that it has understood the message and committed to improving its R&D investment.

### Premium Brand and Price Point

As one of the oldest and most respected infant nutrition brands, MJN is known for its commitment to quality and continued innovation. MJN's infant and children's formula products compete with the other global pediatric nutrition producers at premium price points. For example, Enfamil is priced at near the same level in China as the United States. While we expect consumer spending to increase in 2010, MJN's premium price position makes it more susceptible to a weak consumer environment.

## Valuation

MJN's high emerging market exposure and superior operating margins has it currently trading at 19.0 times our 2010 EPS estimate, a 25% premium to the large-cap packaged food group. While this sounds like a hefty premium, when we look at valuation using a regional sum-of-the-parts analysis, we arrive at an equity value of \$45 per share, which is before a take-out premium. We used the premier Chinese food company Tingyi's (0322.HK) P/E multiple of 26 to value MJN's business in key Asian markets (about 26% of sales) and a P/E multiple of 16.5 for the remainder.

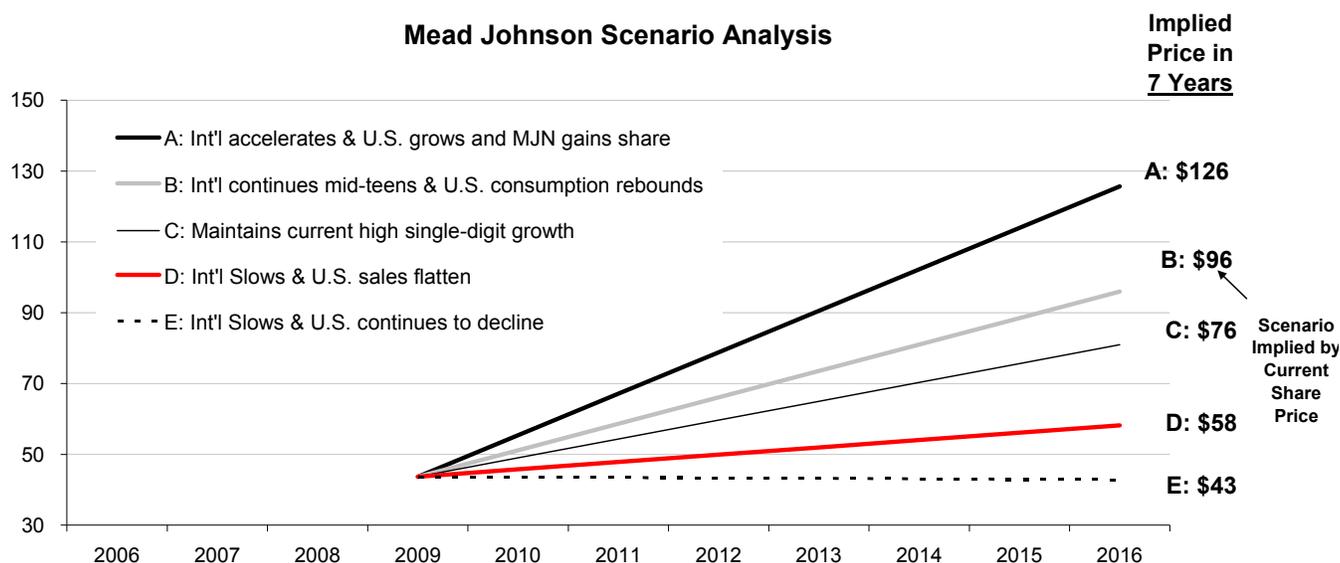
### Exhibit 164: Sum-of-the-Parts Valuation Analysis For MJN

	Benchmk	% of total	Seg Profit	After Tax Net Income	P/E Multiple	Equity Value
N. America/Europe	General Mills	38%	391	191	15.0x	2,871
China, Malaysia Thailand	Tingyi	27%	277	136	26.0x	3,525
Mexico	FEMSA	12%	129	63	16.3x	1,028
Philippines		9%	97	47	15.0x	709
Hong Kong		4%	45	22	15.0x	331
Other Asia/LatAm	FEMSA	9%	97	47	15.3x	724
			1,034	507		
			Equity Value			9,188
			Share Outstanding			205
			<b>Equity Value Per Share</b>			<b>\$44.91</b>

Source: Company data, Credit Suisse estimates.

## Financial Statements and Comparable Valuation

### Exhibit 165: Current Stock Price Embeds Conservative Growth Expectations



	2009A	2016 Scenario Analysis				
		A	B	C	D	E
Mead Johnson sales	2,825	6,250	5,250	4,500	3,500	2,825
Growth CAGR	-	12%	9%	7%	3%	0%
EBIT margin	27%	25%	26%	27%	28%	29%
Interest other expense	102	72	72	72	72	72
Tax rate	31%	31%	31%	31%	31%	31%
Sharecount	205	205	205	205	205	205
<b>EPS</b>	<b>\$2.23</b>	<b>\$5.03</b>	<b>\$4.36</b>	<b>\$3.85</b>	<b>\$3.06</b>	<b>\$2.52</b>
Growth CAGR	-	12%	10%	8%	5%	2%
P/E Multiple	21	25	22	21	19	17
<b>Implied Price, 2016E</b>		<b>\$126</b>	<b>\$96</b>	<b>\$81</b>	<b>\$58</b>	<b>\$43</b>
Implied 7-yr return		169%	105%	73%	24%	-8%
CAGR		15%	11%	8%	3%	-1%

Source: Company data, Credit Suisse estimates.

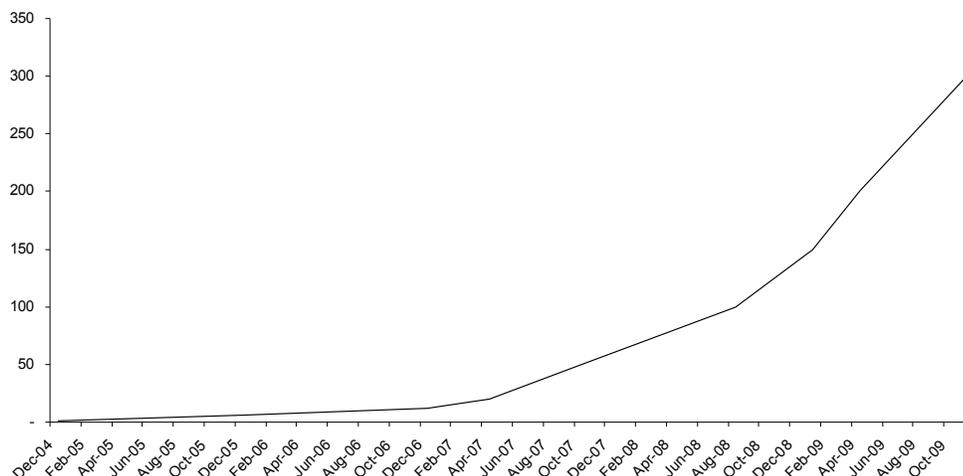
### Exhibit 166: MJN Trades at a Premium to the Group Owing to Above Average Growth Prospects

Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	2009 Stock Perf	EPS				P/E CY08	P/E CY09	P/E CY10	3-Yr Avg P/E	EV-to-Sales	
							FY07	FY08	FY09	FY10E						
<b>Mead Johnson</b>	<b>MJN</b>	<b>46.78</b>	<b>\$9,567</b>	<b>\$10,610</b>	<b>\$2,827</b>	<b>27%</b>	<b>68%</b>	<b>1.99</b>	<b>2.23</b>	<b>2.37</b>	<b>2.67</b>	<b>21.0</b>	<b>19.8</b>	<b>17.5</b>	<b>15.7</b>	<b>3.8</b>
Nestle	712387	52.50	\$177,482	\$173,482	\$103,263	21%	24%	2.58	2.91	3.11	3.45	18.0	16.9	15.2	14.1	1.7
Abbott	ABT	54.38	\$84,112	\$95,200	\$30,765	23%	1%	1.23	3.72	4.23	4.75	14.6	12.8	11.4	14.1	3.1
Danone	DANOY	11.90	\$28,718	\$31,200	\$22,366	13%	2%	0.63	0.72	0.73		16.5	16.3			1.4
Average						21%	24%					17.5	16.5	14.7	14.9	2.5

Source: Company data, Credit Suisse estimates.

# Facebook (Private): The World's Social Network

**Exhibit 167: Facebook Active User Growth (Millions)**



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** Facebook was a strong fourth entrant to the social networking industry, after Friendster (2002), LinkedIn (2002), and MySpace (2003), but has outlasted and grown faster, internationally and in the United States, than the earlier competitors. Started by a Harvard student and initially growing through colleges and then high schools, Facebook grew by building network effects among users' existing strong affiliations (schools) and the trust and verifiability of these initial groups. The brand has succeeded in besting competitors by keeping innovation constant and relevant, trust at its core, and navigation simple for users across a broad range of demographics (versus MySpace's focus of music and media).
- Brand Opportunity.** The biggest opportunities for Facebook lie in international growth, mobile devices, and, most important, turning its significant sticky traffic into revenue beyond banner ads, through additional corporate marketing dollars, virtual sales (gifts, cards, etc.), games, or other revenue streams.
- Market Perception.** While the market it is in broad agreement that Facebook is the best contender for social networking, monetization and social network traffic remain questions for some investors. There is frequent media speculation about a Facebook IPO, and the company did hire a new CFO in June 2009, perhaps to prepare for becoming a public company. However, the company recently indicated that an IPO is not imminent, despite its newly formed dual stock structure.

Spencer Wang

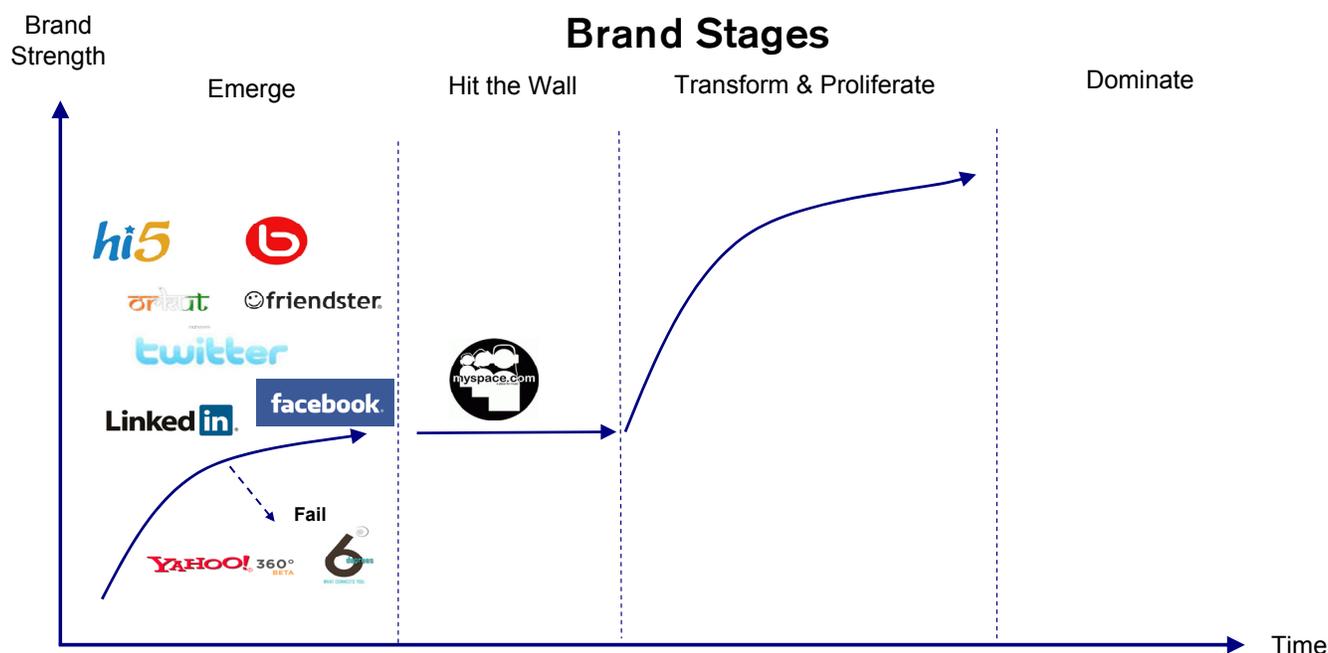
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**Exhibit 168: Social Networking Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

## Brand Overview

Facebook was started in February 2004 by a Harvard undergraduate that wanted to connect his classmates. It managed its early growth well by adding incremental schools as its servers could support the traffic, starting with Stanford, Columbia, and Yale, and then all Ivy League and Boston-area colleges. This initial focus on strongly integrated communities helped Facebook to grow quickly, leveraging the viral, network effects inherent in schools' communities and alumni networks. In September 2005, high schools were added to the mix, initially by invitation only. A year later, anyone aged 13 or older could join Facebook.

Users of Facebook can join and create groups, communicate their status, or on their "wall," and post photos and videos. Facebook claims that one-half of its active users are on the Web site on any given day, which is a high frequency of visits.

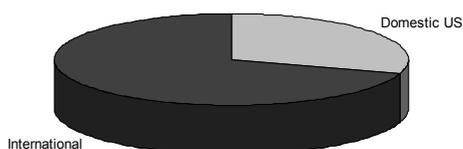
Facebook has successfully navigated the social networking industry and begun to build a powerful brand on the back of existing affiliations (school, workplace, geographical region, interests). It also established trust through its weeding out of stranger "friend requests," which other competitors such as MySpace and Orkut (in Brazil and India) failed to do successfully, watering down the networks of their users. Therefore, Facebook is built on real identities. Moreover, its focus on a well organized, easy to navigate Web site, and continuous innovation led it overtaking MySpace in the United States in May 2009 and to have a total of over 300 million active users around the world.

### Success in a Dynamic Competitive Landscape

The competitive landscape of social networking has been fluid in the past four years. MySpace, the strongest U.S. competitor to Facebook, focused on music and highly customizable profiles. After being acquired by News Corporation (NWSA) in July 2005, the MySpace brand has recently hit the wall, with user numbers flattening out and criticisms of a chaotic user interface. LinkedIn has maintained its professional niche (50 million registered users worldwide, 50% in the United States) and grown successfully in the United States and abroad, from 10 million users in 2007. Friendster (100 million-plus

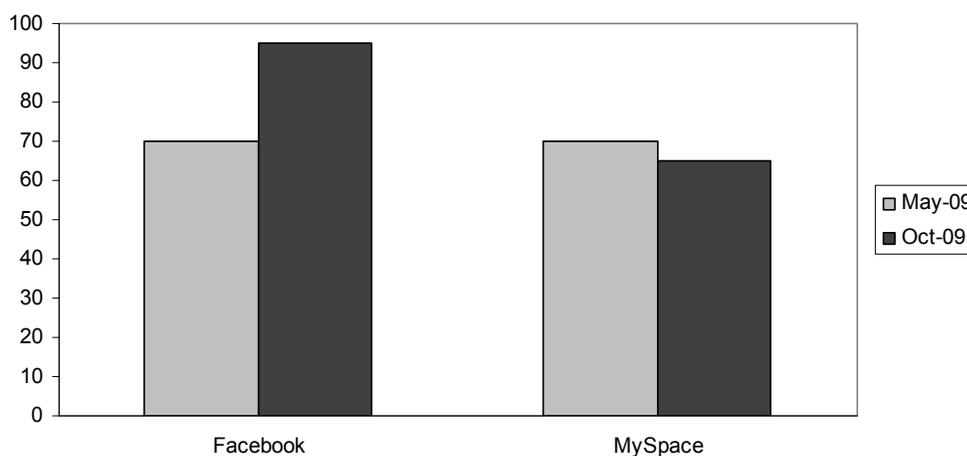
registered users) has successfully focused on Asian growth, with 90% of traffic originating in Asia, after ceding the U.S. market to MySpace in 2005-06. Other international players include Bebo in the United Kingdom, Hi5 in the Caribbean, and Orkut in India and Brazil.

#### Exhibit 169: Facebook Geographic Mix (Active Users, Year to Date 2009)



Source: Company data, Credit Suisse estimates.

#### Exhibit 170: Facebook Has Won the War Against MySpace in the U.S. (Unique Visitors)



Source: Company data, Credit Suisse estimates.

## Brand Development State: Emerging

In our view, Facebook has nearly emerged and will move on to Transforming and Proliferating in the next five years. The key criteria left to be proven before emergence is complete is solidifying revenue streams. Once that has been achieved, Facebook will be well positioned to proliferate and become *the world's default social network*.

## Exhibit 171: Facebook Is Close to Completing the Brand Emergence Phase

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Monetizing Traffic

We believe that Facebook has made the bulk of its limited revenues from banner ads, for which it has an exclusive relationship with MSFT. Facebook must find more and better revenue streams to build its top line. Some possibilities include virtual gifts, collaborative online games, or creative ways to attain additional corporate marketing dollars. On the corporate marketing front, the latest method of monetizing traffic is through lead generation, for which Facebook could be a rich source. The user data controlled by Facebook could be strategically—and carefully—tapped, so as not to upset users.

### Continued Domestic U.S. Market Share Growth

Continuing to build market share in the United States and additional demographics (i.e., 35-plus year olds) without losing the core audience will be key to growing the Facebook brand.

### International Growth

About 70% of Facebook's users currently are outside of the United States, totaling 200 million-plus users based on current company data. There is significant upside potential for the brand, as connectivity continues to roll out around the world and as countries move up the adoption curve for social networking.

### Mobile Applications

Facebook already has an application for the iPhone and other smartphones, but will have to stay aggressively ahead of this trend. According to the company, 65 million Facebook users (21%) currently access Facebook through their mobile devices. As more communication moves to this channel, building a strong presence will be the key to keeping the brand relevant to users.

## Major Catalysts

We believe the two key catalysts for Facebook over the next five years are the following.

- **Revenue and profitability validation.** Facebook needs to increase monetization to grow to a highly profitable brand. While it may not do so before its IPO, the brand must create new categories of revenue, such as online games, virtual gifts, and—most promising—additional creative marketing initiatives for corporations without violating the privacy and trust of its user base.
- **Continued innovation.** Staying ahead of the curve will be critical to the brand's success in a fast-moving industry such as social networking. This includes interface changes, functionality, platforms, and other areas of innovation.

## Key Risks

### Fail to Innovate

Just as Friendster and MySpace lost to Facebook in the U.S. market by failing to continuously innovate, Facebook could fall victim to this, especially as it grows larger, and potentially out of touch with core users. So far, Facebook has kept ahead of the competition.

### Next New Thing for Younger Demographic

As Facebook expands its 35-plus year old user group, the younger generation may distance itself from the brand and look for the next new, cool service. Since Facebook is built on social relationships and networks, this could become an issue for the brand, as it could quickly snowball into user attrition, given little lock-in effect.

### User Privacy Violated

Facebook has had a couple of near misses, such as with its launch of Beacon in 2007, when users revolted against a new Web site feature. When the Web site introduced Beacon, which let Friends see what others were buying and recommending without asking for an opt in, users rapidly communicated their privacy concerns. Facebook resolved the issue, but other such concerns would fundamentally undermine the brand promise of protecting users private lives, such as pictures, videos, Walls, and significant demographic data.

### Elusive Profitability

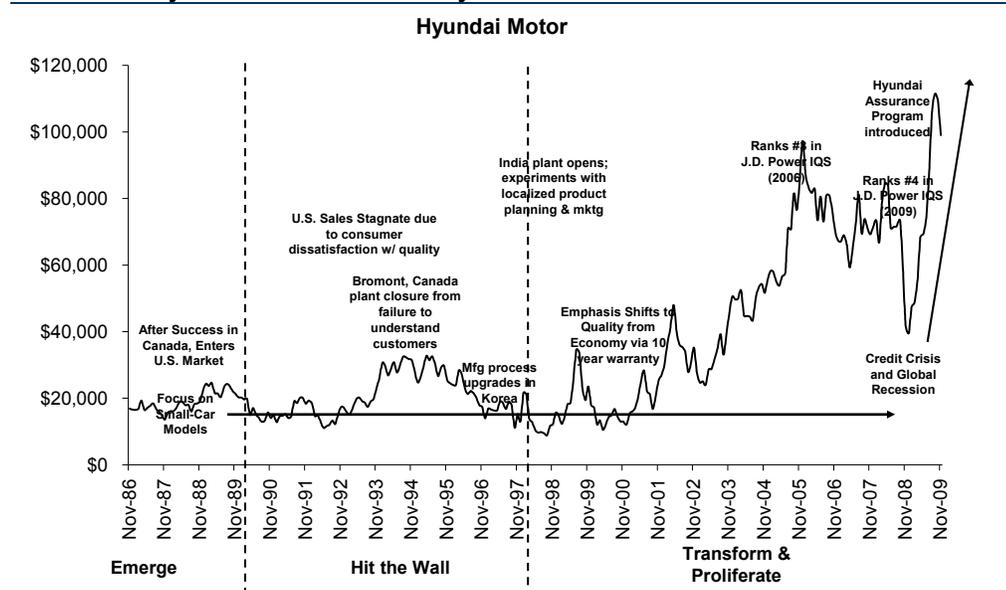
Facebook claims to have become cash flow positive for the first time in September 2009. A key downside risk to the business model and brand is whether the company can become profitable before investors seek greener pastures.

## Valuation

A stock buyback for internal investors in April 2009 valued the company at \$6.5 billion (active users were at 200 million at that point). Microsoft's (MSFT) investment in October 2007 (50 million active users) valued it at \$15 billion, but that MSFT obtained preferred stock with first-out priority and a banner ad deal suggests that this valuation could be misleading.

# Hyundai Motor (005380.KS): Poised for Increased Penetration

Exhibit 172: Hyundai Stock Price History



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## Investment Summary

- Unique Brand Story.** Hyundai has made significant market share gains in the past year, as demand has shifted to lower-end cars. The economic downturn put Hyundai at the right place at the right time in terms of its value proposition as a solid but inexpensive car. The company is focused on shifting its brand perception toward a higher-end view, while maintaining a low price point. We would liken Hyundai's prospects to those of Volkswagen (VOWG\_p.F) five years ago, when its Golf and Jetta models gained more appeal among young consumers as fun, spirited, and stylish cars. The Hyundai brand is currently underpenetrated in the United States, and we believe there is scope for significant gains in that market over the next five years.

We like Hyundai's strategic focus and believe that there is little balance sheet downside risk in 2010. In our view, Hyundai's key market share risk in 2010 is a potential shift in industry product mix back toward historical norms, in which light trucks and large passenger cars would take a greater share of the industry mix. However, market share gains achieved in 2009 are assumed to hold through 2010, while renewed dedication to platform integration is likely to allow Hyundai to sustain momentum from market share gains, especially after 2012. However, we believe 2011 will see strong demand recovery for the global auto industry, of which Hyundai is likely to be a key beneficiary.

- Brand Opportunity.** We believe the Hyundai brand is poised for significant appreciation in the U.S. market, as the company executes a two-pronged approach: (1) working to enhance its brand perception from a marketing point of view and (2) strategically focusing on platform integration to reduce vehicle time to market.

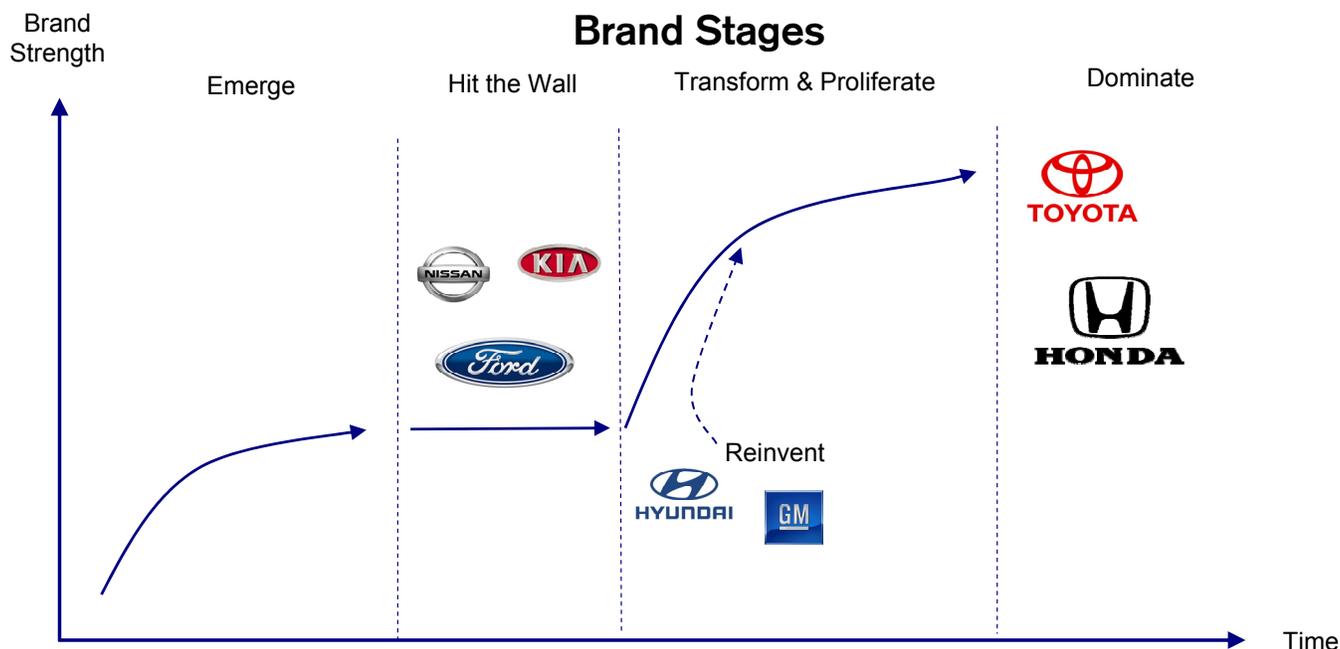
We believe Hyundai's current strategic initiatives set the groundwork for sustainable share gains in overseas markets in the next five years. We are impressed with Hyundai's recent statements about its strategic initiatives, mostly with its reaffirmation of its commitment to platform integration, which we believe to be the single most

important factor in achieving a foundation to enhance its long-term brand equity and return on invested capital. The 2012 time line for completing platform integration seems aggressive, in our view; however, we believe the basic direction is strategically sound.

There have been discussions in the stock market about potential opportunities for Hyundai as a brand in the wake of Toyota Motor Corp. (7203) recalls. While we believe prospects for long term Toyota market share erosion hinges upon attractiveness of future products and the strength of brand loyalty from an established base of Toyota buyers, recent events surrounding product recalls and government investigation can result in short term market share loss. While potential beneficiaries will likely be other Japanese automakers and particularly Ford in the US, Hyundai also stands to achieve temporary gains as a result, particularly in small passenger car segments where Hyundai has historically been strong. It is also worthy to note that Hyundai has very little presence in some other segments such as pickup trucks, vans and large and luxury cars that Toyota is competitive in, meaning that any significant share gains in such segments are likely to come from other strong Toyota competitors in those segments. In any event, sustainability of any such short term gains will have to be supported by the sustainability of brand perception amongst car buyers.

- **Market Perception.** Hyundai's market diversification strategy to grow volumes over the past 20 years has enabled the brand to achieve a good balance in terms of developed and emerging market regional exposure mix. Differentiated product strategies in the United States, Europe, and emerging economies have helped to achieve increased penetration, but we believe successful branding in emerging markets also depends on market perception in the key U.S. market. A key factor in Hyundai's favor is a mix bias toward smaller vehicles, which essentially cater to the young car buyers that are critical in forming a long-term brand perception; in our view, that brand perception has been improving steadily in the past five years.
- **Valuation.** Our current Underperform rating on Hyundai is based on our 6-12 month view that industry fundamentals are likely to be weaker than what the KOSPI is currently pricing into shares. We believe Hyundai's seven-year valuation outlook warrants a rather compelling brand transformation story. Our seven-year target price reflects 12.0 times PER, which is essentially the valuation range in which the stock currently trades.

Exhibit 173: Hyundai Industry Competitive Brandscope

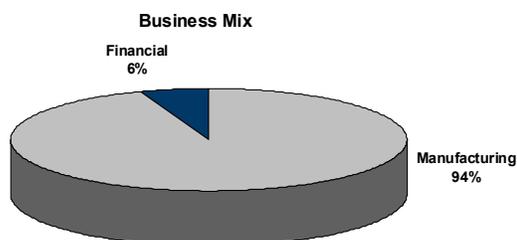


Source: Company data, Credit Suisse estimates.

## Brand Overview

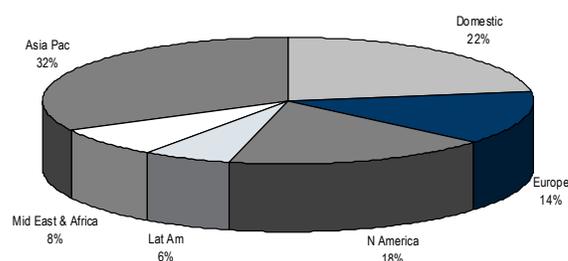
Hyundai Motor Company (HMC), a division of Hyundai Kia Automotive Group, was established in 1967. It currently is the fourth largest automaker globally, and is considered one of the Big Asian Four, with competitors Toyota (7203), Honda (7267), and Nissan (7201). The company began selling cars in the United States in 1986 with the Hyundai Excel and currently sells 14 models in over 180 countries. In 2009, approximately 77% of global unit sales were made in overseas markets, with 48% of its 3.1 million units global production made outside of Korea. HMC has a diversified sales portfolio: Asia excluding Korea represents 33%, North America represents approximately 18%, and Europe represents about 14%. HMC developed five midterm and long-term strategies including global management, higher brand values, business innovation, environmental management, and strengthening product competitiveness.

Exhibit 174: Hyundai Consolidated Business Mix, 2009



Source: Company data.

Exhibit 175: Hyundai Brand Geographic Mix, 2009



Source: Company data, Autodata.

## Brand Development State: Transform & Proliferate

The past decade has seen Hyundai continue to vertically integrate technologically and to reduce dependence on external technology providers while strengthening its global footprint with localized production and design. Management has been smart in staying away from trying to leapfrog competition by buying competitors with the benefit of experience, especially from the Kia acquisition during the Asian Crisis. Rather, it has adhered to its basic philosophy of organically developing proprietary technology and design, especially regarding powertrain, and has made noticeable strides in beefing up its technological arsenal in critical areas in the past decade.

Improvements in production processes allowed Hyundai to experiment with novel marketing approaches, such as being the first industry player to offer ten-year product warranties that cost the company little, since the warranties apply only to original car buyers. However, such gimmicks backed by significant improvements in quality surveys in the past decade have drawn favorable attention from fairly young car buyers in the United States that do not remember the Yugos and the first Hyundai Excels from the 1980s, and have years left to develop brand loyalty. We believe this is a factor that is not yet proven in the market.

We do not believe Hyundai's aim is to become a technology leader in the global automotive industry, which we believe to be reflective of its marketing philosophy. Rather, we believe Hyundai aims to provide reliable basic products without going overboard on technology that the average car buyer may not need or want. We believe that another powerful means of improving market penetration will be added to its marketing arsenal when the brand can increase its new models/total unit sales ratio through platform integration. By 2016, we believe Hyundai will have the basic structure set in place to advance to the dominance phase in the global automotive industry.

### Exhibit 176: Hyundai Completed Brand Emergence Phase, Has Made Significant Progress in Transform & Proliferate Phase, but Needs to Advance to the Dominance Phase

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### HMC's Product Positioning and Long-Term Strategy

We expect market share gains achieved in 2009 to hold through 2010, while HMC's renewed dedication to platform integration is likely to allow it to sustain market share gain momentum, especially after 2012. We believe that while 2010 may witness growth that is slower than the equity market anticipates, 2011 should be the real year of strong demand recovery for the global auto industry, of which HMC is likely to be a key beneficiary.

## Platform Integration

One of the key drivers to gaining market share in mature developed markets is the ability to turn over a greater percentage of an automaker's product line; this task becomes easier with fewer platforms, in our view. This is because common platforms allow automakers to (1) spread the cost of powertrain development over a greater number of units throughout a product lifecycle while (2) reducing the time required to introduce new products by developing model variations based on a common platform. Automakers typically spend US\$1-2 billion on new platform development, which is likely to be used over a 5- to 15-year period. If an automaker cannot maximize the number of units over a single platform, chances increase that the life of the platform also lengthens, with negative implications on sustained product acceptance by end customers the longer it takes to introduce new platforms.

The HMC-Kia platform integration originally was to have been completed by 2006, which we considered to be a key strategic initiative for the merged entity. However, this plan was gradually extended to 2012. While we are excited by HMC's reaffirmation of its commitment to the integration plan time line (by 2012), this seems aggressive, in our view. We believe that the primary execution risk for the plan lies in the amount of likely costs that could be involved in reducing the current number of platforms by 66% over three years while increasing the number of total models by 38%. This means that it could extend beyond the current target date. Hyundai has made no specific references about the implications of R&D spending related to this planned time line, based on our discussions. While much of the core platforms have been developed, with phase-outs planned for excess platforms, current plans seem to tell us that HMC's investment phase may not be completely over with the completion of Kia's Georgia plant, and that at least some portion of cash that has been used for new plant construction will likely be reallocated for R&D. If so, this would be a welcome prospect from a strategic angle, as we have been alarmed at what we have believed to be R&D underspending by HMC over the past five years.

## Blue Drive Initiative

HMC's Blue Drive Initiative emphasizes its quest to remain environmentally friendly. The Blue Drive initiative has five stages: low carbon models, biofuel vehicles, hybrid electric vehicles, electric vehicles, and hydrogen fuel cell vehicles.

## Major Catalysts

We see several major catalysts for HMC over the next seven years.

- **Structural shift in consumer preference for smaller vehicles.** The current economic downturn and recovery could lead to a reversion to broad consumer preference for small vehicles, similar to in the early 1980s. As HMC is essentially a small car producer, we believe it can benefit from this midterm trend even as the company plans a more aggressive long-term, high-segment entry.
- **Platform integration.** The current time line for platform integration targets completion by 2011, when 2009's 18 platforms will be reduced to 6. Management currently seeks to have 2 million units of global compact car production for the combined HMC-Kia brands to come from a single platform. This will likely have the combined effect of higher return on invested capital per platform and significant reduction in time to commercial introduction of new models, which we see as a critical structural prerequisite for HMC to complete its brand transformation.
- **Steady and consistent market share penetration.** Automotive branding is a long-term process. HMA's market share gains achieved in 2009 came largely as a result of unplanned events, but set the foundation for future gains. We are less interested in short, unsustainable bursts of market share gains and more interested in slow steady increases in market penetration and presence.

## Key Risks

### Forex Risk

Only 23% of Hyundai's global shipments are to the Korean domestic market, which has historically left the company with a vulnerable forex position. While increasing localization of production in the past decade has raised overseas production to 48% of total volumes, 29% of global shipment volumes are exported from Korea to overseas locations.

While the company's operating margins currently are enjoying the effects of U.S. dollar weakness, any sharp and sudden reversal can negatively affect the company's cash flows, in our view.

### Market Share Erosion

We believe that much of the market share gains that the brand witnessed in 2009 can be attributed to factors external to management control, as governments around the world introduced stimulus measures resulting in increased demand for small cars, especially in Western Europe and China. Even in the United States, where a cash-for-clunkers program was in place for a fairly short period, the economic downturn caused large vehicle and light truck demand to fall below historical norms, resulting in market share gains for the Hyundai brand, whose exposure is largely to small cars and SUVs.

In our view, a key risk for Hyundai is that with front-loaded small car demand that largely cushioned what could have been a steeper fall in industry demand across the globe in 2009, an economic recovery could lead to a sharp reversal in industry mix in 2010, as our European automotive research team believes. Under such a scenario, we believe the negative impact could hit small mass segment carmakers such as Hyundai stronger than high-end automakers in the coming one to two years.

### Platform Integration Execution

Hyundai has been known to delay execution of its original platform integration plans scheduled for 2006 completion, following its post-Asian Crisis merger with Kia. The plan had been devised by Hyundai's previous management team. Following a management change in 2002, the new management team delayed execution. As the new management team was new to the automotive industry, our impression has been that it initially underappreciated the capital intensive (but necessary) new product development efforts that occur, especially under the hood.

In our view, powertrain development and local product development focus in key markets in the past few years culminated with this past summer's announcement reaffirming its commitment to platform integration. We believe the learning curve has been rather steep, and the risk of execution delay should be minimal.

## Valuation

The HMC brand currently has 3.4 million units in global capacity out of a combined 5.3 million unit global capacity for the combined HMC-Kia brands. This means that from a scale perspective, it will be difficult for HMC to achieve Toyota's level of global market share penetration by 2016, although brand transformation will likely allow HMC to raise its average selling price through mix shift and price hikes.

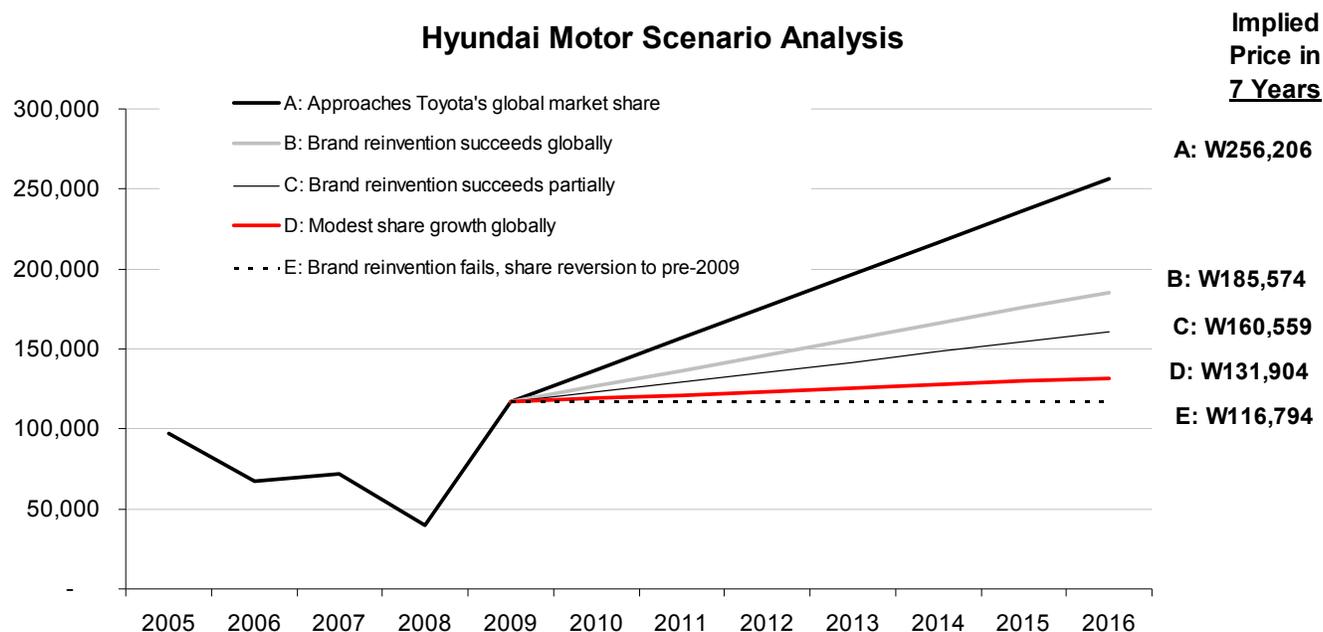
In our valuation scenario analysis, we assumed that no capacity additions will be made before 2016. However, we assumed that HMC will gain greater pricing power with incremental improvements in brand equity, with positive implication for its EBIT margins under improving pricing power scenarios.

Our valuation scenarios have applied Hyundai's current valuation multiples to suggested EPS under each scenario, with the resulting suggested nominal stock price implications in 2016. We took the present values of these prices using a cost of equity assumption of 11.7%. In present value terms, we believe that the equity market currently is pricing in an

assumption that Hyundai will likely reach Toyota's brand equity by 2016. As that is something that needs to be proven with concrete results, we maintain our Underperform rating on the stock, based on our perception of industry dynamics in 2010 for a 6-12 month investment horizon, rather than on our positive expectations about Hyundai's brand equity in 2016.

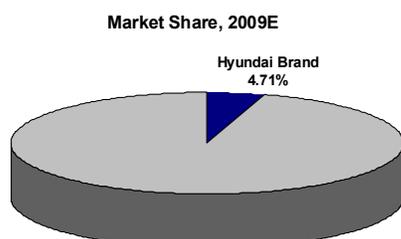
## Financial Statements and Comparable Valuation

### Exhibit 177: Current Stock Price Reflects Successful Global Brand Reinvention

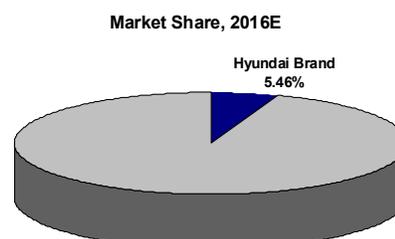


	2009	2016 Scenario Analysis				
		A	B	C	D	E
Sales (Won bn)	31,859	70,000	54,000	48,000	37,000	32,000
Growth CAGR	-	11.9%	7.8%	6.0%	2.2%	0.1%
EBIT margin	7.0%	9.5%	8.2%	7.6%	7.4%	7.0%
Interest other expense	(1,546)	(1,546)	(1,546)	(1,546)	(1,546)	(1,546)
Tax rate	21.7%	22.0%	22.0%	22.0%	22.0%	22.0%
Sharecount (mn)	220	220	220	220	220	220
<b>EPS (Won)</b>	<b>13,176</b>	<b>28,852</b>	<b>20,898</b>	<b>18,081</b>	<b>14,854</b>	<b>13,153</b>
Growth CAGR	-	11.8%	6.8%	4.6%	1.7%	0.0%
P/E Multiple	8.9x	8.9x	8.9x	8.9x	8.9x	8.9x
<b>Implied Price, 2016E</b>		<b>256,206</b>	<b>185,574</b>	<b>160,559</b>	<b>131,904</b>	<b>116,794</b>
Implied 7-yr return		119.0%	58.6%	37.2%	12.7%	-0.2%
CAGR		11.8%	6.8%	4.6%	1.7%	0.0%
Discount rate		11.7%	11.7%	11.7%	11.7%	11.7%
<b>NPV</b>		<b>118,090</b>	<b>85,534</b>	<b>74,004</b>	<b>60,797</b>	<b>53,832</b>

Source: Company data, Credit Suisse estimates.

**Exhibit 178: Hyundai Represents 4.7% of Estimated 66 Million Unit Global Auto Market**


Source: Company data, Credit Suisse estimates.

**Exhibit 179: Our Base Case Assumes Hyundai Market Share Increases to 5.5% by 2016**


Source: Company data, Credit Suisse estimates.

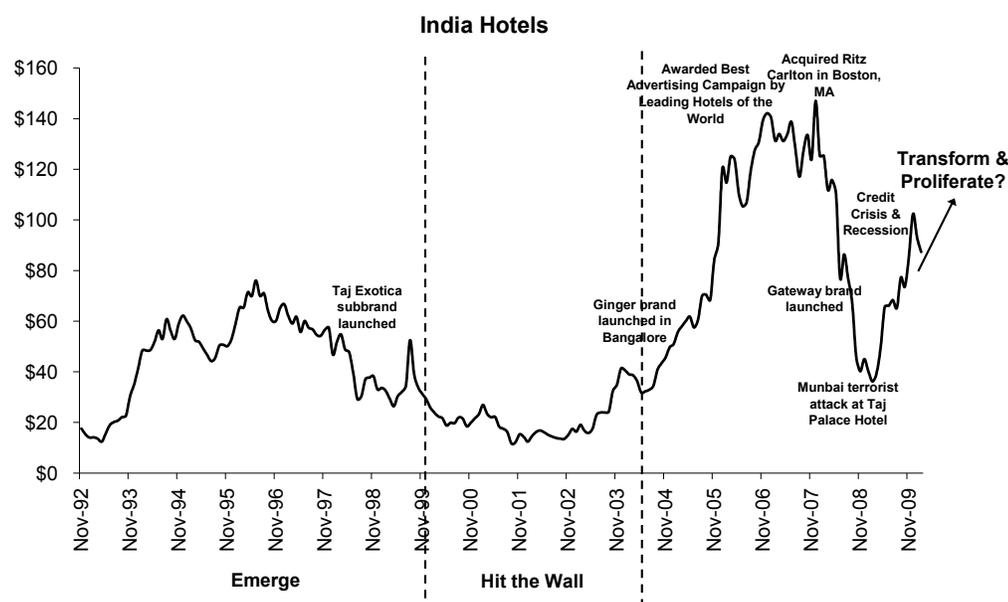
**Exhibit 180: Hyundai Trades at a 2010 P/E Multiple of 9.9x Relative to Group Average of 16.6x**

	Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009	2008	EPS				P/E	P/E	P/E	3-Yr	
								Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	Avg P/E	EV-to-Sales
<b>Hyundai Motor</b>	<b>005380-KR</b>	<b>104,000</b>	<b>\$19,663</b>	<b>\$56,192</b>	<b>\$63,305</b>	<b>4%</b>	<b>-</b>	<b>161%</b>	<b>-59%</b>	<b>5,737</b>	<b>5,325</b>	<b>10,106</b>	<b>10,453</b>	<b>19.5</b>	<b>10.3</b>	<b>9.9</b>	<b>-</b>	<b>0.9</b>
Ford	F-US	8.97	\$29,797	\$144,802	\$146,277	21%	9%	293%	-66%	-	-	-	0.48	-	-	18.8	0.1	1.0
Toyota	7203-JP	3,760	\$140,582	\$234,194	\$207,852	-3%	-	23%	-41%	566	-	-	146	-	-	25.8	-	1.1
Honda	7267-JP	2,985	\$60,205	\$97,159	\$101,359	2%	-	50%	-37%	382	76	100	172	39.5	29.9	17.4	-	1.0
Kia	000270-KR	17,650	\$5,907	\$14,390	\$17,639	2%	-	169%	-52%	-	328	2,831	2,846	53.8	6.2	6.2	-	0.8
Volkswagen	VOW-DE	80.52	\$35,342	\$118,429	\$158,199	7%	-	-68%	52%	11.34	-	-	-	-	-	-	-	0.7
Daewoo	047050-KR	32,950	\$2,781	\$3,240	\$9,072	1%	-	44%	-56%	1,178	926	1,306	1,518	35.6	25.2	21.7	-	0.4
Average						5%	9%	96%	-37%					37.1	17.9	16.6	0.1	0.8

Source: Company data, Credit Suisse estimates.

# Indian Hotels (IHTL.BO): A Segmented Play on Indian Growth

Exhibit 181: Indian Hotels Stock Price History



Source: Company data, Credit Suisse estimates

## Investment Summary

- Unique Brand Story.** The Indian Hotels Company Ltd. (IHCL), part of the Tata conglomerate but traded separately, is a heritage/luxury brand of the Taj Hotels. This brand has an authentic domestic Indian heritage which began in 1903 with the Taj Mahal Palace Hotel. Three newer brands, Vivanta for the premium segment, Gateway for the middle-market, and Ginger for the “smart basics”/budget segment, have differentiated brand personalities and positioning. Together, the brands have 99 locations in India, the United States, Europe, Asia, the Middle East, Australia, and Africa.
- Brand Opportunity.** The upside for Indian Hotels is two-fold. Domestic Indian tourism growth, especially among the middle and budget segments should hold huge potential for the brand in the next five years as the Indian middle class expands. Internationally, 25% of IHCL’s current revenue will recover with the macroeconomic environment, and Taj is well-positioned in the United States and Europe to take advantage of this and build share. In 2009, the brand signed its first deal to open a location in Beijing. The company also sees opportunities for Gateway and Ginger to expand internationally to South America, Russia, China, and Sub-Saharan Africa.
- Market Perception.** The big question in the Indian hospitality market is whether recent entrants such as international competitors Hilton, Sheraton, Four Seasons, will steal share from domestic players like IHCL. We believe that Taj’s brand’s authenticity with Indian consumers and its market segmentation with its three new brands will help it win a growing share of the expanding pie of the Indian hotels market.

Govindarajan Chellappa

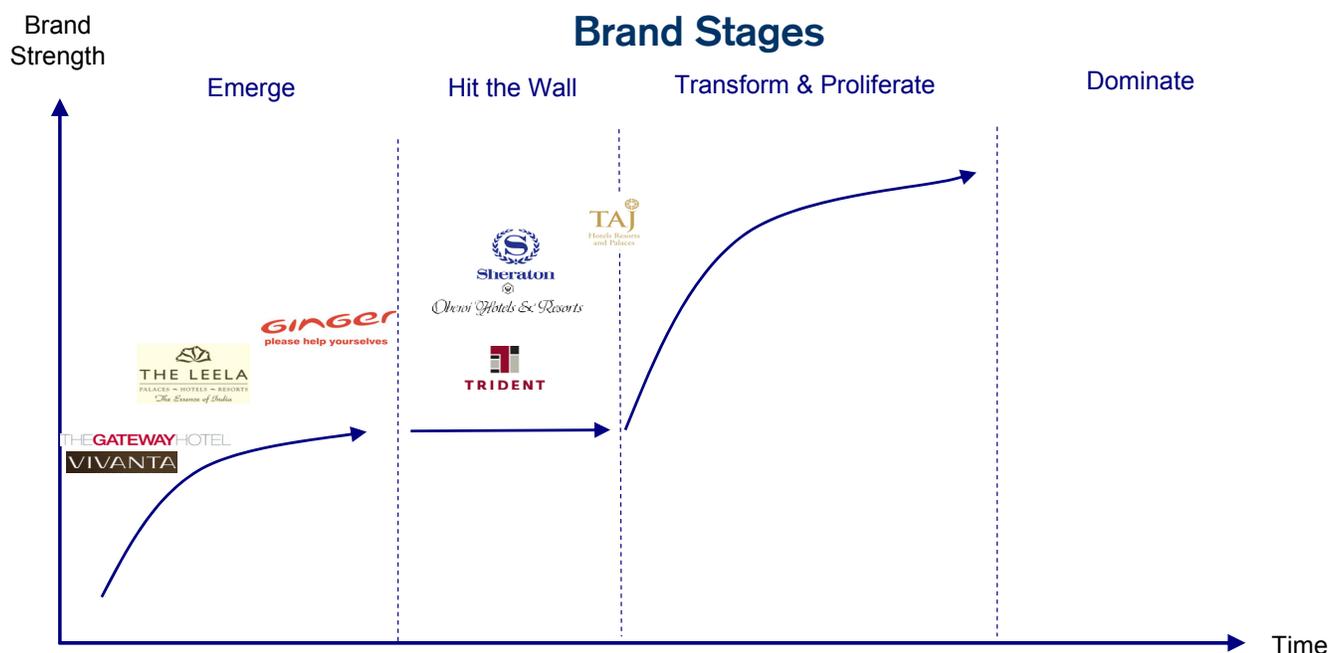
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**Exhibit 182: Indian Hotel Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

## Brand Overview

Indian Hotels flagship brand, Taj Hotels, was founded at the Taj Mahal in 1903 by local Indian entrepreneur and Tata Company founder Jamshetji Nusserwanji Tata to counter British discrimination that prevented Indians from entering local hotels. The brand initially focused on iconic city sites that were linked to Indian heritage and history. It expanded to international markets in 1980 with its first hotel in Yemen. The brand then acquired the U.K.'s Crowne Plaza in the late 1980s followed by branching out within India to vacation spots (Exotica) in the 1990s and Indian safari locations. By 2009, 25% of its revenue came from international markets, and the brand was trying to diversify away from reliance on international visitors/businesspeople with a focus on the domestic traveler.

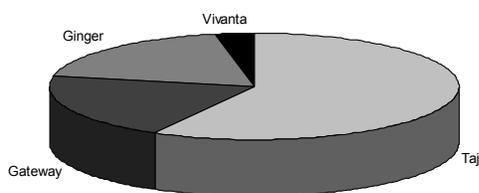
### New Brands Segment the Domestic Market

Indian Hotels has launched three new brands in the past five years to address growing segments in the Indian hotel industry. Ginger, the budget or “smart basics” brand, was started in 2004 and targets young, globally-inclined consumers with its self-serve, high-tech approach (“Please Help Yourself”). With 19 hotels in India currently, some in mixed-use/mall locations and some leased vs. owned, the brand has a distinctive feel to it.

In 2008, Gateway was launched as IHCL's middle-market brand, a repositioning of its Residence brand. In total, this brand has 20 locations, of which four are new properties and 16 refurbished Residence brand locations. These brands are entirely domestic, but international expansion is an explicit part of the brand's five-year plan.

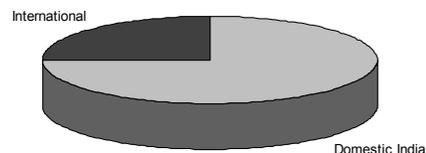
Vivanta is the newest brand, addressing the premium category with a modern feel, serving business and leisure customers in downtown locations. With only three current locations, all of which were “re-branding” vs. new builds, the potential of this brand is still unknown.

**Exhibit 183: Indian Hotels Brand Mix by Number of Locations (2009)**



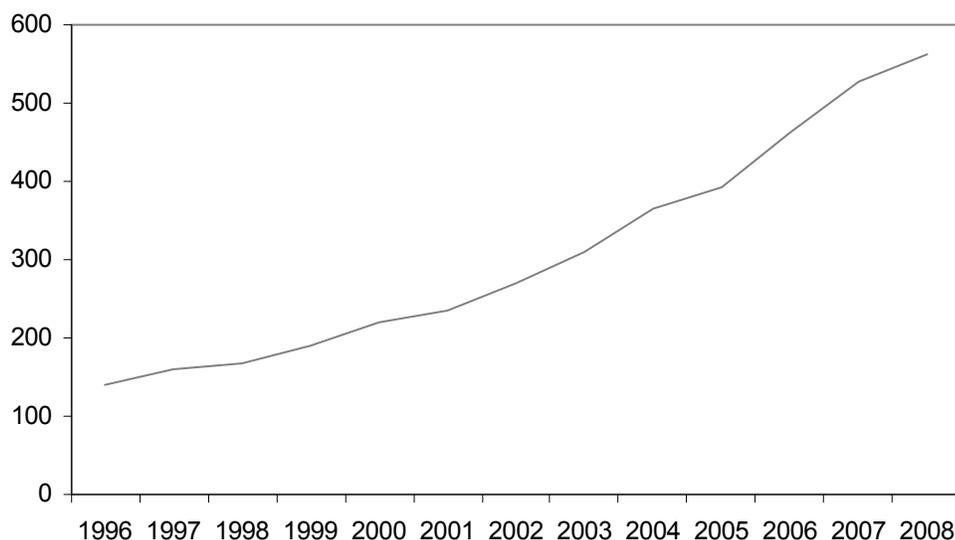
Source: Company data, Credit Suisse estimates.

**Exhibit 184: Indian Hotels Geographic Mix (FY08/09)**



Source: Company data, Credit Suisse estimates.

**Exhibit 185: Growth in Domestic Indian Tourist Visits (Millions)**



Source: Company data, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

While the Ginger, Gateway, and Vivanta brands are emerging, the flagship Taj brand is well-established in India. The key to transforming and proliferating will be staying off international competitors in this attractive growing market and building the three additional brands to help the company grow domestic market share across segments without losing focus on the core brand.

## Exhibit 186: Indian Hotels has Completed the Brand Emergence Phase, and is Progressing toward the Transform and Proliferate Phase

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Three New Segmented Brands

Indian Hotels has domestic build-outs planned for both Ginger and Gateway, as well as an eye to international expansion in second- and third-world countries. For Ginger, the plan is to build 45-55 new hotels by 2011-12 for a total of 60-70 hotels. For Gateway, they plan to have an additional 13 hotels built by 2012 and then add a further 17 by 2015, bringing the total to 50 properties. Within five years, these brands may also dip their toes in international markets such as China, Russia, South America, and Sub-Saharan Africa, but specific plans are not on the books at this point. Expansion plans for Vivanta, the newest brand, have not been publicly discussed.

### International Growth

About 25% of revenues are currently from international operations, which include 15 international hotels in the United States, U.K., Malaysia, Bhutan, Sri Lanka, Africa, the Middle East, and Australia. Much of this growth has been through acquisitions, such as the Ritz Carlton Boston in 2007.

### Flagship Brand Upside

Corporate-wide growth targets of 20,000 rooms, up from the current 12,000 signal that the flagship brand also has some expansion on the horizon. As noted, the company just signed a deal to open a hotel in Beijing, China.

## Major Catalysts

We believe the three key catalysts for Indian Hotels over the next five years are as follows:

- **Successful Emergence of Three New Brands for Domestic Market.** Ginger, Gateway, and Vivanta should be built out across India to take advantage of predicted growth in domestic tourism of 42% in the next 10 years and possibly internationally. These should increase Indian Hotels overall market share and not cannibalize the flagship Taj brand.
- **Strength in the Face of Additional International Competitors.** While it will not be straightforward, Indian Hotels is well-positioned to defend its leading market position from an increasingly competitive landscape of international hotel chains.

- **Improved Macroeconomic Environment.** While 2010 looks to be a small improvement on 2009, the longer view is more promising for the tourism and hospitality industries. This should also flow through to credit markets, enabling more projects to move forward.

## Key Risks

### Additional International Competitors

Established competitors such as Hyatt, Sheraton, Inter-Continental, Holiday Inn, and Best Western are being joined by new entrants Hilton, Marriott, Four Seasons, Country Hospitality and others. This poses a direct threat to Indian Hotels across its four brands. Some of these competitors will be stymied by weak domestic markets in the United States and Europe as well as difficult debt environment in the short term. But they could be formidable competitors for Indian Hotels in the Indian domestic market.

### Macroeconomic Environment

The signs are good for the macroeconomic environment stabilizing. Prices in the Indian hotel industry have slowed their drop and occupancy rates are crawling out of their trough, up from 53% to 57% year over year and are predicted to rise to 65% in the next year. Taj outperformed the industry with 66% occupancy (including the disruption from the terrorist attack) but was down from 73% the previous year. Tourism and hospitality are very sensitive to changes in economic outlook, especially in the luxury/heritage segment, which directly affects the Indian Hotels brands.

### Terrorism

The Taj Mahal Palace Hotel was the target of the November 2008 terrorist attack. The hotel remains under renovation but the brand is vulnerable to both direct terrorist attacks as well as the instability that terrorism imposes on international travel/tourism.

### Real Estate Prices and Debt Markets

The hotel industry in particular is sensitive to fluctuations in the real estate market. While that may not be a problem now, given the macroeconomic environment, this could hurt Indian Hotels in the future, especially with new, deep-pocketed competitors seeking to gain share. Related to this is the risk of access to the debt markets to finance projects.

# Julius Baer (BAER1.VX): Leading Independent Pure-Play Private Bank

Exhibit 187: Julius Baer Stock Price History

Thomas Kalbermatten

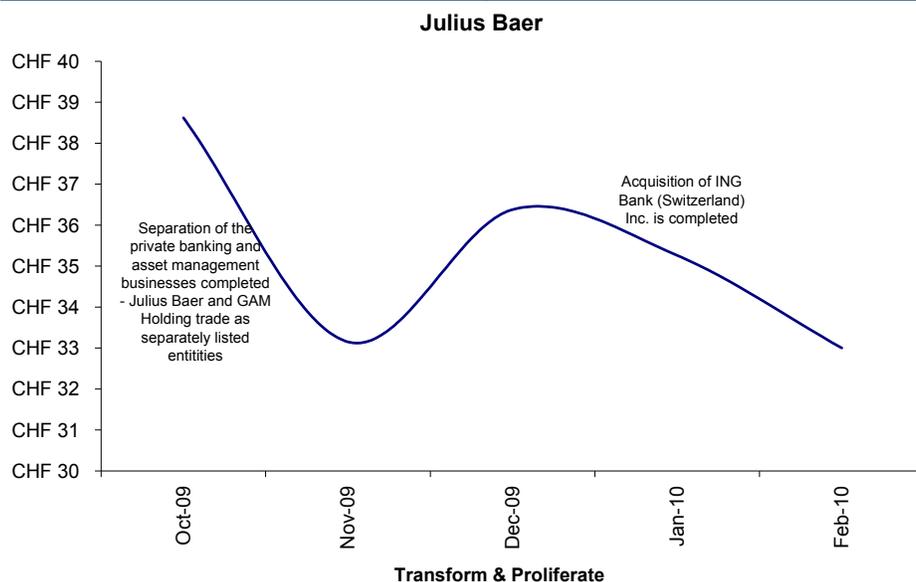
41 44 333 0548

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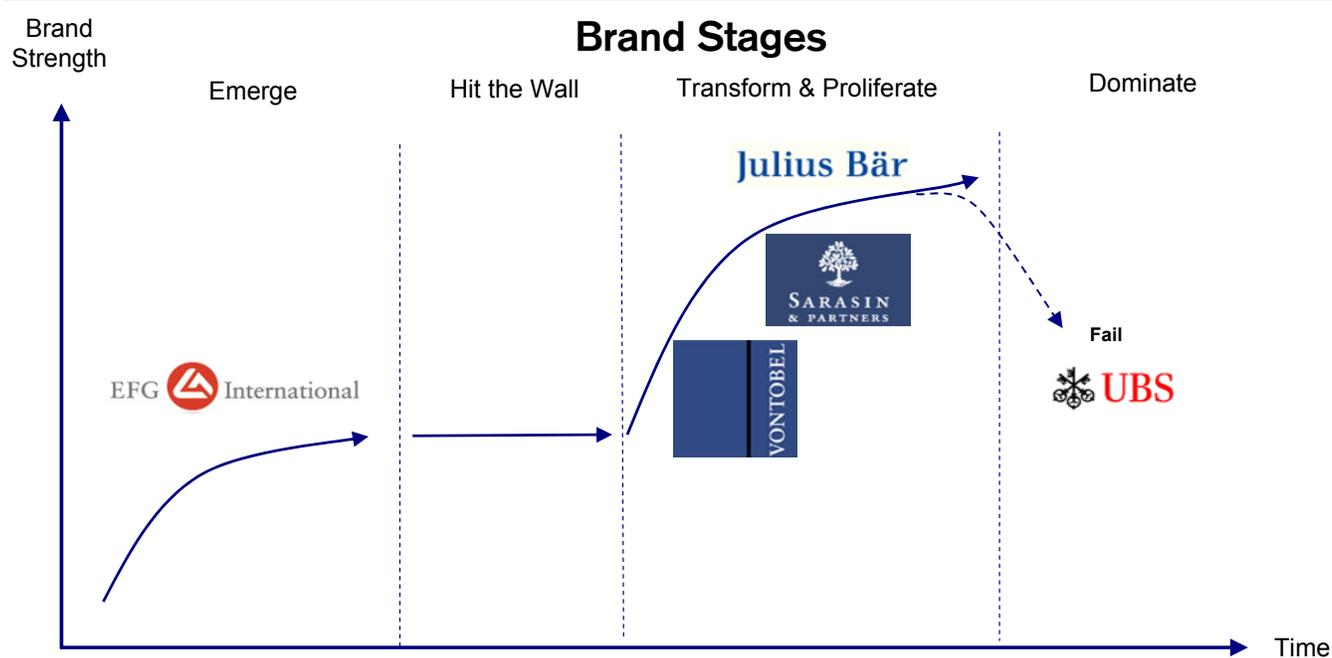
Source: Company data, Credit Suisse estimates.

## Investment Summary

- **Unique Brand Story.** The recent restructuring in Julius Baer hiving off the asset management businesses to GAM Holding further strengthens Julius Baer's position as a leading independent pure-play private bank catering to an increasing market with requirements for such specialized services. The restructuring exercise will help the bank to further focus on its key business and a fresh impetus to its ongoing expansion plans.
- **Brand Opportunity.** We continue to believe that Julius Baer is well positioned to capture further market share in its home market of Switzerland and to accelerate growth at its international locations. Our positive view is based on the fact that Julius Baer, similar to many other Swiss private banks, has heavily invested into expansion into untapped markets, such as the Middle East, Central and Eastern Europe, Latin America, and Asia, where there is increasing demand. Therefore, the company is less dependent on growth in its home market of Switzerland (offshore). Despite the tough market conditions, net new money inflows even in the very difficult period during the second half of 2008 and the first half of 2009 has been positive. In its most important markets—Germany and Italy—Julius Baer has gone local. In Germany, Baer has five locations. In Italy, it opened up an office in Milan and made a small acquisition in 2010.
- **Market Perception.** Julius Baer is consistently viewed as best in class, as it has received numerous accolades for its excellence in private banking. Julius Baer is the number one public pure private banking group in Switzerland. Compared with the past (2000-05) it has regained strong growth momentum, which we believe will continue, as Julius Baer has gone through an extensive expansion and is now present in most of the important growth markets, in our view.

- Valuation.** Based on our DCF valuation, we derive a target price of SFr48, which gives investors a upside potential of about 40%. We still believe that the growth potential of this private banking unit is good. Julius Baer has a P/E multiple on 2011 estimates of 13, making the valuation is attractive and at the lower end of its historical trading range of 12-22. In addition, compared with the valuation of U.S. asset managers (about 22), we believe that Julius Baer is cheap.
- We would argue that as a pure wealth manager, the new Baer should deserve a higher valuation than in the past, when it also had institutional/GAM and PLF assets. Institutional assets are less sticky than private banking ones. Furthermore, compared with pre-2005, when Baer started its expansion, it has now a much wider global reach and has achieved significant growth in terms of net new money inflows, whereas in 2000-05, it had almost no growth or even outflows. In addition, from the private banks from acquired UBS in 2005, Baer was able to take out significant synergies and substantially improve its efficiency (to 63% in the first half of 2009 from over 70%).

#### Exhibit 188: Private Banking Industry Competitive Brandscape



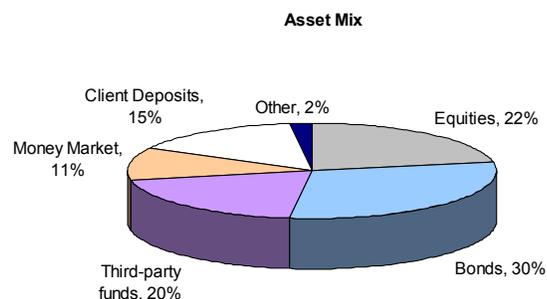
Source: Company data, Credit Suisse estimates.

## Brand Overview

Julius Baer is a renowned Swiss private banking group that has been recognized for being among the best in the industry. The firm was founded in 1890 and has exhibited an intense dedication to helping private clients make appropriate investment decisions. Over the years, Julius Baer has carefully expanded outside of Switzerland and across Europe, the Americas, Middle East/Africa, and Asia.

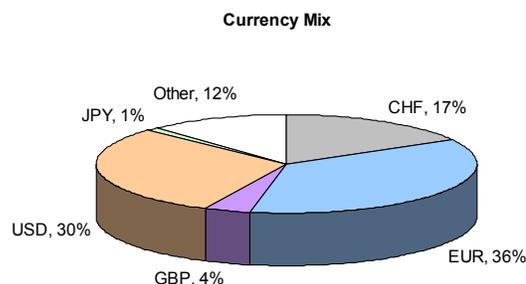
The company has won many accolades for its excellence in private banking, including Best Private Bank by *FinanceAsia Magazine*, Best Wealth Manager 2010 by *Fuchsbriefe* publishers, among many others.

**Exhibit 189: Julius Baer Asset Mix (2009A)**



Source: Company data.

**Exhibit 190: Julius Baer Currency Mix (2009A)**

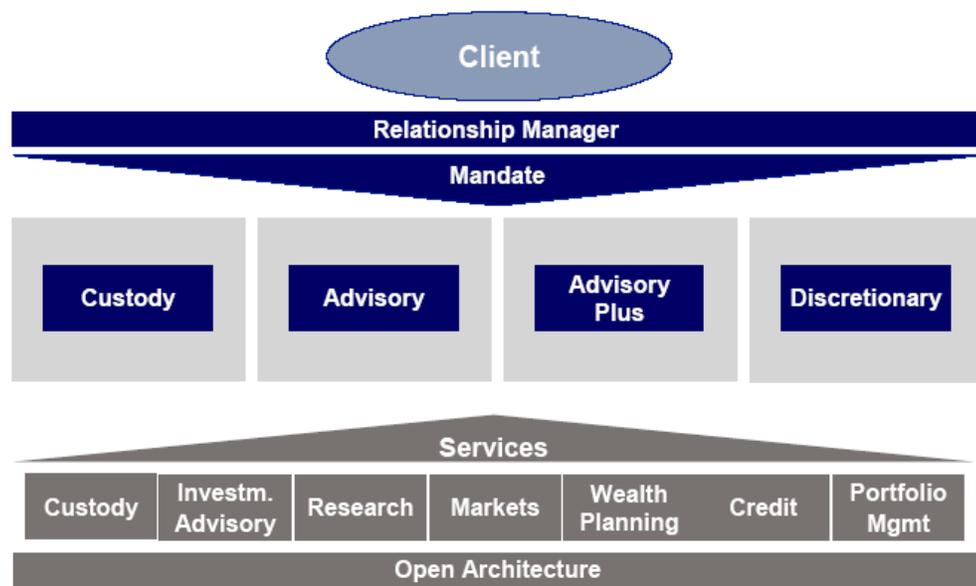


Source: Company data.

**Client Centric/Open Architecture Business Model**

For a wealth manager the size of Julius Baer, we believe (as does Julius Baer) the best business model is the open architecture model. The new client generation is much more sophisticated with a better knowledge of financial markets and a better understanding of the various investment products. We believe that those clients prefer to choose from a wide range of product offerings, want to make their own decisions, and rather prefer a full and comprehensive service (tax advice, inheritance advice; UNWHI: family office service, etc.). In addition, we believe for the size of Julius Baer, this model is more cost efficient and can better serve the client.

**Exhibit 191: Client-Centric Business Model**



Source: Company data.

## Brand Development State: Transform & Proliferate

### Exhibit 192: After a Tumultuous Year, Julius Baer Has Realigned Its Business to Better Suit the Needs of Its Core Customers and Is Quickly Making Its Way Through the Transform and Proliferate Stage

Checklist to Emerge:	Checklist to Transform & Proliferate:	Checklist to Dominate:
<input checked="" type="checkbox"/> Brandable Industry	<input checked="" type="checkbox"/> Continued Investment in the Brand	<input type="checkbox"/> Robust International Presence
<input checked="" type="checkbox"/> New or Underserved Market	<input checked="" type="checkbox"/> Reliable Product/Service Quality	<input type="checkbox"/> Dominant Market Share
<input type="checkbox"/> New Technology	<input checked="" type="checkbox"/> Leadership/Management Strong	<input checked="" type="checkbox"/> Ownership of Category/Mindshare
<input checked="" type="checkbox"/> Differentiated Product	<input checked="" type="checkbox"/> Perpetual Innovation	<input checked="" type="checkbox"/> Loyal Customer Base
<input checked="" type="checkbox"/> Production Innovation	<input checked="" type="checkbox"/> Power Player	<input checked="" type="checkbox"/> Preserve Relevance to Core Customer
<input checked="" type="checkbox"/> Distribution Innovation	<input checked="" type="checkbox"/> Aspirational Marketing Machine	<input checked="" type="checkbox"/> Quality Consistent
<input checked="" type="checkbox"/> Connection with Core Consumer	<input checked="" type="checkbox"/> Continued Sales/Market Share Growth	<input checked="" type="checkbox"/> Maintain Focus on the Brand
<input checked="" type="checkbox"/> Effective Marketing Strategy as a Brand	<input checked="" type="checkbox"/> International Growth	<input type="checkbox"/> Leadership does not Ossify
<input checked="" type="checkbox"/> Authentic Brand Intangibles	<input checked="" type="checkbox"/> Loyal Core Customer	<input checked="" type="checkbox"/> Cash Flow Generation in Core Markets
<input checked="" type="checkbox"/> Sufficient Marketing Investment	<input type="checkbox"/> Success in Category Extensions	<input type="checkbox"/> Leverage Overhead/SG&A with Scale
<input checked="" type="checkbox"/> Reliable Product/Service Quality	<input checked="" type="checkbox"/> Anticipate Challenges from Competitors	
<input checked="" type="checkbox"/> New Product/Service Category	<input checked="" type="checkbox"/> Know When to Say 'No'	
<input checked="" type="checkbox"/> Effective Management & Leadership	<input checked="" type="checkbox"/> Avoid Non-Core Acquisitions	
<input checked="" type="checkbox"/> Robust Sales Growth in Core Market		
<input checked="" type="checkbox"/> Product Evolution & Investment		

Source: Company data, Credit Suisse estimates.

#### The New Julius Baer

With the new realignment, the focus of the bank is as a pure-play wealth manager targeting private clients, family offices, and external asset managers. From its expansion, management expects to gain market share in Switzerland and selectively to expand in Europe while ensuring that it leverages its global footprint by increasing its presence in Asia and other emerging markets, which it considers its second home. Switzerland continues to be its largest markets; as the only pan-Swiss private banking group, it aims further to consolidate its market share in the Swiss market.

From the fourth quarter of 2008 through 2009, Julius Baer was focused on consolidation and the company's realignment. The separation of the private bank and the asset management division was a significant move for Julius Baer in this *Transform & Proliferate* stage. Furthermore, cost reduction was a large initiative for the company to adapt to the constrained environment, and Julius Baer indeed lowered its operating expenses by 8% over 2009.

The company is preparing for the next phase of focused growth, in which it will identify key industry challenges and growth opportunities. It expects to see a return to investment and will organically capitalize on potential growth opportunities and via M&A.

## Growth Strategies & Opportunities

### Market Share Opportunities

Switzerland remains Julius Baer's most important market. In addition to expanding its European onshore presence, Julius Baer declared its goal to build Asia as its second home market. We continue to believe that Julius Baer is well positioned to capture further market share in its home market of Switzerland and to accelerate growth at its international locations. The positive view is based on the fact that Julius Baer, like many Swiss private banks, has heavily invested in expansion into untapped markets, such as the Middle East, Central and Eastern Europe, Latin America, and Asia, where there is increasing demand. Therefore, the company is less dependent on growth in its home market of Switzerland (offshore). Despite the tough market conditions, net new money inflows even in the difficult period during the second half of 2008 and the first half of 2009 has been positive. In its most important markets—Germany and Italy—Julius Baer has gone local. In Germany, Baer has now five locations. In Italy, it opened up an office in Milan and made a small acquisition in 2010.

### Exhibit 193: Switzerland as Key Growth Driver



#### Market Opportunity

- Attractive growth potential
- Opportunity to gain market share through organic growth and consolidation

#### Strategic Priorities

- Switzerland as largest single market for Julius Baer Group
- With 3 strong hubs and 12 other locations, only pan-Swiss pure private banking group
- Reinforce market positioning
- Enhance domestic product and service offering (mortgages, etc.)
- Continue to be provider of choice for external asset managers
- Leverage strong brand

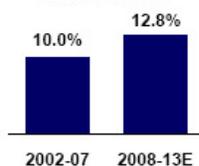
Source: Company data.

### Exhibit 194: Asia Most Important Target Market

#### HNWI AuM (2008)



#### AuM CAGR



#### Market Opportunity

- #3 largest HNWI market in the world
- Highest growth potential; expected to become #1 market by 2013E

#### Strategic Priorities

- Build Asia as 'second home'
  - High AuM growth rates
  - Significant untapped potential
  - More than 350 staff (>10% of overall staff)
- Leverage Singapore as hub for
  - Marketing in South East Asia
  - Global booking center
  - Product platform and backoffice for Asia
- Leverage Hong Kong as North Asia marketing hub (branch status envisaged)
- Julius Baer named best boutique bank two years in a row



Source: Company data.

### The Effects of the Downturn and Recent Restructuring

After the separation, Julius Baer has become a pure private banking group, with no investment banking operations or asset management operations. Therefore, we believe that its revenue stream has become even more stable, as we have seen with its first half 2009 results, in which revenues at the private banking division declined by just 9% compared with the (still good) first half 2008 result. In respect to cost control, we believe that Julius Baer is much better off, as its compensation system has become more flexible. In the first half of 2009, personnel expenses were reduced by 10%, resulting in a good cost/income ratio of 63%. Julius Baer is the number one publicly listed pure private

banking group in Switzerland. Compared with 2000-05, it has regained growth momentum, which we think will continue, as Julius Baer has gone through an extensive expansion and is now present in most of the important growth markets, in our view.

Given the fact that its now a pure private banking player, we argue that the stock should trade well above its historical average, where it was active in investment banking and asset management, areas for which revenues are more volatile and of lower quality. We still think private banking is the most attractive business area in banking, with solid growth prospects, a stable revenue stream, and a rather low capital requirement.

The economic downturn of the past 18 months has had a negative impact on the financial services industry, and it has been manifested in the negative investor sentiment toward the sector. However, this crisis has also given an opportunity for institutions to get an early advantage when the market scenario improves. The current crisis has seen an increase in preference for specialized institutions and specialized services. It is in this context that pure-play institutions stand to leverage their market position and tap this increasing potential. This is more prominent in the case of banks for which pure-play wealth managers and private banks have managed to survive the financial crisis owing to their increased focus on niche or customized services compared with banks with exposure to a large variety of products and services.

### **Strong Net Money Inflows**

The bank has been on target with its estimates and has overachieved its net new money targets in 2007 and 2008, with annualized growth of 9% and 11%. Even in tough market conditions in the first half of 2009, Julius Baer managed to post annualized net new money growth of 6% (SFr4 billion) in-line with the targets. We believe the second half of 2009 should see an acceleration of this growth, given the investments in expansion into newer markets and the hiring of new relationship managers. This has already occurred in the past couple of years (since 2006, when Baer started with its global expansion and the hiring of new relationship managers).

### **Excess Capital Likely to Be Focused on Acquisitions**

The strong capital base allows Julius Baer to play an active role in the consolidation process of the wealth management industry. We believe that any potential acquisition in this field should be quite earnings accretive. We think a reasonable acquisition (at a reasonable price) could bring significant synergies. Even after the announced acquisition of ING (Switzerland), we estimate that Julius Baer has excess capital of about SFr500 million, which would allow it to acquire additional assets under management of SFr25-35 billion.

With a Tier I ratio of 24% (including proceeds from Artio IPO of US\$300 million, before the announced acquisition of ING (Switzerland), Julius Baer is strongly capitalized (Julius Baer's target is a Tier I ratio of about 12%). Even after the announced acquisition of ING, Julius Baer stated that its Tier I ratio stands at about 16%. Based on this, we estimate that the company has an estimated excess capital of about SFr500 million, which would allow them to go for further acquisitions (SFr25-35 billion of assets under management). Julius Baer has a strong track record with acquisitions. The company was able to integrate quickly and smoothly the private banks acquired from UBS in 2005; it also achieved significant synergies and improved efficiency.

## **Major Catalysts**

- **Acquisitions on the horizon?** Even after the completed acquisition of ING (Switzerland), we estimate that Baer still has a Tier I ratio of 15-16%, leaving it with an excess capital position of about SFr500 million. Therefore, we think a further announced acquisition could well be a positive trigger for the stock. Baer announced that it expects the acquisition of ING to be earnings accretive from 2011 onwards (high single digits).

- **Further growth from emerging markets and new relationship managers.** Another trigger could come from accelerated net new money growth in the range it achieved in 2007 and 2008 (9-11%), which we believe should be positive, given its expansion into emerging markets and the hiring of new RMs over the past couple years.

## Key Risks

The biggest risk we see would be a sharp decline of the growth of the emerging markets and hence a much lower wealth creation. However, another risk would be that is more a cyclical issue than a structural problem, that we again see sharply declining equity market, as about 20% of Baer's clients assets are invested in equities.

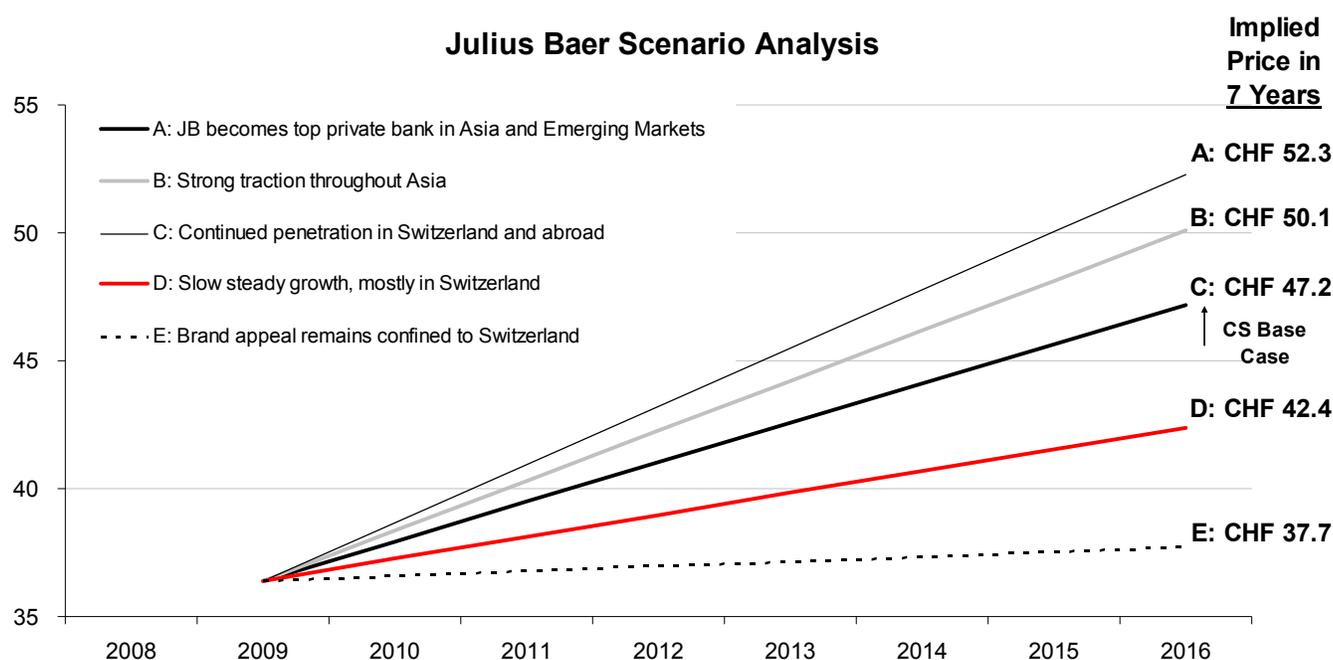
## Valuation

Based on our DCF valuation, we derive a target price of SFr48, which gives investors a potential upside of about 40%. We believe that the growth potential of this private banking unit is good. With a 2011 P/E multiple of 13, the valuation is attractive and is at the lower end of its historical trading range of 12-22. Compared with the valuation of U.S. asset managers (about 22), we believe that Julius Baer is cheap.

We would argue that as a pure wealth manager, the new Baer deserves a higher valuation than when it also had institutional/GAM and PLF assets. Institutional assets are less sticky than private banking ones. Furthermore, compared with pre-2005, when Baer started its expansion, it now has a much wider global reach and achieved significant growth in terms of net new money inflows, whereas in 2000-05 it had almost no growth or even outflows. In addition, from the private banks acquired from UBS in 2005, Baer was able to take out significant synergies and substantially improved its efficiency (to 63% in the first half of 2009 from over 70%).

## Financial Statements and Comparable Valuation

### Exhibit 195: Current Stock Price Embeds Conservative Growth Expectations



	A	B	C	D	E
Discount Rate (%)	10.40%	10.40%	10.40%	10.40%	10.40%
Discounted Cash Flow	1921	1879	1827	1746	1666
Discounted Value of Terminal Value	9295	8916	8427	7610	6815
Value of Surplus Capital	2621	2621	2621	2621	2621
Total Firm Value	13837	13415	12876	11977	11101
Total Equity Value	9797	9375	8836	7937	7061
Shares outstanding	207	207	207	207	207
Equity Value per share	47	45	43	38	34
<b>Implied Price</b>	<b>52.3</b>	<b>50.1</b>	<b>47.2</b>	<b>42.4</b>	<b>37.7</b>

Source: Company data, Credit Suisse estimates.

### Exhibit 196: Julius Baer Trades at a Discount to the Group despite Above Average Growth Prospects

Ticker	Price	Mkt Cap	Group AuM (SFr bn)			EPS				P/E				
			2008	2009	2010E	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	3 Yr Avg	
<b>Julius Baer</b>	<b>BAER1.VX</b>	<b>33.70</b>	<b>6.8</b>	<b>274.6</b>	<b>154.0</b>	<b>181.8</b>	<b>4.36</b>	<b>3.21</b>	<b>2.84</b>	<b>3.28</b>	<b>12.7</b>	<b>14.4</b>	<b>13.0</b>	<b>13.4</b>
EFG	EFGN.S	14.90	2.1	77.2	96.2	119.6	2.06	1.33	0.50	0.90	12.2	30.9	19.5	20.9
Sarasin	BSAN.S	37.60	1.9	69.7	76.6	87.3	3.11	1.55	1.86	2.10	16.9	16.7	14.8	16.1
Vontobel	VONN.S	31.60	2.0	62.4	67.2	73.1	4.10	1.78	1.38	2.11	12.4	22.8	15.0	16.7
Average											13.5	21.2	15.6	16.8

Source: Company data, Credit Suisse estimates.

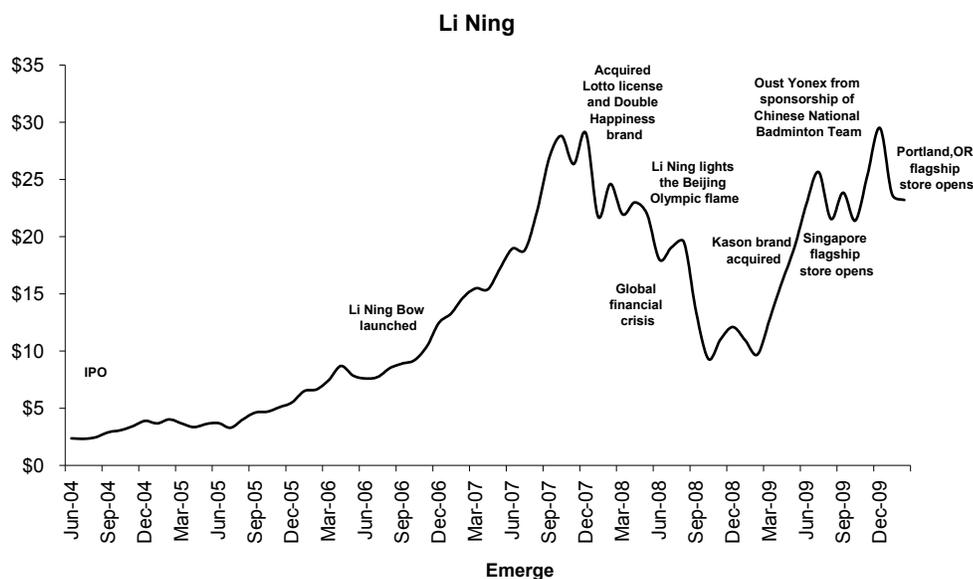
# Li Ning Co., Ltd. (2331.HK): The Authentic Asian Sports Brand?

## Exhibit 197: Li Ning Stock Price History

Catherine Lim

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catherine.lim@credit-suisse.com



Source: Company data, Credit Suisse estimates

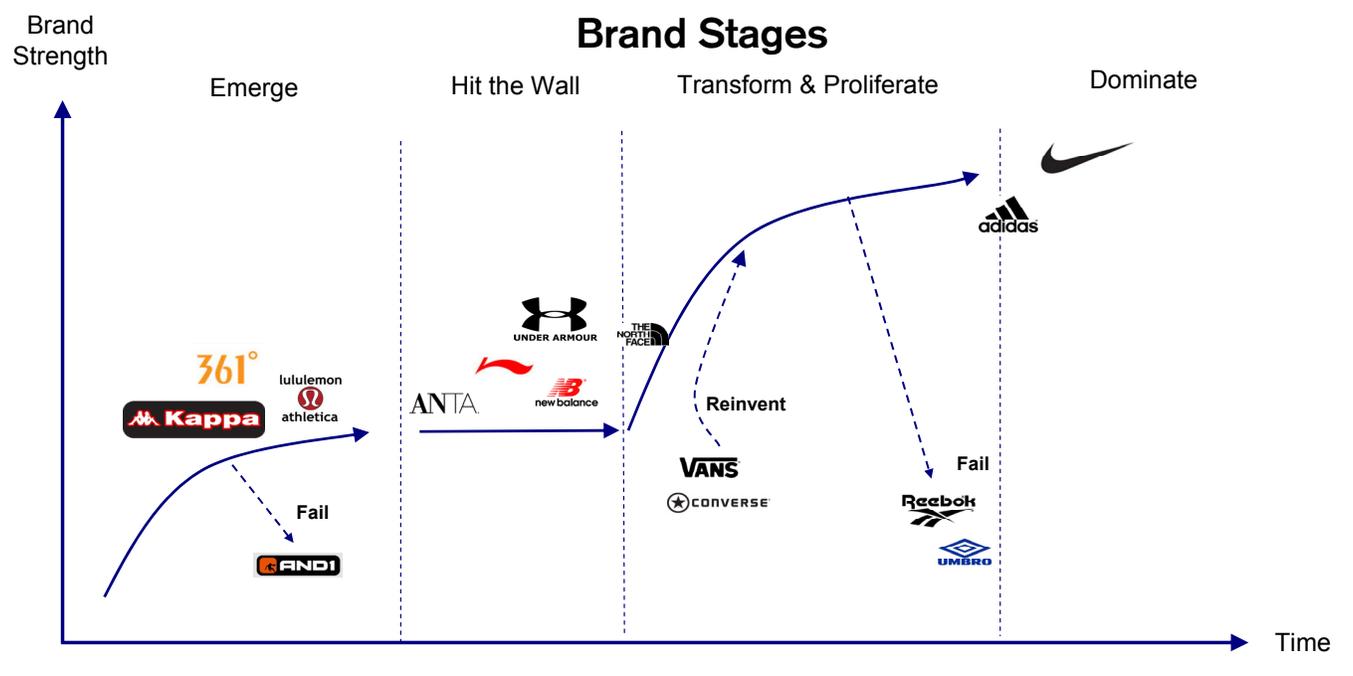
## Investment Summary

- **Unique Brand Story.** Li Ning stands out as a domestic Chinese sports apparel and footwear brand with an authentic link to performance athletics in China, from its founder Olympian gymnast Li Ning and from its growing focus on Asia-friendly sports, such as badminton and table tennis. The way we see it, Li Ning is the early pioneer in the sporting goods market in China, where brands need to have the right combination of functional yet fashionable products to capture a share of its exponential growth.
- **Brand Opportunity.** We believe the presence of the domestic Chinese sports brands in China is understated, particularly if one is to take into account the second and third tier markets of the country. As the segmentation between sports and fashion gets better defined in China in the longer-term, we believe Li Ning is one of the best-positioned domestic brands to tap into the resulting opportunities. Several industry studies have pointed to a doubling of the worth of the sports market in China to more than US\$18.3 billion in China by 2012 from US\$9.6 billion in 2008. From our estimated revenues of 6,690 RMB (US\$966 million) in 2012, we see room for further growth within China and added boost from the international markets to drive revenues to new heights of 16,210 RMB (US\$2.3 billion) in 2012 or more than a three-fold increase over the period.
- **Market Perception.** Within China, Li Ning is the most recognized domestic sports brand among the Chinese consumers, being dubbed by some as “China’s national sports brand”. For those who have been closely following sports events within China, this should not come as a surprise given Li Ning’s close association with some of the strongest Chinese national sports teams. Five of China’s national teams in the fields of diving, gymnastic, table-tennis, shooting and badminton brought in nearly two-thirds of the gold medals won by the Chinese delegation during the Beijing 2008 Olympics. Over the last three years, our Credit Suisse China Consumer Survey had also

consistently affirmed Li Ning's position as the leading domestic Chinese sports brand, being the most frequently purchased brand and that most desired by respondents in eight different cities.

- Valuation.** We see Li Ning as a good long-term investment into emerging brands from China. At its current valuations of 19.4x and 15.2 times our 2010 and 2011 EPS estimates, while the near-term upside potential appears less compelling relative to the rest of the sector, long-term investors should nonetheless be on the look out for entry opportunities that may emerge amid macro volatility. We see a good entry level at HK\$25 or lower, from where the upside potential at an implied 2011 P/E multiple of 15 would be more equitable 12 months down the road.

#### Exhibit 198: Sports Apparel and Footwear Industry Competitive Brandscape: China

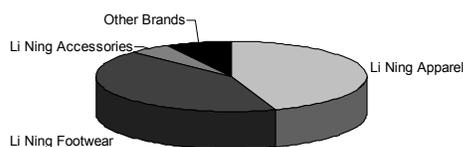


Source: Company data, Credit Suisse estimates.

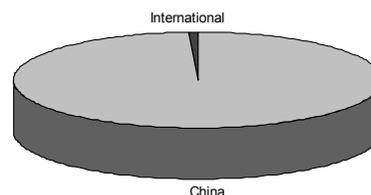
## Brand Overview

Li Ning was started by its namesake in 1989, five years after winning gold in the 1984 Olympics for gymnastics. It was also the first Chinese sports brand/company to be publicly listed in June 2004, on the Hong Kong exchange. The company has a multibrand approach, including Z-DO (via supermarkets), AIGLE (a joint venture with a French outdoor brand), Lotto (an Italian brand license), and two equipment brand acquisitions (Double Happiness for table tennis and Kason for badminton) that could eventually have their own lines of apparel and shoes in China. The Li Ning brand contributes the vast majority of sales, over 90% in 2008, and is in over 7,000 stores, of which 6,800 carry the Li Ning brand. Among its many milestones, the most notable would likely be during the Beijing 2008 Olympics, when its founder, Mr. Li Ning, was selected to light the cauldron of the Olympic flame at the final act of the astounding opening ceremony of the games in China.

In addition to plans for its core Li Ning brand, the company has nearly completed its plans for the next wave of development in China's sporting goods sector through a multibrand portfolio (Double Happiness, Karson, Lotto, Aigle, Z-Do) that provides for a wide spectrum of functionality and fashion needs of its targeted consumers at various price segments in China.

**Exhibit 199: Li Ning Business Mix (1H09)**

Source: Company data, Credit Suisse estimates.

**Exhibit 200: Li Ning Geographic Mix (1H09)**

Source: Company data, Credit Suisse estimates.

## Brand Development State: Emerging

Li Ning is in the process of cementing its long-term positioning, through its focus on Chinese sports and reinforcing its authenticity with the Chinese consumers, albeit its lead over domestic peers.

### Exhibit 201: Li Ning Is In the Brand Emergence Phase and Will Quickly Move in the Transform & Proliferate Phase

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Keep Reinforcing the Authenticity and Asian Qualities of the Brand

We believe Li Ning is moving in the right direction of finding a spot in the upper echelon of sports brands globally by first establishing its credibility in the Asian sports markets. Management has set its eyes on dominating the fields of badminton and table tennis, which should not be too difficult a task, given that it already has a large domestic market in China from which to draw strength. Continuing to present Asian athletes with role models and differentiated products could be the authenticity that allows Li Ning to win.

Li Ning has already shown its distinct abilities to tailor made marketing programs geared toward its targeted consumers in China, where it has been actively incorporating the Chinese culture into its products, such as its patented Li Ning Bow (李宁弓) (launched in 2006) antishock concept, which was inspired by the ancient Chinese arch and bridge structures; Li Ning also launched four different categories of badminton rackets—namely Windstorm (风), Flame (火), Rocks (山), and Woods (林)—that epitomize the blend of Chinese traditional art of war and modern technology, as it kicked off plans to dominate

the field of badminton. On top of this, Li Ning has its flagship program, LI-NING Hero Vans (李宁英雄大篷车), where dedicated personnel travel across China for 175 days during each year and stopover at 70 cities to encouraging sports enthusiasts to participate in sports activities and enjoy the pleasure of sports. Such event can reach out to at least 250,000 consumers in China on an annual basis and more important, makes a greater impact on consumers in China versus TV advertisements or even selected sponsorship.

**Niche in Local Distribution and sales in China** Second- and third-tier cities are expected to outperform the first-tier ones in the coming years, and with this growth will come increased discretionary spending. Li Ning has the capability to navigate the chaotic and fragmented distribution in these second- and third-tier markets better than large established foreign brands and gain share at their expense. For instance, to achieve the growth support from improved store productivity, LN has begun working with its top 23 distributors (customers) to help lift their overall retail management abilities. In particular, some of these self-grown entrepreneurs are running retail operations that are several times bigger than when they started and, in view of the escalating costs pressures from higher rentals and wages, more sophisticated managerial and resource allocation skills need to be established. Li Ning essentially helps each of these distributors evaluate their strengths and weakness and participate in the setting of the long-term strategy and goals for them. We believe such collaborative relationships of the Chinese sports brand with their on-the-ground distributors are one of the key competitive advantages over their international competition in China.

### International Expansion

Li Ning is reaching out to the rest of the world, starting from Asia with the launch its branded badminton products in Southeast Asia (SEA), one of the world's biggest badminton markets out of China. Using SEA's key economic hub, Singapore, as its platform, Li Ning currently is sponsoring the Singapore National Badminton Team and has also sponsored the Singapore Open in June 2010. In addition, it also established its first badminton flagship store in the high-end ION Orchard mall in Singapore in July 2010. The benefits of these moves may be more progressive rather than immediate, but we believe they could be worth the wait.

### Leverage from Other Brands

Li Ning's multibrand portfolio remains fairly understated at this stage. This portfolio currently comprises three other self-owned brands—Double Happiness, Z-Do, and Kason—and two long-term licensed brands, Aigle (French-based niche, functional sports brand), and Lotto (Italian fashion-oriented brand). Double Happiness, which together with its subsidiaries, is principally engaged in the manufacture, research and development, marketing and sale of table tennis, badminton and other sports equipment under the Double Happiness and Kason brands, which fall in-line with Li Ning's targeted focus on these sports. Z-Do brand is used to capture an initial presence through hypermarket channels that is expected to see exponential growth in the long term.

The long-term benefits of the licensed brands appear weak, but they provide additional avenues of sales and income for Li Ning in China for the next decade until the existing disparities in tastes and preferences by Chinese consumers narrow. Notwithstanding, we are of the view that there are know how in product design and technologies from their joint venture partners for AIGLE and Lotto brands that Li Ning would be able to learn from while they last. These could lay the foundational for the next wave of opportunities/growth for Li Ning in future.

## Major Catalysts

As its core Li Ning brand continues to evolve, we see the following three drivers backing the company's growth ahead.

- **Continued success from tailor-made marketing programs for its target consumers.** Li Ning has always deemed brand building as the focus of its business and a reflection of the company's core competencies. As the first domestic sports brand to gain visibility through its public listing in Hong Kong in 2004, the management team holds strong sports marketing resources and marketing capabilities to enhance the brand image and equity of the Li Ning brand. Li Ning's commitment to brand building can also be noted from its continued investment in the advertising and promotion, despite the fall off in sales earlier in 2009. While NKE dropped its marketing spend in China 74% to RMB208 million (US\$30 million), Li Ning increased its budget by 16.5% and surpassed NKE, at RMB286 million (US\$42 million) in the first half of 2009.
- **Ability to tap second- and third-tier city growth.** Li Ning should be in a strong position to tap into the stronger growth from the second- and third-tier cities of China. As the Chinese economy expanded, investment and development are increasingly focused on second- and third-tier cities, which have shown stronger economic growth than first-tier cities such as Beijing, Shanghai, Guangzhou, and Shenzhen in recent years. Based on official Chinese statistics from CEIC, in 2001-06, the GDP per capita for select second- and third-tier cities has grown at an average CAGR of 16.3% and 22.3%, respectively, higher than the 15.1% average CAGR of GDP per capita experienced by selected first-tier cities during the same period. However, these markets of huge growth potential are often characterized by what would appear to be unruly retail distribution systems by developed market standards, which we believe the domestic Chinese brands can deal with better than their foreign peers. Meanwhile, Li Ning is also taking steps to mitigate an expected consolidation albeit mild within the Chinese market in the medium term. Essentially, instead of relying on store openings for growth, more (60%) of Li Ning's growth over the next five years will be driven by improved store productivity, i.e. same-store-sales (SSS), versus new store openings.
- **International expansion into rest of Asia.** With less than 1% of 2008 sales coming from international markets, there is huge potential as this brand rolls out in Asia and progressively to the rest of the world. Li Ning's first overseas (excluding China) flagship store was launched in July 2009 in Singapore (ION Orchard Mall), followed by a second one in Hong Kong (Tsim Sha Tsui). A separate visit to Hanoi, Vietnam (Big C) seemed to suggest that there are other stand-alone Li Ning stores in other parts of the world. In SEA, Li Ning has more than 100 points of sales, though these are mainly located in multibrand sports stores with the exception of the store in Singapore. A third flagship store currently is slated to open in Portland, Oregon, located at the base level of its design and technical development studio in Portland. Similar to the store in Singapore, the one in Portland will be directly operated by Li Ning. Since the store is to be located at the basement of the same premises that houses its technical center so that the incremental costs to Li Ning is expected to be minimal. While moves outside of China is likely to remain small in the near term, if long-term plans are well conceived, these may present new opportunities for Li Ning, especially given its status as one of the most esteemed domestic sports brand.

## Key Risks

### Poor Sponsorships/Marketing Could Take the Brand Back a Couple Years

Sponsorships or sports events and/or sports stars historically come with their share of challenges, scandals, and switched loyalties. The unfortunate side effect of such controversies is negative brand association. The impact on corporate sponsorships versus individual sponsorships is likely to be far less direct, but companies must pay attention to controversy related to the sports they sponsor and prepare a crisis communication plan should something overly negative occur. In the worst-case scenario of the termination of a sponsorship, it is unclear if there would be any follow-through repercussions from the

unwinding of extensive contractual relationships, elimination of jobs related to support the sponsorship, and perhaps most important the relations among sponsors, suppliers, partners, customers, and fans, etc.

### **Creating Conviction in Its Technological Expertise**

The general market perception toward the emphasis by Chinese sports brands on product research and development and enhancement of the technological content of products remains weak relative to that of brands from the developed markets. The way we see this, it would likely be an issue of time before the market warms up to the Chinese sports brands, which are younger than their developed market peers. As we continue to monitor this progress, it should be noted that Li Ning has made one of the earliest investments into design, research, and development centers in mainland China, Hong Kong, and Portland, Oregon, each staffed by their own team of professionals. Li Ning has worked on an ongoing basis with reputable education institutions and professional bodies in conducting research and development. Established in November 2008, the Li Ning Sports Science Research and Development Center specializes in sports science research, product testing, research and development of core technology, and enhancement of product functionality, through which management aims to uplift its technological standards to a higher level and to contribute to the technological innovation of China sporting products. In our view, perhaps the greater challenge for Li Ning, is how to convince the skeptics that it is or can be as good as some of the better known foreign brands.

### **When Will the Leverage from Other Brands Happen?**

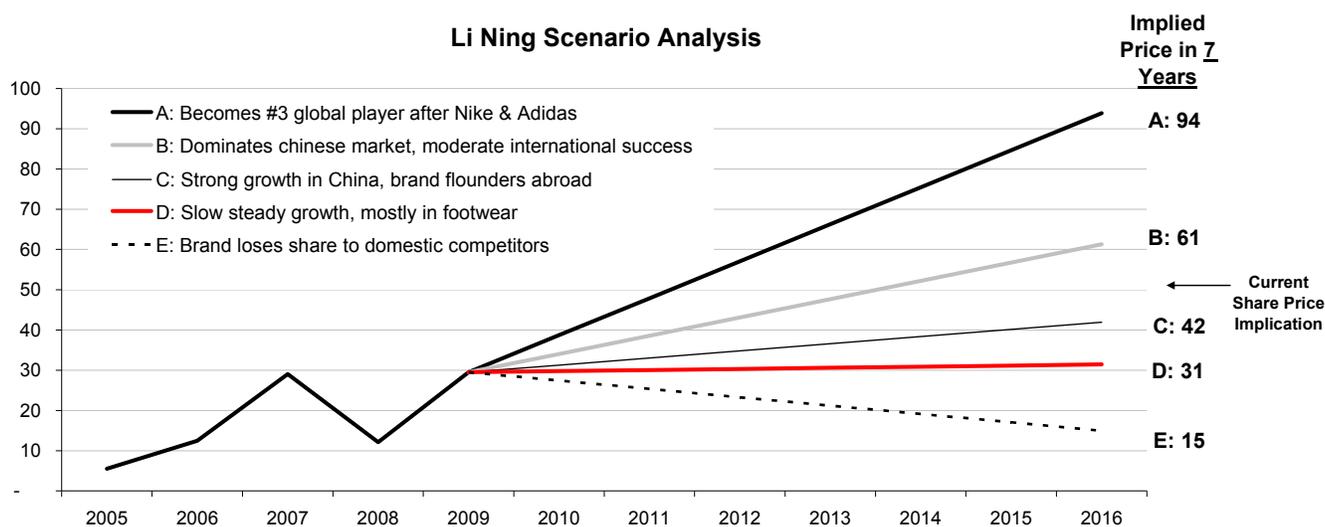
Li Ning first began developing its multibrand strategy in 2006 with a joint venture with AIGLE, but the execution on this had admittedly been patchy to date. AIGLE has yet to deliver much in terms of concrete results though starting 2009 and into 2010, management was convinced that it had fixed the problems of unsuitable product and design mix and overly high pricing and cost structure for a lesser-known brand in China. From the first half of 2009, sales at AIGLE stores improved YoY albeit gradual. Z-DO, which was launched in 2007, made better progress and was profitable within 12 months of its launch. It remains to be seen if the same can be created for Lotto as well as that for Double Happiness, especially as this traditional equipment brand branches out to carry its own line of apparels and shoe products

## **Valuation**

We see a fair value of HK\$27.60, where the implied 2010 P/E multiple of 21.9 is backed by EPS CAGR of 27.4% in 2009-2012, or 0.8 times PEG. We see Li Ning as a good long-term investment into emerging brands from China. At its current valuations of 19.4x and 15.2x times our 2010 and 2011 EPS estimates, respectively, while the near-term upside potential appears less compelling relative to the rest of the sector, long-term investors should nonetheless be on the look out for entry opportunities that may emerge amid volatilities from the macro market. Overall, we see a good entry level at HK\$25 or lower, where the upside potential at an implied 2011 P/E multiple of 15 would be more equitable 12 months down the road.

## Financial Statements and Comparable Valuation

### Exhibit 202: Current Stock Price Embeds Conservative Expectations



	2009E	2016 Scenario Analysis				
		A	B	C	D	E
Sales	8,279	40,000	28,000	20,000	15,000	12,000
Growth CAGR		25%	19%	13%	9%	5%
EBIT margin	13%	15%	14%	13%	13%	8%
Interest other expense	4	4	4	4	4	4
Tax rate	18%	18%	18%	18%	18%	18%
Sharecount	1,048	1,048	1,048	1,048	1,048	1,048
<b>EPS</b>	<b>0.87</b>	<b>4.69</b>	<b>3.07</b>	<b>2.10</b>	<b>1.57</b>	<b>0.75</b>
Growth CAGR	1%	29%	21%	15%	10%	-1%
P/E Multiple	29	20	20	20	20	20
<b>Implied Price, 2016E</b>	<b>25</b>	<b>94</b>	<b>61</b>	<b>42</b>	<b>31</b>	<b>15</b>
Implied 7-yr retrun	0%	280%	148%	70%	27%	-39%
CAGR	0%	21%	14%	8%	3%	-7%

Source: Company data, Credit Suisse estimates.

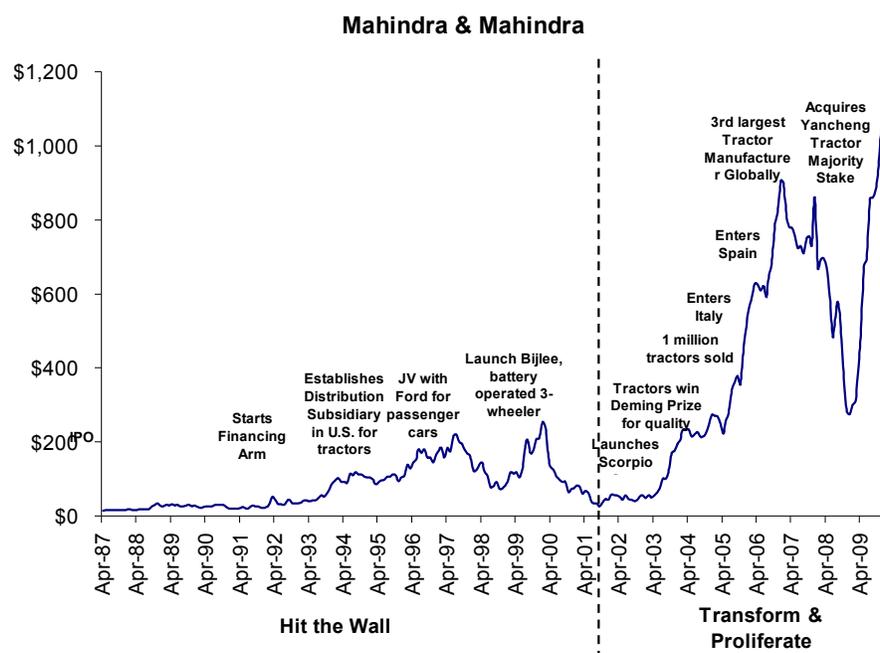
### Exhibit 203: Li Ning Trades at a Premium to the Peer Group Owing to Above Average Growth Prospects

Listed stock name	Stock Code	Price (HK\$)	TP (HK\$)	Up/ (down) (%)	Rec	Mkt cap (US\$m)	6M Daily TO (US\$m)	6M Daily TO (m shares)	010-EV/		011-EV/		010-FCF		011-FCF		Fwd 3-yr EPS CAGR	PEG(α)	
									010-PE*	011-PE*	EBITDA*	EBITDA*	yield*	yield*	010-ROE	011-ROE			
<b>SPORTING GOODS</b>																			
1 Li Ning	2331 HK	24.45	27.60	13%	OUTPERFORM	3,298	12.1	4.1	19	15	13	10	4.4%	3.0%	38%	37%	28%	0.7	
2 Anta Sports	2020 HK	10.22	13.00	27%	OUTPERFORM	3,280	10.8	8.4	15	12	11	8	5.5%	7.2%	27%	29%	28%	0.5	
3 China Dongxiang	3818 HK	4.92	n.a.	n.a.	Not rated	3,597	15.4	24.2	14	12	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	25%	0.6	
4 Xtep	1368 HK	5.19	n.a.	n.a.	Not rated	1,473	1.9	3.7	13	11	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	25%	0.5	
5 Peak Sports	1968 HK	4.99	6.30	26%	OUTPERFORM	1,348	4.5	12.0	12	9	8	6	4.2%	4.9%	27%	29%	23%	0.5	
6 361^^	1361 HK	6.18	n.a.	n.a.	Not rated	1,647	4.9	9.5	12	9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	25%	0.5	
7 China Hongxing@	CHHS SP	0.16	0.16	0%	NEUTRAL	327	3.4	23.8	4	4	(1)	(2)	-0.6%	-2.4%	11%	12%	15%	0.3	

Source: Company data, Credit Suisse estimates.

# Mahindra & Mahindra (MAHM.BO): Indian Brand Takes on the Overseas Auto Market

Exhibit 204: MAHM Stock Price History



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** After starting as an authentic Indian tractor brand, Mahindra & Mahindra (MAHM) has expanded over the past 25 years to include passenger, utility, and light commercial vehicles. While it has not been afraid to partner with foreign companies (including Jeep, International Harvester, Renault, and Ford), the company remains focused on building the credibility of the MAHM brand of vehicles across segments.
- Brand Opportunity.** MAHM is the dominant tractor manufacturer in India, and the biggest opportunities for the brand lie in overseas expansion, to developing countries such as China and parts of Africa and mature markets, such as the United States. The other big opportunity is to continue to proliferate into other automotive categories, building on its success in utility vehicles.
- Market Perception.** While some believe that the stock is fully priced, we believe the combination of margin expansion in its core India business in conjunction with top-line growth driven by international expansion should have significant upside potential for the stock in the next five years.
- Valuation.** MAHM has been among the best-performing auto stocks in the past year, reflecting the strong underlying profitability. With fiscal 2010 (March 2010) marking peak profitability, the stock appears fairly valued, in our view. Our SOTP-based target price of Rs1,014.50 factors in core auto business value of Rs756 (12 times core EPS, in-line with listed peers). However, taking a long-term perspective, we are enthusiastic about MAHM's expansion strategy, especially in international SUV markets.

Govindarajan Chellappa

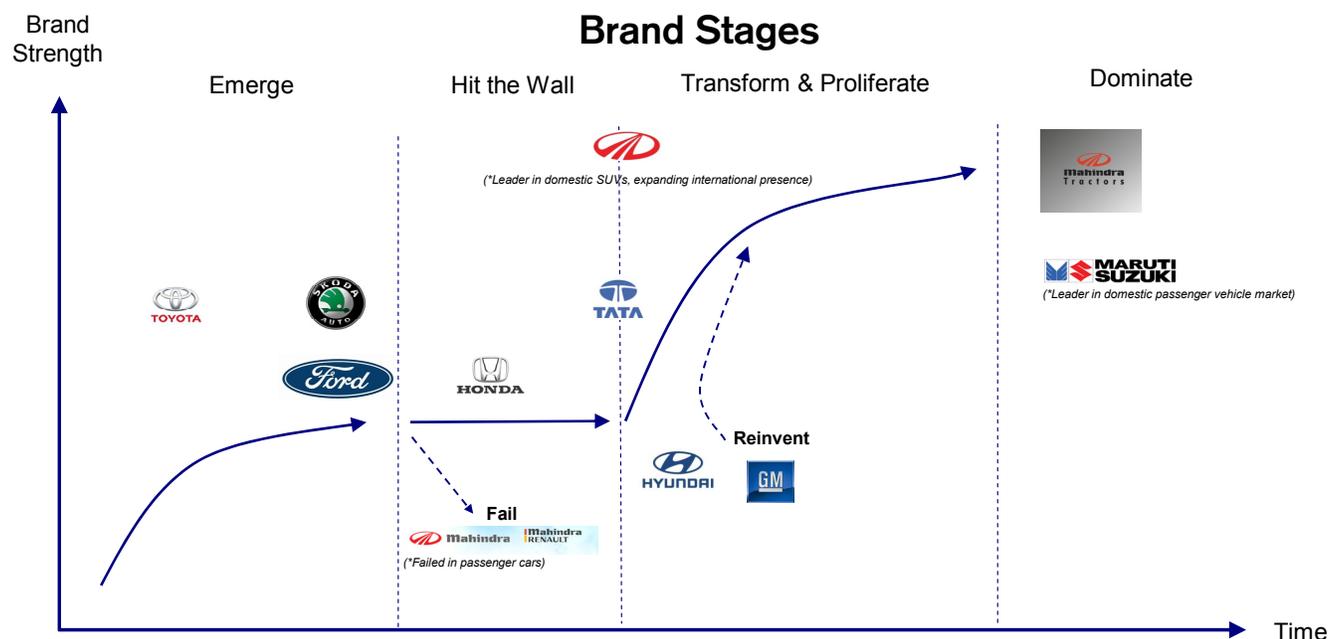
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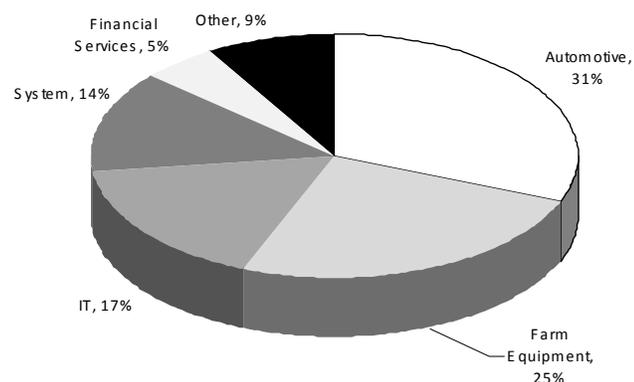
**Exhibit 205: Indian Tractor, MUV, Passenger, and Light Commercial Vehicle Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

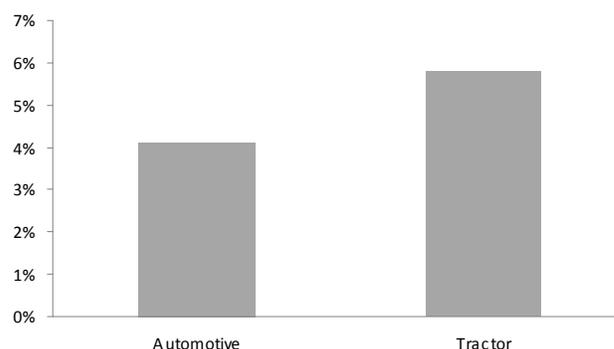
## Brand Overview

Established as a franchise of Jeeps in 1945, the brand really emerged in 1982 with the launch of the MAHM brand of tractors. It focused on domestic growth for about ten years and then began the process of expanding internationally, including the entry to the United States in 1994 to distribute tractors. The next phase of development for the brand was to expand the categories of vehicles the brand manufactured. It initially partnered with foreign companies (e.g., Ford for passenger cars in 1996 and a bus and truck joint venture in 2005), but the brand found its own legs and began to go it alone in certain categories, such as Bijlee a battery-powered three-wheeler launched in 1999 and India's first biodiesel tractor in 2008. The break-through for the brand in terms of category extensions was the Scorpio SUV, launched in 2002, the first Indian SUV.

The company currently is a \$6.3 billion conglomerate. While the company has a range of activities and business units, including infrastructure development, IT systems, and trade and logistics services, vehicles make up well over one-half of its revenue, with tractors gradually taking second place to other types of vehicles (MUV, SUV, light commercial). Recent successes, such as the Xylo launch in utility vehicles and the Scorpio Pik Up model, strictly an export product, have helped diversify the brand's revenue. The big international push for MAHM is two pronged. The first is building on its foothold in Africa, where it sells in 15 markets, and other developing nations, including China (through majority share acquisition of Yancheng Tractor in 2008). The second prong, which is more uncertain than the first, is the entry into developed, competitive markets, such as the United States and Europe. The brand first entered Europe via Italy in 2005, followed by Spain. In 2003-08, international sales had a 64% CAGR, off of a small base.

**Exhibit 206: MAHM Business Mix (Fiscal 2008–09)**

Source: Company data, Credit Suisse estimates.

**Exhibit 207: MAHM Geographic Mix (International Unit Sales as Percentage of Total Units, by Sector, Fiscal 2008–09)**

Source: Company data, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

MAHM is in the high-risk stage of the transform and proliferate stage of brand development. As the brand is tested in new international markets and in new product categories, it must demonstrate that it deserves the trust and reputation that the automobile sector demands of brands.

**Exhibit 208: MAHM Completed the Brand Emergence Phase, Has Made Progress in the Transform & Proliferate Phase, but Remains Far from Approaching the Dominance Phase**

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Tractors for Developing Markets

MAHM currently is one of the top three tractor manufacturers in the world. Building on its 41% market share in tractors in India, it currently aims to solidify its position in one of the other top three tractor markets—China—through a majority share acquisition of Yancheng Tractor, the third largest tractor brand in China. In addition, it is currently growing its market share in parts of Africa, South America, and Eastern Europe. Less than 6% of tractor units currently are sold overseas (about 7,000 units in fiscal 2008-09), so there is considerable upside potential in this arena. Given its huge scale, currently MAHM has the

best cost structure globally, particularly for low-horsepower tractors, and seems well placed to succeed in these markets.

### Entering the Big Leagues on the International Scene

The much-awaited launch of SUVs and pickups in the United States is MAHM's next step toward expanding its international presence. The United States is one of the most competitive markets and has not seen much growth in the past few years. Creating a brand in a segment characterized by strong loyalty is bound to be a challenge. MAHM's strategy centers around a unique product offering: low cost, compact, diesel-driven utility vehicles. The company plans to launch its flagship brand, Scorpio, and two products in the pickup segment. The pickup truck is ready to be launched as soon as April 2010.

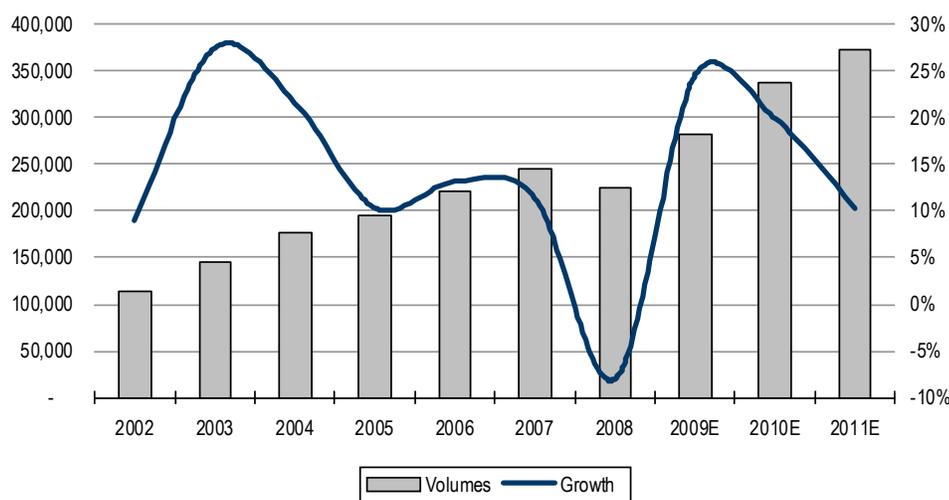
### Product Category Proliferation

MAHM's expansion of its brand into additional product categories outside of tractors and MUVs has been hit and miss, but could provide significant growth opportunities for the brand. Its three-wheeler line and SUVs have found success domestically and abroad. Its passenger car line, even in India, has recently hit speed bumps. MAHM must continue to demonstrate the strength of its brand with category extensions in the core automotive market. If it can successfully do so, it will leverage its competitive advantages of its distribution network to maximize the potential of the brand.

### Indian Domestic Growth

While the Indian economy has softened in the past year, revival in domestic consumption has picked up significantly, aided by the stimulus package and a recovery in global markets. India's GDP is expected to grow at around 8% for the next two years (Credit Suisse estimate). From a consumer side, the SUV and MUV market will strengthen with economic growth. In addition, as farming becomes more mechanized in India, this should play to MAHM's leading position in the tractor market.

**Exhibit 209: Growth of Utility Vehicles in India**



Source: Company data, Credit Suisse estimates.

## Major Catalysts

We believe the three key catalysts for MAHM over the next five years are the following.

- Expansion in developing countries.** MAHM sees that it has much to offer the developing world, primarily in terms of tractors, but secondarily light commercial, utility, and passenger vehicles. Most prominent of the developing countries are China, but Africa and other developing markets should provide the brand with significant upside.

- **U.S. launch of pickups.** MAHM is set to launch three of its vehicles (Scorpio and two pickup trucks) in the United States over the next two to three years. The pickup is expected to be launched as early as April 2010. The U.S. SUV/pickup industry is one of the most competitive markets in the world and has seen little growth over the past few years. MAHM's strategy is to create a niche by introducing a fuel-efficient, low-cost compact truck. The vehicle will be based on diesel engine, which makes it a unique product offering. The company has already tied up a partner (Globe Traders) to manage the sales and distribution of its brands.
- **Growth of the Indian economy.** Continued strengthening of the growth in the Indian economy will help maintain, if not accelerate, volumes in MAHM's core domestic tractor and utility vehicle (UV) business. We expect domestic UVs to grow at a CAGR of 18% in the next three years, while tractors could remain steady.

## Key Risks

### Domestic Competition in the UV Segment

The UV business benefited immensely in the recent past from the success of Xylo, and saw tremendous growth in Balero and pickups. MAHM has also benefited from lack of new products from its key competitors. That is likely to change in the next few months. Xylo will face competition from Tata's (TAMO.BO) Indicruz. As the domestic Indian market grows, competitive pressures can only be expected to increase, posing a downside risk to the proliferation of the MAHM brand.

### Indian Economic Growth

The Indian economy is projected to grow at nearly 8% for the next two years, with strong growth persisting even in the long term. However, over the past few years India has become increasingly linked to the global economy and will be subject to its vagaries. In addition, any decline in government spends can soften growth.

### Commodity Prices Rise

Manufacturing inputs (especially steel) and fuel costs can negatively affect the cost structure of MAHM and the consumer and commercial customer's desire to purchase.

### Tightening of Credit

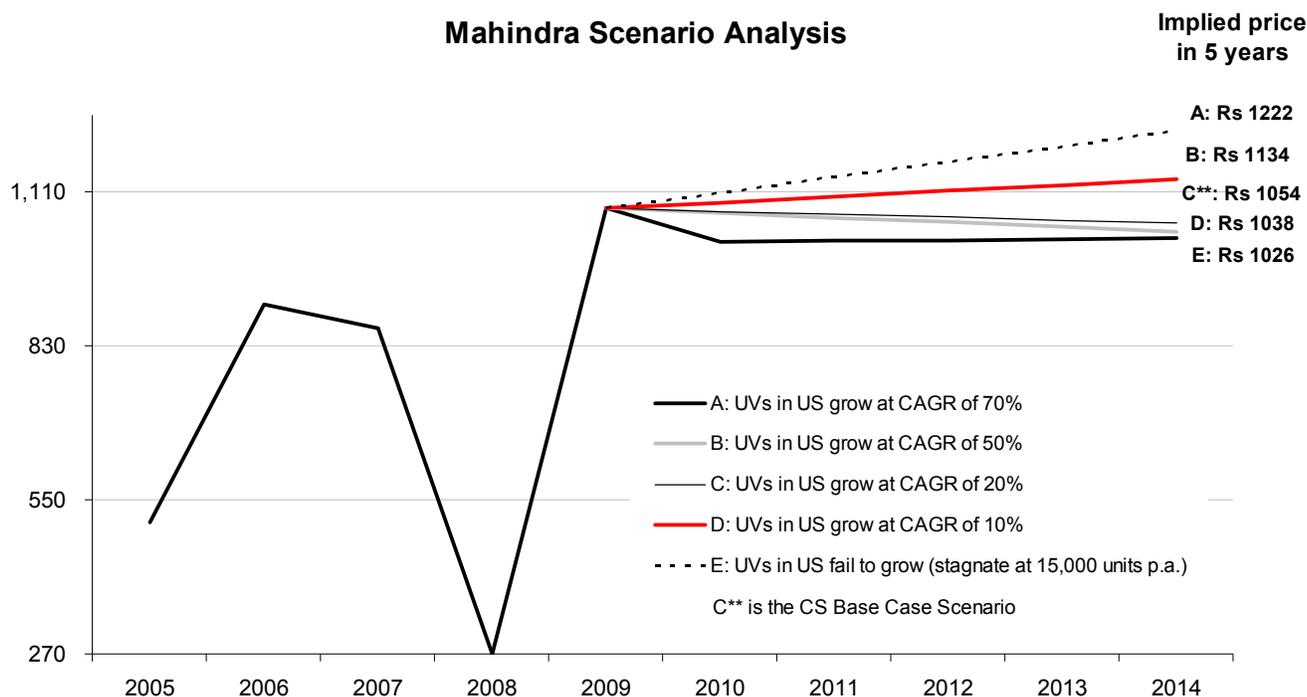
If credit were to tighten, especially in the tractor segment where 80-90% of purchases are financed, this could dampen MAHM's growth. During the credit crisis, tractor industry sales dropped 20% globally, illustrating the damaging effect tight credit can have on this industry. More recent, there have been delinquency problems in the tractor segment at MAHM.

## Valuation

We value MAHM on a SOTP basis, given its substantial holdings in subsidiaries. The core auto business accounts for only about 50% of its revenues, with the rest coming from diverse businesses ranging from IT services to auto components. At Rs756 per share, the core auto business accounts for about 75% of the stock valuation. In the recent past, the company has benefitted from a confluence of favorable factors—strong tractor/UV growth, high margins—leading to strong outperformance. Therefore, the stock appears fairly priced in the midterm, in our view.

However, we are positive about MAHM's expansion/diversification strategy. We believe its foray into pickups and SUVs in the international markets will help the company extend its high growth trajectory over the long term.

## Financial Statements and Comparable Valuation

**Exhibit 210: Current Share Price Embeds Conservative Growth Expectations**


	2009E	2014 Scenario Analysis				
		A	B	C	D	E
Volumes	-	125,282	75,938	31,104	21,962	15,000
Growth CAGR (2010E-14E)		70%	50%	20%	10%	0%
EBITDA/vehicle	40,642	51,951	51,951	51,951	51,951	51,951
EBITDA	0	6,509	3,945	1,616	1,141	779
Tax rate	27%	27%	27%	27%	27%	27%
Post-tax impact	0	4,751	2,880	1,180	833	569
Sharecount	256	256	256	256	256	256
Incremental EPS	0	18.6	11.2	4.6	3.3	2.2
P/E	12	12	12	12	12	12
Increase in share price, 2014E		223	135	55	39	27
<b>Implied Price, 2014E</b>		<b>1222</b>	<b>1134</b>	<b>1054</b>	<b>1038</b>	<b>1026</b>
Implied 5-yr return		22%	14%	6%	4%	3%
CAGR		4.1%	2.6%	1.1%	0.8%	0.5%

Source: Company data, Credit Suisse estimates.

**Exhibit 211: MAHM Trades at a Premium to the Group Owing to Above Average Growth Prospects**

Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	2009	2008	EPS				P/E	P/E	P/E	3-Yr	EV-to-	
						Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	Avg P/E	Sales	
<b>Mahindra &amp; Mahindra Ltd.</b>	<b>500520-IN</b>	<b>\$980.45</b>	<b>\$6,214</b>	<b>\$8,302</b>	<b>\$5,189</b>	<b>12%</b>	<b>312%</b>	<b>-74%</b>	<b>64.09</b>	<b>51.80</b>	<b>76.35</b>	<b>84.82</b>	<b>18.9</b>	<b>12.8</b>	<b>11.6</b>	<b>-</b>	<b>1.6</b>
Honda Motor Co.	7267-JP	\$3,110.00	\$64,002	\$102,727	\$101,359	2%	59%	-37%	382.44	75.50	146.71	204.37	41.2	21.2	15.2	-	1.0
Ford Motor Co.	F-US	\$11.80	\$37,073	-	\$118,300	4%	337%	-66%	(3.02)	-	0.90	1.38	-	12.8	8.4	14.7	-
Toyota Motor Corp.	7203-JP	\$3,325.00	\$126,324	\$226,912	\$207,852	-3%	30%	-41%	566.23	(139.13)	40.08	160.87	(23.9)	83.0	20.7	-	1.1
Tata Motors Ltd.	500570-IN	\$699.10	\$7,318	\$13,909	\$13,778	-1%	422%	-82%	58.30	(56.80)	(3.22)	39.91	(12.3)	(217.4)	17.5	-	1.0
Maruti Suzuki India Ltd.	532500-IN	\$1,336.85	\$8,637	\$8,320	\$4,073	8%	214%	-58%	54.98	42.49	84.75	96.81	31.5	15.8	13.8	-	2.0
Average						4%	229%	-60%					9.2	(12.0)	14.5	2.5	1.1

Source: Company data, Credit Suisse estimates.

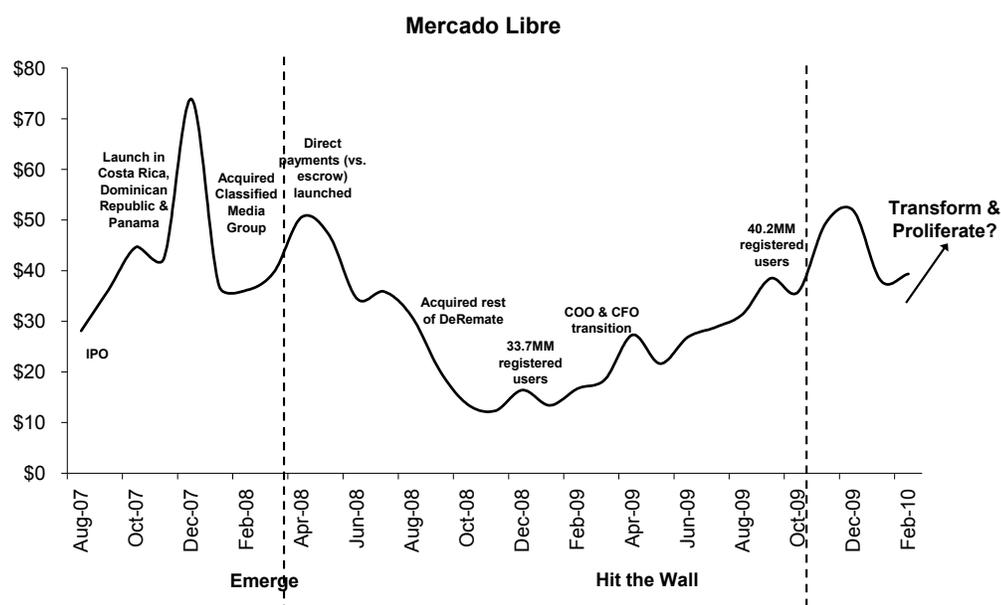
# MercadoLibre (MELI): Latin America's eBay, Paypal, and Craigslist?

Exhibit 212: MELI Stock Price History

Vanessa Quiroga

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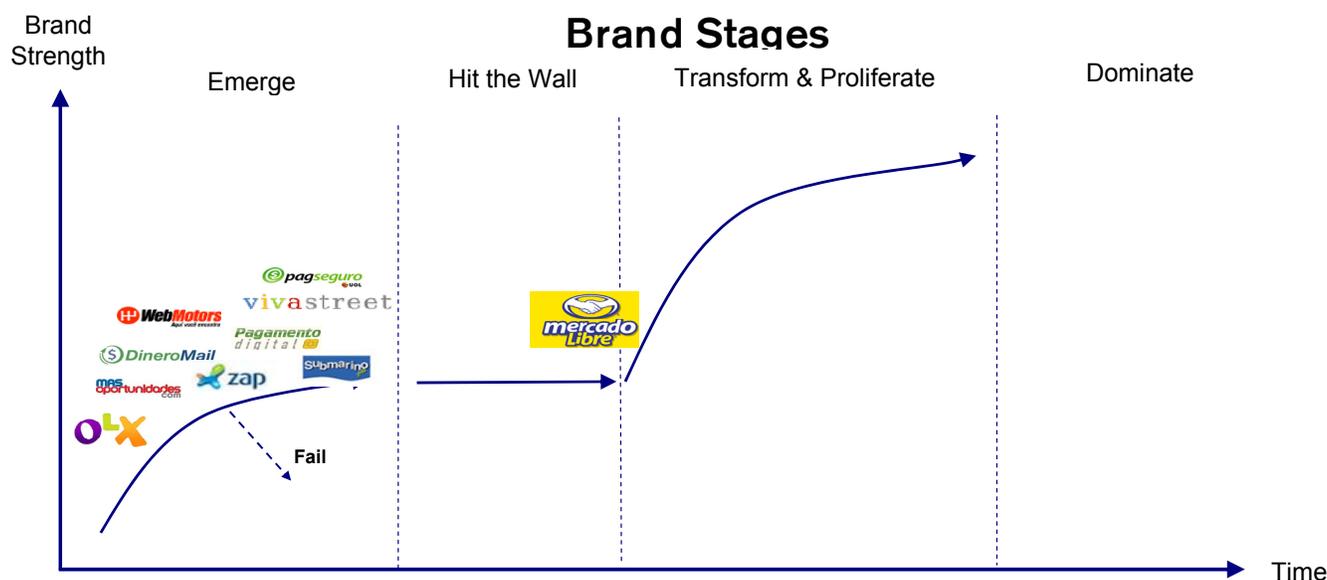
vanessa.quiroga@credit-suisse.com



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** While it may seem like just a copy-cat eBay (EBAY) Web site, MercadoLibre (MELI), the largest Latin American online consumer trading platform and payments processor, has spent the past ten years establishing trust with a consumer accustomed to in-person, cash transactions. This foundation and some strategic acquisitions and partnerships (with EBAY), has positioned the brand to leverage the network effects of the auction business to dominate the nascent online commerce market in Latin America. With a market-leading presence in nine countries, the brand has migrated with the market from a solely auction-based used goods business to a predominantly fixed-price, new inventory model. It has added classified ads and payments to its brand, beginning the transform and proliferate stage of brand development.
- Brand Opportunity.** The big opportunity for MELI is to build its payments business (20% of revenue in 2008), as EBAY has done in the United States with Paypal (PYPL), expanding within its marketplace and to other e-commerce Web sites. This high-margin, low-competition business would serve to extend the brand and to grow its customer base. In addition, as Internet penetration expands in Latin America (currently at 30%, up from 13% mid-2007), the brand should be a beneficiary, given its early-mover status.
- Market Perception.** Despite the comparison to EBAY, MELI has carved out a brand personality for itself and extended the brand beyond just EBAY services, such as classifieds. It has also remained true to its focus on Latin America, not overextending itself by prematurely entering international markets.

**Exhibit 213: Latin American e-Commerce, Payments, and Classifieds Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

## Brand Overview

Started by Stanford Business School graduate Marcos Gaperin in 1999 in Argentina, MELI strived to increase the efficiency of markets using online commerce. The brand quickly grew to have a leading position in Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela. Its marketplace sells used (20%) and new (80%) merchandise using auctions (10%) and fixed pricing (90%). The brand earns revenue from listing fees (about 1%), final value fees (5-10%), optional features fees, and online advertising. Since 2007, it has offered escrow and direct payments services on its Web site, for which it earns 2-10% commission and installment purchases, which are quite lucrative at 13-40% commissions. The final piece of the model was added in 2008 with the acquisition of Classified Media Group, which provides classified ads for cars, real estate, and other services.

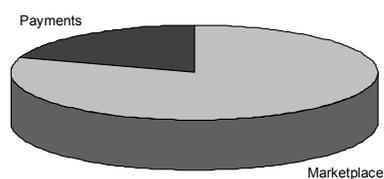
The brand currently has more than 40 million registered users across Latin America, with Brazil, Venezuela, and Argentina being its biggest markets. Its gross merchandise volume was \$2.1 billion in 2008, and has grown by 20%-plus throughout 2009. After becoming cash flow positive in 2004, the margins have consistently expanded, as the brand built scale to leverage SG&A.

### A Trusted Brand

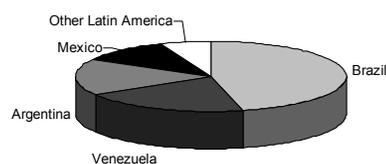
MELI has built trust with consumers in Latin America despite its *buyer beware* fraud policies, more of a reflection of local third-party liabilities laws than MELI's philosophy. It is also seen as a Latin American brand through its country-by-country customization of its Web site for searches.

### Strong Competitive Positioning

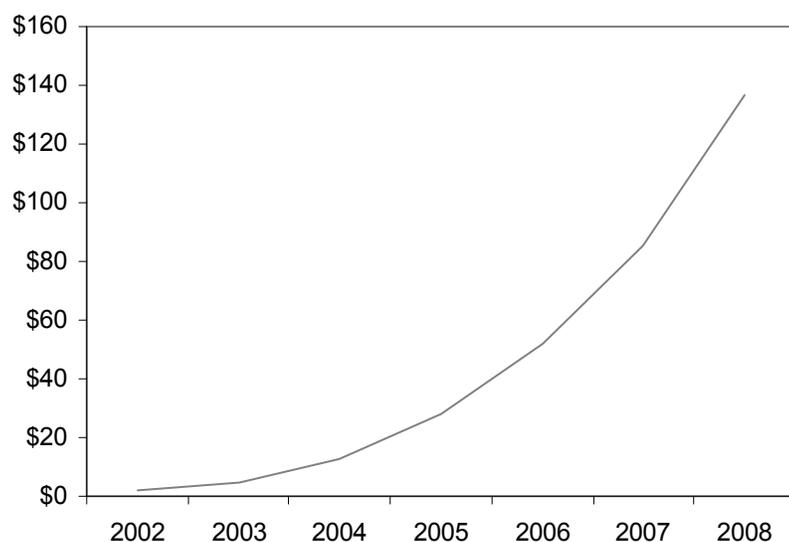
In September 2001, early in its development, MELI established a strategic partnership with EBAY, including a five-year noncompete clause, which helped buy the brand some time to build its presence and gave it significant Brazilian assets from iBazar. EBAY has not sold much of its 19.5% stake in the company and has not made any indications that it intends to enter the Latin American market. After acquiring competitor DeRemate in November 2005 and the remainder in 2008, MELI has a virtual monopoly on auctions and payments in most Latin American countries. This has led to high gross margins—about 80%—almost 10 percentage points higher than those of EBAY.

**Exhibit 214: MELI's Business Mix (2008)**

Source: Company data, Credit Suisse estimates.

**Exhibit 215: MELI's Geographic Mix (2008)**

Source: Company data, Credit Suisse estimates.

**Exhibit 216: MELI Revenue Growth (USD in Millions)**

Source: Company data, Credit Suisse estimates.

## Brand Development State: Ready to Make the Leap

MELI has emerged as the leading e-commerce brand in Latin America, but still has to prove its trustworthiness to consumers as it transforms and proliferates, especially in its payments business. If the company can achieve this trust, the network effects of the auction business should propel into a fairly unassailable market position.

## Exhibit 217: MELI Completed the Brand Emergence Phase, Has Made Significant Progress in the Transform & Proliferate Phase, but Remains Far from Approaching the Dominance Phase

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### A Trusted Market Maker

With over \$2 billion in gross merchandise value and 21 million items sold in its marketplace in 2008, consumers are clearly voting with their wallets in terms of from who they trust to buy online. While MELI does have a *buyer beware* policy toward fraud, it also encourages buyer and seller feedback and ratings, similar to EBAY. If fraud laws become more enlightened in Latin America, this should permit some flexibility in MELI's rules.

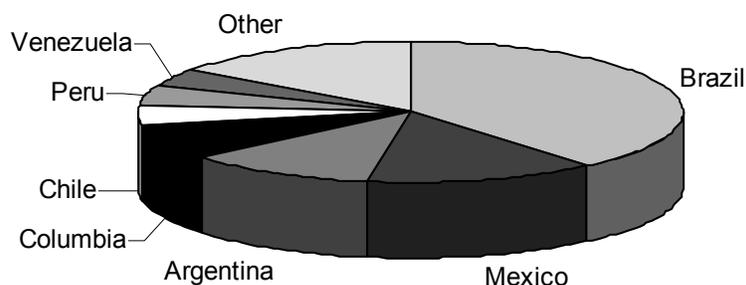
### Latin American Internet Penetration Growth

The past five years have seen rapid adoption of the Internet in Latin America, growing from 11% penetration in 2005 to 13% in 2007 and then to 30% in 2009. MELI has succeeded in recruiting these Internet users to become MELI users, with 23% of them registered as of 2009. Continued growth in Internet penetration should translate into growth for MELI.

### Online Payments Growth

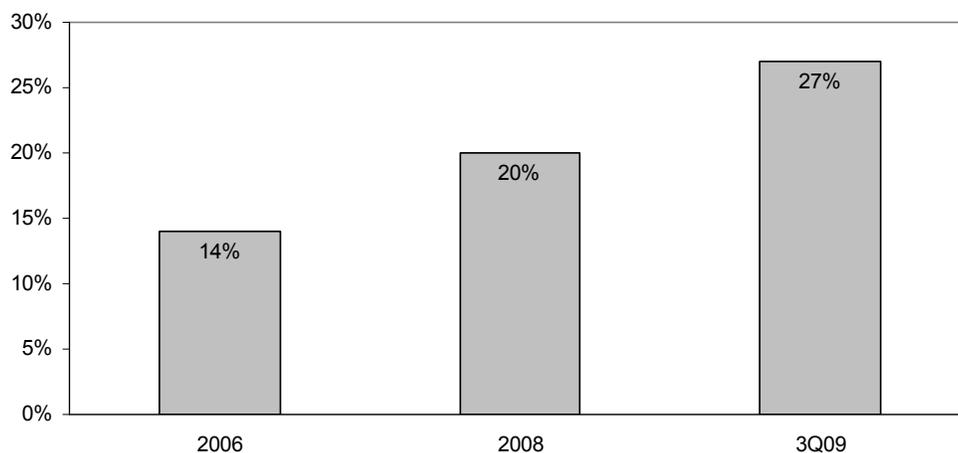
The online payments business, called Mercado Pago, has seen solid growth since its 2007 launch, but has significant upside potential within the Mercado marketplace and in external transactions. The first product, launched in 2007, was an escrow product by which MELI held the buyer's money until the buyer had received the merchandise from the seller. This morphed into direct payments, which functions like a bank account, similar to PYPL in the United States. MELI customized this payments business to the Latin American market by offering installment options to customers at 13-40% commissions. Only 12% of gross merchandise value used Mercado Pago, showing significant potential to increase this penetration. Furthermore, Mercado Pago is not yet offered as a payment option anywhere outside of MELI's Web site, pointing to further room to build this business as the consumer learns to trust online payments. By comparison, PYPL accounts for 33% of EBAY's revenue and surpassed the purchase volume of EBAY's marketplace in 2008. Local competitors in this space include DineroMail, Pageseguro, and Pagamento Digital.

### Exhibit 218: Latin American Internet Users by Country (2009)



Source: Company data, Credit Suisse estimates.

### Exhibit 219: MELI Payments Revenue as a Percentage of Total Revenue



Source: Company data, Credit Suisse estimates.

## Major Catalysts

We believe the two key catalysts for the MELI stock over the next five years are the following.

- Latin American Internet penetration growth.** Out of Latin America's 600 million people, only 175 million of these (30%) use the Internet. While this is up significantly from just 13% two years ago, there is plenty of room to grow, and MELI is well positioned to capitalize on this market expansion.
- Online payments share of wallet increase.** Online commerce has suffered from Latin American liability laws, which hold merchants fully liable for losses owing to third-party fraud (versus limited liability in other geographies). In addition, cash is the primary payments method in this market, owing to in part development, but also to concerns of trust in plastic, electronic, and other forms of payment. As consumers' trust in online transactions and payments grows, this will dovetail with MELI's business model.

## Key Risks

### **EBAY/PYPL Jumps into Latin America**

The five-year noncompete with investor EBAY ended in September 2006, and EBAY has made no effort to enter the Latin American market to compete with MELI. However, that is no guarantee that it will not do so. This could significantly erode MELI's competitive position and market share and eat into its profitability. If EBAY's subsidiary PYPL attacked the Latin American payments market more aggressively (PYPL is in Mexico and Peru), the impact could be devastating to this high-potential payments business.

### **Political and Economic Instability**

Another perennial risk with Latin America is political and economic instability. Owing to its laser focus on Latin America, MELI is especially vulnerable to these risks. Embedded in this is the currency risk that MELI faces operating across nine notoriously volatile markets.

### **Liability and Fraud Laws**

The laws that govern fraud and third-party liability are particularly harsh in Latin America. These laws give marketplace Web sites and payment processors such as MELI less protection and open them up to litigation expenses and financial remuneration of significant scale if this risk is not appropriately managed. Copyright and piracy abuses abound in Latin America, as in many emerging markets, increasing the possible allegations against MELI.

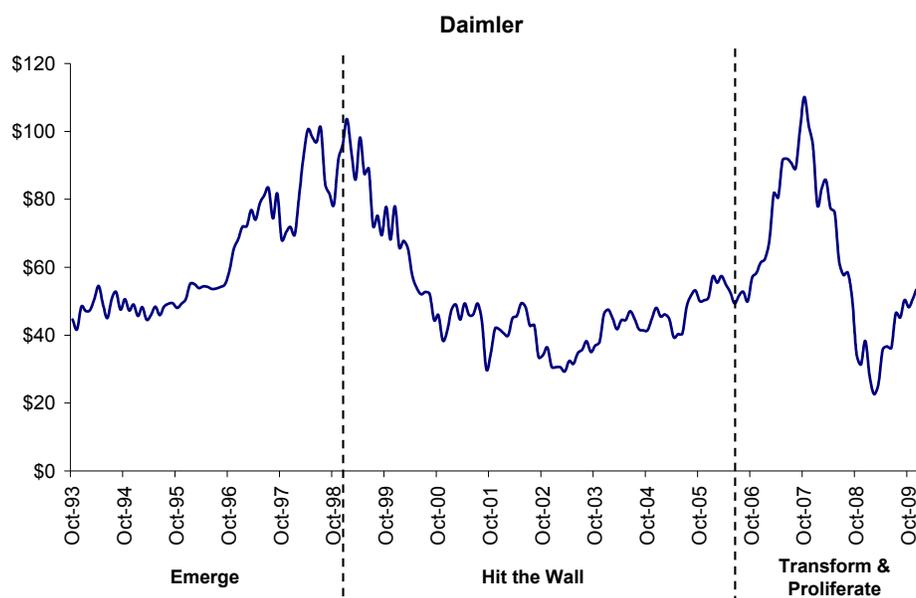
### **Tariff and Tax Evasion Investigations**

Recent investigations into income tax and import tariff evasion involving sales on MELI point to another potential risk for the brand. In Brazil in particular, this issue was raised in late 2009, with ongoing governmental efforts to enforce the payment of import tariffs and income tax by merchants operating on the Web site. Owing to the significant rate of tariffs (up to 50% of the price of merchandise in some cases), the incentive to deal in grey market activities online is significant for consumers and merchants, and the government is equally motivated to pursue this important source of revenue. If MELI becomes linked to such activities, this could negatively affect the perception of trust of the brand.

# Mercedes-Benz: Hidden Value in Mercedes and Trucks

*Mercedes-Benz is a brand within Daimler (DAIGn.DE)*

## Exhibit 220: Daimler Stock Price History



Source: Company data, Credit Suisse estimates

## Investment Summary

- Unique Brand Story.** The turmoil that the auto industry experienced over the last year has reshaped the industry. We believe Mercedes, a car brand of Daimler (DAIGn.DE), stands out from the rest of the industry, owing to its reputation and performance as the leading premium brand. At the upper end, the E and S class and Maybach models offer exquisite luxury. At the lower end, affordable luxury is available through the A/B and C class brands, while the Smart brand offers compact mobility in increasingly congested cities.
- Brand Opportunity.** Overall, we find the brand underestimated. Volume, mix, and pricing all point to a strong year in 2010 and beyond. The Mercedes car brand is well positioned for long-term growth, as disposable income among the middle classes in the developing world continues to grow, attracting custom for the brand's upper-end products. On the other hand, the product mix development seen at Mercedes over the past decade should serve it well in developed economies, as total cost of ownership, fuel efficiency, and safe mobility become increasingly important for aging populations.

Alongside the car brand, Daimler is the world's largest truck maker. We expect the truck market to come back in 2011, a recovery from which Daimler should benefit. Daimler remains at the forefront of automobile technology and innovation. With the continued focus on fuel efficiency within automobiles, Daimler is redirecting its product lines to focus on fuel efficiency, as seen through the Smart car as well as the electric vehicles that are currently in the company's pipeline.

- Market Perception.** From a consumer perspective, Mercedes has always been a brand linked to luxury and superior high-performing vehicles. From an investor perspective, Daimler has consistently been viewed as a company with too many

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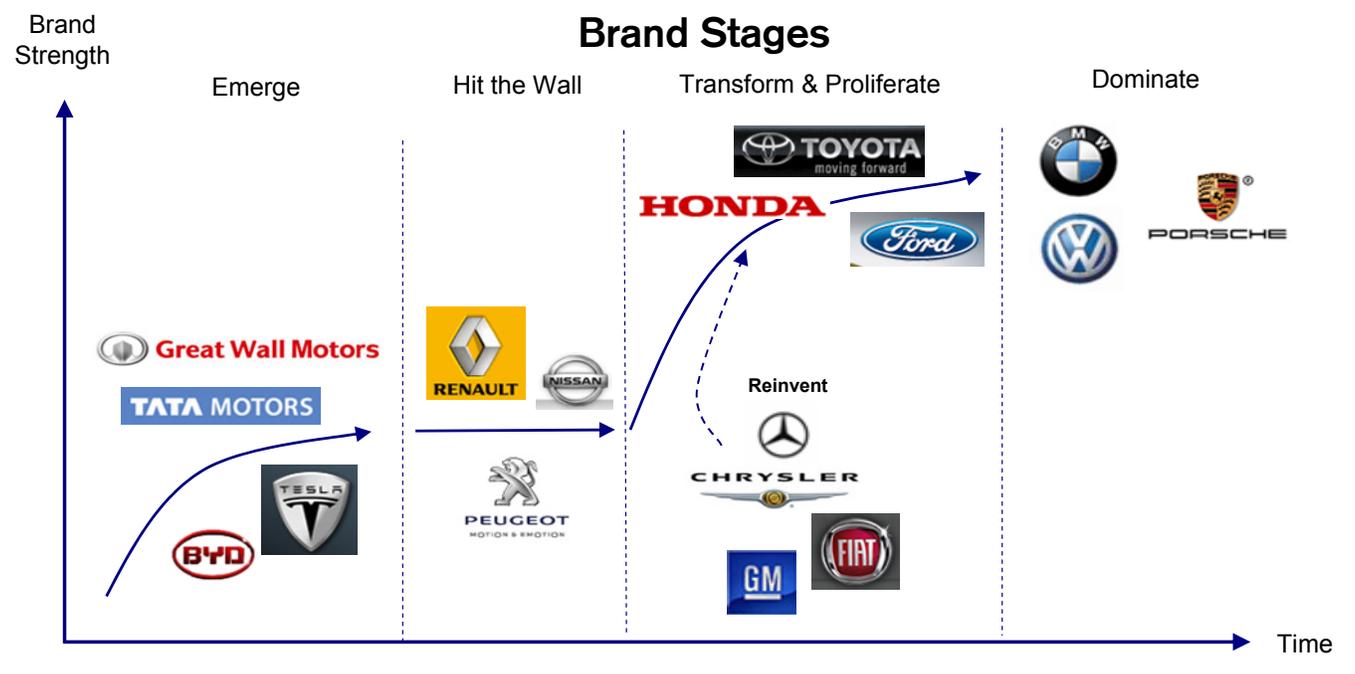
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moving parts and little visibility into those parts, leaving investors in the dark. The company is taking the appropriate steps to increase clarity and understanding of their business model while continuing to emphasize and focus on the Mercedes brand that has driven its brand appeal for years.

- **Valuation.** With 2010E/11E EV/sales of 32%/26%, Daimler remains an attractive investment, in our view. On EBITDA, the shares are trading at 3.3/2.9x 2010E/11E. Our 2011 sum-of-the-parts analysis suggests a fair value of €52, on which we apply a 10% discount for our €47 target price.

#### Exhibit 221: Automotive Industry Competitive Brandscape



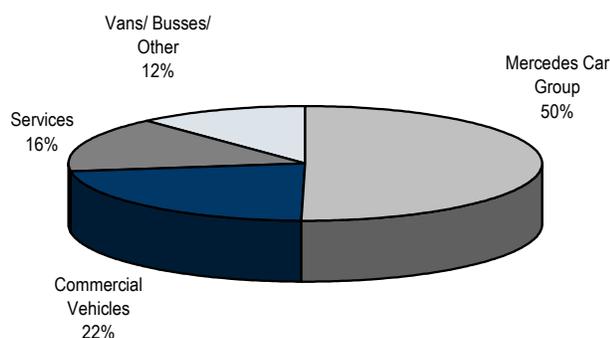
Source: Company data, Credit Suisse estimates

## Brand Overview

Daimler is a global leader in premium passenger cars, as well as the largest manufacturer of commercial vehicles in the world. Within the Daimler umbrella are a total of 14 brands that span across passenger cars, vans, buses, trucks, and financial services. The company's main initiative is dedicated to producing premium automobiles, trucks, vans, and buses while providing customized services around these products. The main brand that drives the overall value in Daimler's share price, we argue, is Mercedes-Benz.

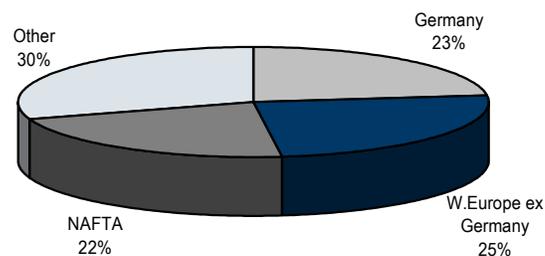
Mercedes cars are recognized worldwide as symbols of quality, safety, and refined motoring. Mercedes automobiles are designed with a focus on detail, efficiency, and value and are distributed to nearly 200 countries worldwide.

Exhibit 222: Business Mix (2009E)



Source: Company data, Credit Suisse estimates

Exhibit 223: Geographic Mix (2009E)



Source: Company data, Credit Suisse estimates

### How Recent Trends Have Affected Car Brands

The trend toward smaller vehicles and more fuel-efficient mobility in mature markets raises the question of how premium will be defined in future. We do not question the superior brand equity and technology of Mercedes, but *over the past decade all premium makers grew their businesses with cheap leasing and financing deals, which did not reflect the real cost of capital and risk*. This raises the questions of which is the “real/natural” demand for expensive cars and which pricing should be assumed for future volume planning. It appears to us that assuming a stable pricing environment, at least in mature markets, could prove to be optimistic.

In addition to the risk of a potential underlying price erosion, environmental requirements are driving complexity, and thus cost-of-car manufacturing (more than €1000 in additional cost per vehicle in the case of combustion engines).

These two longer-term drivers – changes in pricing and increasing costs – raise major questions about Daimler’s future set-up of its passenger-car business. We are convinced that Daimler needs a partner to safeguard its technology leadership.

As we have argued before, we see a major industrial logic for BMW and Mercedes joining forces to exploit manufacturing synergies and reduce duplicate spending. This, in our view, would be the best solution for both players to safeguard their premium car-manufacturing business by exploiting the benefits of increased economies of scale. It would reduce the threat of brand dilution by selling cars with subsidized leasing and financing rates to gain critical size.

The trend toward smaller cars and a more fragmented product offering is not new. In the past, carmakers extended their product portfolios downward to reach young customers. Nowadays, the pressure to reduce fleet consumption and offer contemporary products for urban mobility appears to be the driving force. In any case, Daimler sold about 50% of its cars as E Class and above models during the 1990s; however, this declined to approximately 39% in 2009.

With the introduction of the A and B Class and the Smart brand, Mercedes has leveraged its strong premium reputation to respond to the changing demands of developed-markets consumers. Smart cars offers compact urban mobility with urban fuel efficiency, while the A/B class has become a favorite among traditional Mercedes clients who are downsizing. Our work on demographics (*From baby boomers to Empty Nesters*, June 11, 2009) highlights that over 40% of A/B class customers in Germany are over 60, compared with only 30% for the E series.

## Powertrain Complexity to Increase

We expect Mercedes to close its gap to BMW's superior engine performance with the introduction of its new diesel and gasoline engines in 2010/11. Regarding combustion engines, we see Daimler as well positioned, even though it lacks critical size, especially because an engine accounts for approximately 30% of the cost to make a car.

The bigger challenge lies in the question of how Daimler will deal with the electrical drivetrain. The company currently has four main electric car initiatives:

- Joint venture with BMW and GM on hybrids,
- Joint venture with Evonic on batteries,
- 10% shareholding in Tesla, and
- S Class Lithium-Ion hybrid with Conti and JCI-Saft.

*It is unclear how Daimler intends to integrate these activities into a powerful and focused roadmap toward the electrification of individual mobility.* The key question is how the supply of batteries will be secured. As most meaningful battery makers are Asian players, such as Panasonic, NEC, Toshiba, or Sanyo, Daimler (similar to each European player) could end up highly dependent on a supplier outside Europe.

## Brand Development State: Transform & Proliferate

**Exhibit 224: Mercedes Has Completed the Emergence Phase. After Struggling through the Last Year (Along with the Rest of the Auto Industry), Mercedes Is Making the Right Moves to Transform & Proliferate**

Checklist to Emerge:	Checklist to Transform & Proliferate:	Checklist to Dominate:
<input checked="" type="checkbox"/> Brandable Industry	<input checked="" type="checkbox"/> Continued Investment in the Brand	<input checked="" type="checkbox"/> Robust International Presence
<input checked="" type="checkbox"/> New or Underserved Market	<input checked="" type="checkbox"/> Reliable Product/Service Quality	<input checked="" type="checkbox"/> Dominant Market Share
<input checked="" type="checkbox"/> New Technology	<input checked="" type="checkbox"/> Leadership/Management Strong	<input checked="" type="checkbox"/> Ownership of Category/Mindshare
<input checked="" type="checkbox"/> Differentiated Product	<input checked="" type="checkbox"/> Perpetual Innovation	<input checked="" type="checkbox"/> Loyal Customer Base
<input checked="" type="checkbox"/> Production Innovation	<input checked="" type="checkbox"/> Power Player	<input checked="" type="checkbox"/> Preserve Relevance to Core Customer
<input checked="" type="checkbox"/> Distribution Innovation	<input checked="" type="checkbox"/> Aspirational Marketing Machine	<input checked="" type="checkbox"/> Quality Consistent
<input checked="" type="checkbox"/> Connection with Core Consumer	<input checked="" type="checkbox"/> Continued Sales/Market Share Growth	<input checked="" type="checkbox"/> Maintain Focus on the Brand
<input checked="" type="checkbox"/> Effective Marketing Strategy as a Brand	<input checked="" type="checkbox"/> International Growth	<input type="checkbox"/> Leadership does not Ossify
<input checked="" type="checkbox"/> Authentic Brand Intangibles	<input checked="" type="checkbox"/> Loyal Core Customer	<input checked="" type="checkbox"/> Cash Flow Generation in Core Markets
<input checked="" type="checkbox"/> Sufficient Marketing Investment	<input checked="" type="checkbox"/> Success in Category Extensions	<input type="checkbox"/> Leverage Overhead/SG&A with Scale
<input checked="" type="checkbox"/> Reliable Product/Service Quality	<input checked="" type="checkbox"/> Anticipate Challenges from Competitors	
<input checked="" type="checkbox"/> New Product/Service Category	<input type="checkbox"/> Know When to Say 'No'	
<input checked="" type="checkbox"/> Effective Management & Leadership	<input type="checkbox"/> Avoid Non-Core Acquisitions	
<input checked="" type="checkbox"/> Robust Sales Growth in Core Market		
<input checked="" type="checkbox"/> Product Evolution & Investment		

Source: Company data, Credit Suisse estimates

Mercedes still faces the toughest time in its history. In addition, management has to discover why its performance is significantly behind that of its competitors. Volatility of earnings and the magnitude of losses (Q408/Q109 = -€1.4bn) and cash burn (Q408/Q109 = -€3.5bn) have been a setback, despite the downturn in end markets.

Benchmarking Mercedes to its European premium competitors highlights the brand's core advantage, which remains its high revenue per unit contribution. Even though the delta to BMW and Audi has narrowed from c15-20% to c10%, it remains a strong reflection of Mercedes's superior product mix. Nevertheless, revenues/unit also show the impact of a mix shift to smaller vehicles: from peak of €43,600 per unit in 2006, Mercedes reported €38,100 revenues/unit in 2008. We appreciate that next to mix several other drivers are having an impact on the top line, but we would also stress that downsizing will likely

continue to put some pressure on revenue generation. Economies of scale in Mercedes's small car range are thus crucial to the division's profitability target of a 10% EBIT margin.

From a product renewal cycle viewpoint, Mercedes is coming to the end of major renewals. The new E Class will be critical, because it contributes approximately 30% of Mercedes's earnings. Compared with key competitor BMW, Mercedes shows less new product momentum for the upcoming year. The approximately 20% better profitability of the new E Class and the indirect efficiency enhancement of the C Class from component sharing should thus be of material importance.

## Growth Strategies & Opportunities

### The Mercedes Story

The inclusion of Daimler in this list of great brands hinges on the Mercedes story, which we believe will experience a significant earnings recovery. As Mercedes accounts for up to 54% of estimated group sales, the brand's outlook augurs well for the strength of Daimler as a whole.

We recently increased our 2010 Daimler volume growth projection from 4% to 10%, which reflects our expectations for better end-market performance and solid momentum from Mercedes products. We base our estimates on a projected recovery of the US SAAR to 11.5 million (up 9.5% year over year); 6% growth in China; and a 19% increase in European demand from corporate customers (70-80% of Mercedes's European Union sales are to corporate customers).

In our view, consensus expectations for Mercedes's 2010 EBIT of approximately €1.7 billion (approximately 4% margin) and company guidance (>€1.5 billion) are too low. *We expect Mercedes's 2010 EBIT to reach €2.9 billion at a margin of 6.4%, based on our forecast of a 10% increase in revenues.* Mercedes reported peak EBIT of €4.8 billion in 2007, with unit sales of 1.286 million. (We estimate 1.208 million units for 2010.) In other words, our 2010 estimates are approximately 6% below peak sales and 40% below peak earnings.

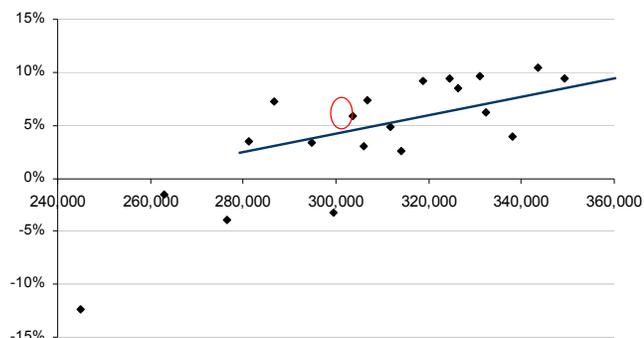
We argued in our December 8, 2009, note (*Look what St Nicholas is bringing*) that Mercedes should deliver a 6% EBIT margin for fourth quarter 2009. Mercedes delivered a clean 6.8% margin, putting in question Daimler's implicit guidance for a 3-4% margin at Mercedes in 2010.

- (5) Our 2010 Mercedes EBIT expectation stands at €2.9 billion (6.4% margin), versus consensus expectations of €1.7 billion (3.7% margin on our sales estimate) and company guidance of €1.5 billion.
- (6) Our 2010 sales estimate includes 265,000 E Class sales (up 25.5% year over year). Following a normal product life cycle, 2010 should be a peak year for the new model. We regard our forecast as reasonable, as it stands significantly below the last peak of E Class sales in 2003 of 305,000.
- (7) China sales continue to rise (6% of Mercedes sales in 2009; 23% of S Class). Mercedes reports increasing demand for S Class models in China. We expect S Class sales to increase from 65,500 in 2009 to 73,500 in 2010 (versus the 110,000 peak).
- (8) In addition to approximately 20% lower variable costs on the new E Class, management expects to keep the €5 billion efficiency gains it garnered in 2009 for 2010. We expect €3 billion of the savings to be allocated to Mercedes.
- (9) Looking at data from the US, Mercedes should be able to lower discounts considerably in 2010. A €1,000 improvement in pricing/unit would enhance earnings by approximately €1 billion. Data from Autodata suggest that Mercedes lowered discounts on the E Class from a peak of US\$11,600 to US\$3,600 on the new model.

Figure 225 and Figure 226 highlight that Mercedes's EBIT historically shows a higher sensitivity to volume fluctuations than BMW. Given its favorable near-term product momentum, Mercedes should be well equipped to report a meaningful recovery in EBIT in 2010.

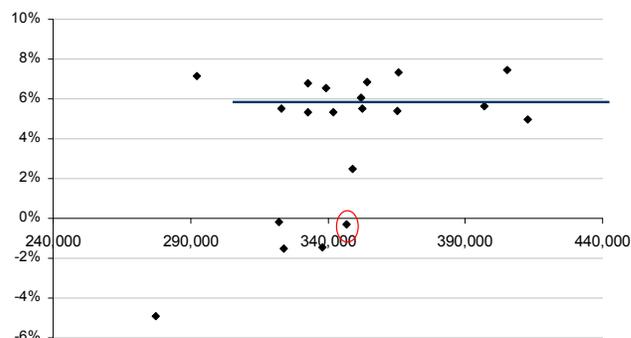
**Figure 225: Mercedes EBIT Margin Sensitivity**

*autos quarterly EBIT margins vs unit sales*



**Figure 226: BMW EBIT Margin Sensitivity**

*autos quarterly EBIT margins vs unit sales*



A key reason for Mercedes's relatively higher profitability is a lower capital intensity compared with BMW. This is related to both a lower level of organic investment and more restructuring activity at Mercedes (and related asset impairments). Based on historical numbers, Mercedes reported up to 300 basis points lower depreciation-to-sales levels.

As we expect this gap to change slowly, and Mercedes should benefit from a fairly strong top line over the following quarters, we are more optimistic about an earnings recovery at Mercedes than at BMW. At a later stage, however, BMW should also benefit from the combination of declining capex/improving product (top-line) momentum. We expect this to be the case from 2011 onward.

### Pricing Will Be Key

With improved product momentum and better end markets, we expect pricing to improve in 2010. If Mercedes-Benz (excluding Smart) could lower discounts by €1,000 per vehicle, it could experience an earnings uplift of approximately €1 billion.

In the US in 2009, Mercedes reported average discounts of US\$4,883, an increase from US\$3,680 in 2008. Mercedes finished 2009 at a discount level of US\$4,000, largely driven by the introduction of the new E Class – the model represents 15-25% of total Mercedes sales in the US. Given the recent renewal, we expect a share at the upper end of that range in 2010.

### Cost Savings – A Big Number, as Always

Daimler expected to increase efficiency by approximately €5 billion in 2009 and to keep the majority of these savings into 2010. We assume Daimler will have to introduce new measures to offset the increase in costs from its fading 8.75% wage reduction agreement (running out in June 2010) and some other cost rebounds. In total, Daimler still has approximately 30,000 workers under the German short-term working scheme (Kurzarbeit). If demand levels remain depressed, we would expect some additional efforts to reduce headcount, especially in Germany. (Daimler employs 163,000 workers in Germany out of a global workforce of 255,000). *Management confirmed on its latest conference call that it does not expect higher labor costs in 2010 versus 2009.*

### Trucks to Come into Play in 2011

Unlike some other market participants, we do not expect a major profit in trucks in 2010. In our view, the level of volume recovery is simply not strong enough, and we would regard it as a major achievement if Daimler were to report an earnings swing of €1 billion, after losing approximately €700 million (clean) in 2009E.

Daimler remains the global leader in heavy trucks, with the only company of similar size and regional diversification being Volvo. As detailed in our January 8, 2009, trucks report (*Riders on the storm*), we prefer the truck industry to the car manufacturing business. We thus see Daimler's truck exposure as a core asset to the company. The current downturn will likely hurt near-term earnings, but in the long run, we are convinced that the truck industry will come back to the 8% EBIT margin level.

As Daimler generates approximately 23% of its truck revenues in the NAFTA region (2008), we see some room for stabilization in 2010. We estimate that Daimler's NAFTA truck sales ended 2009 at only 36% of trucks sold at the peak in 2006. There should thus be some room for improvement in 2010.

In a strong year, we believe Daimler has the potential to sell up to 550,000 heavy trucks, generating approximately €35 billion in revenues and €2.8-3.5 billion in EBIT. Nevertheless, given the different cyclicity of end markets, 2012 might be the earliest for such a scenario. In the meantime, Daimler will have to keep costs under control in its European (German) and Asian (Fuso) operations and wait for the recovery in the US. Recent additions to capacity in the region via a Mexico plant should enable Daimler to participate in the recovery while reducing costs (net costs to be reduced by an estimated 30-40%) and improving profitability.

As highlighted before, we see material hidden value within Daimler, owing to the undervaluation of its truck operation. Fundamentally, we don't think it matters how management extracts this value, but it appears to us that it hasn't done the right things so far to find an appropriate structure.

## Major Catalysts

In the short term, a rebound in fleet customers should help. Over the medium term, the truck market should rebound to levels seen in past cycles, and in our view, longer-term demographic changes and tightening fuel efficiency regulations in core markets will continue to pose challenges to Daimler and other premium brands.

## Key Risks

### Limited Visibility

Throughout the downturn, Daimler had too many interlinked efficiency, restructuring, and emergency programs in place, and it was difficult to keep a clear view on where the company stood. We believe that this may have weighed on Daimler's shares in recent months. More recently, poor communication between the firm and investors (i.e., with regard to dividends) have continued to affect the stock, in our view.

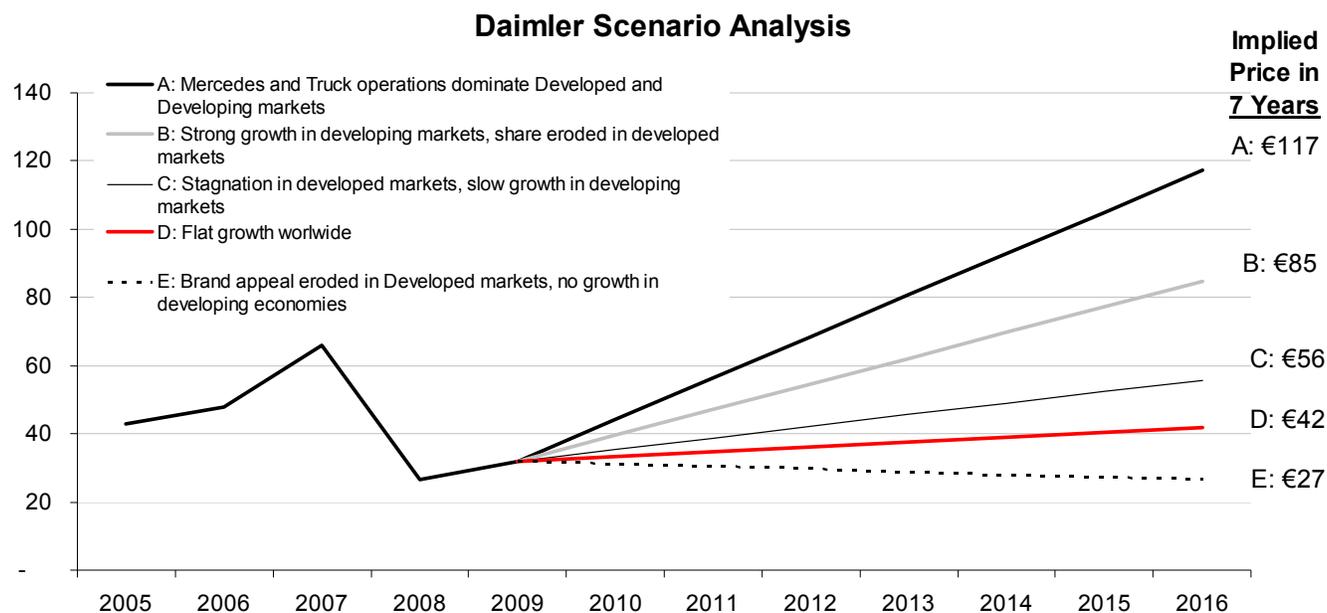
Daimler is implicitly guiding for 3-4% margin at Mercedes after reporting a clean margin of approximately 6% in H2 2009. This seems overly conservative to us, given our estimate of 6.4%. If Daimler's Mercedes guidance reflects the fundamental picture, however, we must ask ourselves if we are missing some major headwinds (pricing, mix, etc.) for 2010.

## Valuation

With 2010E/11E EV/sales of 32%/26%, Daimler remains an attractive investment, in our view. On EBITDA, the shares are trading at 3.3/2.9x 2010E/11E. Our 2011 sum-of-the-parts analysis suggests a fair value of €52, on which we apply a 10% discount for our €47 target price.

## Financial Statements and Comparable Valuation

### Exhibit 227: Current Share Price Embeds Conservative Growth Expectations



	2009E	2016 Scenario Analysis				
		A	B	C	D	E
Daimler sales	78,924	144,276	126,735	111,054	90,659	73,562
Growth CAGR	-	9%	7%	5%	2%	-1%
EBIT margin	-1.9%	9%	8%	7%	7%	5%
Interest other expense	700	(200)	(200)	(200)	(200)	(200)
Tax rate	-15.0%	30%	30%	30%	30%	30%
Sharecount	1,024	1,024	1,024	1,024	1,024	1,024
<b>EPS</b>	<b>-€ 2.47</b>	<b>€ 9.01</b>	<b>€ 7.07</b>	<b>€ 5.07</b>	<b>€ 4.17</b>	<b>€ 2.65</b>
Growth CAGR	-	-220%	-216%	-211%	-208%	-201%
P/E Multiple	(13)	13	12	11	10	10
<b>Implied Price, 2016E</b>		<b>€ 117.17</b>	<b>€ 84.81</b>	<b>€ 55.78</b>	<b>€ 41.65</b>	<b>€ 26.51</b>
Implied 7-yr return CAGR		266%	165%	74%	30%	-17%
		20%	15%	8%	4%	-3%

Source: Company data, Credit Suisse estimates

### Exhibit 228: Daimler Trades at a Discount to Other Luxury Car Makers despite Strong Growth Potential

	Ticker	Price	Mkt Cap	Enterprise Value	EBIT Margin	2009	2008	EPS				P/E	P/E	P/E	3-Yr Avg
						Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	P/E
<b>Daimler</b>	<b>DAI-US</b>	<b>31.39</b>	<b>\$19</b>	<b>\$20</b>	<b>-2%</b>	<b>39%</b>	<b>-60%</b>	<b>3.83</b>	<b>1.41</b>	<b>(1.21)</b>	<b>2.78</b>	<b>18.8</b>	<b>NM</b>	<b>11.3</b>	<b>15.1</b>
BMW	BMWG.F	29.52	\$18,900	\$20,100	0%	47%	-49%	4.71	3.41	0.31	2.50	55.4	NM	11.8	33.6
Fiat	FIA.MI	8.14	\$9,835	\$19,000	1%	123%	-74%	1.61	1.62	(0.68)	0.35	4.4	NM	23.3	13.9
Peugeot	PEUP.PA	20.41	\$4,777	\$8,295	-2%	95%	-77%	3.88	(1.51)	(3.66)	(0.52)	NM	NM	NM	-
Renault	RENA.PA	32.27	\$9,194	\$2,320	-2%	95%	-81%	10.32	2.23	(9.27)	1.70	10.2	NM	19.0	14.6
Volkswagen	VOWG-P.F	59.53	\$23,800	\$27,700	2%	-69%	60%	10.47	10.84	2.75	3.23	20.8	21.6	18.4	20.3
MAN	MANG.DE	53.10	\$7,696	\$9,043	-1%	41%	-66%	7.37	4.90	(0.98)	2.71	NM	NM	19.6	19.6
Scania	SCVb.ST	97.20	\$77,300	\$64,300	3%	19%	-46%	5.05	7.28	7.76	1.06	8.0	NM	NM	8.0
Volvo	VOLVb.ST	61.40	\$125,500	\$176,700	-7%	43%	-60%	10.69	10.68	(6.89)	1.65	NM	NM	NM	-
Average					-1%	48%	-50%					19.6	21.6	17.2	13.9

Source: Company data, Credit Suisse estimates

# Polo Ralph Lauren (RL): A Transcendent & Leveragable Brand

## Exhibit 229: RL Stock Price History

Omar Saad

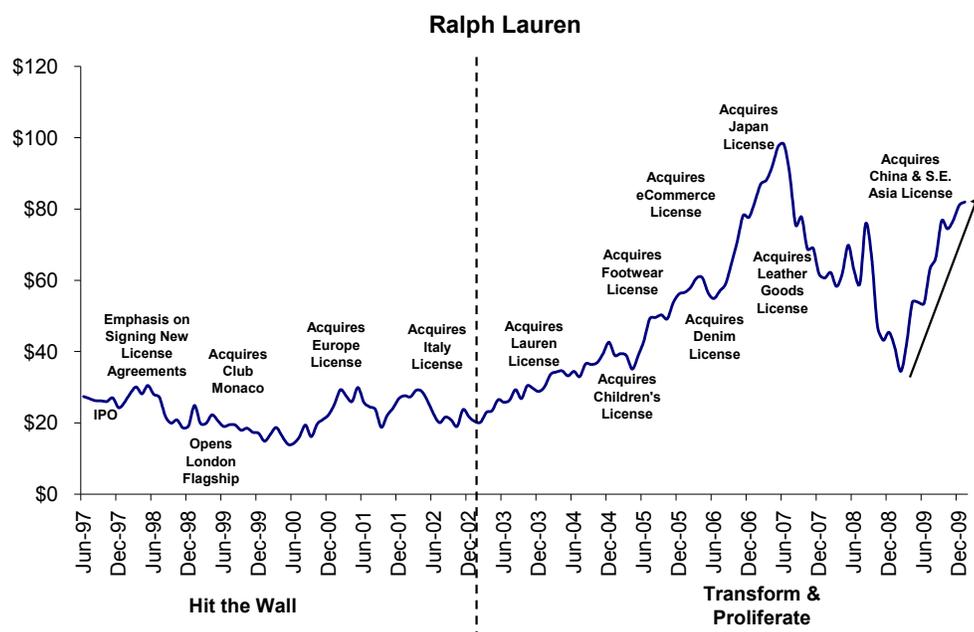
212 325 3656

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Spencer Hill

212 538 2266

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Source: Company data, Credit Suisse estimates.

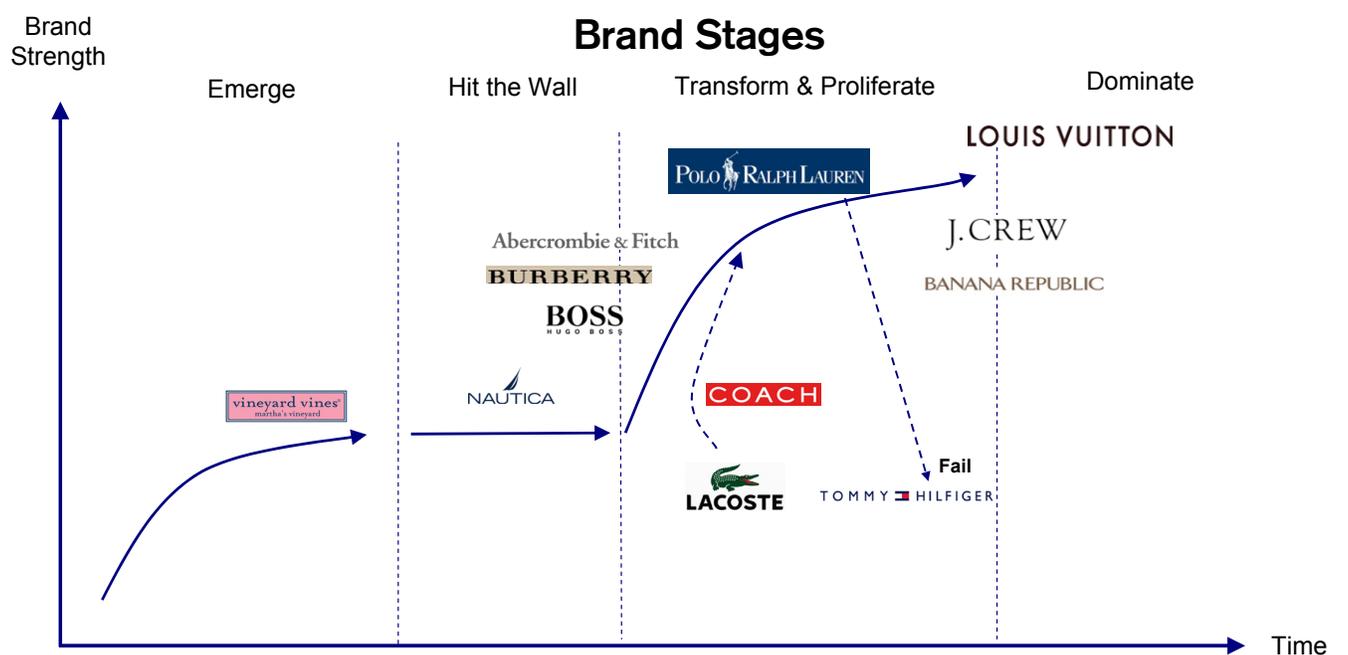
## Investment Summary

- Unique Brand Story - It is Nike (NKE) 15 years ago.** We believe RL will be one of the best stocks in all of retail over the next five years; we increased our target price to \$120 from \$91. With \$9-plus of EPS power by 2015, driven by huge opportunities in Europe, Japan, non-Japan Asia, and handbags, we see the RL story unfolding similarly to that of NKE in the mid-1990s, when NKE went to 60% international from 35% in 13 years and the stock rose tenfold.
- Brand Opportunity - A transcendent brand.** The number one reason we believe RL will post superior earnings growth is because of the brand's ability to resonate across so many different spectrums: (1) age (from seniors to infants); (2) price points (from a \$17,000 Ricky Bag to a \$30 Chaps shirt); (3) geography (from Canada to Southeast Asia and everywhere between); (4) category (from jeans and T-shirts to handbags and sunglasses to furniture and paint); and (5) channel (from the Omotesando flagship in Tokyo to a run-of-the-mill J.C. Penney in Iowa). Now that RL has acquired its key regional and category licenses, it has the control necessary to properly invest behind and grow its Asian, European, and handbags operations, businesses that had been operated by misincentivized licensees that were milking the brand via the path of least resistance.

**Tremendous earnings power.** We are confident that RL can achieve its long-term goal of generating an equal distribution of sales across North America, Europe, and Asia (versus its current 65/20/15 distribution). The brand is only 20% as penetrated internationally as it is in the United States, and we expect RL successfully to leverage its product breadth and design and sourcing capabilities into new markets. However, it is not just a top-line story. The positive margin mix benefit from having all the growth come from naturally higher margin regions (Europe and Asia) and categories (handbags) is equally powerful. We assume RL's geographic mix will reach 45% North America, 30% Europe, and 25% Asia in five years, which, combined with the margin mix shift benefit, would translate into \$9-plus EPS and \$40-plus net cash per share.

- **Market Perception - Ignore the chart.** Given the stock's 150% run, it is natural for investors to dismiss RL in the *I missed it* category. However, we believe that it remains the most misunderstood and underappreciated name that we cover and would urge investors to take a second look.
- **Valuation.** As we expect the company to continue its stellar track record of simultaneously delivering strong execution and earnings results while investing for the long term, our \$120 target price is 18 times our fiscal 2012 EPS estimate of \$5.85, plus \$15 of projected net cash per share.

### Exhibit 230: Preppy, Aspirational Apparel Industry Competitive Brandscape



Source: Company data, Credit Suisse estimates.

## Brand Overview

The number one reason we believe RL will post superior earnings growth is because of the brand's ability to resonate across so many different spectrums.

- **Age.** RL is an iconic lifestyle brand that is perfectly acceptable across all age groups, and RL makes product for people of all ages, from 3 months to 93 years.
- **Price points.** Selling bridge/luxury product such as Black Label and Purple Label in high-end department stores down to affordable basics at Kohl's (KSS) and JCPenney's (JCP) for under \$50, RL has something for people across all income demographics.
- **Geography.** It is amazing that the RL brand is so well understood across continents, climates, countries, and political boundaries. Its heritage as a traditional, aspirational America brand truly resonates globally, from Canada to Southeast Asia and everywhere between.
- **Categories.** RL has done phenomenal job developing product, design, and sourcing expertise, from footwear and apparel, jeans and T-shirts to handbags and sunglasses, furniture and paint. We believe this is a truly unique capability in the marketplace.
- **Distribution channels.** One of our favorite things about the RL story is the brand's flexibility and management's willingness to distribute across a variety of channels that are most appropriate for the brand and that reflect evolving consumer shopping

preferences. Whether it is the rapidly growing e-commerce channel, success in full-price and outlet-owned stores, or key specialty and department store wholesale partners, RL management has a strong track record of simultaneously managing distribution and growth.

**Exhibit 231: RL Is a Universal Brand that Appeals Across Incomes, Ages, Categories, Geographies, and Channels**



Source: Company data, Credit Suisse estimates, RalphLauren.com.

## Brand Development State: Transform & Proliferate

The number one reason we believe RL will post superior earnings growth is because of the brand's ability to resonate across so many different spectrums: (1) age (from seniors to infants); (2) price points (from a \$17,000 Ricky Bag to a \$30 Chaps shirt); (3) geography (from Canada to Southeast Asia and everywhere between); (4) category (from jeans and T-shirts, to handbags and sunglasses, to furniture and paint); and (5) channel (from the Omotesando flagship in Tokyo to a run-of-the-mill J.C. Penney in Iowa). Now that RL has acquired its key regional and category licenses, it has the control necessary to properly invest behind and grow its Asian, European, and handbags operations, businesses that had been operated by misincentivized licensees that were just milking the brand via the path of least resistance.

## Exhibit 232: RL Progressing Nicely in the Transform & Proliferate Phase

---

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

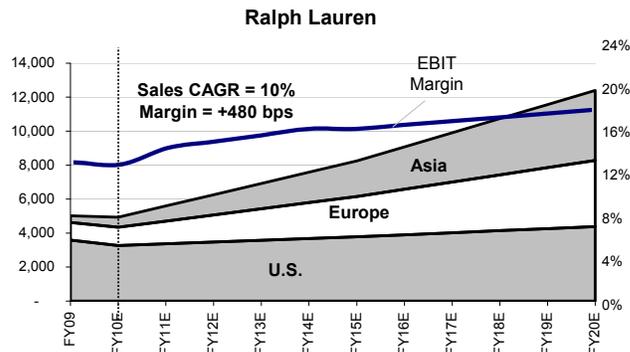
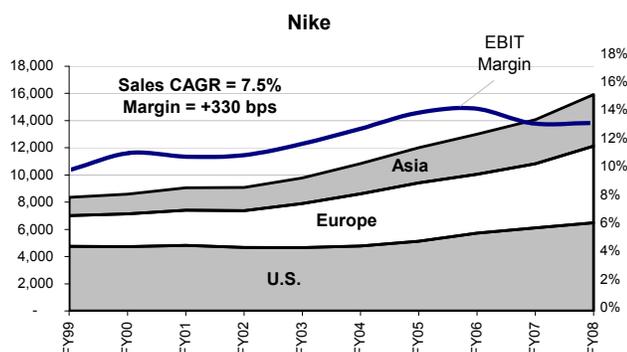
- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

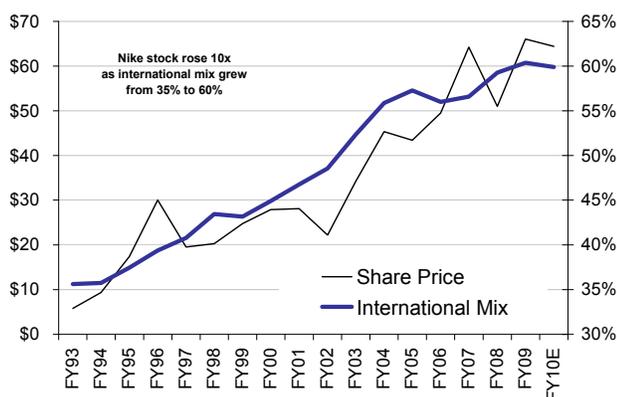
Everyone is looking on the athletic fields for the next NKE. We believe that investors should be looking to fashion, and that it is RL. RL's growth trajectory and international opportunity are highly reminiscent of those of NKE in the mid-1990s. NKE shareholders were handsomely rewarded, as that brand transformed globally, going to 60% international from 35% in 13 years, driving a 1,000%-plus return over that period. The one difference is our belief that RL has a much greater margin opportunity than NKE did at the time, primarily driven by the favorable mix shift impact of robust accessories growth.

Exhibit 233: RL Could Mirror NKE's International Growth Trajectory

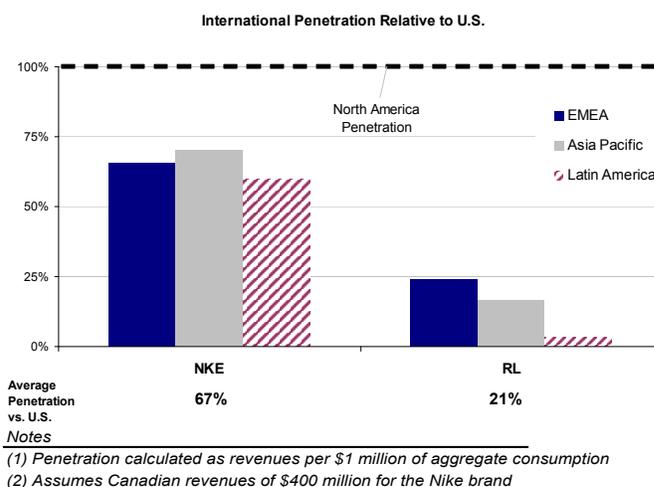
Ralph Lauren Today is Like Nike 15 Years Ago...



...and Nike Shareholders Were Rewarded Handsomely During this Globalization



RL Underpenetrated Internationally Relative to both U.S. and Nike

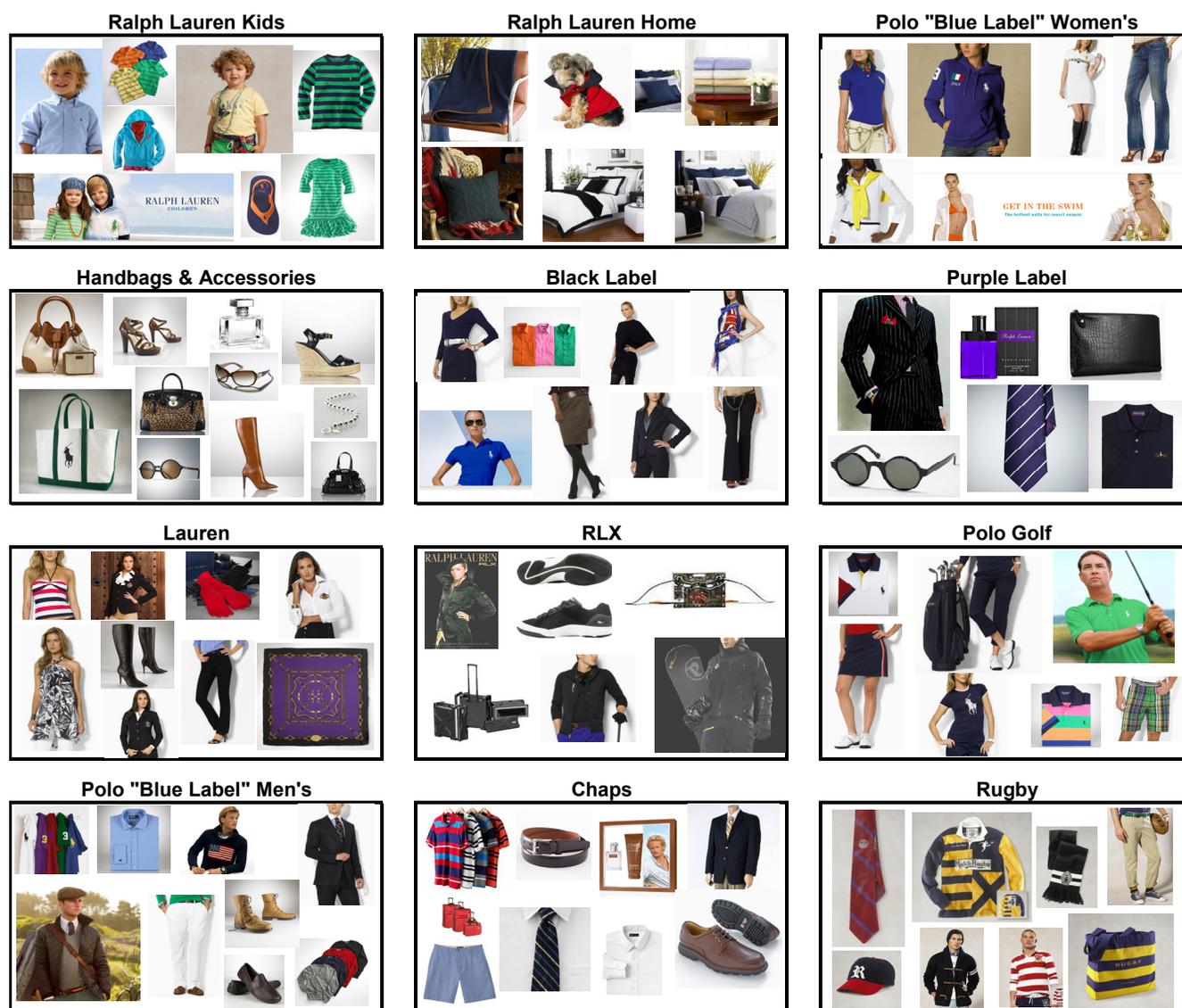


Source: Company data, Credit Suisse estimates.

Growth Strategies & Opportunities

Department Store Shop-in-Shops Key to Asian Growth

We believe the department store concession model, prevalent in Japan, China, and many parts of Europe, is perfectly suited for the many aspects of the Ralph Lauren brand. The concession model, in which RL runs the shop-in-shop as its own retail store, paying fixed and variable rent to the department store owner, is an ideal model for the brand, as it allows the company to control its growth and brand image. RL typically operates only two to three concessions within a given department store in Asia. However, the company now completely controls its brand and operations in Japan and Southeast Asia and has a broad product offering across categories. We believe that the company has the opportunity to triple, quadruple, or even quintuple in some cases its footprint in Asian department stores. For example, we believe the brand could go from operating a Polo Blue Label men's and a Polo Golf shop in a given single department store to also operating a Lauren shop, a Ralph Lauren Home shop, a Ralph Lauren Kids shop, and an Accessories shop, effectively tripling its square footage in the same door.

**Exhibit 234: Dream the Dream: As Many as 12 Concessions/Shop-in-Shops in One Asian Department Store**


Source: Company data, Credit Suisse estimates, RalphLauren.com.

## Major Catalysts

We believe that the key catalysts for RL stock over the next five years are robust growth and profitability in Asia, Europe, and accessories.

### Sizing the European Opportunity

The European region, to which RL reacquired the license nine years ago, has been a key growth driver for the company. In this highly complex and sophisticated market, RL has built an extensive platform and infrastructure for growth that it is only beginning to leverage. Its success is evident in its growth to over \$1 billion currently from roughly \$200 million nine years ago. As the company layers in the greater breadth of its product offerings in full-price and outlet-owned retail, deepening penetration across the continent, we believe that the brand could approach \$4 billion in Europe over the next ten years.

### Exhibit 235: Europe to Fuel \$2.5 Billion-Plus of Incremental Growth over the Next Ten Years

	FY10E	FY15E	FY20E
<b>Europe Retail</b>			
<b>Full price</b>	160	556	1,075
CAGR		28%	14%
Stores	18	54	90
CAGR		25%	11%
Sales per store	8.9	10.3	11.9
CAGR		3%	3%
<b>Outlet</b>	108	266	473
CAGR		20%	12%
Stores	23	49	75
CAGR		16%	9%
Sales per store	4.7	5.4	6.3
CAGR		3%	3%
<b>eCommerce</b>	-	125	250
CAGR			15%
<b>Total Europe Retail</b>	<b>268</b>	<b>948</b>	<b>1,798</b>
CAGR		29%	14%
<b>Europe Wholesale</b>			
<b>Bridge</b>	750	913	1,109
CAGR		4%	4%
Doors	2,500	2,625	2,750
CAGR		1%	1%
Sales per door	0.3	0.3	0.4
CAGR		3%	3%
<b>Better</b>	141	295	485
CAGR		16%	10%
Doors	1,250	1,625	2,000
CAGR		5%	4%
Sales per door	0.1	0.2	0.2
CAGR		10%	6%
<b>Moderate</b>	-	165	422
CAGR			21%
Doors	-	500	1,000
CAGR			15%
Sales per door	-	0.3	0.4
CAGR			5%
<b>Off-price</b>	29	54	84
CAGR		13%	9%
Doors	123	187	250
CAGR		9%	6%
Sales per door	0.2	0.3	0.3
CAGR		4%	3%
<b>Total Europe Wholesale</b>	<b>920</b>	<b>1,427</b>	<b>2,100</b>
CAGR		9%	8%
Doors	3,873	4,937	6,000
CAGR		5%	4%
<b>Total Europe</b>	<b>1,188</b>	<b>2,375</b>	<b>3,898</b>
<b>CAGR</b>		<b>15%</b>	<b>10%</b>

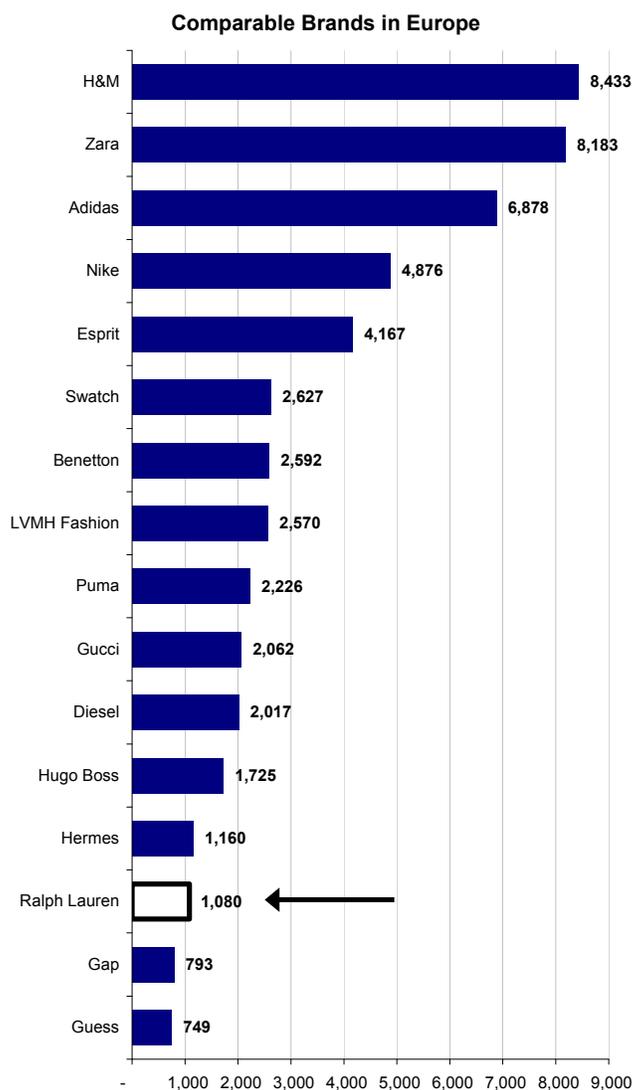
#### Notes

- (1) Assumes 10% growth in Europe in FY10
- (2) Chaps U.S. mens business is a \$175 million business licensed to Warnaco
- (3) Assumes women's Chaps business (in house) is half the size of men's
- (4) Assumes \$300 million American Living business at JCPenney
- (5) Note that European wholesale distribution relies more on specialty retail than department stores
- (6) RL FY10 sales breakdown by channel and price point are CS estimates
- (7) Assumes 60% of U.S. eCommerce business is bridge and 40% better
- (7) Europe comps show brand sales in Europe unless otherwise noted

Source: Company data, Credit Suisse estimates.

### Sizing the Asia Opportunity

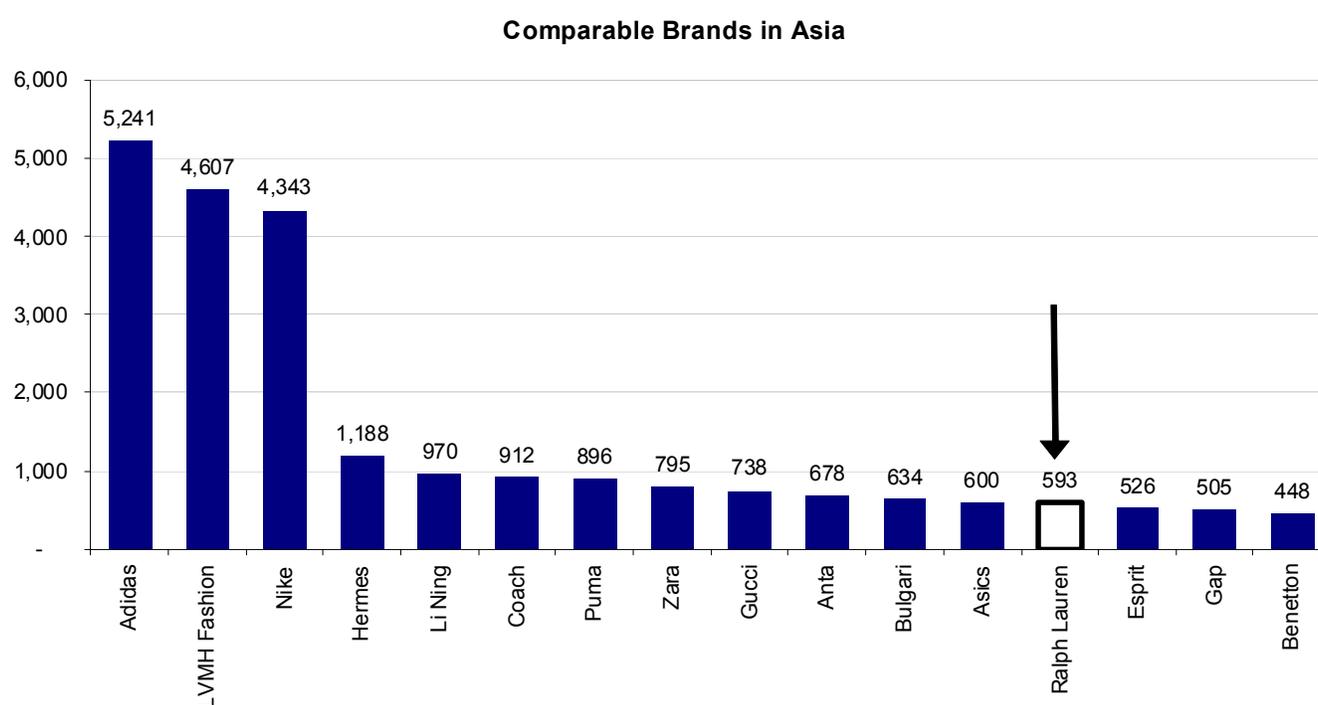
When analyzing the Asia opportunity for RL, it is important separately to look at Japan and the rest of Southeast Asia. The brand has been in Japan for several years and is already at the \$400 million mark. However, since acquiring the license two years ago, management has been tirelessly working to better control distribution, revamp the brand's image, and more deeply penetrate key department store accounts with the breadth of its product offerings. We believe that RL is reaching an inflection point in Japan and expect to see growth accelerate in this large and critical market in the next few years as it opens new concession shops.



Southeast Asia is a much more recent license acquisition, with the deal closing only at the beginning of 2010. However, this is a region with even greater promise for this evolving global brand, particularly in China, where the brand has virtually no presence relative to its European and American counterparts. We expect the company to have significant success in this market over the next five to ten years, given the favorable consumer spending and macroeconomic dynamics and the Southeast Asian consumers' desire for great American brands such as RL.

One concern is that heavy investment spending in Asia (which began before the company officially acquired the license) will mute earnings growth in the near term, limiting upside potential. However, we view these as great investments with huge potential, and we wish we covered more stocks with these types of investible opportunities. Furthermore, RL has consistently demonstrated its ability to reward shareholders by simultaneously investing in long-term growth while generating great results over the past five years.

#### Exhibit 236: Plenty of Room to Move up in Asia



Source: Company data, Credit Suisse estimates.

**Exhibit 237: Japan to Drive \$1 Billion-Plus of Incremental Growth over the Next Ten Years**

	Japan		
	FY10	FY15	FY20
<b>Department Stores</b>			
Sales	370	818	1,355
CAGR		17.2 %	10.6 %
Doors	120	120	120
CAGR		— %	— %
Shops per door	2.0	4.0	6.0
CAGR		14.9 %	8.4 %
Sales per shop	1.5	1.7	1.9
CAGR		2%	2%
<b>Full Price Retail</b>			
Sales	20	80	100
CAGR		32.0 %	4.6 %
Stores	1	10	20
CAGR		58.5 %	14.9 %
Sales per door	20.0	8.0	5.0
<b>Outlet Retail</b>			
Sales	10	28	61
CAGR		22.5 %	17.2 %
Stores	4	10	20
CAGR		20.1 %	14.9 %
Avg sq ft	7,400	7,400	7,400
CAGR		— %	— %
Sales per door	2.5	2.8	3.0
Comp CAGR		2%	2%
<b>Chaps/American Living</b>			
Sales	-	53	74
CAGR			7.1 %
Doors	-	75	87
CAGR			3%
Sales per door	-	0.7	0.9
Comp CAGR			4%
<b>eCommerce</b>			
Sales	-	10	75.9
CAGR			50%
<b>Total Region</b>			
Sales	400	988	1,666
CAGR		19.8 %	11.0 %

Source: Company data, Credit Suisse estimates.

**Accessories Mix Shift to Drive Margin Expansion**

The handbag category is the true *dream-the-dream* opportunity for RL. It is one of the most profitable and highest-return segments in all of consumer, as demonstrated by the huge market capitalizations and high margins of companies such as Coach (COH), LVMH, and Hermes. RL acquired its handbag license two years ago, but it has yet to release any major new product lines, as the company has been working meticulously to develop the right aesthetic, product line, and sourcing platform for this leg of growth. If RL can generate only a fraction of the success of the aforementioned accessories companies, given the high profitability levels of the category, we believe accessories could be hugely accretive to RL's earnings.

**Exhibit 238: China, Non-Japan Asia to Drive \$2 Billion-Plus of Incremental Growth over the Next Ten Years**

	S.E. Asia		
	FY10	FY15	FY20
<b>Department Stores</b>			
Sales	96	681	1,580
CAGR		48.0 %	18.3 %
Doors	75	175	250
CAGR		18.5 %	7.4 %
Shops per door	2.0	5.0	7.0
CAGR		20.1 %	7.0 %
Sales per shop	0.6	0.8	0.9
CAGR		4%	3%
<b>Full Price Stores</b>			
Sales	54	144	244
CAGR		21.6 %	11.2 %
Stores	27	65	100
CAGR		19.2 %	9.0 %
Sales per door	2.0	2.2	2.4
Comp CAGR		2%	2%
<b>Outlets</b>			
Sales	-	22	147
CAGR			46.3 %
Stores	-	10	50
CAGR			38.0 %
Sales per door	1.5	2.2	2.9
Comp CAGR		8%	6%
<b>Chaps/American Living</b>			
Sales	-	105	163
CAGR			9.2 %
Doors	-	150	191
CAGR			5%
Sales per door	-	0.7	0.9
Comp CAGR			4%
<b>eCommerce</b>			
Sales	-	10	44.8
CAGR			35%
<b>Total Region</b>			
Sales	150	962	2,179
CAGR		36.3 %	17.8 %

Source: Company data, Credit Suisse estimates.

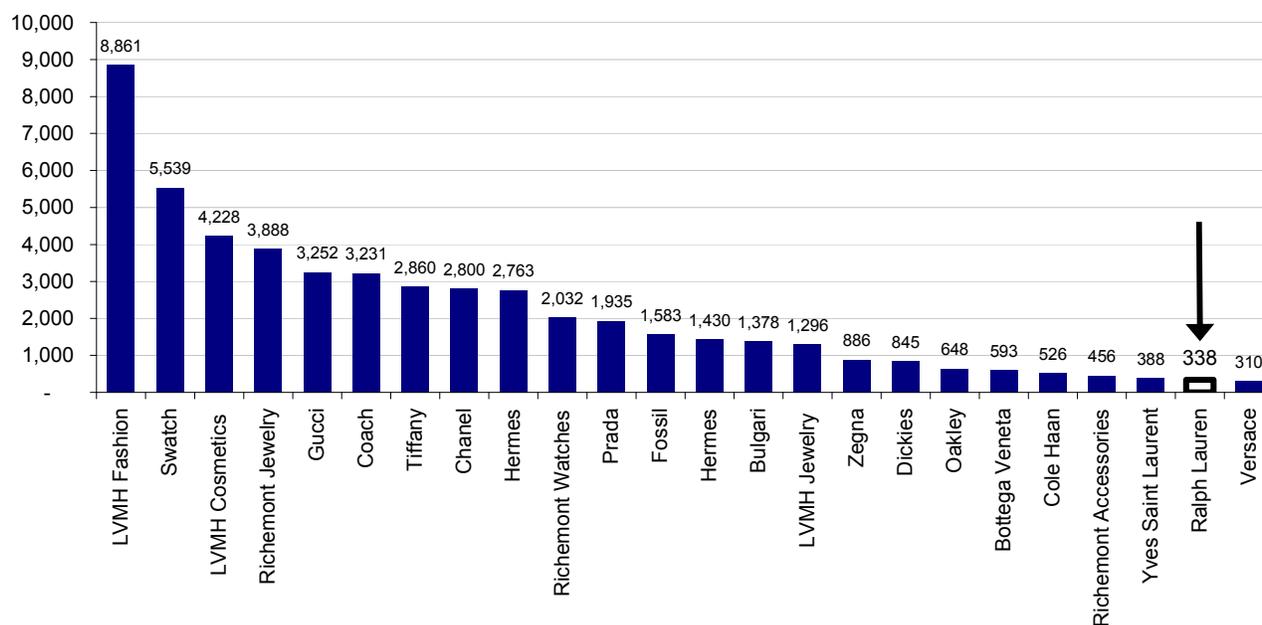
### Exhibit 239: Accessories to Drive \$2 Billion-Plus of Incremental Growth and 300 Basis Points of Margin Expansion over the Next Ten Years

	FY10E	FY15E	FY20E	Comps			
<b>Bridge Handbags</b>	100	400	700	1,951	827	1,161	1,680
CAGR		32%	12%	<i>Gucci</i>	<i>Bulgari</i>	<i>Prada</i>	<i>Chanel</i>
<b>Better Handbags</b>	125	313	500	1,938	263	314	
CAGR		20%	10%	<i>Coach</i>	<i>Cole Haan</i>	<i>Guess</i>	
<b>Footwear</b>	40	120	200	323	105	387	306
CAGR		25%	11%	<i>Coach</i>	<i>Cole Haan</i>	<i>Prada</i>	<i>Nine West</i>
<b>Watches &amp; Jewelry</b>	30	515	1,000	2,860	1,583	3,888	5,539
CAGR		77%	14%	<i>Tiffany</i>	<i>Fossil</i>	<i>Richemont</i>	<i>Swatch</i>
<b>Eyewear &amp; Other</b>	43	147	250	760	1,163	7,750	
CAGR		28%	11%	<i>Oakley</i>	<i>Ray-Ban</i>	<i>Luxottica</i>	
<b>Total</b>	<b>338</b>	<b>1,494</b>	<b>2,650</b>				
CAGR		35%	12%				

#### Notes

- (1) Assumes handbags are 60% of mix at Gucci, Bulgari, Prada, Chanel, and Coach, 50% at Cole Haan, and 15% at Guess
- (2) Assumes footwear is 10% of mix at Coach, 20% at Cole Haan and Prada, and 40% at Nine West
- (3) Oakley sales as of 2006; assumes Ray-Ban is 15% of Luxottica mix

### Comparable Brands in Accessories



Source: Company data, Credit Suisse estimates.

## Key Risks

The huge run in the stock over the past six months aside, there are two key areas of pushback on RL that we believe are worth addressing.

- Investor concern.** Heavy investment spending abroad will mute earnings growth, limiting upside potential. **Counterpoint.** We view these as great investments with huge potential, and we wish we covered more stocks with these types of investible opportunities. Furthermore, RL consistently demonstrated its ability to reward shareholders by simultaneously investing in long-term growth while generating great results over the past five years.

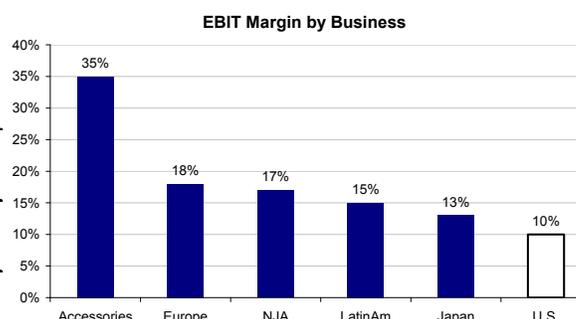
- **Investor concern.** High exposure to the U.S. consumer (roughly 65%) and (even worse) the department store channel (around 20%) are bigger downside risks than international and handbags are opportunities. **Counterpoint.** We find this to be one of the biggest misconceptions related to RL, and cite the diversity and discipline of RL's U.S. distribution as a source of strength. First, over the past ten years, RL underwent a long, painstaking process of rationalizing its U.S. distribution and is no longer over distributed. RL simply not cannot be found in every U.S. department store; it is only distributed through the top 50-60% performing department store doors. Second, we appreciate RL's exposure to the quietly powerful premium outlet channel (see our report titled *The Hidden Gem of Retail: Rethinking the Outlet Channel*, dated January 11, 2010), which should continue to take market share from traditional mall channels. Last, the brand operates large and profitable businesses at a variety of price points, from couture down to moderate, further reducing volatility risk of its U.S. business.

## Valuation

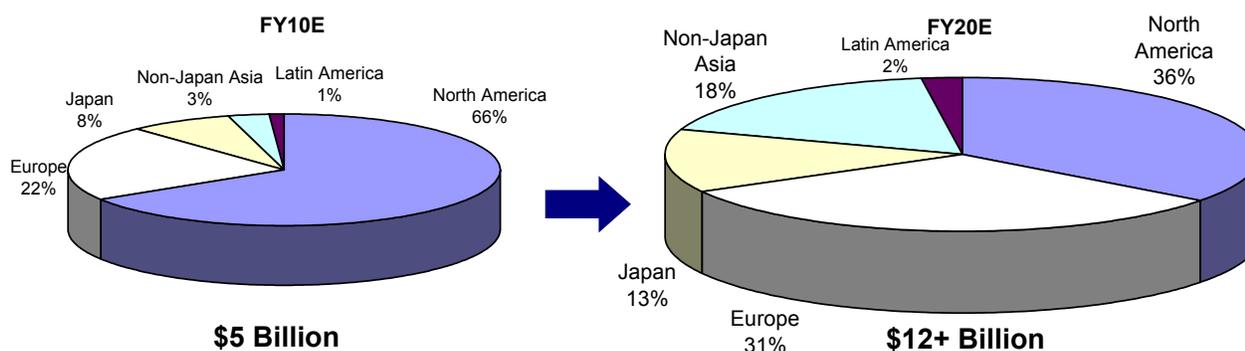
Given RL's 150% run, it is natural for investors to dismiss RL in the *I missed it* category. However, we believe that it remains the most misunderstood and underappreciated name that we cover and would urge investors to take a second look. As we expect the company to continue its stellar track record of simultaneously delivering strong execution and earnings results while investing for the long term, our fiscal 2010 and 2011 EPS estimates are \$4.30 and \$5.00. Our \$120 target price is 18 times our established fiscal 2012 EPS estimate of \$5.85, plus \$15 of projected net cash per share.

**Exhibit 240: Revenues to Nearly Double Over the Next Five Years as Mix Shifts Toward International and Accessories****All of Ralph Lauren's Growth Coming From High-Margin Businesses**

	FY10E	Mix	FY15E	Mix	FY20E	Mix
North America	3,037	62%	3,290	40%	3,745	30%
Europe	1,006	20%	2,067	25%	3,332	27%
Japan	366	7%	860	10%	1,424	11%
Non-Japan Asia	140	3%	837	10%	1,862	15%
Latin America	47	1%	124	2%	227	2%
Global accessories	338	7%	1,069	13%	1,800	15%
<b>Total revenues</b>	<b>4,933</b>	<b>100%</b>	<b>8,247</b>	<b>100%</b>	<b>12,390</b>	<b>100%</b>
Operating margin	13.0%		16.3%		18.1%	
EBIT	643		1,348		2,242	
<b>EPS</b>	<b>\$4.30</b>		<b>\$9.10</b>		<b>\$15.13</b>	
Net cash/share	\$8.97		\$42.47		\$103.05	
P/E multiple	18		18		17	
<b>Share price</b>	<b>\$85</b>		<b>\$206</b>		<b>\$360</b>	
Return CAGR			19%		12%	



<b>NPV</b>	<b>\$121</b>
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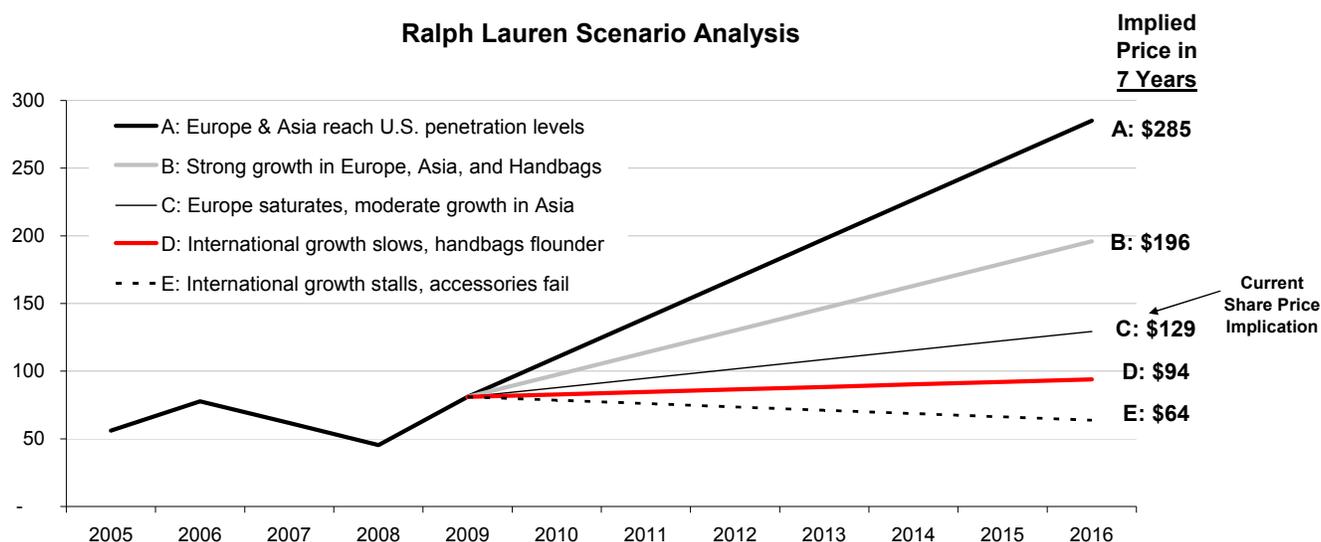
**Notes**

- (1) Assumes 5% growth in Europe in FY10
- (2) Assumes Japan revenues flat in FY10
- (3) Assumes North America Business grows at 3% CAGR with no margin expansion
- (4) Assumes Accessories margin is 1000 bps below Coach peak margin and expands 500 bps over the next 10 years
- (5) Assumes operating margin expansion of 300 bps in Europe, 400 bps in Japan, 300 bps in NJA, and 100 bps in LatAm
- (6) Assumes ratio of free cash flow to net income of 100% vs. historical average of 133%
- (7) Assumes 11.5% discount rate
- (8) Global accessories estimated separately and backed out of each geographic region

Source: Company data, Credit Suisse estimates.

## Financial Statements and Comparable Valuation

### Exhibit 241: Current Stock Price Embeds Conservative Growth Expectations



	2009E	2016 Scenario Analysis				
		A	B	C	D	E
Sales	4,878	12,000	9,000	7,000	6,250	5,000
Growth CAGR	-	14%	9%	5%	4%	0%
EBIT margin	12%	18%	17%	16%	14%	12%
Interest other expense	16	16	16	16	16	16
Tax rate	31%	25%	27%	30%	31%	31%
Sharecount	102	102	102	102	102	102
<b>EPS</b>	<b>\$4.05</b>	<b>\$15.84</b>	<b>\$10.88</b>	<b>\$7.61</b>	<b>\$5.87</b>	<b>\$3.99</b>
Growth CAGR	-	22%	15%	9%	5%	0%
P/E Multiple	20	18	18	17	16	16
<b>Implied Price, 2016E</b>		<b>\$285</b>	<b>\$196</b>	<b>\$129</b>	<b>\$94</b>	<b>\$64</b>
Implied 7-yr return		250%	140%	59%	15%	-22%
CAGR		20%	13%	7%	2%	-3%

Source: Company data, Credit Suisse estimates.

### Exhibit 242: RL Trades at a Premium to the Peer Group Owing to Above Average Growth Prospects

Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009	2008	EPS				P/E	P/E	P/E	3-Yr	EV-to-Sales	
							Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	Avg P/E		
<b>Ralph Lauren</b>	<b>RL</b>	<b>81.47</b>	<b>\$7,947</b>	<b>\$7,613</b>	<b>\$5,019</b>	<b>14%</b>	<b>11%</b>	<b>78%</b>	<b>-27%</b>	<b>3.62</b>	<b>4.42</b>	<b>4.19</b>	<b>4.77</b>	<b>18.4</b>	<b>19.4</b>	<b>17.1</b>	<b>14.6</b>	<b>1.5</b>
Burberry	BRBY	6.34	\$4,319	\$4,279	\$1,722	21%	-	203%	-72%	0.29	0.31	0.33	0.37	20.7	19.2	17.2	-	2.5
Hugo Boss	BOS3	24.54	\$1,152	\$1,973	\$2,241	10%	-	76%	-60%	2.18	1.62	1.50	1.78	15.1	16.3	13.8	-	0.9
LVMH	MC	80.08	\$52,715	\$57,788	\$23,899	20%	-	69%	-45%	4.00	3.70	4.28	4.85	21.6	18.7	16.5	-	2.4
PPR	PP	84.05	\$14,605	\$22,408	\$28,891	7%	-	87%	-60%	6.74	5.63	6.38	7.41	14.9	13.2	11.3	-	0.8
Warnaco	WRC	41.75	\$1,900	\$1,996	\$2,065	5%	13%	115%	-44%	1.99	2.70	2.80	3.20	15.5	14.9	13.0	12.0	1.0
Phillips Van-Heuse	PVH	42.29	\$2,192	\$2,264	\$2,492	8%	14%	102%	-45%	2.96	2.95	2.80	3.24	14.3	15.1	13.1	11.0	0.9
VF Corp.	VFC	76.87	\$8,493	\$9,309	\$7,220	12%	10%	34%	-20%	5.20	5.16	5.70	6.32	14.9	13.5	12.2	11.6	1.3
Nike	NKE	64.48	\$31,368	\$28,442	\$19,083	14%	12%	30%	-21%	3.30	3.81	3.69	4.11	16.9	17.5	15.7	14.5	1.5
Average						12%	12%	88%	-44%					16.9	16.4	14.4	12.7	1.4

Source: Company data, Credit Suisse estimates.

# Sonova Holding (SOON.S): A Hearing Healthcare Company

## Exhibit 243: SOON Stock Price History

Christoph Gretler

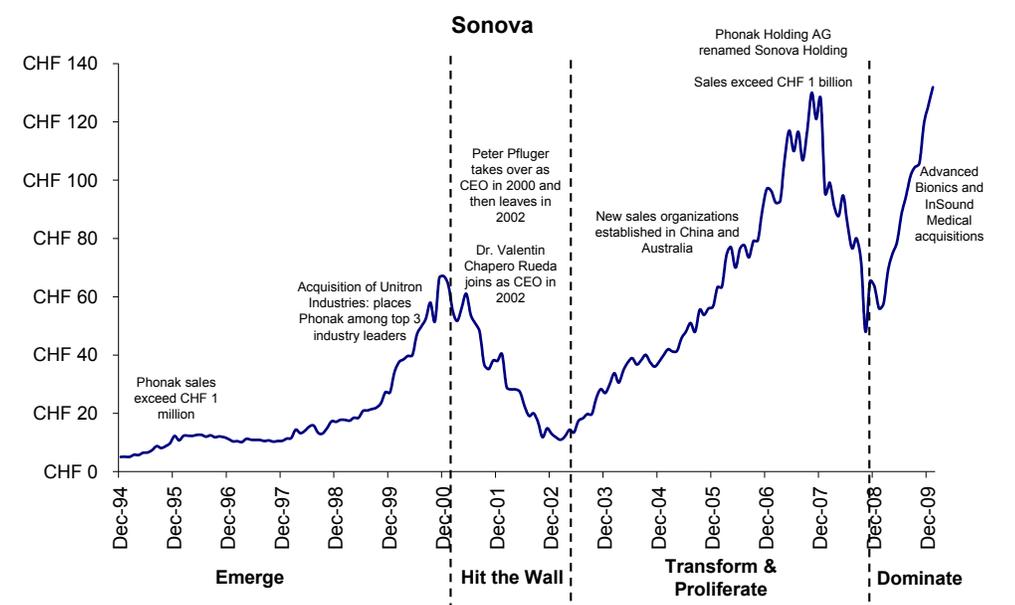
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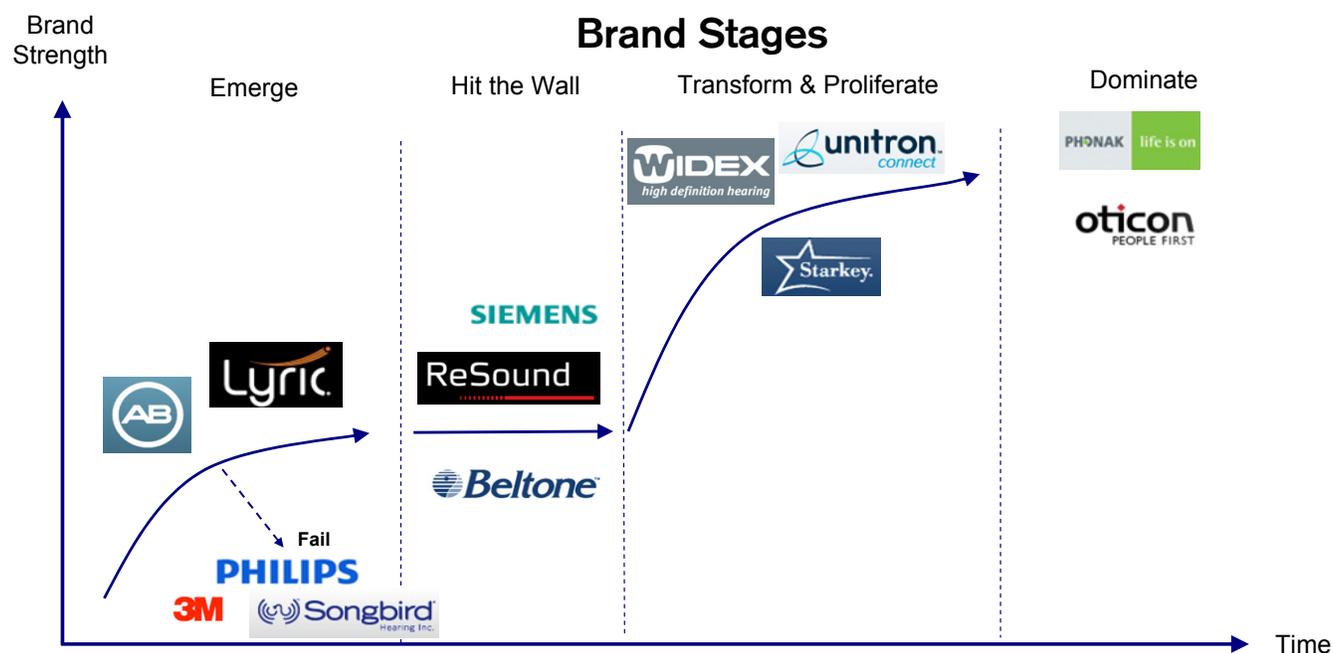
scott.bardo@credit-suisse.com



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** SOON is a medical device company dedicated to improving the hearing of individuals globally via a strong portfolio of hearing devices and wireless communication systems. Through its competitive technology and services, SOON has become a global leading provider of hearing healthcare solutions. While its foundation remains in hearing systems, with core brands Phonak and Unitron Hearing, SOON has expanded into the realm of medical implants via strategic acquisitions of key brands, including Advanced Bionics.
- Brand Opportunity.** We believe that the hearing device market is less cyclical than some may think, given the lasting demographic trends that represent key drivers of growth. Global populations continue to grow and the incidence of hearing loss is increasing, owing to an aging population with a generally higher exposure to noise. SOON estimates that of the people with hearing loss, an average of 20% wear a system, leaving significant opportunity for hearing companies. Furthermore, SOON offers a range of devices at different price points, allowing its product portfolio to be accessible to a range of individuals across various distributions of wealth.
- Market Perception.** SOON has been building its presence in the hearing device market through key acquisitions over recent years. Despite the seemingly diverse product line under several different brand names, SOON has made clear efforts to brand itself under one umbrella. The group is dedicated to raising awareness around hearing loss and, through these campaigns, is becoming a company most easily linked to and identified with hearing awareness and initiatives.
- Valuation.** Our price target of SFr 155 assumes that Sonova can deliver mid term sales growth of close to 10% and an average EBIT margin of c30%. At 22x P/E FY 2011E, Sonova trades around the middle of its historic trading range. As a comparison, Cochlear (COH.AX) and William Demant (WDH.CO) trade at c23x forward P/E 2011, respectively, based on Credit Suisse forecasts.

**Exhibit 244: Hearing Devices Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

## Brand Overview

SOON develops, manufactures, and distributes a broad range of hearing devices and wireless communications systems. In recent years, SOON has consistently won market share on the back of innovative new products and aggressive expansion of sales and marketing efforts. We expect management aggressively to continue this strategy.

SOON's business strategy is clearly focused on growing the company and building its market share via innovation, customer focus, and active cost management. The group is currently one of the top three manufacturers of hearing systems. SOON has a global presence, with locations in more than 90 countries and employees stationed across the globe.

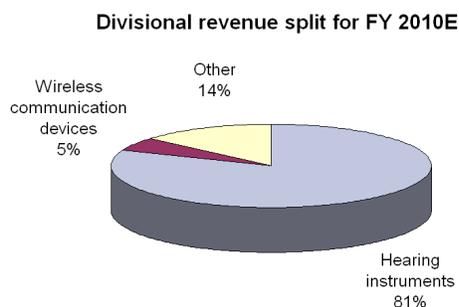
SOON has significantly grown over the years while remaining committed to its overarching goal to "improve individual hearing ability and speech recognition, thereby enhancing the quality of life of millions of people worldwide who suffer from hearing loss." (Excerpt from *SOON Panorama*, SOON's marketing brochure.)

### Brand Focus

In particular for a healthcare device company, SOON views itself as a brand-driven company; therefore, it is dedicated to maintaining its brand strength and value. In 2007, the company changed its name from Phonak Holding AG to Sonova Holding AG. This move was a deliberate effort to refocus investors and customers on the Phonak brand and to allow them to view the company as a parent of several high-profile successful brands.

### Product Portfolio

SOON has successfully built and grown a strong profile of brands over the past few years. The company has taken advantage of opportunities in the marketplace to acquire strong hearing-related companies to build upon the two core brands that have served as SOON's foundation. Phonak and Unitron Hearing are the central brands around which SOON originally built its name and international presence. Hearing system brand Argosy and Acoustic Implants are helping to bring the company to new levels, pioneering new areas of development in the field of hearing and hearing devices.

**Exhibit 245: SOON Business Mix (2010E)**

Source: Company data, Credit Suisse estimates.

**Exhibit 246: SOON Geographic Mix (2010E)**

Source: Company data, Credit Suisse estimates.

**Dedication to R&D**

Research and development is instrumental to SOON's success, as the company continues to set the standard for the hearing industry. As the pioneer of the industry, SOON believes that it is able to remain at the cutting edge of technology and innovation through its focus on R&D. New hearing products and technologies have been founded by Phonak's R&D department and the company's chip technology, which lies at the heart of every hearing system, is best in class.

SOON challenges the limits of technology to develop innovations that will help people hear, understand, and experience their surroundings. In 2006-2011, we estimate that SOON dedicates 6.5% of sales to R&D.

**Delivering the Brand**

SOON has invested in its global sales network over the years to ensure that Phonak and Unitron Hearing products have an effective presence in all of its core markets. Improvements within the group's salesforce efficiency and global coverage have been key initiatives for SOON.

SOON is investing aggressively in wholesale, but also in retail hearing device activities. We estimate that 20-30% of sales are currently generated with hearing device retailing activities already, and estimate that the percentage will likely increase further.

**Hear the World Initiative**

Through its *Hear the World* initiative, SOON teamed up with famous musicians globally to help raise awareness around topics of hearing and to promote good hearing. The campaign focuses on the social and emotional consequences tied to hearing and hearing loss, as well as the solutions to better hearing. The initiative is also tied to a foundation that lends its support to charitable organizations and projects that are dedicated to helping the hearing impaired.

Through its team of ambassadors such as Amy Winehouse, Harry Belafonte, and Bobby McFerrin, SOON hopes to relay the importance of good hearing to different populations.

## Brand Development State: Dominate

### Exhibit 247: SOON Successfully Emerged, then Transformed and Proliferated through Several Strategic Acquisitions and Changes in Its Leadership, and It Has Now Checked All Boxes in the Dominant Phase

Checklist to Emerge:	Checklist to Transform & Proliferate:	Checklist to Dominate:
■ Brandable Industry	■ Continued Investment in the Brand	■ Robust International Presence
■ New or Underserved Market	■ Reliable Product/Service Quality	■ Dominant Market Share
■ New Technology	■ Leadership/Management Strong	■ Ownership of Category/Mindshare
■ Differentiated Product	■ Perpetual Innovation	■ Loyal Customer Base
■ Production Innovation	■ Power Player	■ Preserve Relevance to Core Customer
■ Distribution Innovation	■ Aspirational Marketing Machine	■ Quality Consistent
■ Connection with Core Consumer	■ Continued Sales/Market Share Growth	■ Maintain Focus on the Brand
■ Effective Marketing Strategy as a Brand	■ International Growth	■ Leadership does not Ossify
■ Authentic Brand Intangibles	■ Loyal Core Customer	■ Cash Flow Generation in Core Markets
■ Sufficient Marketing Investment	■ Success in Category Extensions	■ Leverage Overhead/SG&A with Scale
■ Reliable Product/Service Quality	■ Anticipate Challenges from Competitors	
■ New Product/Service Category	■ Know When to Say 'No'	
■ Effective Management & Leadership	■ Avoid Non-Core Acquisitions	
■ Robust Sales Growth in Core Market		
■ Product Evolution & Investment		

Source: Company data, Credit Suisse estimates.

### In a League of Its Own

While medical devices are arguably not overly receptive to brands, SOON has successfully developed its brand and has become the pioneer of the hearing industry. The company has found that the hearing needs of populations globally are underserved and has launched several campaigns to increase the awareness around hearing impairment, creating a strong tie between the company and the medical need.

With its focus on innovation, SOON has created new technologies to improve the hearing of individuals while remaining focused on the aesthetics and comfort of each hearing device. SOON's R&D department has helped it to be at the forefront of advances in hearing technology, and the company has consistently invested in these efforts.

As the link between the company and the customer, SOON's salesforce remains a focal point. SOON continues to expand its global sales and distribution structures, allowing the company to adapt to local requirements and improve customer loyalty in various regions.

Last, the company has actively managed down its costs to optimize its cost efficiency.

Through the combination of a dedication to innovation, constant improvements to its sales and distribution capabilities, and active cost management, SOON has become the dominant brand in hearing devices and systems. SOON currently is the number one manufacturer of hearing systems globally (capturing 25% market share in value). It is also the market leader in wireless communication systems for audiology applications.

## Growth Strategies & Opportunities

We believe that the hearing device market conditions will pick up further and that the stabilizing economic environment will lead to normalizing trading patterns and therefore to an improving product mix. We believe that SOON provides an attractive offering for retailers and that it will gain substantial market share, with its comprehensive and new (technologically wise) product portfolio, competitive technology, and service.

### Demographics to Remain the Key Driver of Growth

Although some investors appear to be concerned that the hearing device market could be cyclical, we see the main growth drivers as being largely unaffected by the current economic downturn. The global population continues to grow and the incidence of hearing

loss is slowly increasing owing to an aging population and generally higher exposure to noise. Longer life expectancies are leading to higher replacement sales, as hearing devices are required for longer periods. *We estimate the global hearing device market to grow 4-5% in 2010, up from 3-4% in 2009*, with demographics being the main driver of growth. The only variable that we see being potentially affected by the current economic weakness is the average life of the device, which we believe is lengthening in tougher economic times.

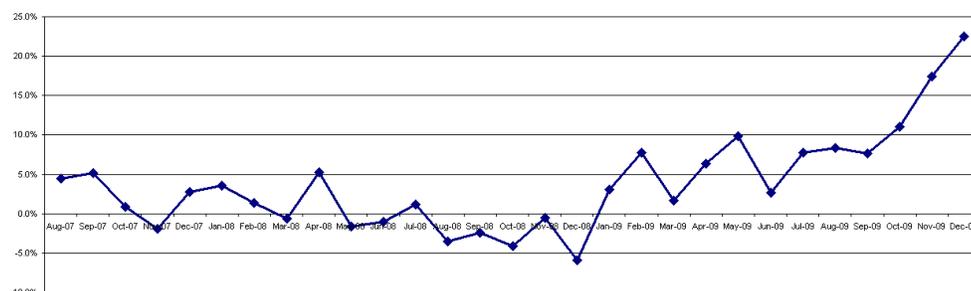
We believe that investors underappreciate the scope and sustainability of market share gains in hearing devices and the strategic merits of entering into the attractive hearing implant market. SOON estimates that approximately 16% of the population is hearing impaired; however, of the number of people with hearing loss, the company estimates that only 20% on average wear a hearing system. The low penetration rate of hearing systems in the population of hearing impaired represents a significant opportunity for SOON.

### The U.S. Market

Volume growth trends in the United States, almost one-third of the total global market (an important part) has been surprisingly strong throughout 2009. While the private market has been steadily growing at around 5% in 2009, according to the Hearing Aid Association, which is quite respectable compared with overall economic growth, the majority of the market growth came from the Veterans Affairs (10-15% of the overall market in volume terms), where volume grew handily at around 28% in 2009.

We believe that this development bodes well for SOON, which derives about 35% of its sales directly from the United States and which we estimate to have an overproportionate market share in Veterans Affairs.

### Exhibit 248: Total Hearing System Units Sold in U.S. by All Manufacturers (Year-over-Year Growth Rate)



Source: Hearing Industry Association.

While investors focus on monthly U.S. hearing device statistics, we point out the following. First, the majority of the market is international and therefore is more important, but less transparent. We believe that the main markets, such as France and Germany, have been holding up quite well in recent months. Second, while market growth trends are doubtless important, its ability to shift market shares in its favor is the more important investment consideration at SOON, in our view.

### Diverse Product Portfolio

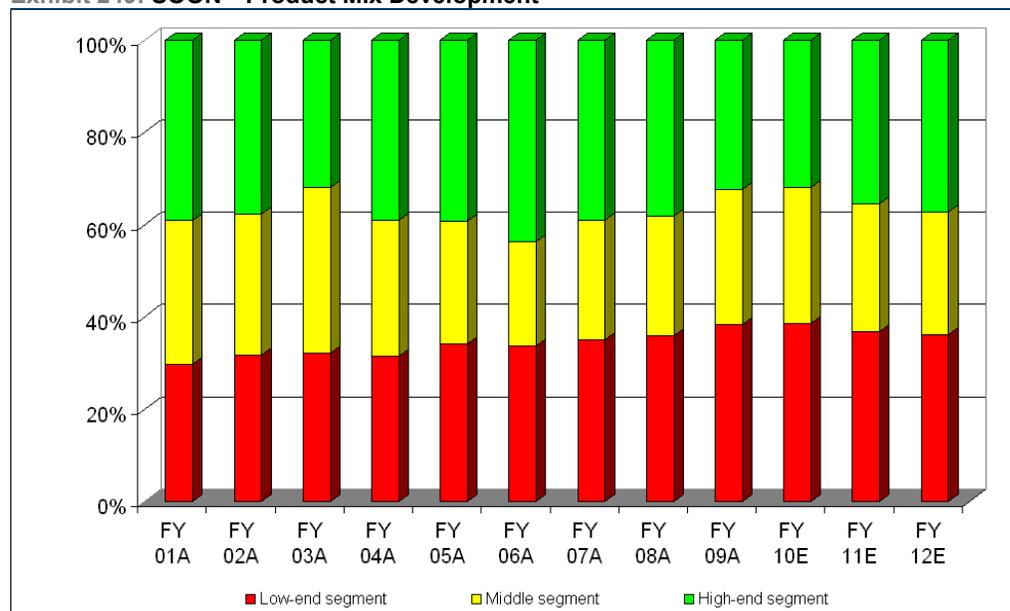
We believe that the market is underestimating the product mix effect (high end was 32% of hearing device sales in fiscal 2009, versus a long-term average of 38%), which could provide further upside potential to our forecasts, depending on features and market acceptance of the new product range.

While we believe that volume growth in hearing devices has little correlation to economic activity, there is at least anecdotal evidence that the product mix is affected. Over the course of the past few quarters, management of several wholesale and retail hearing device companies reported to some degree a trading down pattern by selected patients.

Therefore, some companies reported mix-related pressure on average selling prices. We believe that such trading down pattern is likely to reverse, leading to trading up and an improved product mix and sales growth, as economic growth is resuming.

The sales mix at SOON currently is particularly skewed toward lower- and mid-end products, not only for cyclical reasons. A more important driver has been the product launch schedule of the company, in our view. As SOON's higher-end offering of the company, Phonak's Savia Art, launched in autumn 2006, and Phonak's Exelia, launched in autumn 2007, were launched more than two years, it is not surprising that the high-end product sales declined.

**Exhibit 249: SOON—Product Mix Development**



Source: Company data, Credit Suisse estimates.

We believe that it is not unreasonable to assume that the company will soon come up with a new high-end device offering, which we believe would coincide well with the current economic upswing and the corresponding expected trading up. Hence, we believe that product mix at SOON is likely to improve/normalize over the next 24 months.

### Acquisition Strategy

Beyond its core brands, SOON has increased its own portfolio by acquiring companies specializing in hearing systems and medical technologies. In addition to growth by acquisitions, we see the company to gain further market share as some of the competitors (e.g., GN Resound, Siemens [SIEGn.DE]) make few investments in distribution and product development. Therefore, we see SOON consistently outperforming the market over the coming years, unless there are substantial changes at competitors.

**InSound Medical.** SOON recently announced the purchase of U.S.-based, privately held, InSound Medical. SOON further broadens its product offering with an interesting disposable hearing device concept, potentially adding another substantial midterm growth opportunity.

With the acquisition of InSound Medical, SOON adds the disposable hearing device, Lyrics, to its product portfolio. This addition comes only two months after the acquisition of Advanced Bionics, which moved SOON into cochlear implants, and further broadens the addressable end markets. Lyrics is directly placed in the ear canal and is invisible. It primarily fits mild to moderately impaired younger patients that have high expectations on aesthetics and proved to be difficult to convince to wear hearing devices. InSound has over 3,000 customers generating about US\$5 million in sales in fiscal 2009. The financial

terms disclosed appear to be reasonable, in our view, and are highly dependant on the market success of the concept. SOON pays US\$75 million, upfront, plus an earn-out based on sales and gross margin development. Management expects to generate US\$200-300 million in sales with Lyrics in five years, which is around 10% of our SOON projected sales at that time. According to our calculations, this translates into roughly 80,000 binaurally fitted patients annually, which we regard optimistic, but not unrealistic.

**Advanced Bionics.** On November 9, 2009, SOON announced the acquisition of California-based Advanced Bionics (AB), which is the global number two, with 18% market share in the approximately US\$750 million market for cochlear implants. We like the AB deal. The purchase offers exposure to an attractive market and eliminates SOON's costs of building its own direct distribution network with ENT specialists ahead of the DACS (Direct Acoustic Cochlear Stimulation) launch.

In contrast to hearing devices, cochlear implants are used for profoundly hearing impaired to deaf patients. About 50% of patients are children with the remainder of the patients being adults with hearing loss due to accidents, illness or toxicity. The products consists of an external component (microphone, processor, wireless inductive link, etc.) and a surgically implanted element, which is used to stimulate the auditory nerves inside the cochlea. We regard the market overlap between hearing devices and cochlear implants and hence cannibalization threat as relatively minimal as quite different patient groups are targeted and treated.

AB was founded in 1993 by the well known medical technology pioneer Al Mann. He sold the cochlear implant and neurostimulation business to Boston Scientific (BSX) in 2004, but bought the cochlear implant business in 2007 as BSX was less interested in that part of the business. Despite the uncertainties created by the changes in ownership, AB organically grew sales by around 15% per annum over the past four years and SOON estimates that AB will achieve sales of US\$127 million, a gross margin of around 69%, and an operating breakeven in 2009. In the first half of 2009, AB generated sales of US\$62 million and an operating loss of US\$1 million, which indicates that SOON's expectations are realistic.

We believe the takeover of AB is strategically important. The market for cochlear implants is growing and highly profitable. Credit Suisse analyst Saul Hadassin expects number one cochlear implant company COH.AX, with a global market share of roughly 67%, to grow sales by around 11% per annum over the next two years. We believe that investors should not be worried by the only 2% reported unit growth that COH.AX reported for fiscal 2009. Our analysts estimate that the company achieved unit growth of closer to 5%, as the company did not benefit from donated China sales in fiscal 2009 and experienced distributor destocking of inventory. Implant surgeries, according to implant registrations, grew at 11% and are probably a better proxy for market growth. The market growth is attractive and the profitability potential can be achieved. Our analysts estimate COH.AX to generate an average EBIT margin of roughly 27% over the next two years.

SOON aims to grow AB sales by 15-25% per annum and to increase EBITA margin to at least 20% over the next three to five years. We believe such objectives are realistic, given the market growth rate and the distribution and technology synergies between SOON and AB, which should lead to market share gains. We believe that the purchase eliminates SOON's need and expenses to build its own distribution presence with ENT specialists and cochlear implant centers, in which surgical treatment are performed, ahead of the DACS launch.

SOON agreed to pay US\$489 million in cash for AB, which is approximately 4 times last-12-month sales. This is somewhat lower than the multiple of 5 at which COH.AX currently trades; however, the company has substantially higher margins. We estimate the purchase to dilute SOON EPS by around 3% in fiscal 2011, but to be slightly EPS accretive in fiscal 2012.

## Major Catalysts

- **Demographic trends.** Demographics continue to be the largest driver for SOON. As populations grow, the aging population that often requires hearing assistance also grows. In addition, as life expectancies have lengthened, there are higher replacement sales of hearing devices by the aging population. Furthermore, the number of young people with hearing impairments has increased with the increases in noise pollution.
- **Emerging markets.** Given SOON's penetration in the United States and Europe, we believe that significant opportunity remains for the company to expand and focus on other regions of the world.
- **Economic upturn.** While we argue that SOON is not as tied to the economic downturn as many investors had feared, as the economy rebuilds itself and discretionary spend increases, the high-end segment of SOON's product portfolio should benefit.
- **Technology improvements.** We believe that improvements in hearing aid technology will lead to increases in penetration rates, as only 20% of the hearing impaired currently utilize hearing systems. As hearing devices become smaller and more discreet, we expect the usage of devices per capita grow, particularly with the younger generations.
- **Upcoming earnings.** On May 18, 2010, SOON reports fourth quarter 2009 and fiscal 2009 results.
- **Annual general shareholders meeting.** We expect this meeting to take place on June 15, 2010.

## Key Risks

### Product Flow

Over recent years, SOON has brought increasingly advanced hearing aids to the market, and the company is now facing a risk that it may not be able to maintain this stream of product flow. We believe that SOON is well positioned for continued growth, with a particular focus on its product portfolio. It has made strategic acquisitions to round out its product portfolio in the past, and we expect the company to continue this strategy when appropriate. Furthermore, we would not be surprised if the company were to offer a new high-end hearing device as the economy continues to improve.

### Integration of Advanced Bionics

We see some vertical integration risk with the AB acquisition. This acquisition, which introduced cochlear implants into SOON's product line, comes with some risk, as SOON will now be faced with FDA regulations, something to which SOON was not accustomed to with its other hearing systems. Despite this risk, we believe that the demand for implants is sizeable and that SOON's will be able to manage through the regulation appropriately.

### Strengthening Competition

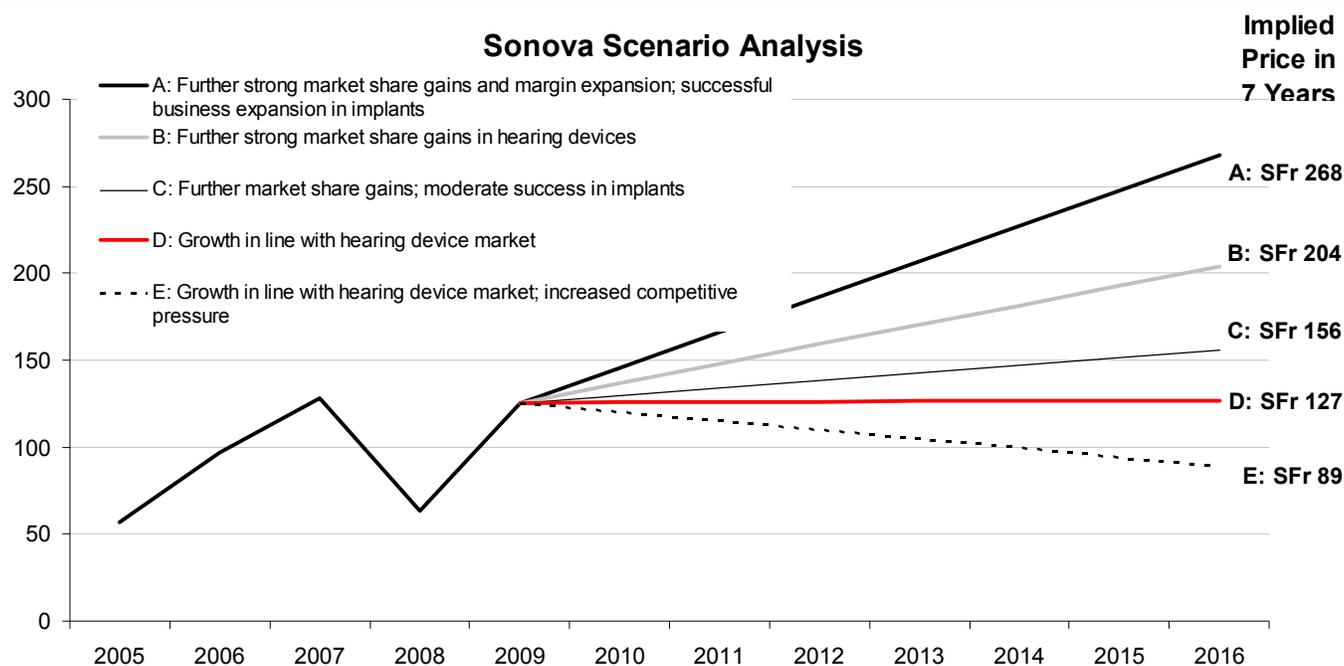
Some of the currently struggling brands could be revitalized under new management. This could increase competition and make it more difficult for SOON to gain market share.

## Valuation

Our price target of SFr 155 assumes that Sonova can deliver mid term sales growth of close to 10% and an average EBIT margin of c30%. At 22x P/E FY 2011E, Sonova trades around the middle of its historic trading range. As a comparison, Cochlear and William Demant trade at c23x forward P/E 2011, respectively, based on Credit Suisse forecasts.

## Financial Statements and Comparable Valuation

### Exhibit 250: Current Stock Price Embeds Conservative Growth Expectations



Growth rate	EBIT margins			Growth rate	A	B	C	D	E
	25%	30%	35%						
8%	CHF 89	CHF 127	CHF 161	16%	16%	11%	8%	8%	
11%	CHF 106	CHF 156	CHF 192	EBIT margins	35%	30%	30%	30%	25%
16%	CHF 138	CHF 204	CHF 268	Implied Price	268	204	156	127	89

Source: Company data, Credit Suisse estimates.

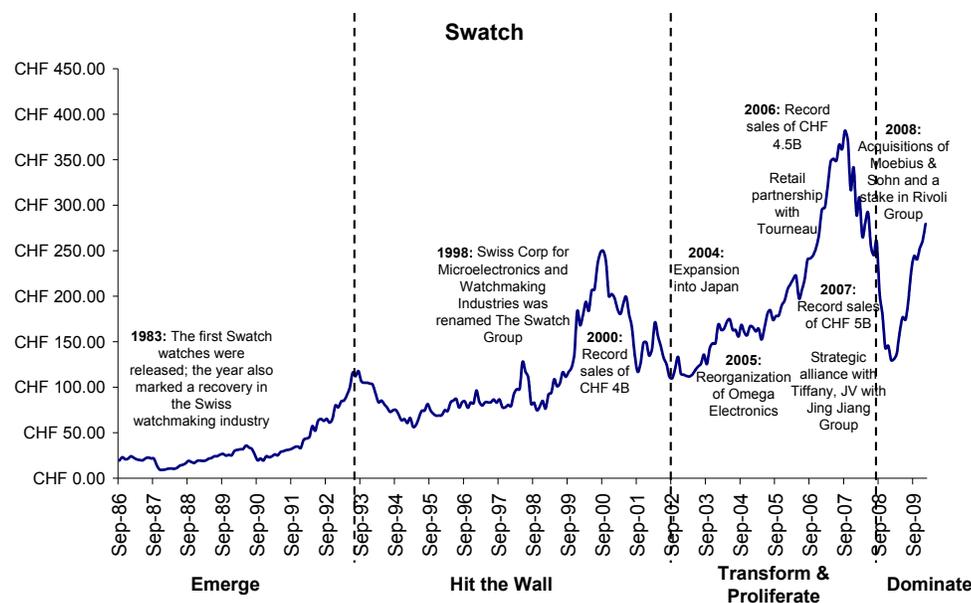
### Exhibit 251: SOON Generally Trades In-Line with the Group but Warrants a Premium Valuation

Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	2009	2008	EPS				P/E	P/E	P/E	3-Yr Avg	EV-to-Sales	
						Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	P/E	P/E	
<b>Sonova</b>	<b>SOON.S</b>	<b>134.00</b>	<b>\$8,727</b>	<b>\$8,335</b>	<b>\$1,249</b>	<b>29%</b>	<b>98%</b>	<b>-26%</b>	<b>3.60</b>	<b>4.60</b>	<b>4.40</b>	<b>5.40</b>	<b>30.1</b>	<b>25.9</b>	<b>23.1</b>	<b>26.4</b>	<b>6.1</b>
Cochlear	COH.AX	64.10	\$3,334	\$3,613	\$698	28%	25%	-26%	1.80	2.10	2.30	2.70	29.1	25.3	21.8	25.4	5.2
GN Store Nord	GN.CO	32.20	\$1,306	\$7,822	\$4,725	6%	173%	-75%	1.00	0.50	1.00	1.20	61.9	31.3	26.4	39.9	1.7
William Demant	WDH.CO	397.20	\$23,300	\$25,100	\$5,614	24%	80%	-54%	14.80	11.70	14.10	16.80	34.0	28.3	23.6	28.6	4.5
Average						22%	94%	-45%					38.8	27.7	23.7	30.1	4.4

Source: Company data, Credit Suisse estimates.

# Swatch Group (UHR.VX): Keeping Its Spot at the Top

Exhibit 252: Swatch Group Stock Price History



Source: Company data, Credit Suisse estimates.

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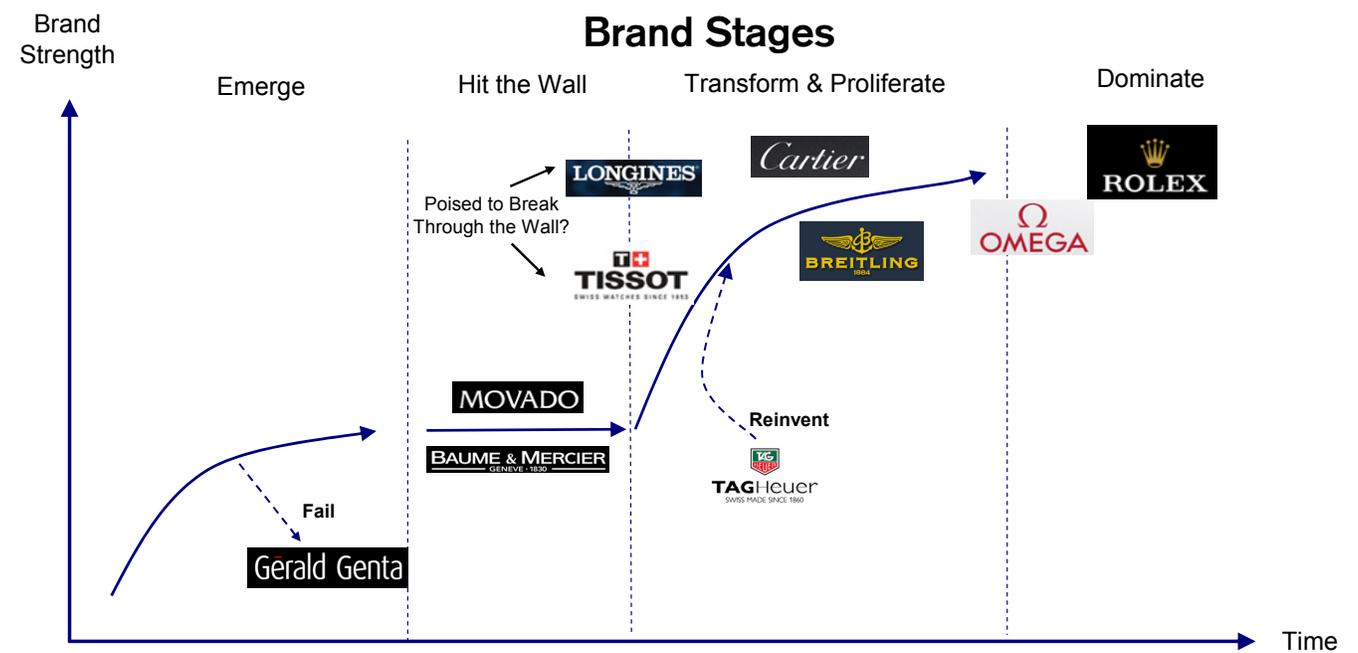
## Investment Summary

- Unique Brand Story.** Swatch is well known and well recognized as a global leader in the luxury watch industry. In watches, it is well diversified across the low-, medium-, and high-priced segments, making it somewhat defensive in a challenging market. Unlike other watchmakers that have their foundation in jewelry or clothing, Swatch's main business and expertise is watches. Furthermore, although its main business is watches, Swatch has wisely chosen select industries to extend itself, such as jewelry and technology (via microelectronics and micromechanics)
- Brand Opportunity.** Swatch Group structurally and geographically is one of the best-positioned players in the luxury sector mainly owing to the company's strong diversification of its 19 watch brands across different various categories. The vertical integration at Swatch is unsurpassable, as the company produces practically all the components necessary to its full portfolio of watch brands. Furthermore, Swatch's dedication to technology and innovation, precision and perfection has created a pioneer brand in time. In the coming years, Swatch will continue to build leverage its intense brand value to gain traction in important yet fairly underpenetrated markets, such as non-Japan Asia, which we expect to continue to benefit from a secular rise of private consumption.
- Market Perception.** While being a luxury good company, Swatch has evolved through the downturn fairly untarnished as its brand awareness, history, tradition, and high quality have continued to attract consumer despite the strain on discretionary spend. In difficult years, we have seen stronger brands tend to amplify market share gains at the expense of struggling weaker/shadow brands as shoppers become more selective. We have seen the smaller/weaker brands suffer the worst declines in the industry. Furthermore, Swatch's 2009 results showed significant outperformance in the group's brands versus a sharp decline in orders for movements in the production division.

Among the outperforming brands were Tissot, Omega, and Longines (all owned by Swatch).

- **Valuation.** Swatch currently trades at 19.1 times our 2010 EPS estimate, which we believe offers upside potential, considering that our 2010 EPS estimate is around 15% below historical peak earnings. Based on our DCF-valuation approach, we derive a fair value of SFr350.

#### Exhibit 253: Luxury Watch Industry Competitive Brandscape



Source: Company data, Credit Suisse estimates.

## Brand Overview

The Swatch Group is an international group active in the manufacture and sale of finished watches, jewelry, watch movements, and components. The group supplies nearly all components required by its 19 watch brands and Swatch Group companies supply movements and components to third-party watchmakers in Switzerland and around the world.

### Company history

The Swatch Group was founded in 1983 via the merger of Swiss watch manufacturers ASUAG and SSIH into SMH Swiss Corporation. However, Swatch is much more than just the Swatch brand. With its own worldwide network of distribution organizations, the Swatch Group in Biel, Switzerland is the largest manufacturer and distributor of finished watches, movements, and components in the world (in value). It is among the only global players that is fully vertically integrated as it produces practically all the components necessary to its 19 watch brand companies. The group's various subsidiary companies supply movements and components to Swatch Group brands and the entire Swiss watch industry, in addition to some watch companies outside of Switzerland. In addition, after the successful repositioning of Omega and several acquisitions in the luxury watch segment (Blancpain in 1992; Breguet in 1999; Glashütte and Jaquet Droz in 2000), the Swatch Group currently is among the major players in the luxury watch industry.

## Industry Backdrop

The watch industry is mainly concentrated in Asia, Europe, and the United States. The total value of Swiss watch exports in 2008 was SFr17 billion in 2008. The watch market traditionally is segmented according to price (high, medium and low), style (e.g., connoisseurs, jewelry, lifestyle, sport, and fashion), or functionality (i.e., mechanical, quartz movements, etc.). We estimate that in terms of value, the luxury segment accounts for up to 70% of the overall market (depending on the exact definition of the high-price premium).

While the overall watch market worldwide is fragmented, the medium- to high-price segment is fairly concentrated. We estimate that the most important players in this market (i.e., Rolex, Swatch, Richemont, LVMH, and PPR) combined to have roughly two-thirds of market share.

In our view, the luxury watch industry can be classified into the following three categories.

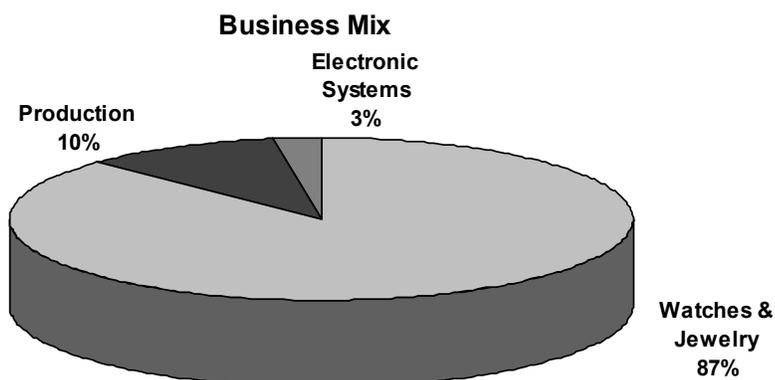
- (10) Traditional watch manufacturers, such as Vacheron Constantin, Audemars Piguet, Patek Philippe, Bédart (Gucci), and Swatch
- (11) Companies that were originally jewelers and moved into fine watchmaking, such as Cartier, Bulgari, and Tiffany
- (12) Fashion-oriented models, such as Gucci

According to the Federation of the Swiss Watch Industry, the value of Swiss watch manufacturers' exports amounted to SFr17.0 billion at year-end 2008, with finished watches accounting for around 94% of total value. With some 26.1 million watches exported in 2008, Swiss watches account for less than 2% in volume of world total production, which we estimate to be roughly 1.2 billion timepieces. *However, Switzerland is one of the world's largest watch manufacturers in terms of value. It is responsible for about half of all world production (in value), which shows that Swiss manufacturers have a strong market share in the medium- to high-priced watch segment.*

### Business Mix and Opportunity: Watches

Unlike other luxury players, which have a great diversity of business mix across variety of different product areas, Swatch is focused on one segment (i.e., watches and jewelry), but enjoys strong diversity within this segment. With regards to Swatch's segmental exposure, we believe that Swatch Group is the best-diversified watch company, which should limit the dependency on one customer group. We estimate that in 2008 the company generated roughly 66% of its sales in the high-price segment (including Omega), 14% in the medium-price segment, and 20% in the low-price segment. Compared with other luxury players, Swatch Group has the most diversified and highest exposure to watches.

**Exhibit 254: Swatch Business Mix (2009)**



Source: Company data.

Swatch currently offers watches in all price and market categories: Breguet, Blancpain, Jaquet-Droz, Glashütte-Original/Union, Léon Hatot, Omega, Longines, and Rado in the luxury, prestige, and the top-range segment; Tissot, Calvin Klein, Certina, Mido, Hamilton, and Pierre Balmain in the middle segment; Swatch and Flik Flak in the basic segment; and Endura produces private-label watches, whose prices vary according to customer wishes.

*We expect the core activity of Swatch to remain in the watch industry. We believe Swatch will further reinforce its presence in the top prestige and luxury segment and expand its jewelry collections via selective smaller to midsized acquisitions.*

### Swatch's Jewelry Segment

Swatch Group's jewelry segment has grown in importance over the past decade. In 2000, the company started to expand in the jewelry market with the launch of Swatch jewelry in the low-price category. It then launched three other jewelry lines in the high-price category under the Omega, Breguet, and Leon Hatot brand names. Although Swatch's jewelry business is fairly small, we see additional growth potential coming from jewelry. The jewelry market is one of the last consumer goods segments that is *not* dominated by brands. We estimate that the combined turnover of the branded jewelry segment account for only roughly 5% of the total jewelry market. In addition, Swatch can leverage its retail network by selling jewelry. *In view of the size of the market, we think Swatch Group has strong potential.*

### Technology and Innovation

However, the Swatch is not only a watch- and jewelry-making group. R&D of state-of-the art products and technologies play a major role in its activities. Microelectronics (e.g., EM Microelectronic-Marin, low power, low voltage), and micromechanics represent another important part of its operations. Swatch is active in the telecoms and service sectors. This includes sports timing, which measures the time at multiple international sports events and most of the Olympic Games. The Swatch Group will be the official timekeeper of the 2012 Summer Olympics in London, the 2014 Winter Olympics in Sochi, and the 2018 Winter Olympics.

## Brand Development State: Dominate

**Exhibit 255: The Swatch Group Checked Nearly All Boxes in the Emerge, and Transform & Proliferate Stages; Has Nearly Completed the Dominate Checklist**

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Credit Suisse.

Swatch Group has successfully transformed into one of the world's top players in the luxury watch industry. We estimate that Swatch Group's high-margin prestige watch segment (with brands such as Omega, Rado, Breguet, Blancpain, and Glashütte) contributes more than 60% of group earnings. On the back of the (1) ongoing strong momentum for its luxury watches, (2) relatively low exposure to the United States and Japanese markets, and (3) substantial mid- to long-term potential in Asia (particularly China), we estimate this share could increase to more than 75% by year-end 2012. We expect Swatch to continue to make selective acquisitions in the luxury watch segment or to return cash to shareholders.

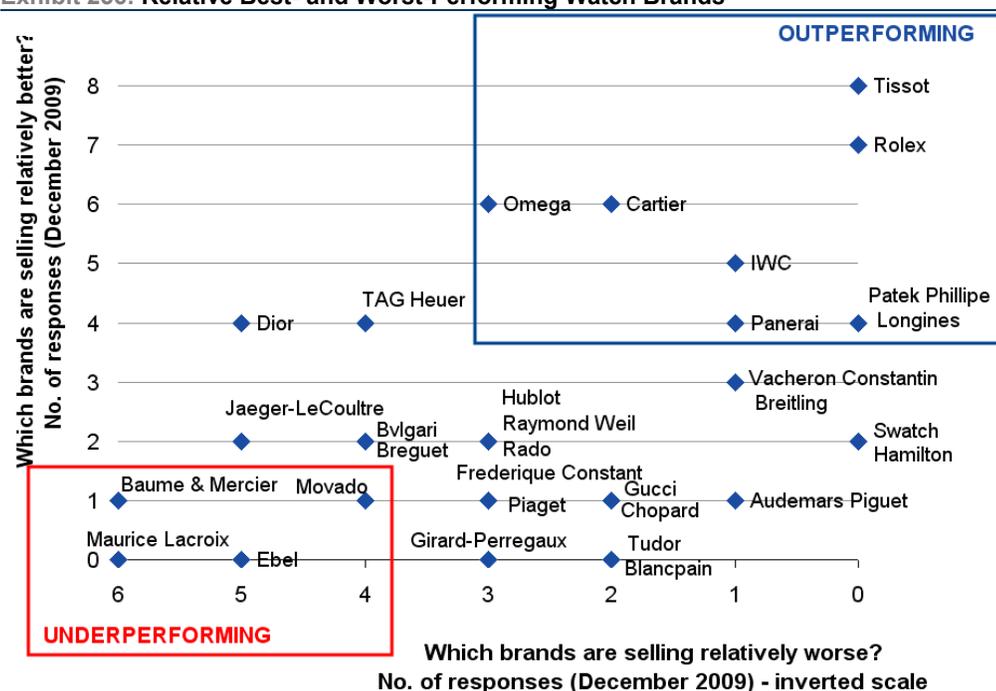
### Significant Brand Equity

**Survey of watch retailers.** We interviewed 14 watch retailers in the United States, Europe, and Asia in December 2009 to gauge how they see (1) sequential demand trends for high-end watches; (2) current inventory levels at retailers; (3) price outlook, and which price segments are performing better and worse; and (4) which leading watch brands are outperforming and underperforming?

Swatch and Richemont (and likely Rolex) recently have significantly outperformed the Swiss watch industry. In a difficult year, stronger brands tend to amplify market share gains at the expense of struggling weaker/shadow brands, as shoppers become more selective.

Exhibit 256 summarizes which watch brands are performing better (shown in top-right corner) and worse (shown in the bottom-left corner) in this sample. Brand equity seems to be more determinant of fortunes rather than price segmentation per se: we have some high-end brands such as *Patek Philippe* and *IWC* among the best performers, and some accessible brands such as *Movado* or *Maurice Lacroix* among the worst performers.

**Exhibit 256: Relative Best- and Worst-Performing Watch Brands**



Source: Credit Suisse survey.

### Intangible Value of Swiss-Made Watches

Swatch is able to capitalize on its full vertical integration because it will no longer deliver just the nonassembled mechanical movements, but will provide the whole value added on mechanical movements and capture the whole margin. In addition, this measure should

help to ensure that Swiss made continues to have a true meaning (i.e., watches should to a lesser extent be diluted with parts that are not Swiss made).

In our view, Swatch's vertical integration in all steps of the watch manufacturing process will provide it with better top-line growth and opportunities to gain market share than its competitors. Its strong industrial base should enable it to be the driving force in terms of innovation, which turns out to be a major competitive advantage in a consumer environment increasingly focused on value-added technical innovations. Last, its dominant position provides Swatch with the ability to track what its competitors are doing.

### **Continuously Innovative**

Product innovation is one of the key success factors for Swatch. New, innovative watches are continually being added to the range of products of the various Swatch Group watch brands. On the back of the fairly small investments needed to exploit the Swatch Group's vast experience, know-how, and production capacities in micromechanics and microelectronics, and to leverage the industrial base of the company, we expect Swatch to continue to develop high-tech components supplied to other sectors, such as computers, telecommunications, medical applications, and electronics.

## **Growth Strategies & Opportunities**

### **Omega: Benefiting from Recent Repositioning**

The key driver for Swatch Group's luxury segment is clearly the Omega brand (an estimated 25-30% of total sales and 40-45% of total EBIT). Omega has excelled owing to a successful repositioning (i.e., gradual upgrade of product quality, expansion of offering to women, price increases, ad campaigns, reduction of POS to enhance exclusivity).

### **Exposure to the Chinese Consumer**

In our view, Swatch Group is among the best-positioned companies to capture Chinese spending at an earlier stage in the development of personal disposable wealth in China as: (1) it has established brand awareness, especially with Omega's over 110 years, providing it with a considerable competitive advantage; and (2) the offer of luxury products at lower price points compared with the high-luxury businesses of some of its peers. We estimate that the group's China exposure currently accounts for around 27% of group sales. We expect the company further to expand its retail presence directly through its own stores or through Xinhua Hengdeli, the largest luxury goods retailer and wholesaler in China, which recently announced that it would further develop its retail business by accelerating its market presence in second- and third-tier cities.

According to our Chinese Consumer survey, which was published on January 11, 2010, (*China Consumer Survey – Consumption Jump*) Omega, which is already among the top consumer brands of the luxury watches in China and was the official timekeeper for the 2008 Olympic Games in Beijing, is the most likely among luxury watches to be purchased (besides Rolex) within the next three years. Furthermore, four brands of Swatch Group are ranked among the brands Chinese consumers would like to own without considering budget limitations. In our view, this shows the significant growth potential for Swatch in the Chinese market. In our view, Swatch Group, LVMH, and Richemont are attractive ways to play the Chinese luxury spending growth owing to their greater and more profitable exposure relative to their peers. This is supported by the ownership of the strongest/most preferred brands in their respective categories by emerging Chinese luxury shoppers.

### **Room to Grow in the United States**

We would like to highlight the long-term growth potential that we see for Swatch Group in the U.S. market, where it has a fairly low market share. We expect the company's market position to improve through additional investment for some of its already established brands in this market (such as Tissot, Omega or Longines) or the launch of Tiffany watches following Swatch's partnership with Tiffany.

## Major Catalysts

- **Economic environment.** As the economic environment continues to improve, management expects sales to pick up across its geographies. The group recently reported strong performance for the second half of 2009 and pointed to a good start in 2010, with January sales representing the second-best January in the history of the group.
- **Monthly export data.** Other catalysts for the stock price are the monthly publications of Swiss watch export data.

## Key Risks

### Dependency on Luxury

Swatch Group's performance is dependent on the demand for luxury goods and consumer spending in general in the markets in which it is active. In addition, the performance of its electronics division is mainly linked to the demand from the telecoms sectors. However, among watchmakers, Swatch is better positioned than its competitors, given its portfolio of brands that span across the low-, medium-, and high-priced segments. Furthermore, Swatch has a private label segment that produces watches with prices that vary according to customer wishes.

### Fluctuations in Currency

Currency movements affect group performance, as it does not strategically hedge against currency movements, and the majority are denominated in SFr. Swatch Group is mainly exposed to the EUR, the USD, and the JPY.

### Retail Operations

The expansion of directly operated retail stores (prestige segment and Swatch) could further increase the company's asset base and increase the group's fixed costs, which could be a risk in the next downturn of the cycle. However, the company does not intend to increase retail sales to more than 10-15% of total watch sales, which limits the downside risk, in our view.

### Others

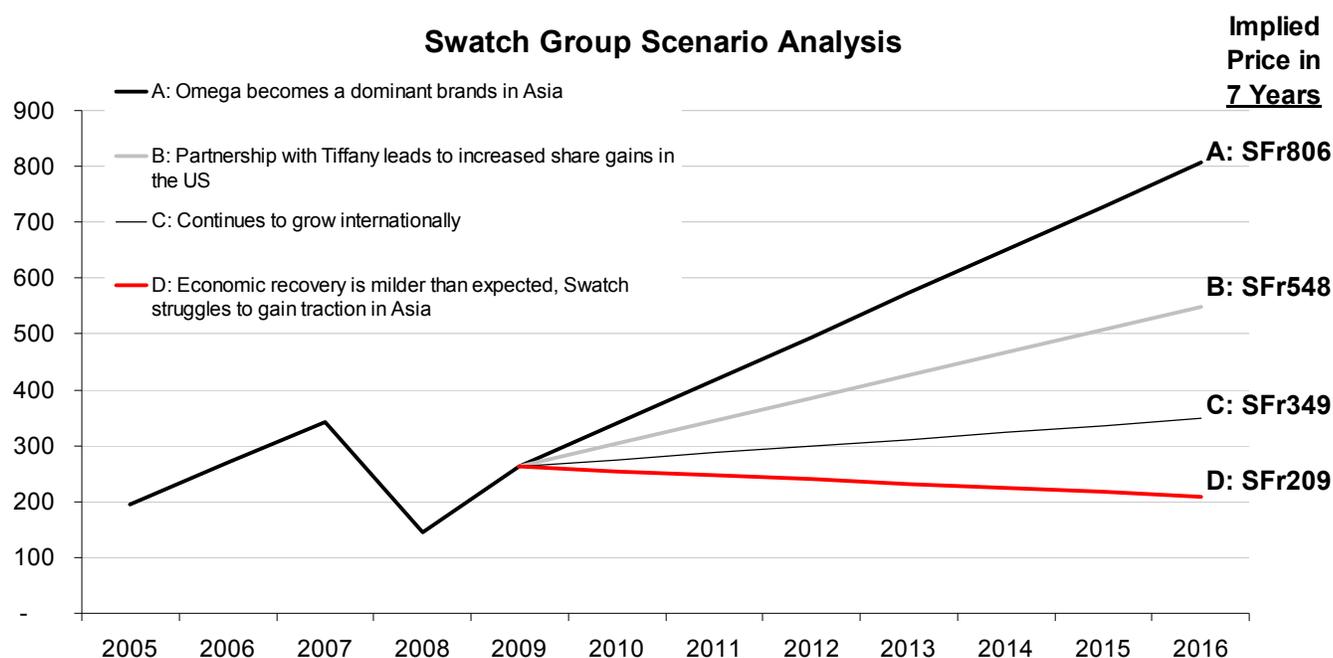
Other potential issues include geopolitical issues that could increase the reluctance to travel; structural risk (e.g., mobile phones, which could be a threat as young people often use a mobile phone as a substitute for a watch), and downside risk from grey markets and counterfeit products.

## Valuation

Swatch currently trades at 19.1 times our 2010 EPS estimate, which we believe offers upside potential, considering that our 2010 EPS estimate is around 15% below historical peak earnings. Based on our DCF valuation, we derive a fair value of SFr350. Therefore, we reiterate our positive view on the high-quality stock of Swatch Group.

## Financial Statements and Comparable Valuation

### Exhibit 257: Current Stock Price Embeds Conservative Growth Expectations



	2009A	2016 Scenario Analysis			
		A	B	C	D
Swatch sales	5,142	12,000	10,000	8,000	6,500
Growth CAGR	-	13%	10%	7%	3%
EBIT margin	18%	28%	26%	24%	21%
Interest other expense	46	46	46	46	46
Tax rate	20%	20%	20%	20%	20%
Sharecount	54	54	54	54	54
<b>EPS</b>	<b>14.02</b>	<b>50.37</b>	<b>39.13</b>	<b>29.07</b>	<b>20.87</b>
Growth CAGR	-	20%	16%	11%	6%
P/E Multiple	21	16	14	12	10
<b>Implied Price, 2016E</b>		<b>806</b>	<b>548</b>	<b>349</b>	<b>209</b>
Implied 7-yr return CAGR		169%	83%	16%	-30%
		15%	9%	2%	-5%

Source: Company data, Credit Suisse estimates.

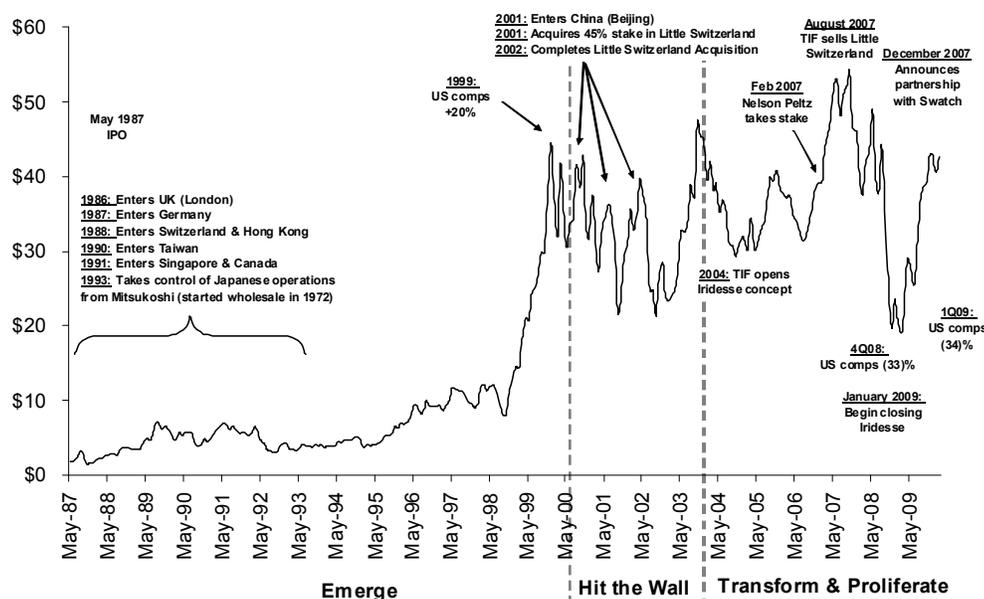
### Exhibit 258: Swatch Trades at a Discount to the Luxury Goods Group Despite a Strong, Defensive Product Portfolio

Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	2009	2008	EPS			P/E	P/E	P/E	3-Yr	EV-to-Sales	
						Stock Perf	Stock Perf	FY08	FY09E	FY10E	CY09	CY10	CY11	Avg P/E		
<b>Swatch</b>	<b>UHR.VX</b>	<b>CHF 299.00</b>	<b>€ 10,669</b>	<b>€ 10,012</b>	<b>CHF 5,416</b>	<b>16%</b>	<b>80%</b>	<b>-57%</b>	<b>CHF 12.60</b>	<b>CHF 15.90</b>	<b>CHF 18.70</b>	<b>23.6</b>	<b>19.1</b>	<b>16.0</b>	<b>19.6</b>	<b>2.8</b>
LVMH	LVMH.PA	€ 79.60	€ 38,999	€ 47,610	€ 17,199	21%	64%	-42%	€ 4.47	€ 3.80	€ 4.28	21.0	18.6	16.2	18.6	2.8
Hermes	HRMS.PA	€ 98.90	€ 10,441	€ 10,102	€ 1,915	26%	-7%	16%	€ 2.75	€ 2.83	€ 3.00	34.9	32.9	29.2	32.3	5.3
Richemont	CFR.VX	€ 36.76	€ 14,387	€ 13,271	€ 5,048	18%	71%	-51%	€ 1.33	€ 1.17	€ 1.38	20.8	19.0	16.3	18.7	2.6
Bulgari	BULG.MI	€ 5.80	€ 1,717	€ 2,021	€ 947	10%	30%	-54%	€ 0.28	€ 0.04	€ 0.24	153.4	24.4	18.2	65.3	2.1
Tiffany	TIF	\$43.10	€ 3,932	€ 4,335	\$2,714	17%	82%	49%	\$2.33	\$2.13	\$2.60	20.1	16.9	15.0	17.3	2.2
Burberry	BRBY.L	641p	€ 3,171	€ 3,163	£1,274	15%	170%	-61%	30p	32p	35p	20.1	18.6	17.0	18.6	2.2
PPR	P RTP.PA	€ 85.60	€ 10,820	€ 16,298	€ 19,092	8%	81%	-58%	€ 6.99	€ 5.12	€ 6.27	16.7	13.6	11.6	14.0	0.9
TOD's	TOD.MI	€ 48.40	€ 1,481	€ 1,481	€ 717	18%	72%	-37%	€ 2.74	€ 2.72	€ 2.97	17.8	16.3	14.8	16.3	2.1
Average						17%	72%	-33%				36.5	19.9	17.1	24.5	2.5

Source: Company data, Credit Suisse estimates.

# Tiffany & Co. (TIF): Seizing the Global Opportunity

Exhibit 259: TIF Stock Price History



Source: Company data, Credit Suisse estimates

## Investment Summary

- Unique Brand Story.** While TIF's business trends suffered during in 2008-09 with the difficult macroeconomic environment, we believe that the brand and business model remain strong. TIF has been careful to protect its brand image by not promoting or discounting over the past year; we believe this will enable a top-line recovery sooner than many estimate, as demonstrated by its better-than-expected third quarter of 2009 and holiday sales results. TIF built its brand by offering high-quality jewelry and accessories with consistent brand marketing, and has maintained the integrity and cache of its brand name over the company's 170-plus year history by maintaining a consistent model and not running promotions on merchandise.
- Brand Opportunity - Domestic Recovery and Square Footage Growth Opportunity.** As evidenced by TIF's holiday sales results (released January 12, 2010), the top-line is recovering faster than many (including us) previously expected, helped by easier sales productivity comparisons. We expect U.S. sales productivity (sales per square foot) to end fiscal 2009 at approximately 2% below its previous ten-year trough, implying fairly easy sales comparisons in fiscal 2010. If we thought this were a business in secular decline, we would not be as optimistic about an improvement in productivity; however, because of the preservation of TIF's brand image, as well as rationalization in the jewelry industry, we believe productivity will begin to improve in fiscal 2010.
- In the long term, the company has indicated it plans to open five to seven regular stores and three to five boutique-format stores per year, reaching a maximum potential of about 170 stores in the U.S. market (compared with 79 currently). The boutique locations are smaller (2,000 square feet versus 5,000-7,000 square feet for a typical store) and carry only a limited assortment of TIF's merchandise (no engagement jewelry), which allows the company to enter new, smaller markets that may not be able to support a regular TIF store, but still generate good returns on higher volume sales of

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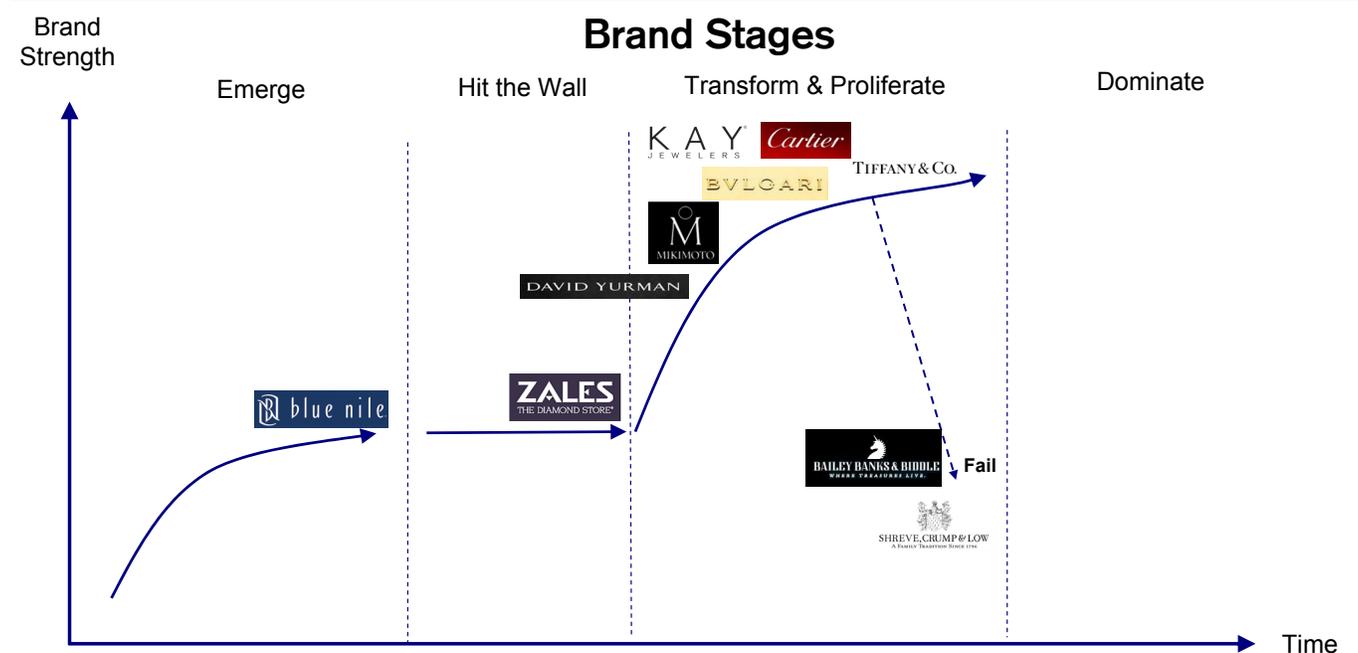
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accessible items, such as gold and silver fashion jewelry. We believe TIF is more likely to open six to nine stores per year in a format between the boutique and full stores (i.e., larger than the typical boutique format, and carrying engagement jewelry, but smaller than a regular store). While we believe opening smaller format stores is an innovative way for TIF to reach incremental new domestic markets, the company must be careful not to overexpand, which could dilute the exclusivity of the brand.

- **Near-Term Gross Margin Opportunity.** In the near-term, we believe the company should achieve gross margin improvements, as lower costs for precious metals (compared with extremely high prices this past year) flow through the income statement. While prices for platinum and silver have decreased significantly from their 2008 peak levels, gross margins have seen little benefit owing to TIF's accounting method (average cost method). As we wrote in our September 10, 2009, report, *Revealing the F10 Gross Margin Story: Upgrade TIF to Outperform*, we believe this benefit will finally flow through cost of goods sold in fiscal 2010, adding a tailwind to TIF's gross margin (we forecast roughly 150 basis points of gross margin improvement).
- **International Opportunity.** Although TIF has had an international presence for nearly 30 years, we believe the brand has significant future growth opportunities in China and Europe. The company believes that it can have 25-30 stores in mainland China in the next 5 years (as of the third quarter of 2009 it only had 9), based on continued strong sales growth in that market. Results in TIF's European segment have been strong throughout the past year, holding up well even in the midst of the financial crisis—in the fourth quarter of 2008, Europe comped flat (constant currency), compared to the U.S. comp of -33%, and Europe comps have been positive in all three quarters this year. TIF believes it can double its store base to roughly 50 over the long term. We believe there are also (smaller) opportunities for TIF to grow in the Asia-Pacific region (in Australia, Singapore, and Hong Kong), and in Italy and select countries across continental Europe.
- **Market Share Gains from Industry Consolidation.** Mass market jewelers such as Whitehall (JWL) and Friedman's (FRDM.PK), and regional players such as Fortunoff, Shane, and Robbins Brothers have declared bankruptcy over the past year or so. Most recent, Finlay (FNLY), which ran jewelry departments in major department store chains such as Macy's (M) and Dillards (DDS), also declared bankruptcy, and was liquidated in fall 2009. Finlay owned the higher-end Bailey, Banks and Biddle business, which is the chain most comparable with TIF. While not all of these jewelers are TIF's direct competitors, the industry remains highly fragmented, so any capacity coming out of the system is an incremental positive for TIF.
- **Valuation.** Our \$52 target price is 20 times our fiscal 2010 EPS estimate and 10 times our fiscal 2010 EBITDA estimate. TIF currently trades at roughly 17 times our fiscal 2010 EPS estimate, a discount to the average comparable group multiple of roughly 20. Applying the comparable group multiple to our fiscal 2010 EPS estimate, there is approximately 21% upside potential to the stock from current levels. Our target price is supported by our DCF-based HOLT® analysis, which assumes asset growth consistent with square footage growth in our earnings model (3-4% per year) and CFROI® increasing to around 13% in 2013 from roughly 11% in 2009.

## Brand Overview

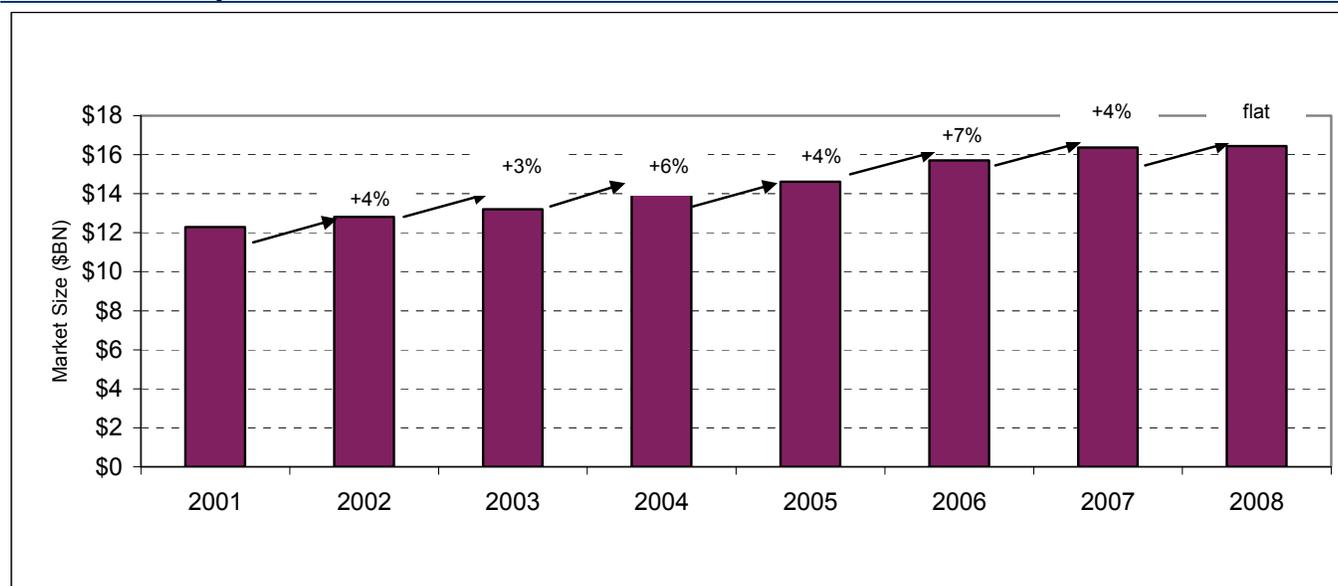
TIF, known by its signature blue box, has been designing and selling jewelry since it was founded in 1837. The brand has weathered the economic cycles and continues to be successful over the past 170 years owing to the high standard of quality it represents, the personal in-store service, and the exclusive, aspirational nature associated with the brand (and blue box).

**Exhibit 260: Jewelry Industry Competitive Brandscape**


Source: Company data, Credit Suisse estimates.

Barriers to entry in the jewelry business are fairly low (the result is a highly fragmented market), but the ability to profitably produce high-end jewelry rests on a company's ability to effectively source high-quality diamonds, precious metals, and gems. The high-end market is more capital intensive and smaller, less well capitalized competitors may not have the ability to purchase the necessary raw materials in the quantity to compete effectively. TIF has the aforementioned capital and capabilities and agreements with diamond mining companies that enable it to access high-quality diamonds more easily than most. Its large scale also makes it economical for TIF to cut and polish rough stones itself, eliminating one layer or markup within the supply chain.

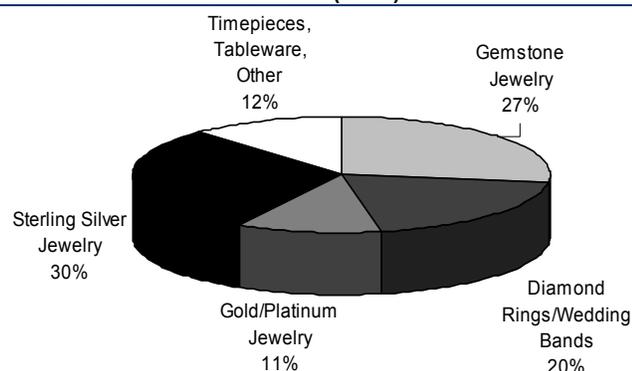
While TIF is one of the most recognized brand names, it only has around 2% market share in the \$65 billion jewelry and watch market, and 8-10% market share for high-end jewelry. (We estimate this market to be roughly \$16 billion). Since 2001, the market has grown at a CAGR of 4%. (See Exhibit 261.)

**Exhibit 261: Jewelry and Watch Market Has Grown at a CAGR of 4% Since 2001**

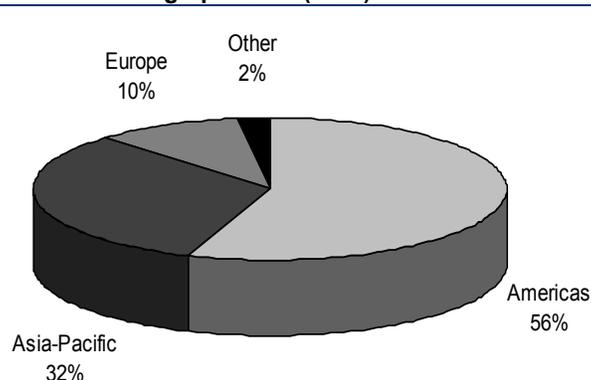
Source: U.S. Commerce Department.

\*\*Data represents estimated comparable market for TIF at 25% of overall addressable market.

TIF's sales mix comprises five key categories: sterling silver (30%); gemstone jewelry (27%); diamond rings and wedding bands (20%); timepieces, tableware, and other (12%); and gold and platinum jewelry (11%). Sterling silver jewelry, the largest category, also carries the highest gross margins, (we estimate 75-80%, on average). Diamond jewelry has 35-45% gross margins, and high-end diamond jewelry carries 25-35% gross margins. The Americas (which includes the United States, Canada, and Latin and South America) contributed 56% of 2008 sales, followed by Asia-Pacific (32%), Europe (10%), and other regions (2%). (See Exhibit 262 and Exhibit 263.)

**Exhibit 262: TIF Business Mix (2008)**

Source: Company data, Credit Suisse estimates.

**Exhibit 263: TIF Geographic Mix (2008)**

Source: Company data, Credit Suisse estimates.

### An Aspirational (Yet Accessible) Brand

While TIF has its roots in the luxury segment of the market and competes with jewelers such as Cartier, Bulgari, and Harry Winston, it can also be viewed as an accessible luxury brand, given the increasing popularity of its entry-level silver jewelry. (Silver represented 30% of total sales in fiscal 2008.) With a wide range of price points starting at around \$100 (for silver jewelry and accessories) to \$50,000 and above (for diamond engagement rings and statement items), there is a fairly wide disparity between the customer that shops TIF from the low-end of the pricing spectrum to the top. At the low end, we believe many

consumers trade up to TIF's silver jewelry to share in the blue box experience. (Similar silver items could be purchased for much less elsewhere, but TIF's packaging adds cache.) At the high end, (engagement rings and statement jewelry), we believe the business is in large part driven by a wealthier customer, which also contributed to the significant weakness TIF saw during the financial market turmoil over the past year.

## Brand Development State: Dominate

TIF has proven itself as the brand proliferated across the United States and into international markets around the world. Its diversity of products, ranging from accessible silver to statement jewelry, has proven that the brand has power and flexibility. Truly to dominate the market from the accessible end to the high-end luxury categories, TIF must successfully expand its European and Chinese segments and become a major player in those markets while maintaining its success in the established U.S. market.

### Exhibit 264: TIF Needs to Maximize International Presence to Reach the Dominance Phase

Checklist to Emerge:	Checklist to Transform & Proliferate:	Checklist to Dominate:
<input checked="" type="checkbox"/> Brandable Industry	<input checked="" type="checkbox"/> Continued Investment in the Brand	<input checked="" type="checkbox"/> Robust International Presence
<input type="checkbox"/> New or Underserved Market	<input checked="" type="checkbox"/> Reliable Product/Service Quality	<input type="checkbox"/> Dominant Market Share
<input type="checkbox"/> New Technology	<input checked="" type="checkbox"/> Leadership/Management Strong	<input checked="" type="checkbox"/> Ownership of Category/Mindshare
<input checked="" type="checkbox"/> Differentiated Product	<input checked="" type="checkbox"/> Perpetual Innovation	<input checked="" type="checkbox"/> Loyal Customer Base
<input type="checkbox"/> Production Innovation	<input checked="" type="checkbox"/> Power Player	<input checked="" type="checkbox"/> Preserve Relevance to Core Customer
<input checked="" type="checkbox"/> Distribution Innovation	<input checked="" type="checkbox"/> Aspirational Marketing Machine	<input checked="" type="checkbox"/> Quality Consistent
<input checked="" type="checkbox"/> Connection with Core Consumer	<input checked="" type="checkbox"/> Continued Sales/Market Share Growth	<input checked="" type="checkbox"/> Maintain Focus on the Brand
<input checked="" type="checkbox"/> Effective Marketing Strategy as a Brand	<input checked="" type="checkbox"/> International Growth	<input checked="" type="checkbox"/> Leadership does not Ossify
<input checked="" type="checkbox"/> Authentic Brand Intangibles	<input checked="" type="checkbox"/> Loyal Core Customer	<input checked="" type="checkbox"/> Cash Flow Generation in Core Markets
<input checked="" type="checkbox"/> Sufficient Marketing Investment	<input type="checkbox"/> Success in Category Extensions	<input checked="" type="checkbox"/> Leverage Overhead/SG&A with Scale
<input checked="" type="checkbox"/> Reliable Product/Service Quality	<input checked="" type="checkbox"/> Anticipate Challenges from Competitors	
<input type="checkbox"/> New Product/Service Category	<input type="checkbox"/> Know When to Say 'No'	
<input checked="" type="checkbox"/> Effective Management & Leadership	<input type="checkbox"/> Avoid Non-Core Acquisitions	
<input checked="" type="checkbox"/> Robust Sales Growth in Core Market		
<input checked="" type="checkbox"/> Product Evolution & Investment		

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Growing International Presence

TIF first entered the international market in 1986 with a company-owned store in London, followed by Europe, Hong Kong, Taiwan, Singapore, and Canada in the late 1980s/early 1990s. In 1993, TIF took control of its Japanese wholesale operations, which had previously been run by an outside partner (Mitsukoshi); in 2001, TIF entered the Chinese market, with its first store in Beijing. Total international sales have grown at an 11% CAGR over the past five years, to \$1.3 billion in 2008 from less than \$800 million in 2003. International retail sales (including Canada and Latin America) composed roughly 46% of TIF's total \$2.9 billion in sales worldwide.

TIF has been struggling in Japan for some time, but has performed better in Europe, non-Japan Asia, and Mexico and Canada. As previously mentioned, we believe the brand's future growth opportunities will be concentrated in China and Europe. Our 2009 China consumer survey indicated that TIF brand awareness is growing in China despite having few stores; while Chinese brands represented the top two ranked jewelry brands consumers plan to purchase, TIF ranked in the top five (number five) in the survey. The company believes that it can grow to 25-30 stores in mainland China over the next five years (as of the third quarter of 2009 it only had nine). Results in the European segment have been strong throughout the past year, holding up well even in the midst of the financial crisis; in the fourth quarter of 2008, Europe comped flat (constant currency), compared to the U.S. comp of -33%, and Europe comps have been positive in all three quarters this year. TIF believes it can double its European store base to around 50 in the long term.

### **New Store Format for Domestic Growth**

While TIF's U.S. presence has been for the most part established, there remains an opportunity to open stores in the new TIF *boutique* format. These boutique locations are smaller than a typical store (2,000 square feet versus 5,000-7,000 square feet) and carry only a limited assortment of TIF merchandise (no engagement jewelry). This allows TIF to enter new, smaller markets that may not be able to support a regular TIF store, but would generate strong returns on higher volume sales of accessible items, such as gold and silver fashion jewelry. While the smaller format stores are a better alternative than rolling out full-size TIF locations, the company has to be careful not to roll out too many, which may dilute the brand owing to the focus on lower price point products (i.e., gold and silver fashion jewelry).

### **Market Share Gains from Industry Consolidation**

Mass market jewelers such as JWEL and FRDM and regional players such as Fortunoff, Shane and Robbins Brothers have declared bankruptcy over the past year or so. Most recent, FNLY, which ran jewelry departments in major department store chains such as M and DDS, also declared bankruptcy, and was liquidated in fall 2009. FNLY also owned the higher-end Bailey, Banks and Biddle business, which is the chain most comparable with TIF. While not all of these jewelers are TIF's direct competitors, the industry remains highly fragmented, so any capacity coming out of the system is an incremental positive for TIF, especially at the low- to mid-price range at which customers may then trade up to TIF's high margin silver/fashion jewelry.

## **Major Catalysts**

We see three key catalysts for TIF over the next three to five years.

### **Faster-Than-Expected Top-Line Improvement**

While TIF's business trends have been negatively affected by the current economic downturn, we do not believe its business model or brand have been permanently tarnished. Owing to the careful management of pricing and promotions, TIF's brand image remains one of aspiration, exclusivity, and quality. The company initiated limited price reductions in engagement jewelry (reducing some rings by 10% in November 2008 in the United States), but overall, the store has not participated in the promotional activities of its competitors. To be clear, there were no red lines drawn through old engagement ring prices, the items were just repriced.

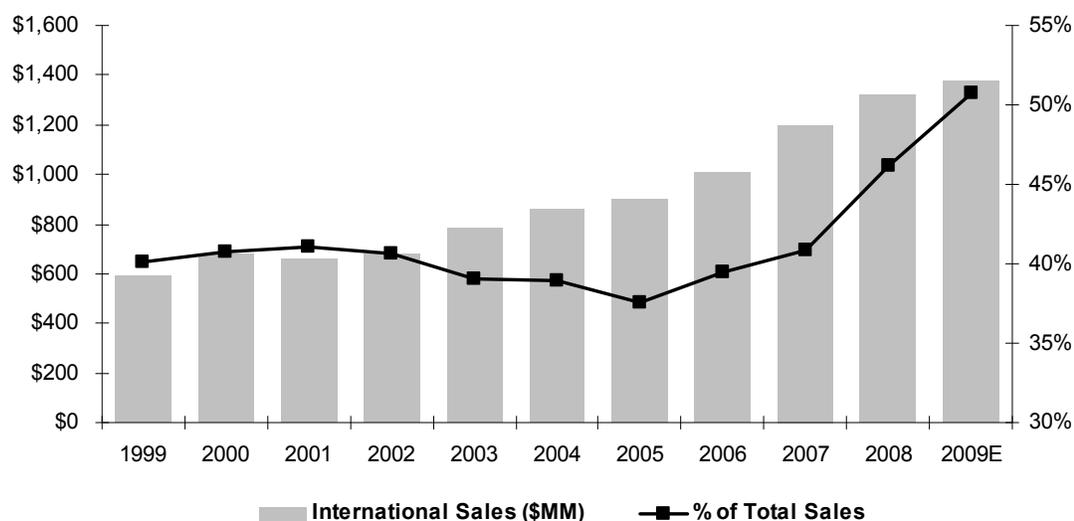
As demonstrated by its holiday sales results (results for the two-month period ending December 31, 2009, reported on January 12, 2010), TIF's top line is continuing to recover faster than most expected, driven by improvement in the U.S. business. U.S. comps were up 16% in November 2009 and up 10% in December 2009, for a consolidated period comp of up 12%, a significant sequential improvement from the -10% comp in the third quarter of 2009. While Japan was still weak in the holiday period, Asia-Pacific outside of Japan comped up 26%, and comps in Europe were up 16%, driven by positive double-digit comps in the United Kingdom and many other countries. The return to positive comps in the United States, non-Japan Asia, and Europe was particularly encouraging in this period, as holiday (November-December) sales typically represent around 80% of fourth quarter sales, and the fourth quarter is historically a strong quarter (around 35% of annual sales).

## International Growth in Europe and Non-Japan Asia.

Total international sales have grown at an 11% CAGR over the past five years, to \$1.3 billion in 2008 from less than \$800 million in 2003. In Exhibit 265, we show the increasing contribution of the international business to total TIF sales.

If TIF is able to reach its store growth targets of 25 stores in mainland China and around 50 stores in Europe over the next five years, we believe revenues from non-Japan Asia (driven by China) will grow at a 19% CAGR, to nearly \$970 million by fiscal 2013 from \$400 million in fiscal 2008, and European revenues will grow at a 12% CAGR, to about \$500 million by fiscal 2013 from \$285 million in fiscal 2008.

**Exhibit 265: International Growth 1999–2009E**



Source: Company data, Credit Suisse estimates.

## Key Risks

### Macroeconomic Environment

The high-end jewelry business has been hard hit by the economic downturn of the past year, and TIF has consistently called out weakness in its own highest price point categories. While current trends seem to indicate that the worst is behind, weakness in tourism, and/or a worsening of the economic environment in the United States would negatively affect TIF's business.

### Raw Material Prices

Part of our bullish stance on TIF in the near term is based on gross margin upside in fiscal 2010. However, the fluctuation in gross margin over the years highlights a long-term risk, that increasing materials prices over the next several years could pressure TIF's gross margin if it is unable to offset higher costs with higher prices.

### Foreign Currency Risk

As a growing percentage of TIF's sales are generated in international markets, TIF is exposed to foreign exchange fluctuations that may significantly affect its business.

## Valuation

TIF reported better-than-expected holiday sales results on January 12, 2010, based on strong top-line improvement in the United States and internationally. Management raised its fiscal 2009 EPS guidance to \$2.07-2.12 versus previous guidance of \$1.88-1.98 and the consensus of \$1.93, based on sales of roughly \$2.7 billion. This implies fourth quarter 2009 EPS of \$1.05-1.10. While weakness in Japan remains a concern, this is one of the

few stories in retail with easy sales and gross margin comparisons in 2010. While we initially were most excited about the gross margin opportunity in 2010, sales upside potential is turning into an even more compelling piece of the TIF story.

Our \$52 target price is 20 times our fiscal 2010 EPS estimate and 10 times our fiscal 2010 EBITDA estimate. TIF currently trades at around 17 times our fiscal 2010 EPS estimate, a discount to the average comparable group multiple of around 20. Applying the comparable group multiple to our fiscal 2010 EPS estimate, there is approximately 21% upside potential to the stock from current levels. (See Exhibit 266).

Our target price is supported by our DCF-based HOLT® analysis, which assumes asset growth consistent with square footage growth in our earnings model (3-4% per year) and CFROI® increasing to around 13% in 2013 from roughly 11% in 2009. (See Exhibit 267).

**Exhibit 266: Comparable Group Multiple Implies 18% Upside Potential to Current Levels**

CS 2010 EPS Estimate	\$2.60
Avg F10 Comparable Multiple	20x
Implied Price	\$51.97
Current Price	\$43.05
<b>Upside / (Downside)</b>	<b>21%</b>

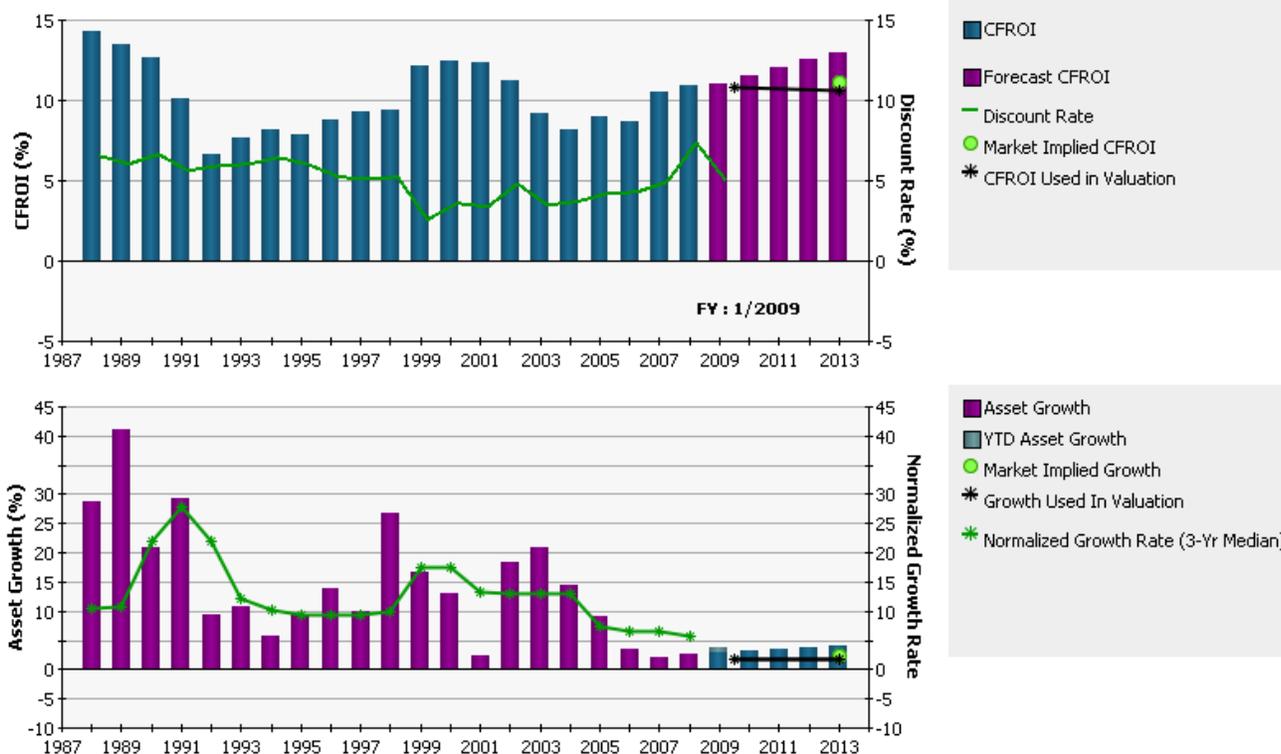
Source: Company data, Credit Suisse estimates

Comparable group includes ANF, Coach, LVMH, Hermes, Richemont, Bulgari, Swatch, Burberry, PPR, TOD's.

## Exhibit 267: Our \$52 Target Price

TIFFANY &amp; CO (TIF)

Specialty Stores



Source: HOLT ValueSearch.

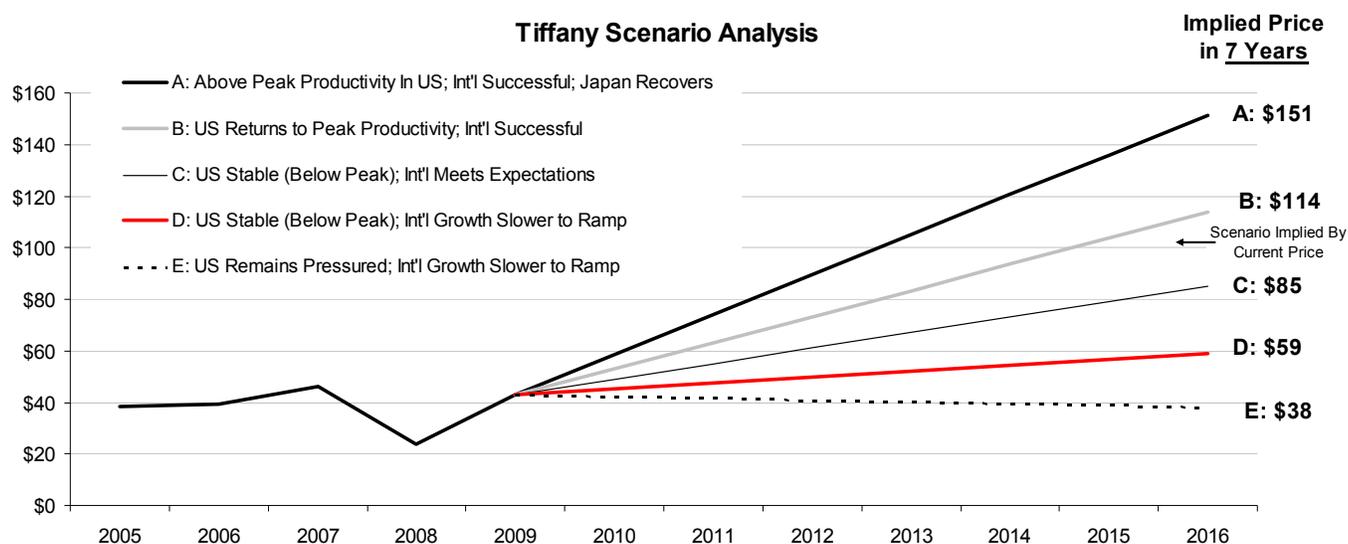
## Financial Statements and Comparable Valuation

## Exhibit 268: 2016 Scenario Assumption Inputs

	2009E	2016 Scenario Analysis				
		A	B	C	D	E
TIF sales	2,714	5,500	5,200	4,800	4,200	3,800
Growth CAGR	-	11%	10%	8%	6%	5%
EBIT margin	16%	25%	22%	20%	18%	15%
Interest other expense	48	48	48	48	48	48
Tax rate	32%	35%	35%	35%	35%	35%
Sharecount	125	125	125	125	125	125
<b>EPS</b>	<b>\$2.13</b>	<b>\$6.88</b>	<b>\$5.69</b>	<b>\$4.73</b>	<b>\$3.67</b>	<b>\$2.71</b>
Growth CAGR	-	18%	15%	12%	8%	4%
P/E Multiple	20	22	20	18	16	14
<b>Implied Price, 2016E</b>		<b>\$151</b>	<b>\$114</b>	<b>\$85</b>	<b>\$59</b>	<b>\$38</b>
Implied 7-yr return		252%	164%	98%	37%	-12%
CAGR		20%	15%	10%	5%	-2%
Discount rate		12%	12%	12%	12%	12%
<b>NPV</b>		<b>\$68</b>	<b>\$50</b>	<b>\$38</b>	<b>\$26</b>	<b>\$16</b>

Source: Company data, Credit Suisse estimates.

Based on the inputs in Exhibit 268, we calculate five different scenarios for TIF stock over the next seven years.

**Exhibit 269: Current Stock Price Embeds Conservative Growth Expectations**

Source: Company data, Credit Suisse estimates.

**Exhibit 270: TIF Trades at a Discount to the Group Despite Brand Strength and Significant Growth Opportunities**

Company	Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	2010	2009	Actual EPS		Consensus EPS		P/E	P/E	P/E	EV-to-Sales
							Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	
<b>Tiffany &amp; Co.</b>	<b>TIF</b>	<b>43.05</b>	<b>\$5,231</b>	<b>\$5,609</b>	<b>\$2,860</b>	<b>14%</b>	<b>-2%</b>	<b>82%</b>	<b>2.17</b>	<b>2.33</b>	<b>2.07</b>	<b>2.42</b>	<b>18.5</b>	<b>20.8</b>	<b>17.8</b>	<b>2.0</b>
Abercrombie & Fitch	ANF	35.38	\$3,101	\$2,459	\$3,540	6%	1%	51%	4.78	1.12	1.64	2.24	31.6	21.6	15.8	0.7
Bulgari	BUL-IT	5.63	\$2,267	\$2,692	\$1,329	N/A	-5%	34%	0.52	0.28	0.02	0.18	20.1	281.3	30.7	2.0
Burberry	BRBY-GB	6.37	\$4,211	\$4,174	\$1,722	N/A	3%	203%	0.29	0.31	0.33	0.37	20.8	19.4	17.3	2.4
Coach	COH	36.05	\$11,360	\$10,282	\$3,230	31%	-1%	76%	1.79	1.91	2.16	2.38	18.9	16.7	15.1	3.2
Hermes	RMS-FR	98.04	\$13,897	\$13,188	\$2,376	26%	3%	-4%	2.62	2.76	2.82	3.13	35.5	34.8	31.4	5.6
LVMH	MC-FR	78.69	\$52,076	\$56,412	\$23,899	20%	-1%	69%	4.00	3.70	4.28	4.85	21.3	18.4	16.2	2.4
PPR	PP-FR	84.72	\$14,659	\$24,195	\$28,891	7%	0%	87%	6.74	6.95	5.14	6.18	12.2	16.5	13.7	0.8
Richemont	CFR-CH	36.07	\$17,321	\$17,938	\$8,792	17%	2%	76%	4.32	1.92	1.19	1.39	18.8	30.4	25.9	2.0
Swatch	UHR-CH	295.50	\$8,406	\$14,283	\$4,974	N/A	11%	85%	17.37	14.26	16.24	18.65	20.7	18.2	15.8	2.9
Tod's	TOD-IT	47.78	\$1,975	\$1,875	\$984	N/A	-9%	78%	2.33	2.74	2.73	2.97	17.5	17.5	16.1	1.9
<b>Average</b>						<b>17%</b>	<b>0%</b>	<b>76%</b>					<b>21.4</b>	<b>45.1</b>	<b>19.6</b>	<b>2.4</b>

Source: Company data, Credit Suisse estimates.

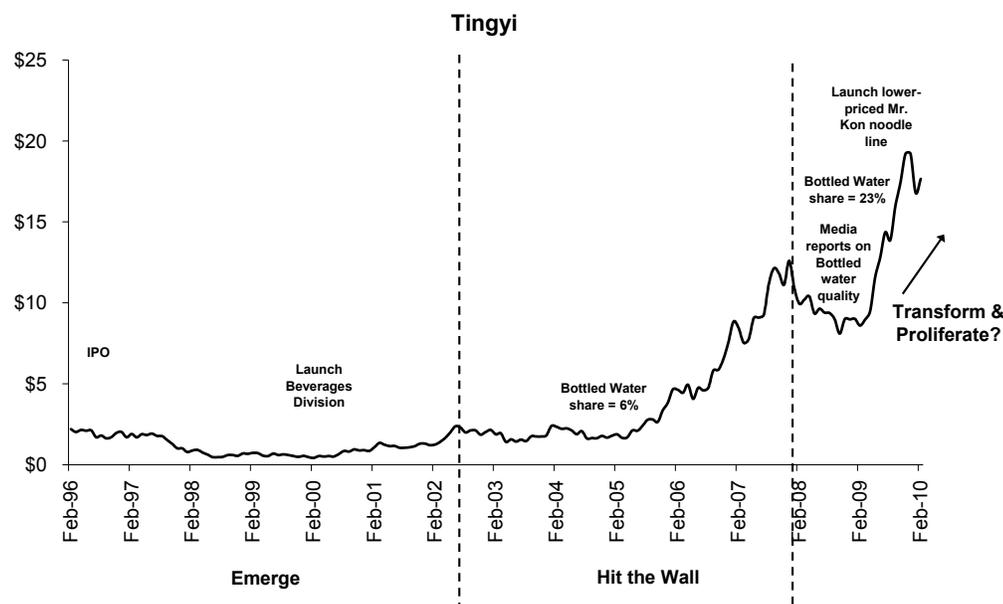
# Tingyi (0322.HK): A Power Player in China F&B

## Exhibit 271: Tingyi Stock Price History

Catherine Lim

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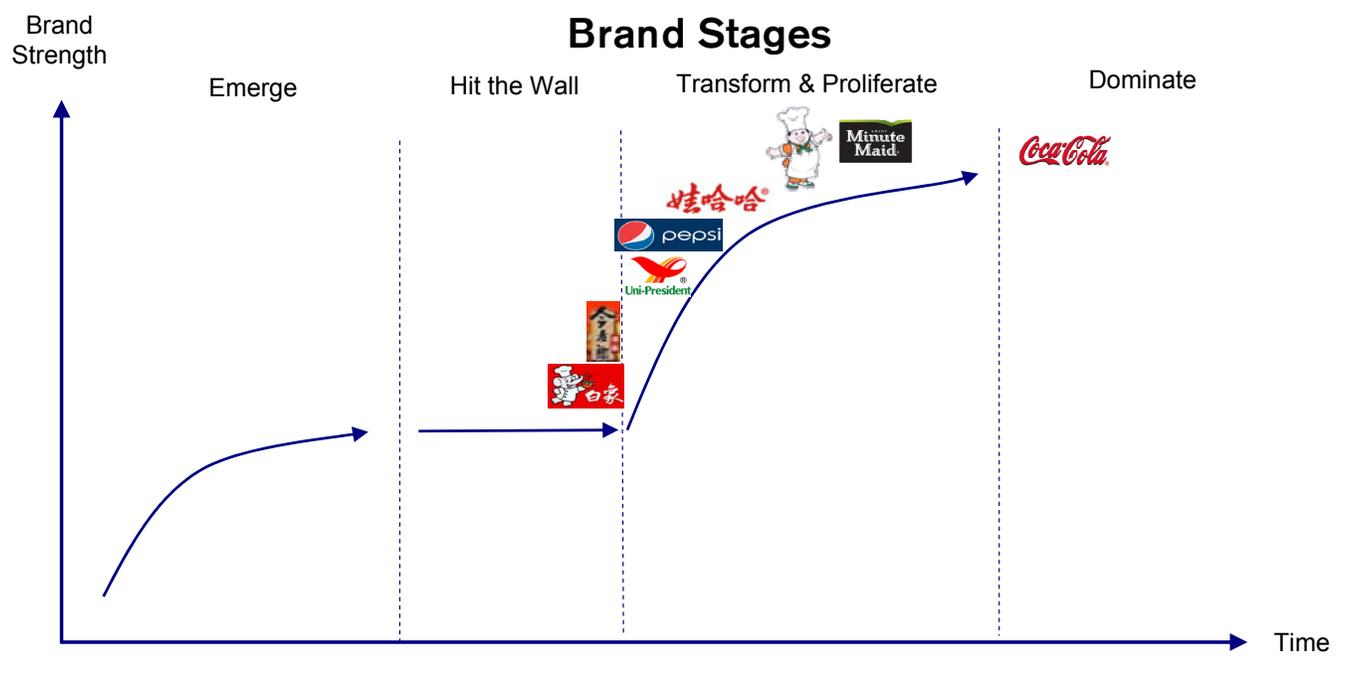
catherine.lim@credit-suisse.com



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** Tingyi started in Taiwan, but made its name in mainland China. Under the same brand name of Master Kong, Tingyi's instant noodle, beverage, and bakery products have been well received across China. After 15-plus years of experience in China, Tingyi is the largest instant noodle and ready-to-drink (RTD) tea producer in China, with 40-50% market share. In most regions of China, the Master Kong brand is perceived as an icon of general instant noodle and RTD red tea products. Combining a cost advantage with a strong, established distribution network of over 5,600 wholesalers and 72,000 direct retailers, this power player brand is poised to take advantage of China's food and beverage growth.
- Brand Opportunity.** While Tingyi continues to solidify its dominant position in high-priced and low-priced noodle product lines, the real growth story is in RTD tea and bottled water—Tingyi is the market leader in China in both areas. The bottled water market is growing (nearly one-half of the size of the beverage market), but the RTD tea market grew year to date by five times the rate (30.6%) as water, and Tingyi is well positioned to ride this growth.
- Market Perception.** The challenges and competition is mainly from multinational brands, such as Coca-Cola (KO) and Pepsi (PEP), which have established strong brand strength to leverage globally. KO has had success in the carbonated drinks and juice sectors, but has not dominated the bottled water sector, where Tingyi is strong and innovative. We believe that with Tingyi's authentic focus on RTD tea and its cost advantage in bottling for water, it is well positioned to counter the KO threat.

**Exhibit 272: China Beverage and Noodle Industry Competitive Brandscape**


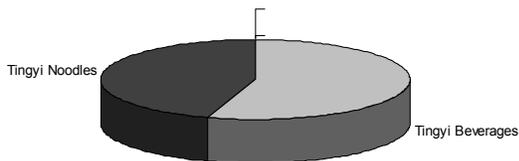
Source: Company data, Credit Suisse estimates

## Brand Overview

Founded in 1992 as a Taiwanese instant noodle brand, Tingyi rapidly expanded its factories and distribution in China. The company currently has 192 noodle production lines across China and noodle revenues of \$2 billion; it is the dominate noodle producer in China. As of November 2009, Tingyi held 54.6% market share by value and 41.5% by volume, ahead of Hualong's 13-14%, the second largest noodle producer and a local Chinese brand.

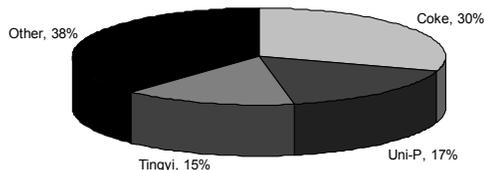
Tingyi expanded to beverage business from instant noodle business in early 2000. Based on its extensive distribution network and 206 production lines in 30-plus tea bottlers across China, Tingyi enjoys its leading position in China's beverage industry. In the RTD tea segment, Tingyi holds 49.7% market share by volume, well ahead of second largest player, Uni-President (1216.TW) China, with 21.3%. In the bottled water segment, Tingyi holds 22.2% market share by volume, ahead of the number two player, Wahaha, with 15.5%. In the diluted juice segment, Tingyi is the third largest player, with volume market share of 30.9%, after KO's 30.9% and Uni-President's 16.2%. In the past years, the brand has focused on establishing a manufacturing cost advantage, honing in on bottle, which is 60% of the cost of the product, and by vertically integrating by handling its own bottling, differing the company from its competitors.

**Exhibit 273: Tingyi Business Mix (First Half 2009)**



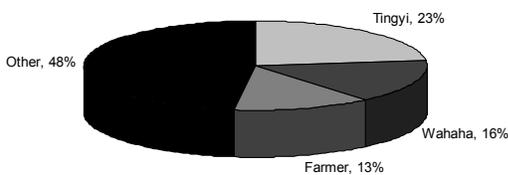
Source: Company data, Credit Suisse estimates.

**Exhibit 274: China RTD Juice Market, \$2.8 Billion (2008)**



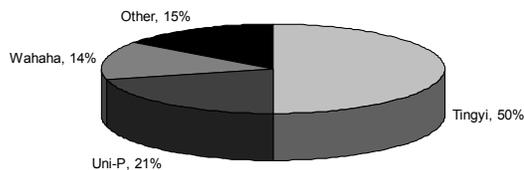
Source: Tingyi, AC Nielsen, China Beverage Industry Association, Credit Suisse estimates.

**Exhibit 275: China Bottled Water Market, \$10.2 Billion (2008)**



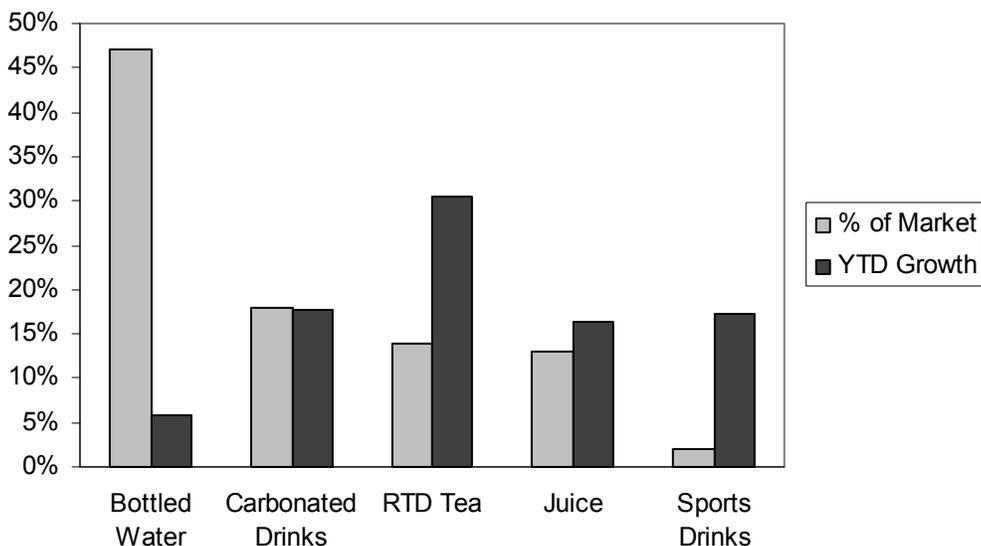
Source: Tingyi, AC Nielsen, China Beverage Industry Association, Credit Suisse estimates.

**Exhibit 276: China RTD Tea Market, \$3.0 Billion (2008)**



Source: Tingyi, AC Nielsen, China Beverage Industry Association, Credit Suisse estimates.

**Exhibit 277: China Beverage Market Segments (Market Share and Growth)**



Source: Tingyi, AC Nielsen, China Beverage Industry Association, Credit Suisse estimates.

## Brand Development: Transform & Proliferate

Tingyi is in the transform and proliferate phase of brand development, building off of its position as a power player in the Chinese food and beverage market. If the brand can successfully cement its lead in beverages as the market grows and expand to select international markets, it could make progress toward becoming a dominant brand.

### Exhibit 278: Tingyi Completed the Brand Emergence Phase, Made Significant Progress in the Transform and Proliferate Phase, but Is Far from Approaching the Dominance Phase

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#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### An Authentic, Powerful Asian F&B Brand

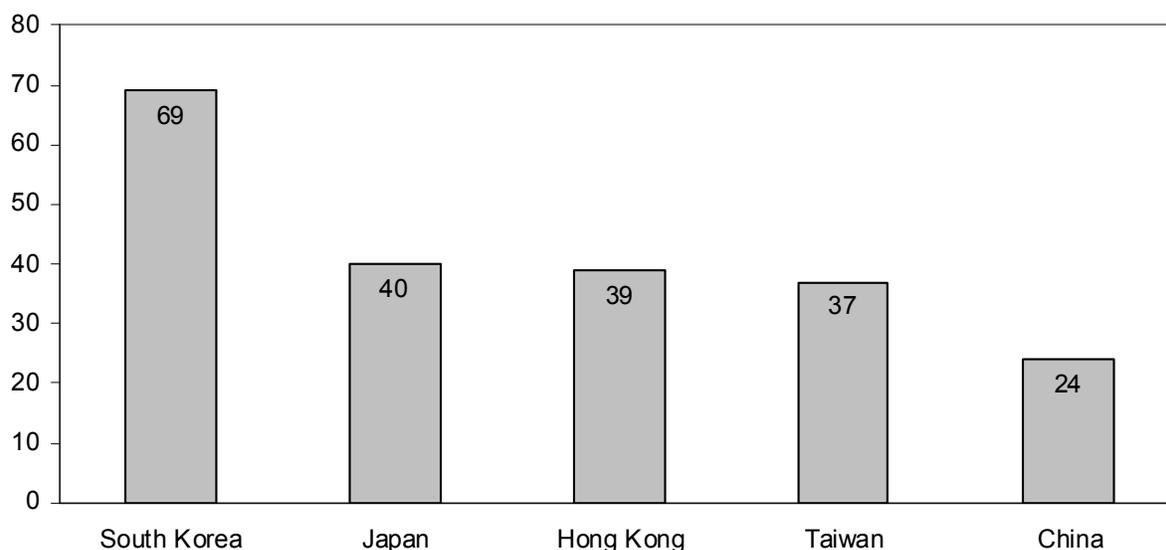
Tingyi is a strong brand in China with a track record of managing the business. While the instant noodle business is a steady cash-cow for Tingyi, the fast-growing RTD tea, juice, and bottled water segments offer more exciting growth opportunities. Based on the well recognized brand name, lean operation management, pricing power, and strategically located production facilities (near markets), Tingyi is staking out a strong position in the beverage industry.

#### Continue to Grow Self Distribution

One of Tingyi's key success factors is its extensive distribution network across China. The company's 5,667 wholesalers achieved 80-85% of total revenue, while 15-20% revenues come from 72,551 retail and director accounts. We expect the direct sales portion to trend upward, as the modern trade format (hypermarket, supermarket, and convenience stores) rapidly evolves in China.

#### Noodles Have Room to Grow

While the market may not be as dynamic as the beverage sector, instant noodles are a key net profit contributor. When compared with other Asian countries, considerable growth potential remains in terms of frequency of purchase per household. Tingyi positioned itself for market share gains by subsegmenting the noodle category with its low-priced Mr. Kon launch in 2009. In addition, this is a less competitive market and has the potential to spin off cash for uses in the other lines of business.

**Exhibit 279: Instant Noodle Consumption Per Capita, 2008 (Packs per Year)**

Source: Company data, AC Nielsen, Credit Suisse estimates.

### Build the Bakery Business

The bakery segment contributes nearly 3% of Tingyi's total revenue. Tingyi mainly competes with Kraft (KFT), Danone (DANO.PA) and other local Chinese brands. The bakery segment could be a long-term growth driver for Tingyi.

### Dip a Toe in International Markets

International sales may seem premature when the domestic market holds so much growth potential. Tingyi should be looking ahead to the coming five years to expand into select international markets, most in Asia.

## Major Catalysts

For the next five years, Tingyi has set a clear strategy—to focus on the Chinese instant food and beverage business. We believe the key catalysts for Tingyi over the next five years are the following.

- RTD tea market share and category growth.** While Tingyi enjoys a dominant position, with 50% market share, the brand will have to continue to defend this position, as this rapidly growing (30%-plus) market evolves in China. Based on its competitive advantages in the distribution channel and industry know-how (especially the tea business), we expect Tingyi to maintain its leading position over the next five years.
- Benefiting from rural consumption take-off.** The China economy is gradually transitioning to a consumption-led one from an investment/export-led one. The Chinese government has exhibited a firm commitment to improve farmers' income level, and hence, unfold rural consumption. Based on its extensive distribution network, Tingyi should benefit from an improving standard of living and consumption boom.

## Key Risks

### Coca-Cola and Pepsi

KO has committed to the Chinese market in carbonated drinks and juice. PEP is aggressively expanding into the China juice market. Tingyi is much more competitive in distribution network and tea-product know-how compared with multinational players. However, the muscle of such competitors cannot be underestimated.

### Other Chinese Competitors

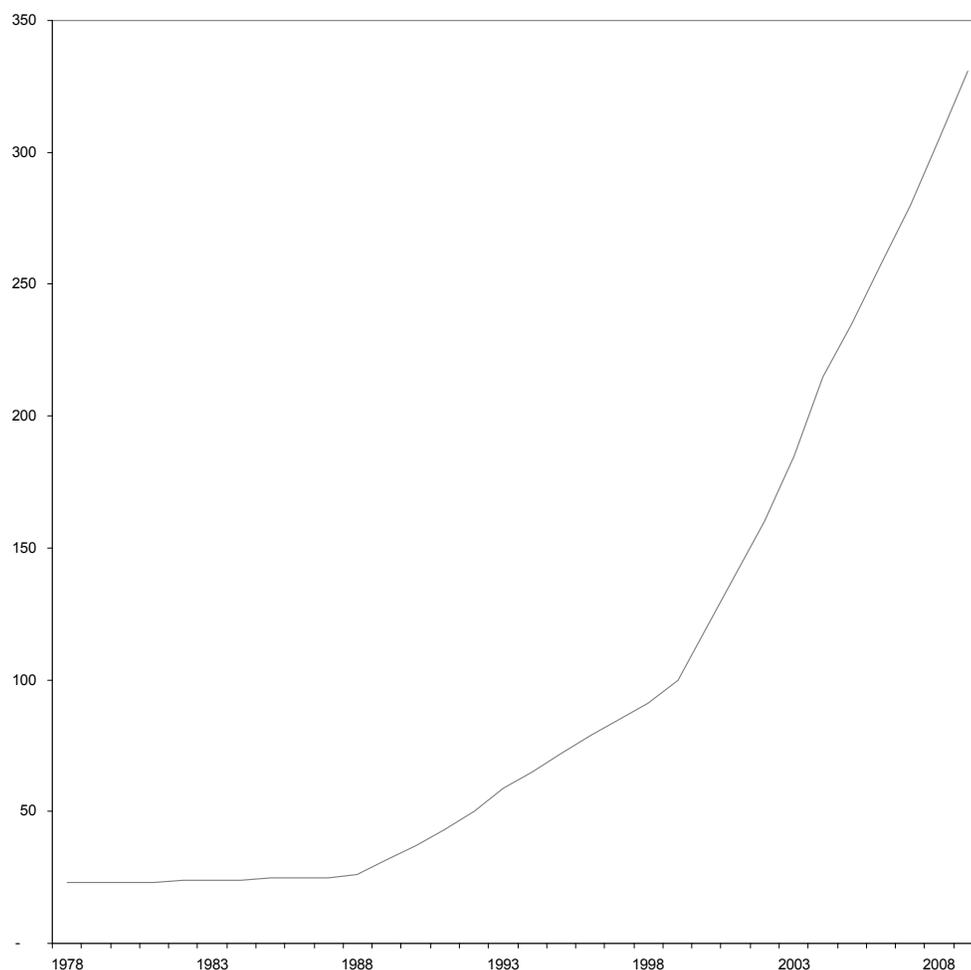
In noodles, Hualong and Baixiang are strong in low-priced noodle segments, where the profitability is less attractive for Tingyi. When Tingyi decides aggressively to expand into this market, it will face more direct competition from local Chinese players. On the beverage side, the challenges come from Uni-President, Farmer's Spring, Wahaha and potential newcomers. In addition, the ability to predict, understand, and lead Chinese consumers' preference and tastes is one determining factor.

### Market Noise on Water Quality

In 2008, the Chinese media were talking about the source of major food and beverage companies' bottled water products, including those from Tingyi. It is likely that competitor(s) triggered this debate. Quickly nipping this in the bud and establishing a record of quality will be critical for the brand. Tingyi's beverage sales are on the right track in 2010, with a successful public relation campaign and a sensible promotion strategy. If quality—or the perception of quality—declines, especially in the food and beverage market, a brand issue—generally an irreversible one—quickly follows.

# Trader Joe's (Private): Proliferating in the United States

**Exhibit 280: Trader Joe's Store Growth in the United States (Estimated)**



Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** Trader Joe's began as a convenience store in the 1950s, but repositioned itself as a budget gourmet food retailer in 1967, buying surplus goods from importers and distributors. With 23 stores on the West Coast, Trader Joe's was purchased by privately held German budget food retailing giant Aldi (Sud) in 1979. Since then, the brand has differentiated itself from traditional supermarkets with a large array of specialty niche private label products sold in a small, off-mall format environment as well as a fun, relaxed store atmosphere. By staying true to its brand promise to customers of delivering value on hard-to-find items through active buying expertise, Trader Joe's has grown to over 300 stores in the United States, with an estimated \$7 billion-plus in revenue, approaching Whole Foods' (WFMI) \$8 billion.
- Brand Opportunity.** While growth plans have been conservative in the past (average of 15 new stores per year), relying on internal cash flow (not debt) for expansion, the full potential rollout of Trader Joe's could be 1,000-plus stores in the United States alone. Add to this possible online sales and a slightly larger store footprint, and sales

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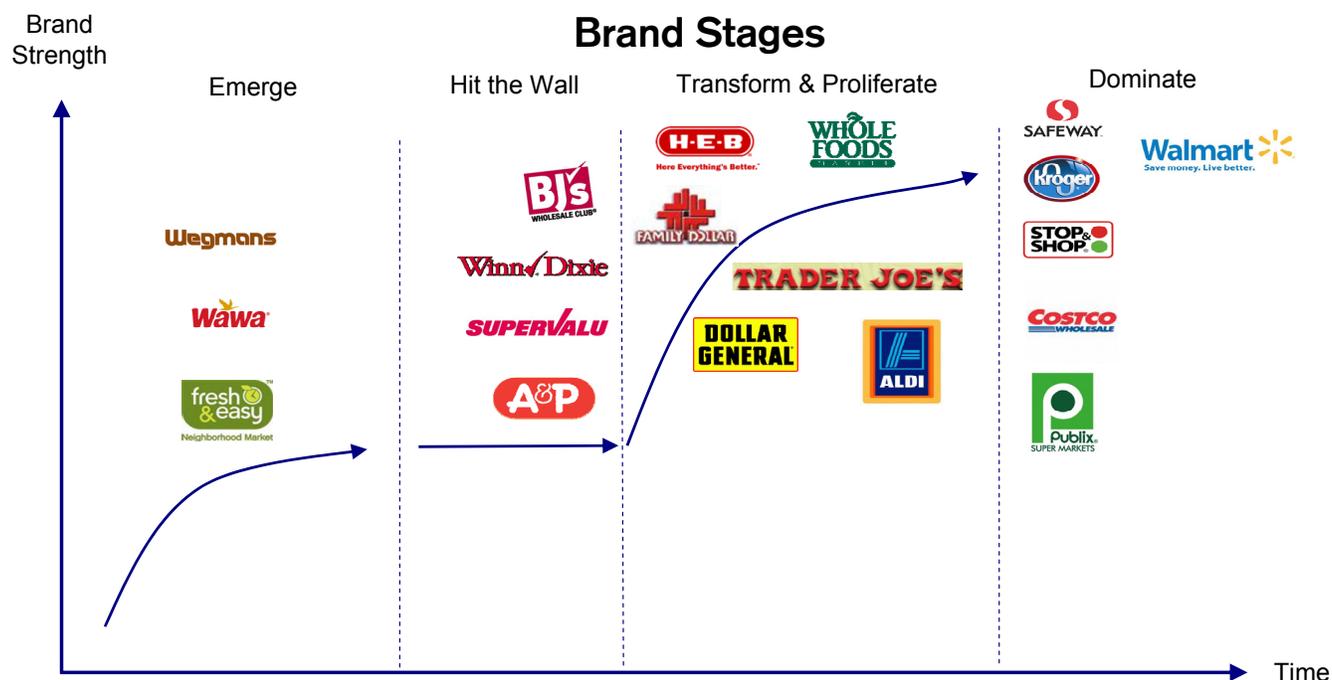
212 325 1372

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growth could easily accelerate. In addition, the company differentiates itself with a large offering of private label products that are unique and proprietary to Trader Joe's, which could be rolled out into other retailers as the brand gains traction.

- Market Perception.** The Albrecht brothers, the founders of Aldi in Germany, have historically shunned publicity (especially after a kidnapping attempt in 1971) and public markets. However, at age 89 and 87, these founders are relying on the next generation to continue in this mold. At least one son is involved in the German Aldi operations, while another left the company for personal reasons. Whether Trader Joe's will ever IPO is an open question.

**Exhibit 281: U.S. Food Retailing Industry Competitive Brandscape**



Source: Company data, Credit Suisse estimates.

## Brand Overview

Founded in 1958 as Pronto convenience stores, but renamed Trader Joe's in 1967, this food retailer was an attempt to bring unusual, international items to customers at reasonable prices. The chain initially relied on overstocks from importers and distributors to fill its shelves, but gradually replaced this with a 20-plus person buying operation unique to supermarket retailing. By specking out the desired product and putting its own private label on it, Trader Joe's differentiated itself and made price comparisons tough for these items. Private label items make up over 80% of Trader Joe's sales and usually focus on specialty niche segments, such as vegetarian, ethnic, or healthy foods, and are particularly strong in frozen foods.

### The Anti-Supermarket

From the small store format to the only 2,000 SKUs stocked (versus 25,000 for the typical supermarket) to the friendly, proactive employees in Hawaiian shirts, Trader Joe's has come to personify the anti-supermarket. It resembles Costco (COST) for its quick one-time specials, encouraging the customers to treasure hunt and visit frequently, which is key for a store that is based on impulse and optional purchases. In many aspects, the store resembles more of a specialty food store as opposed to a supermarket.

## Loyal, Vocal Customers

While no one shops exclusively at Trader Joe's, often those that do are extremely loyal to the retailer (more so than to supermarkets). These raving fans of the brands serve as free PR for the store and its products, the most powerful motivator for this type of nonnecessity purchase.

## A Corporate Culture that Enables the Differentiation

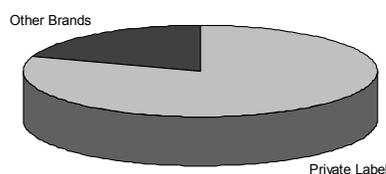
Trader Joe's corporate culture is fun, humorous, chatty and somewhat antiestablishment. Whether it is the Hawaiian shirts and retro fishing nets in the stores, or the product names (Trader Jose for Mexican foods, Trader Giotto for Italian), Trader Joe's prides itself on having fun with its customers. This has the effect of making the shopping experience one that invites the customer to linger and browse (food sampling included), leading to more impulse purchases. In addition, Trader Joe's pays its *crew* (employees) and *captains* (store managers) above industry average rates and promotes from within, fending off unions and increasing employee loyalty and morale.

## High Private Label Mix and Low Cost Structure Drive Profitability

Trader Joe's keep costs low at virtually every level except its investment in its buying team and other employee compensation. Locations are leased in off-mall, often run-down centers with a smaller footprint (10,000 square foot). Assortment is 10% of a typical supermarket, lowering handling and inventory carrying costs. Trader Joe's limits produce and other perishable items, which helps lower shrink expense, a significant challenge for most traditional grocers. Last, Trader Joe's does virtually no marketing, except the in-store (and sometimes direct mail) piece called the *Fearless Flyer* and the occasional radio spot.

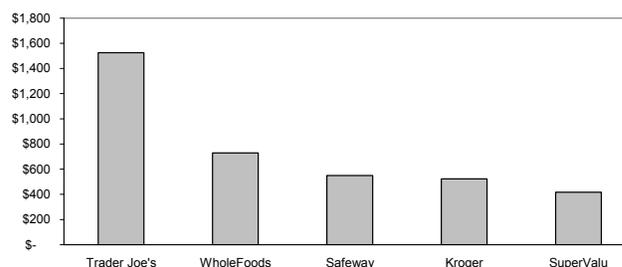
High private label penetration at Trader Joe's contributes to the company's above average margins and productivity. Private label represents over 80% of Trader Joe's total SKUs and can generate gross margins 10% higher than corporate brand margins, on average. Trader Joe's increases brand loyalty and drives a more profitable sales mix, by continuing to grow the company's private brand business. While private label products are generally lower priced and make it more challenging to leverage sales, we see opportunities to offer premium prices on many private label products, given the unique nature and lack (or need) of a branded competitor in some categories.

Exhibit 282: Trader Joe's Business Mix

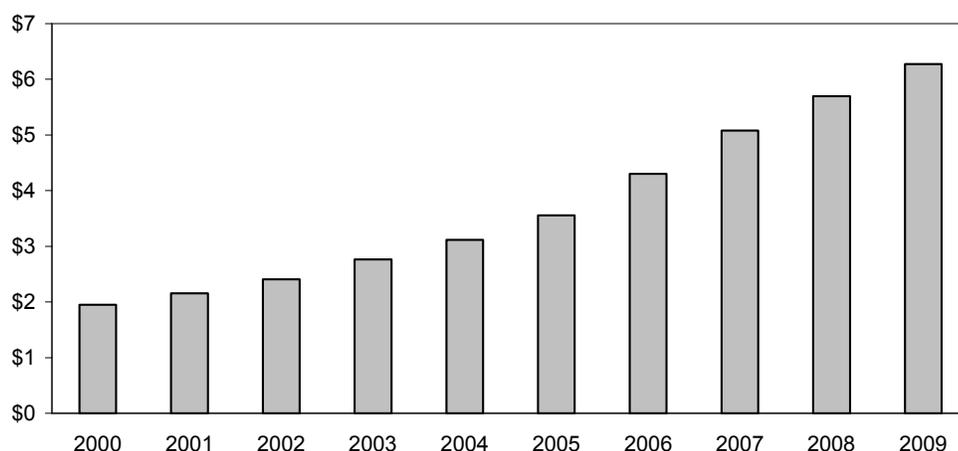


Source: Company data, Credit Suisse estimates.

Exhibit 283: Trader Joe's Sales Per Square Foot versus Competitors (2008)



Source: MVI, Company data, Credit Suisse estimates.

**Exhibit 284: Trader Joe's Sales (USD in Billions)**

Source: MVI, Company data, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

Trader Joe's is reaching the tipping point for U.S. growth, with about 330 stores, but could go much further—as much as 1,000 stores in the United States alone, as it transforms and proliferates. The key drivers of its success in moving through this phase will be anticipating challenges from WFMI and other competitors, carefully managed growth in new types of markets (NYC, international) and continued category expansion.

### Exhibit 285: Trader Joe's Completed Brand Emergence Phase, Has Made Significant Progress in Transform & Proliferate Phase, Remains Far from Approaching Dominance Phase

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Continued Proliferation in the United States

With over 330 stores in the United States and estimates of full potential at 1,000-plus stores, there is room to grow in the United States for Trader Joe's. The brand followed a path of West Coast to East Coast (in 1996) to the Midwest (early 2000s). It is now approaching more challenging, nontraditional markets, such as New York City, etc., which it entered in 2006. In addition, the brand is experimenting with slightly larger stores

(12,000-13,000 square feet), which could add incremental sales. We believe our 1,000 store estimate is achievable, based on similar estimates for Supervalu's (SVU) Save-A-Lot banner, which expects to double its 14,000-15,000 square foot boxes in five years from roughly 1,200 stores. While the formats cater to different demographics, the comparison highlights management's belief that the market can support a substantially higher amount of small-box food retail formats.

### Dipping a Toe in International Markets

Trader Joe's brands have been seen in Aldi stores in Germany, raising the question of whether the brand will experiment with international expansion in the near future. Canada, Europe, and Australia, among others, certainly hold promise for the brand's expansion.

### Online Sales

Trader Joe's Web site is not e-commerce enabled. While certain items would not lend themselves to online sales, customers clammer for Trader Joe's across the country and the large proportion of nonperishable products makes us wonder whether limited online sales could be an avenue for growth (as well as a good predictor of where to open new stores).

### Third-Party Distribution

We believe the opportunity to drive higher sales and increase brand awareness through third-party distribution is attractive for Trader Joe's, given its strong brand loyalty yet limited advertising budget. In addition, we believe familiarizing shoppers with a sampling of Trader Joe's products in areas currently without a store could increase consumer awareness before the company enters a market. Given the uniqueness and proprietary nature of many Trader Joe's products, we believe this could add a meaningful amount of sales to the company while increasing penetration of the brand into markets where there is currently no presence. As a point of reference, SWY cited a \$3-5 billion opportunity for third-party distribution of its private label products (*O Organics* and *Eating Right*) on base sales of \$600 million.

## Major Catalysts

We believe the three key catalysts for Trader Joe's over the next five years are the following.

- **Continued store growth in the United States.** While recent store growth in the U.S. has been dramatic and profitable, we believe that there is still significant growth opportunities left in the U.S. In addition, the new 20-30% larger stores have met with success and could provide incremental sales growth.
- **Select international expansion.** Whether it is selling Trader Joe's products through Aldi or opening stand-alone stores in receptive markets, international growth holds potential for the Trader Joe's brand.
- **Online channel development.** Launching e-commerce on the Trader Joe's Web site could reach customers in the United States that do not yet have a store near them. (There are stories of people packing extra bags to stock up when they travel to Trader Joe's markets.)
- **Third-party distribution.** Similar to SWY's effort to its private label *O organics* and *Eating Right* in other grocery stores, Trader Joe's could explore a similar strategy. Given the uniqueness and proprietary nature of many Trader Joe's products, we believe this could add a meaningful amount of sales while increasing the penetration of the brand into markets where there is no presence.

## Key Risks

### Whole Foods' 365 Brand

WFMI, not limited to growth from internal cash flow, could pose a threat to Trader Joe's, especially as it gets back to its roots of healthy food and invests in prices of its own private label brand, 365, to match that of Trader Joe's. Since it attracts the same educated, fairly well off, health-conscious consumer, WFMI could steal share from Trader Joe's. However, Trader Joe's often positions its store close to WFMI locations to capitalize on similar educated customers the retailers target.

### Less Low-Hanging Fruit

As Trader Joe's continues to roll out stores, it will encounter markets that may demand different store formats and sizes (e.g., NYC), and other variables. Managing growth and profitability through this expansion will be critical to the brand as it transforms and proliferates around the United States and possibly internationally.

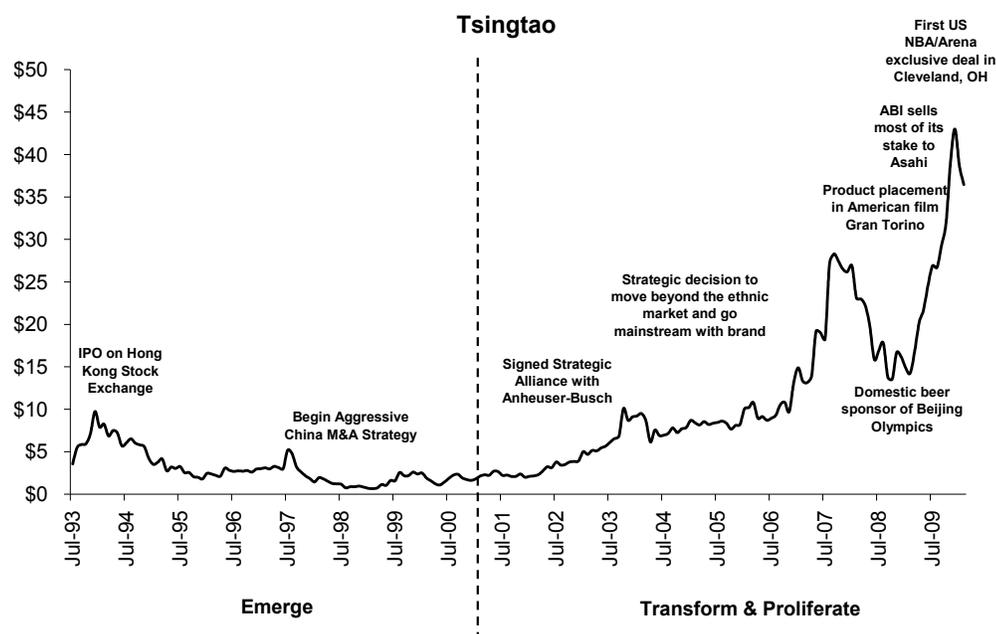
# Tsingtao Brewery H (0168.HK): A Top Beverage Brand in China

## Exhibit 286: Tsingtao Stock Price History

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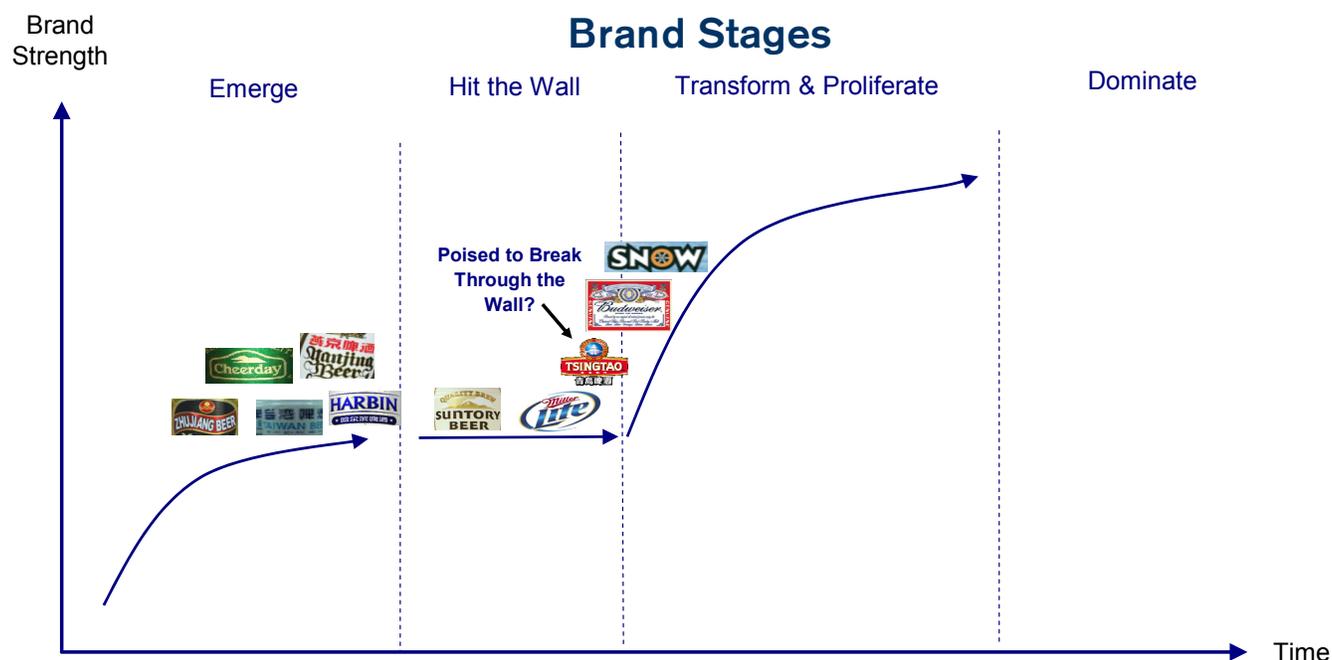


Source: Company data, Credit Suisse estimates

## Investment Summary

- Unique Brand Story.** Tsingtao occupies the unique position of being the only national Chinese premium beer brand with Chinese heritage and legacy. This, in our view, has facilitated management's efforts to incubate Tsingtao in new geographic markets over the past 20 years and achieve pricing at the upper end of the local pricing bands.
- Early Stages of Growth.** It is unusual to refer to one of the largest beer brands in the world as being in early stages of development. But there are many markets in China where Tsingtao is still relatively young, from a brand development perspective. Tsingtao's opportunity to continue a balanced improvement of its premium positioning while growing volumes, market share and profitability is in our view, remarkable.
- Brand Opportunity.** Tsingtao has an opportunity to solidify its position as the most profitable beer brand in the world's largest beer market. Industry profits have been anemic for years owing to trade fragmentation, industry fragmentation, weak regulation, and intense competition from foreign and local brewers. The compelling case for Tsingtao is that it has begun to monetize its unique brand attributes and its investments in building a national footprint and distribution muscle at a time that smaller competitors are fading while large ones deal with difficult issues of their own. The industry's volume leader, China Resources and its Snow brand, has a remarkable market share and profit growth record. We have focused on Tsingtao for this report because of its premium positioning and its concentrated investment exposure to beer.

## Exhibit 287: Chinese Beer Industry Competitive Brandscape

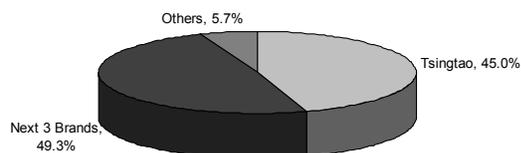


Source: Company data, Credit Suisse estimates.

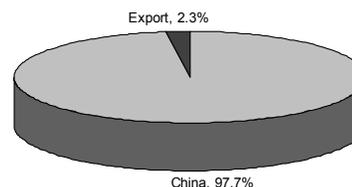
## Brand Overview

Tsingtao management has done an exceptional job of transforming Tsingtao's heritage and legacy into a premium brand beer positioning. Tsingtao and its competitor, China Resources, are in our view the two best positioned brewers to capitalize on the China beer industry's long-term profit potential. Tsingtao management has ably incubated Tsingtao in new geographic markets over the past 20 years to achieve premium pricing. While the competing China Resources joint venture's Snow brand is the leading brand in the country as measured by volumes and revenues, Tsingtao is just behind Snow on total revenues and it claims to be the leading brewer in terms of revenues per hectoliter, with a 33% advantage over Snow. Its largest global competitor in China is Anheuser Busch Inbev (ABI).

Tsingtao has an opportunity to solidify its position as one of China's great local brands. Industry profits have been anemic for years due to trade fragmentation, industry fragmentation, weak regulation and intense competition from foreign brewers. The compelling case for Tsingtao is that it has begun to monetize its unique brand attributes and its investments in building a national footprint with distribution muscle at a time that smaller competitors are fading and under pressure while several large ones deal with difficult issues of their own.

**Exhibit 288: Tsingtao Business Mix (2008)**

Source: Company data, Credit Suisse estimates.

**Exhibit 289: Tsingtao Geographic Mix (2008)**

Source: Company data, Credit Suisse estimates.

**Brand Development State: Ready to Make the Leap**

Tsingtao, with its strong authentic image in China, is poised to make the leap by expanding geographically and continuing to execute a high quality, aspirational product.

**Exhibit 290: Tsingtao Has Completed the Brand Emergence Phase, but Needs to Make the Leap in order to Transform & Proliferate into a Global Brand****Checklist to Emerge:**

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

**Checklist to Transform & Proliferate:**

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
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- Know When to Say 'No'
- Avoid Non-Core Acquisitions

**Checklist to Dominate:**

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

**Growth Strategies & Opportunities**

Tsingtao is the largest domestic brewer in China and it continues to solidify its role as one of China's great local brands. We concur with management's view that as constraints to industry profitability continue to ease, the outlook for Tsingtao to accelerate earnings growth and to redeploy incremental capital toward furthering its lead is compelling.

Top priorities for Tsingtao remain (1) improving ROIC by leveraging its scale advantages (2) potential acquisitions of small local brewers that offer synergies, and (3) a strong focus on efficiency improvements. Management expects mix improvements to continue in its portfolio but no rate increases to consumers, as the industry is too fragmented.

In short, when we ponder the idea of great brands of the future, it is hard to dismiss the potential of Tsingtao to monetize the unique local brand attributes in a Chinese beer industry where brands seem to be increasingly important and where industry profitability expansion may finally be taking off for the stronger participants.

## Major Catalysts

### Evolving Industry Landscape

The Chinese beer industry seems to be at an interesting juncture and one that actually looks more optimistic for profit minded brewers than at any time in its modern history. After a stunning 50 times growth in volumes since the 1980s, the largest beer market in the world seems to be moving toward a more mature status. From here, the industry is likely to be characterized by slower volume growth rates but by rising importance for a narrower set of national brands. In fact, SABMiller indicated at a recent conference that not unlike Tsingtao, it too has narrowed its set of Snow brand extensions down to four core extensions.

Over the past two years, with the exception of Anheuser Busch Inbev, it looks like three of the top four brewers have been able to grow volumes and market share while the rest of the industry lost ground. It raises an interesting question, namely, are we entering a new era in China where beer brands increasingly matter? From the perspective of the leading volume participant, SABMiller (in joint venture with its local operator China Resources), it's hard to tell whether brands finally matter, since push muscle and capability still seem important. The proportion of outlets where brand choice is available to consumers is still small. This is insightful and hard to refute. However, from our perspective the fact that Tsingtao claims to be able to command a 30%-plus lead in revenues per hectoliter makes us wonder if the ability to command higher prices from the trade for its brands isn't itself evidence of a beer market where brands are increasingly important.

### Industry Consolidation

The top four brewers now finally account for more than half of the national volumes and all appear to be focused on strengthening their national brands, improving their route to market capabilities and this will likely enable the industry to continue to advance the consolidation of the many small and underperforming brewers. The consolidation of the Chinese beer industry seems to be increasingly driven by the organic growth of the largest players rather than just the M&A activity that marked the industry for years. With the ability to build greenfield plants for under \$20 per hectoliter (less than half the rate of other emerging markets), M&A take-out valuations for the remaining small brewers may be coming down.

Excess capacity remains a problem in China and a main driver of further M&A consolidation. Mr. Sun, Tsingtao's CEO, recently commented to us that the industry operates with approximately one-third excess capacity. This is the biggest impediment to industry profitability. He expects to add new capacity and to purchase some small brewers, retiring obsolete capacity and shifting volumes to his core brands over the next few years.

Competitors for Tsingtao face difficult questions in China:

- Anheuser Busch Inbev (ABI) faces tough structural, operational and cultural transition challenges. It still needs to sort out the original joint ventures and brand set issues in the legacy InBev territories. These territories were not performing well before the A-B merger with InBev. Integration is not easy. To its credit, ABI inherited a stunning premium beer brand model in the form of Budweiser brand from A-B. Prior to the acquisition of A-B, brand Budweiser was the gold standard in China for distribution and dominance of leadership in the profitable evening accounts. Under ABI, sustaining and building these advantages may be very linked to enhancing the A-B talent retention and talent growth model in China. While investors sort out if ABI's bright Brazilian leadership can take over key positions from A-B management and master all these challenges, Tsingtao seems to be competitively well positioned with relatively lower hurdles to clear in this China beer race.

- SABMiller has an exceptional local partner operating a successful business in China. For SABMiller, the challenge of not owning its own Chinese business and of having to influence its local operator, China Resources, to make brand decisions may not be easy. The Snow JV is heavily focused in the mainstream price bands and does not seem to have the same range of premium brand opportunities in its portfolio that Tsingtao enjoys or that SABMiller pursues in other emerging markets. If indeed brands increasingly matter in China and premium brands need to be nurtured over many years, should SABMiller and its partner incubate a more premium portfolio now? SABMiller has convincingly argued in other markets that premium brands cannot be "pressure cooked" and that they require many years of careful nurturing. China Resources has been a successful and business smart partner. Convincing this partner on major decisions may not be easy for a Western insider such as SABMiller. Tsingtao, for its part seems to be focused on capturing the upper end of the mainstream price bands and of trying to build a more premium portfolio.
- Yanjing Beer Company of Beijing is another major local competitor, but its geographic footprint is less expansive than either Tsingtao or China Resources.

## Key Risks

Beer industry profitability is still low and overcapacity is still meaningful. But with many of the more attractive small brewers already consolidated, M&A may not withdraw excess capacity from the market easily.

The world's largest brewer (ABI) faces meaningful installed capacity in China and a difficult task integrating its many assets in China. We worry about market disturbances when a major player is not running smoothly on all cylinders in a major market.

China Resources has a powerful business model and as the market leader, it has a huge opportunity to encroach on Tsingtao's premium beer positioning.

# Under Armour (UA): The Next Nike?

## Exhibit 291: Under Armour Stock Price History

Omar Saad

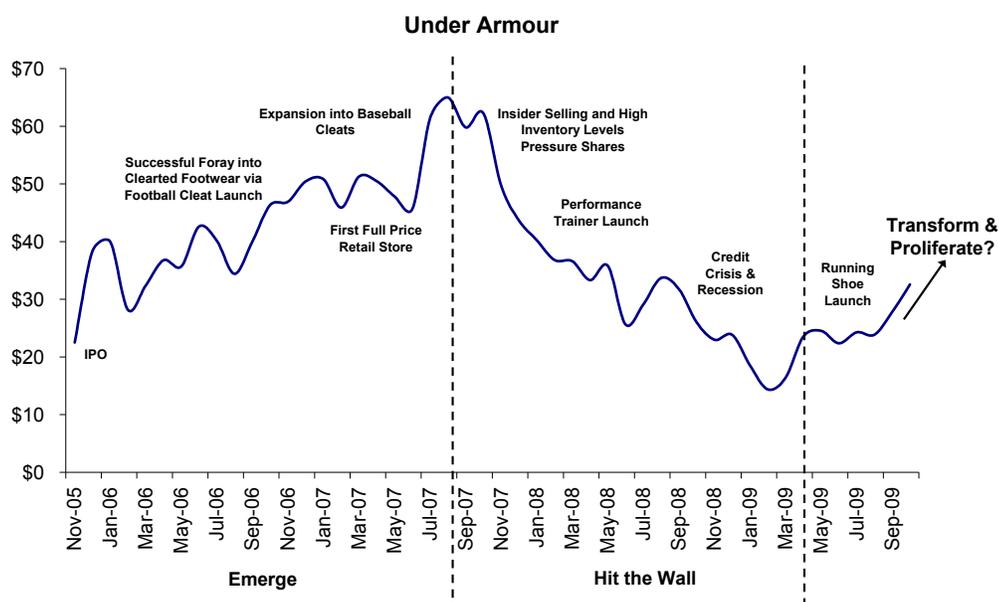
omar.saad@credit-suisse.com

212 325 3656

Spencer Hill

212 538 2266

spencer.hill@credit-suisse.com



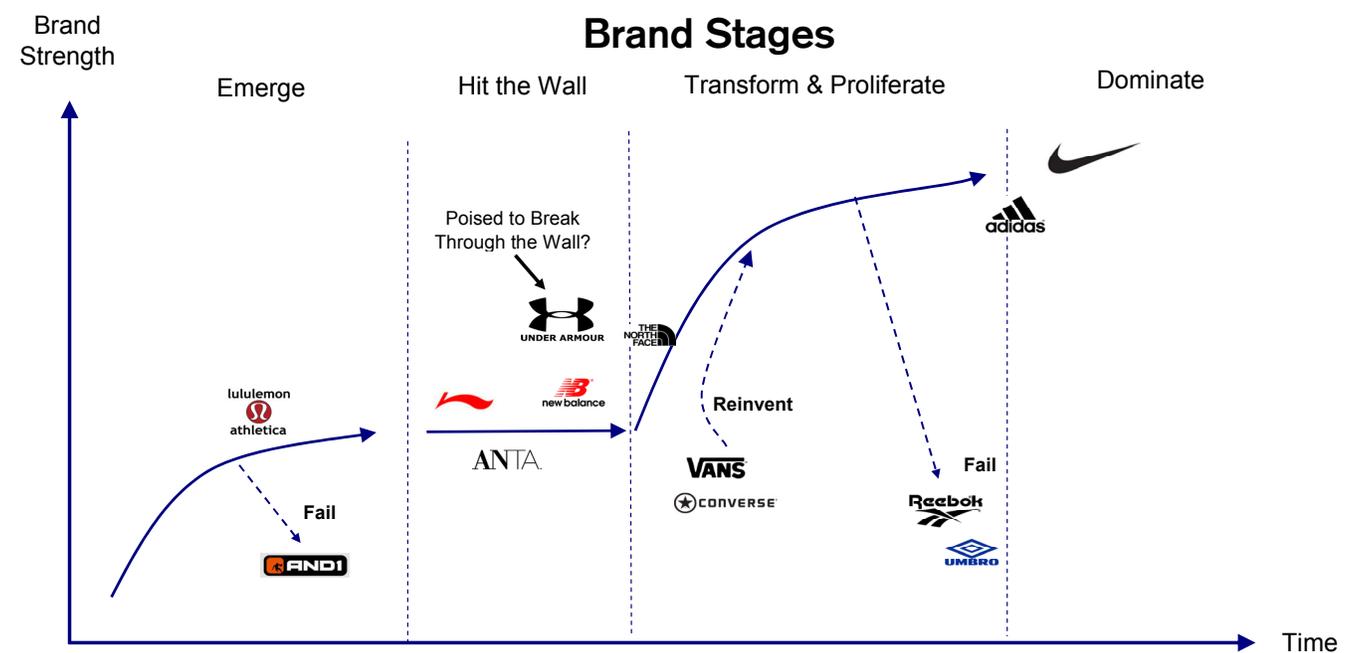
Source: Company data, Credit Suisse estimates.

## Investment Summary

- Unique Brand Story.** The reason that long-term investors should own UA is simple and has not changed: it is the first authentic performance brand since the 1980s to successfully penetrate the global athletic oligopoly of Nike (NKE), adidas (ADSG.F), Reebok (RBK), and Puma (PUMG.DE), and the company has built a business model that allows it to use the highly profitable core wholesale apparel business to fund expansion into huge new categories and channels, such as footwear, own retail, and international. As a brand, it is in the process of transforming and proliferating, which should prove to be a lucrative time to invest. We continue to believe that UA will be a \$2-3 billion company with a midteens operating margin and \$4-plus EPS power in five years. This is the most important consideration in valuation.
- Brand Opportunity.** UA remains in the early stages of growth into new categories (running, soccer, and basketball), channels (athletic specialty and direct), and geographies (Europe and Asia). The brand is in the enviable position of needing to pursue only the most profitable opportunities. We expect new launches and expansion in new markets to drive 30% and 50% top-line and EPS CAGRs over the next five years.
- Market Perception.** Despite successful launches into football, baseball, and performance training footwear, and early progress in running footwear, Europe, and Japan, UA remains highly concentrated in terms of category (80% apparel) and geography (90% United States). The most common pushback from investors is that UA is a niche brand approaching the end of the runway, with a brand image that stands for little more than football and tight T-shirt.

- Valuation.** We believe that taking the long-term view is warranted for a compelling brand story still in the early stages of growth. Our seven-year target price is 16 times our EPS estimate of \$10.50, which embeds \$5.5 billion in sales and a 15% EBIT margin, and would drive a 26% return CAGR over the next seven years.

#### Exhibit 292: Global Athletic Apparel and Footwear Industry Competitive Brandscape



Source: Company data, Credit Suisse estimates.

## Brand Overview

Founded in 1996 by Kevin Plank, former football player at the University of Maryland, UA built its name on compression underwear to be worn under football (or other) pads. The shirts wicked away sweat and fit snugly under the pads, unlike traditional T-shirts. The brand conservatively expanded its product range and always rooted its brand in the competitive athlete, not fashion or glamorous professional players.

The brand has experienced impressive growth, increasing its revenue to \$725 million in 2008 (80% apparel) from just over \$200 million at its 2004 IPO. The brand expanded into footwear, launching football cleats in 2006, a niche market, but one critical to establishing UA footwear credibility among athletes. By 2007, it had emerged as a brand, launching its first store, which simulated a stadium from the athlete's perspective. In 2007, it also launched ColdGear, its outerwear line. In 2008 and 2009, the brand launched training shoes and running shoes, targeting NKE's home turf.

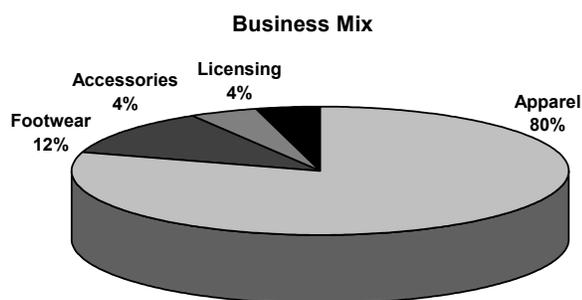
### An Authentic Young Sports Brand

The Under Armour brand has established deep consumer relevance, particularly with the younger generation, as a competitor's brand, linked to authentic presence in outfitting college sports teams, especially football, but expanding to basketball, running, and soccer.

### Disciplined, Strategic Approach

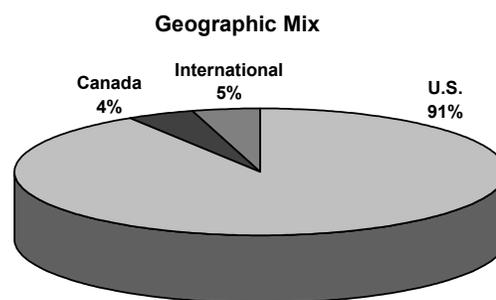
UA's management has taken a slow-and-steady, conservative approach to growth, which should build a lasting, highly authentic brand. Whether in footwear, where it started in the niche cleat to establish credibility, to UA's own stores, where it has had conservative build-out plans, the brand stays in control and preserves its integrity with consumers as it grows.

**Exhibit 293: UA Business Mix (2008)**



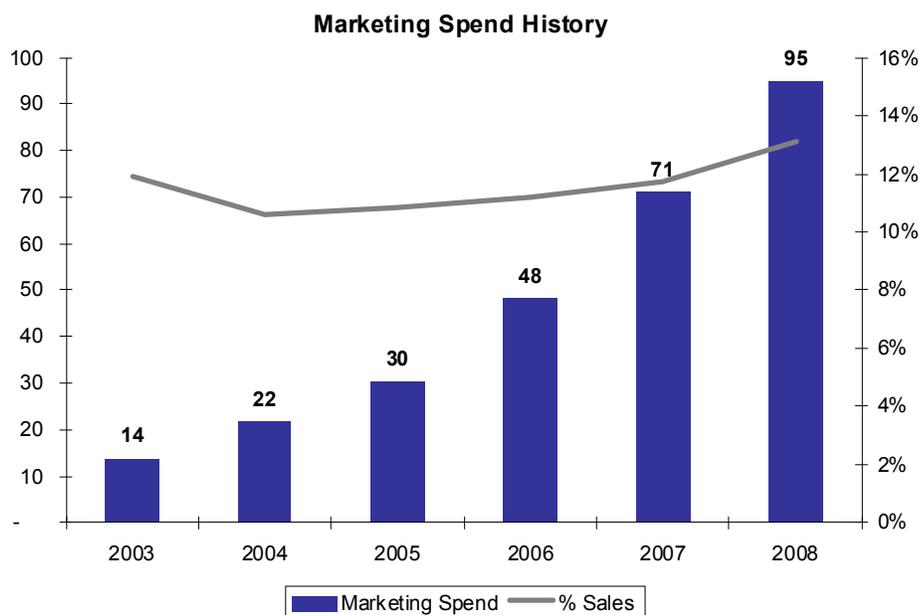
Source: Company data, Credit Suisse estimates.

**Exhibit 294: UA Geographic Mix (2008)**



Source: Company data, Credit Suisse estimates.

**Exhibit 295: Management Continues to Invest Heavily Behind the Under Armour Brand**



Source: Company data, Credit Suisse estimates.

## Brand Development State: Ready to Make the Leap

UA emerged as an authentic sports brand and now must prove that it can grow without violating the brand. Taking the brand to footwear and other product categories, new sports such as soccer, and international success will solidify and proliferate the brand. If successful, this phase can be the most lucrative time to own a branded stock.

## Exhibit 296: UA Completed the Brand Emergence Phase, Has Made Significant Progress in the Transform & Proliferate Phase, but Remains Far from Approaching the Dominance Phase

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

### An Inflection Point for the Brand

While we do not share the common worry that UA is a niche brand approaching the end of the runway, we do believe that management is facing some tough crossroads decisions. Macro environment aside, UA is at a point at which most public growth companies eventually reach, namely, that it must choose between near-term earnings and long-term growth. The brand has received consumer permission to innovate and to create new ways to outfit athletes. However, as management walks the fine line of targeting growth *and* profitability in this economy, it risks underharvesting some high-return opportunities. Investors should carefully track UA's ability to grow new categories while maintaining innovation leadership in its heritage businesses, something with which it has struggled a bit as of late (and a feat that typically requires large investments in talent, systems, infrastructure, R&D, product design, channel management, and marketing).

## Growth Strategies & Opportunities

### A Clear Target: Choice of a New Generation

Echoing Pepsi's path to attack an entrenched competitor, UA's strength is its connection to the 10- to 20-year-old demographic. In its Superbowl ad, it sees itself as a renegade assaulting the status quo, telling *new prototypes* that it is *us versus them* and that *the game has changed*. It is deliberately not a mass brand. It targets athletic *competitors*, even if just from their couch.

### Keep Reinforcing the Authenticity and Aspirational Qualities of the Brand

From its first ad in 1999 in ESPN Magazine to its 2008 Superbowl spot, UA has developed its own marketing, spearheaded by Senior Creative Director Marcus Stephens. Tough, masculine, competitive, and hard working are some of the words that the Under Armour brand connotes. UA has also experimented with some ads that resemble video game animation, such as its lacrosse ads, harkening back to its youthful target market.

Even in tough economic times, UA has maintained its marketing spend. In the second quarter of 2009, SG&A increased by \$3 million, signaling the company's continued marketing commitment. We are encouraged by management's ability successfully to navigate the trade-off between long-term investment and near-term profitability, thus far.

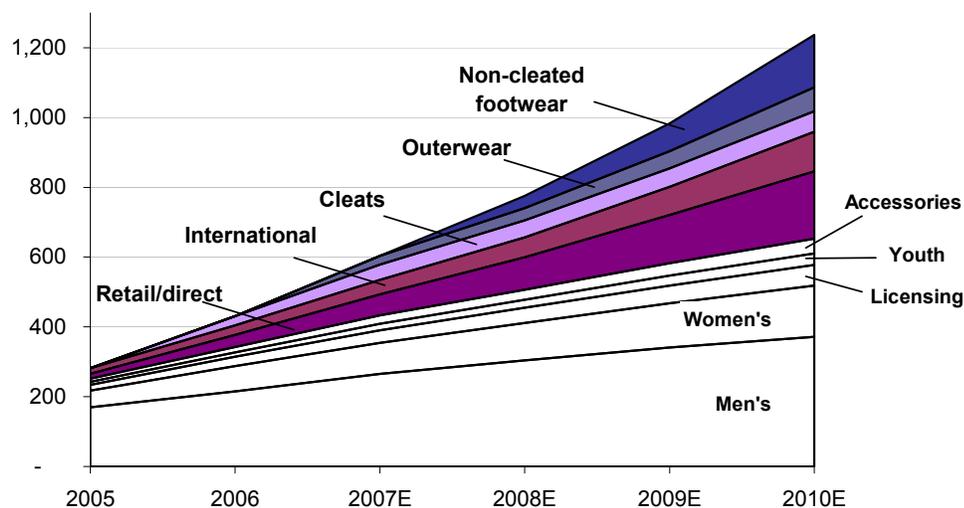
## Retailer Commitment

UA has the retailers—especially mall-based sports specialty retailers—committed to its brand. By attracting the fickle 10- to 20-year-old demographic, UA has proven its importance to retailers, and they have rewarded the brand with increased shelf space and by accommodating launches of new footwear products.

We believe that UA should continue to establish itself as credible outside of football. The current approach is basketball, for which the brand is using its successful formula of grass roots outfitting of high school teams and professional sponsorship. It is also cautiously approaching the soccer market, outfitting some European teams in 2008, and wading into competitive international markets.

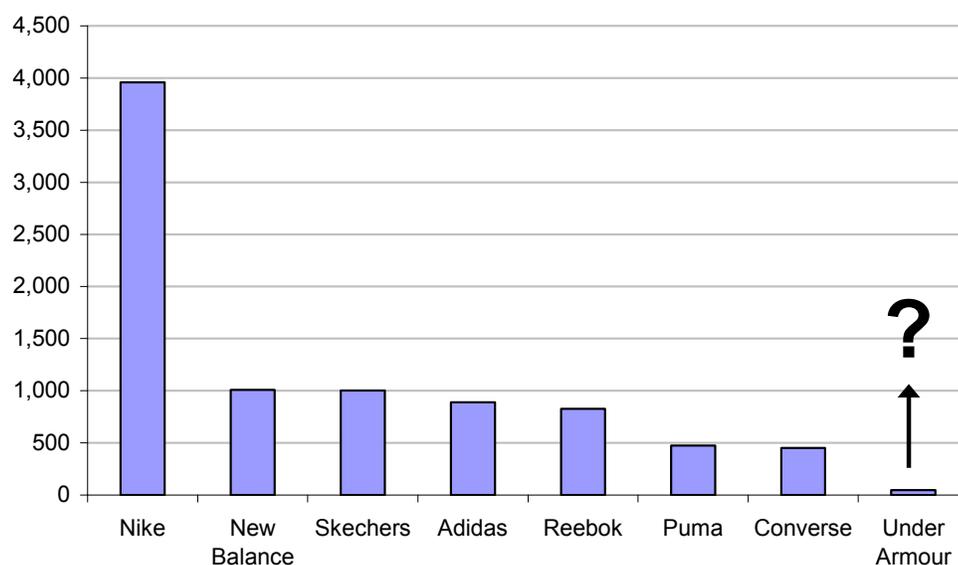
The brand is also focusing on delivering in the footwear market, which will be key to continued revenue growth and brand proliferation. While the running shoe launch was not as wildly successful as some of UA's previous launches, what is most important is that the product is strong from a technical standpoint and that retailers want the brand and product to succeed, which is helping UA to secure shelf space for the updated running line. UA plans to launch a soccer cleat in 2010, continuing to expand its credible cleat line to new sports. The upside potential in footwear is huge if the brand can carve out a reputable spot in the market.

**Exhibit 297: We Expect Core UA Product to Fall as a Percentage of Sales**



Source: Company data, Credit Suisse estimates.

### Exhibit 298: Plenty of Room to Move up Among U.S. Athletic Footwear Brands



Source: Company data, Credit Suisse estimates.

The brand's own-store retail growth will be disciplined, but has huge upside potential once the right formula is found. With four stores currently in Maryland, Illinois, and Massachusetts (and 33 Factory Stores) and an award-winning store design, UA has a lot of room to expand before it reaches NKE's 400-plus own-brand stores.

## Major Catalysts

We believe the three key catalysts for UA over the next five years are the following.

- **Perfecting the running shoe.** Continued improvement in the running footwear line resulting from the new footwear team management has recently built. Following lackluster results with the 2009 launch, we expect improved technical product and design to catalyze market share gains and improved gross margins.
- **Basketball footwear launch.** UA laid the groundworks for a foray into basketball footwear with its acquisition of basketball star Brandon Jennings. We believe we could see a full basketball footwear launch in 2012 or 2013.
- **Growth in Europe.** After a disappointing entry into Europe, the company has put a management team in place that is more in tune with the international consumer, as the company establishes its authenticity with the European consumer, driven by advertising, team sponsorships, and grassroots brand building events.

## Key Risks

### The Ten Thousand Pound Gorilla

NKE, whose marketing spend is almost three times greater than UA's *revenues*, poses the biggest downside risk to UA's success in transforming and proliferating. As UA directly attacks NKE's turf in footwear, the giant's reaction will be critical to UA. Given the reaction to the UA 2008 cross trainer launch, when NKE launched SPARQ shoes at prices 10-15% below UA's training shoes, NKE clearly could use its muscle to dampen UA progress.

### **Trendy versus Authentic**

The other big downside risk is that UA is sucked into being trendy (à la Timberland) rather than a more steady rise to greatness that is built on its authenticity as a brand for athletic competitors. Thus far, the brand has been disciplined in its expansion and channel management, which bodes well for its future decision-making ability.

### **Will Football and Basketball Resonate Internationally?**

The path to international success has to come from sports other than football and basketball, which do not have huge followings outside the United States. The brand has signed Brandon Jennings, who plays on a European professional basketball team. UA also is wading into soccer by outfitting European soccer teams in 2008 and is planning to launch a soccer cleat in 2010.

### **Saying No to Licensing**

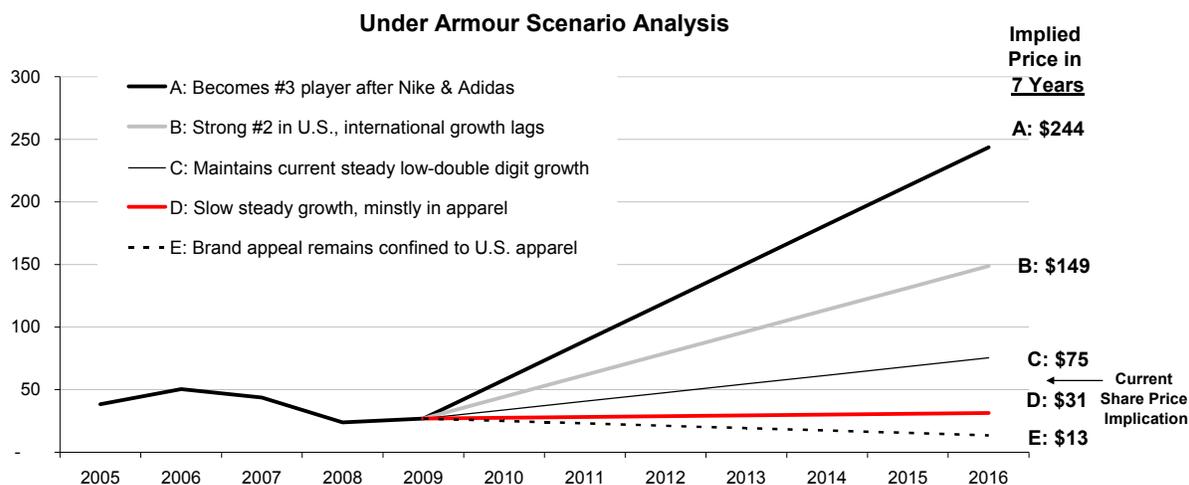
To date, the brand has kept licensing—an easy path to cash, but a potential long-term branding mistake—to a minimum. In 2008, licensing was a negligible 4% of revenues. Continued disciplined in this area will be key to maintaining control over the brand.

## **Valuation**

As long as UA can finance its growth through its own cash flows and its underlying gross profitability remains high, we do not believe the P/E metric is the correct valuation methodology, given the above average tax rate and high SG&A investment required to build out the growth platform. On an EV/sales basis, UA trades at a multiple of 1.7, a 12% premium to NKE (1.5), though it is in a much earlier growth stage. We continue to believe that UA will be a \$2-3 billion company with a midteens operating margin and \$4-plus EPS power in five years. We believe this is the most important consideration in valuation.

## Financial Statements and Comparable Valuation

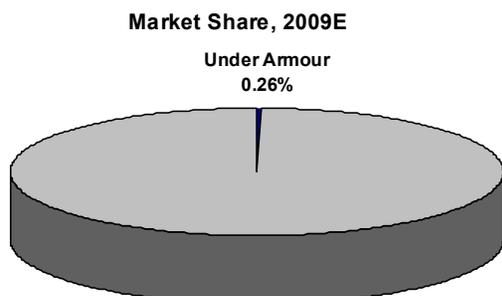
### Exhibit 299: Current Stock Price Embeds Conservative Growth Expectations



	2009	2016 Scenario Analysis				
		A	B	C	D	E
Under Armour sales	856	7,000	5,000	3,000	1,500	800
Growth CAGR	-	35%	29%	20%	8%	-1%
EBIT margin	10%	16%	15%	15%	14%	14%
Interest other expense	3	3	3	3	3	3
Tax rate	43%	35%	37%	39%	41%	43%
Sharecount	51	51	51	51	51	51
<b>EPS</b>	<b>\$0.92</b>	<b>\$14.34</b>	<b>\$9.29</b>	<b>\$5.39</b>	<b>\$2.41</b>	<b>\$1.23</b>
Growth CAGR	-	48%	39%	29%	15%	4%
P/E Multiple	28	17	16	14	13	11
<b>Implied Price, 2016E</b>		<b>\$244</b>	<b>\$149</b>	<b>\$75</b>	<b>\$31</b>	<b>\$14</b>
Implied 7-yr return		840%	473%	191%	21%	-48%
CAGR		38%	28%	16%	3%	-9%

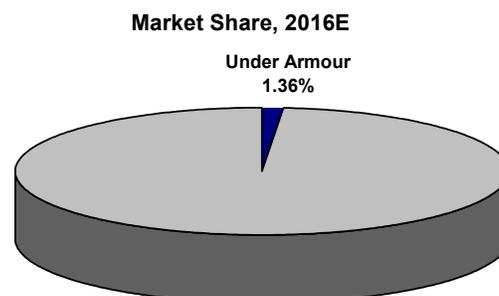
Source: Company data, Credit Suisse estimates.

### Exhibit 300: UA Represents One-Quarter of a Percent of \$280 Billion Global Athletic Apparel and Footwear Market



Source: Company data, Credit Suisse estimates.

### Exhibit 301: Our Base Case Assumes an Increase to 1.4% Market Share by 2016



Source: Company data, Credit Suisse estimates.

**Exhibit 302: UA Trades at a Premium to the Group Owing to Above Average Growth Prospects**

	Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009	2008	EPS				P/E	P/E	P/E	3-Yr	EV-to-
								Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	Avg	Sales
<b>Under Armour</b>	<b>UA</b>	<b>25.94</b>	<b>\$1,292</b>	<b>\$1,126</b>	<b>\$856</b>	<b>9%</b>	<b>19%</b>	<b>14%</b>	<b>-45%</b>	<b>0.95</b>	<b>0.92</b>	<b>1.04</b>	<b>1.21</b>	<b>28.2</b>	<b>25.0</b>	<b>21.5</b>	<b>25.0</b>	<b>1.3</b>
Nike	NKE	64.46	\$31,368	\$28,442	\$19,083	14%	12%	30%	-21%	3.30	3.81	3.69	4.11	16.9	17.5	15.7	14.5	1.5
Adidas	ADS	37.16	\$10,590	\$13,490	\$15,011	10%	-	44%	-50%	2.66	3.25	1.31	2.43	11.4	28.4	15.3	-	0.9
VF Corp.	VFC	76.87	\$8,493	\$8,960	\$7,220	12%	10%	34%	-20%	5.20	5.16	5.70	6.32	14.9	13.5	12.2	11.6	1.2
Puma	PUM	214.85	\$4,449	\$3,745	\$3,530	8%	-	71%	-51%	16.43	8.50	15.85	18.12	25.3	13.6	11.9	-	1.1
Lululemon	LULU	28.41	\$2,610	\$2,125	\$308	17%	25%	280%	-83%	0.16	0.61	0.71	0.94	46.6	40.1	30.1	23.4	6.9
Li Ning	2331-HK	24.70	\$3,298	\$3,318	\$970	14%	-	144%	-58%	0.35	0.70	0.87	1.06	35.4	28.6	23.3	-	3.4
Anta	2020-HK	10.80	\$3,279	\$3,949	\$678	21%	-	226%	-67%	0.06	0.36	0.46	0.54	29.8	23.7	19.9	-	5.8
Average						13%	16%	105%	-49%					26.1	23.8	18.7	18.6	2.8

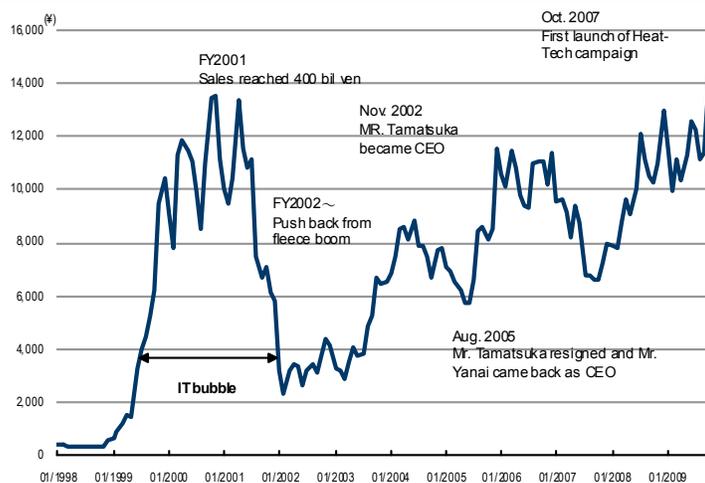
Source: Company data, Credit Suisse estimates.

# Uniqlo:

## Poised for Massive Expansion in Asian Markets

*Uniqlo is a brand within Fast Retailing (9983)*

**Exhibit 303: Fast Retailing Stock Price History**



Source: Company data, Credit Suisse estimates

## Investment Summary

- **Unique Brand Story.** Uniqlo, owned by Fast Retailing (9983), currently dominates the Japanese apparel market, based on its broad customer scope, robust product offerings, and business scale. We believe it is one of the top emerging brands globally, with its aggressive global expansion plans and strong domestic base.
- **Brand Opportunity.** Planned expansion is largely concentrated in China (with 200 new stores expected in the next three years), though the brand's flagship stores in New York and Paris are a key factor in expanding global recognition.
- **Market Perception.** As a brand, the company strives to be fashionable as well as cost conscious, a leader in quality casual apparel.
- **Investing in Uniqlo.** Fast Retailing is a direct way to invest in Uniqlo's brand, with 90% of its operating profit derived from the Uniqlo business.

Exhibit 304: Global Industry Competitive Brandscape

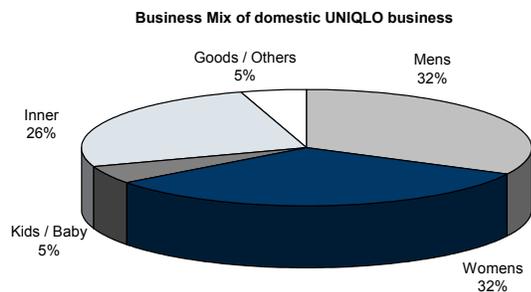


Source: Company data, Credit Suisse estimates.

### Brand Overview

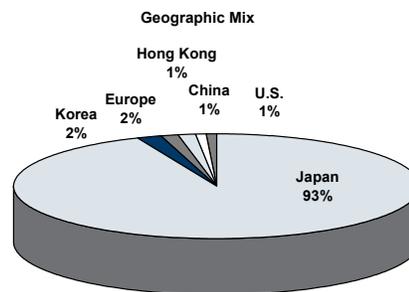
Fast Retailing began as a men’s store called *Ogori Shoji* in Japan in 1949. In 1984, the company, Ogori Shoji Co. Ltd., expanded, opening a unisex store called Unique Clothing Warehouse, which was dubbed Uniqlo. It is known for its low-cost casual clothing line. In 1991, the company changed its name to Fast Retailing Co., Ltd., and by 2006, Uniqlo had broadened its global reach with stores in the United States, the United Kingdom, Hong Kong, and South Korea. Uniqlo currently accounts for approximately 90% of Fast Retailing’s total sales. The brand gained popularity as a supplier of the Japan’s Olympic team uniforms in the 1998, 2002, and 2004 Olympic Games, and as a supplier for J. League’s Thespa Kusatsu team (professional soccer team in Japan). The company currently has 760 stores in Japan; 14 stores in the United Kingdom; 1 each store in the United States, France, and Singapore; 23 stores in South Korea; 19 stores in China; and 11 stores in Hong Kong.

Exhibit 305: Fast Retailing Business Mix



Source: Company data, Credit Suisse estimates.

Exhibit 306: Fast Retailing Geographic Mix



Source: Company data, Credit Suisse estimates.

## Brand Development State: Transform & Proliferate

### Exhibit 307: Uniqlo Is in the Transform & Proliferate Stage

#### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

#### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

#### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Advantageous Business Model

Uniqlo operates under a specialty retailer of private label apparel (SPA) business model, controlling R&D, production, distribution, and marketing aspects. We believe that Fast Retailing has significantly improved its competitiveness and reduced the downside risk of sustained sales and earnings weakness. Management mastered the process of developing and improving new materials, such as its thermal, heat generating material called *Heat Tech*, through its collaboration with major materials companies such as Toray Industries (3402). Through the collaboration with other major material makers, the company has come up with additional new materials, such as *Bra Top* and *Neoleather*. These strategic partnerships have led to significant improvements in offerings within new business areas, such as women's clothing and inner-wear products. In addition, Fast Retailing has strengthened links between sales and production via close collaboration and information exchanges with partner plants and has refined the formulation and implementation of sales and production plans, all of which helps to keep the price of materials down.

### Women's Apparel

The company established a particular positioning through marketing good-quality, reasonably priced casual wear that anyone can wear. For example, akin to Japan's automakers, the company aims to supply consumers throughout global markets with a high-quality Japanese industrial product. Women's clothing is particularly important for the domestic Uniqlo business, since current market share is less than one-half of the share for men's clothing, and support from women has a large impact on sales for other segments. Fast Retailing is promoting a variety of strategies aimed at women, such as the rollout of fashionable products for young women at Tokyo Girls Collection and other fashion shows, reinforcement of Heat Tech inner-wear, denim, knit, and other core products, and expansion of skirts, blouses, jackets, and other products with low market shares. We believe that Uniqlo has the potential for expansion in Japan's women's apparel market, as it currently holds low market share and has the potential to launch stores and expand in Asia, particularly China. In addition, Uniqlo has two R&D design studios, one in Tokyo and the other in New York, enabling it to stay abreast of the latest trends in fashion from around the world.

## Footwear

Fast Retailing launched *UNIQLO Shoes*, while the company withdrew from the *Foot Park* business (shoes wholesale business), which was merged in 2007. Introducing the SPA model, UNIQLO Shoes launched with a total of eight items, including sneakers for ¥1,900. The new shoes business could have significant growth potential in the market, considering that there is only one competitor, ABC-Mart (2670), which has established SPA model for products in the low price range. The challenges for shoes business growth include (1) efficiency compared with the apparel business, (2) know-how and scale in production process; and (3) improvement of recognition in the market.

## Strategic Partnerships

In March 2008, Uniqlo collaborated with artists, designers, and photographers to create a limited edition T-shirt collection. In addition, in October 2009, Fast Retailing teamed up with designer Jil Sander and produced +J brand line of clothing, which represented an expansion from its basic product line.

## Major Catalysts

### The Product

Through a process of trial and error through August 2007, the company raised its capacity for product planning, including in the overseas business. This brought about a clear improvement in product strength in its basic products, through enhanced quality and fresh design. In real terms, this improvement applied to almost all the company's products, including shirts, T-shirts, merino and cashmere knits, cotton pants, fleece jackets, and down jackets.

### The Brand

According to the company, it commands a 20% share of the overall Japanese apparel market, suggesting potential for ¥1.5 trillion in sales in Japan. As consumers continue to carry out strict comparisons of product value, Fast Retailing has been successful in winning market share from all of its competitors, including the general merchandisers, department stores, station-front shopping centers, and other specialty stores. Over the past two years in particular, there has been a sharp improvement on the product front (as previously mentioned) and regardless of sex, age, or income level, almost all consumers have become increasingly value conscious. Therefore, the appeal of Fast Retailing's products in terms of value for money has become increasingly apparent. Once consumers have become used to the prices and quality offered by Uniqlo products, we find it difficult to imagine they will return to other stores. In addition, the Chinese and Hong Kong stores are already operating at a comparable margin to the Japanese stores; given the company's competitiveness and strong positioning, we believe that growth potential remains.

### Long-Term Outlook

Uniqlo's inroads in overseas markets, particularly Asian ones, are the top mid- to long-term priority. Management's long-term vision through 2020 aims to reach ¥3 trillion in overseas Uniqlo sales, with organic growth led by Asian markets (it envisions M&A-driven expansion in U.S. and European markets). Fast Retailing had 44 stores in China and Hong Kong at the end of August 2009; while it does not disclose annual sales for these stores, we estimate combined sales at less than ¥20 billion (and ¥37 billion in total overseas Uniqlo sales). Management plans a multifold increase in store count during fiscal 2010 and a doubling of store volume in fiscal 2011. The long-term goal does not appear to be unattainable, given China's population and market size. We expect Uniqlo growth in China to depend on (1) securing well located stores during the network expansion and (2) recruiting qualified executives to operate and oversee Asian operations and a sufficient volume of high-quality, motivated store managers and employees. We expect Fast Retailing to open nearly 50 new stores annually and to achieve average annual growth

rates of just over 40% for sales and 30% for operating profits over the next three years in the China and Hong Kong area. These realistic, and even somewhat conservative, projections put annual sales at just under ¥70 billion and operating profit at about ¥4.5 billion in three years.

## Key Risks

### Expansion

Over the mid-to-long term, earnings will hinge on overseas expansion, especially in the Chinese market. How the company plans to improve profitability for the overseas Uniqlo business, especially in Europe and the United States (issues of distribution costs, labor costs, and rental costs) will be crucial. In addition, the company may face challenges related to whether it can find a large number of suitable properties at favorable terms in China. Moreover, Uniqlo faces market saturation, marketability, and a deteriorating image if it further increases store numbers in Japan and overseas, as this could lead to a situation in which everyone is wearing Uniqlo, to the point that it could almost become a national uniform.

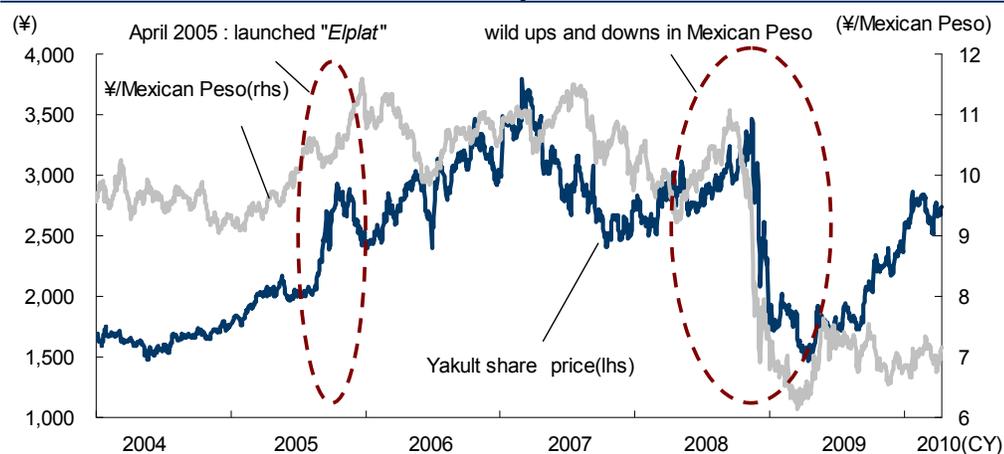
We highlight historical missteps in the company's U.K. expansion plans, whereby the company was forced to close 30-40 unprofitable stores. The management team retrenched after that period to focus on the domestic business; we believe it will emerge in a stronger position to pursue global growth.

### Executive Leadership

Another issue is how the company will be run once Mr. Yanai steps back from direct management, especially as he currently oversees all of Fast Retailing's operations, including the finer details of overall management. Management established a system that enables it to control all upstream production processes, allowing it to make weekly decisions on whether to halt or continue production for a particular item. This system has been in operation for several years; however, two years ago, Mr. Yanai began personally directing any increases or decreases to each product's production. The company has plans to lessen its reliance on Mr. Yanai over the next two to three years by training personnel through MIC (Management and Innovation Center, an institution for human resources development with a target to educate 200 executive trainees in five years). Decision-making speed, processes, and precision could be hampered if the company switches from its current one-man operation to a management-team system; however, it appears that the company acknowledges its overreliance on Mr. Yanai. The level of progress made in nurturing new managers and the steady transfer of control will be interesting. Human resources are clearly a central issue in respect to the company's strengths and the issues it faces. As Fast Retailing seeks strong long-term growth, the hiring and development of personnel will be key to driving its business and sustaining its dynamic corporate culture. We are particularly interested in the scale and pace at which it can develop personnel, as this will likely have a significant impact on earnings over the long term.

# Yakult Honsha (2267): Protecting the Health of People Around the World

Exhibit 308: Yakult Honsha Stock Price History



Source: Company data, Credit Suisse estimates.

## Investment Summary

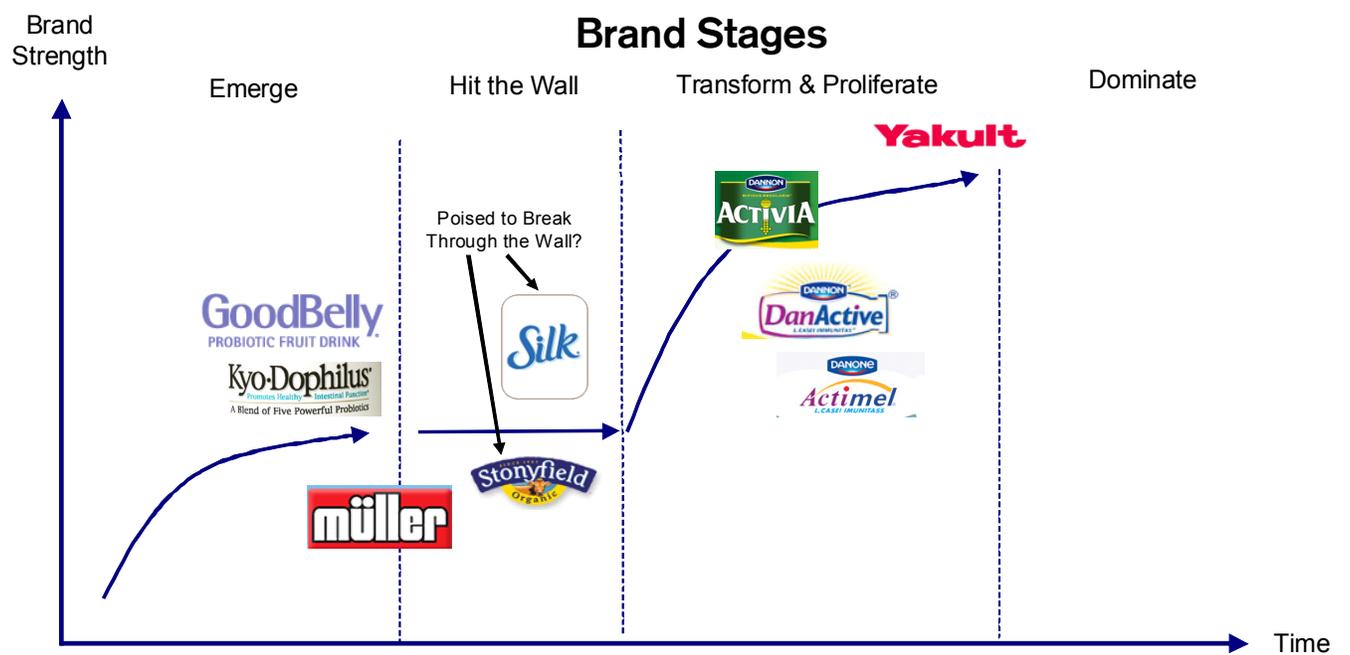
- **Unique Brand Story.** Global marketing of *Yakult* beverage made with proprietary strain of lactobacillus.
- **Brand Opportunity.** In addition to boosting its brand power in advanced economies, Yakult has an opportunity to create markets in emerging economies by communicating the benefits of probiotics.
- **Market Perception.** Yakult is perceived in equity markets to be a rare company that has succeeded in attracting an overseas following for a food product from Japan.
- **Valuation.** The company is also involved in pharmaceuticals: anticancer therapies, making it hard to use simple valuation comparisons with other food manufacturers. Its theoretical share price based on a sum-of-the-parts analysis is ¥2,450.

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## Exhibit 309: Dairy and Probiotic Industry Competitive Brandscape



Source: Company data, Credit Suisse estimates.

## Brand Overview

### Brand 1: Fermented Milk Drink *Yakult*

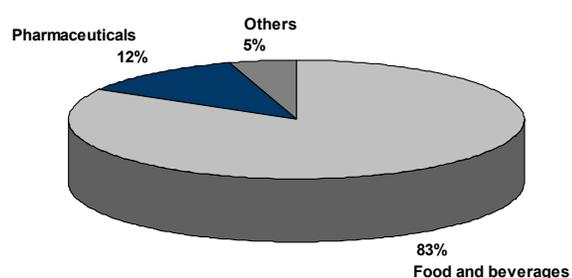
Yakult's creator, Dr. Minoru Shirota, began his medical studies at Kyoto Imperial University (now Kyoto University) in 1921. At the time, Japan was not an affluent country, and many children lost their lives from infectious diseases owing to poor hygiene. Dr. Shirota was painfully aware of this situation as a medical student; this prompted him to study not how to treat someone once they are sick, but rather to study preventive medicine that could help keep people from getting sick in the first place. He discovered that *Lactobacillus* bacteria can inhibit the growth of harmful bacteria in the gut, and he was the first in the world to successfully fortify and culture this strain. This was the strain that is now known by its scientific name as *Lactobacillus casei Shirota*. Since then, Dr. Shirota found a way to manufacture a delicious and inexpensive fermented milk beverage using this *Shirota* strain as a way to deliver the living bacteria to the gut, and that people all around would voluntarily drink. The *Yakult* drink was brought forth in 1935.

The market for *Yakult* has expanded overseas as part of Dr. Shirota's mission of "protecting the health of people around the world." Despite cultural and dietary differences in different countries, the company holds to the belief that wanting to be healthy is common to everyone, and has worked to increase public understanding of the benefits of fermented milk beverages. With its first overseas operations beginning in Taiwan in 1964, the company has expanded into the Asian, Oceania, U.S. and European markets, as it grows its worldwide network. Yakult's milk products are currently sold in 32 countries and regions, with daily sales volume of some 28 million units.

### Brand 2: Pharmaceuticals

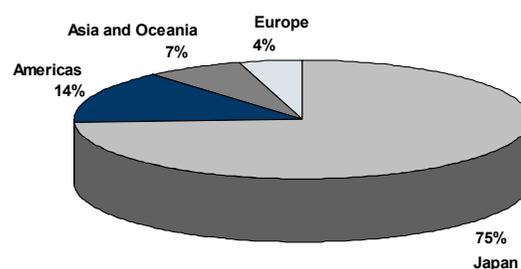
Yakult's pharmaceutical business began in 1961 as an outgrowth of the company's product development, using the enzymes that are raw materials for many foods and pharmaceuticals. Yakult began selling prescription drugs in 1975. The company has since also moved into nonprescription drugs (quasi-drugs), medical devices, reagents, and other related businesses. The company developed its *Campto* intravenous infusion as its mainstay chemotherapy drug. Yakult is establishing itself as an oncology company of worldwide importance based on this and its *Elplat* chemotherapy drug.

Exhibit 310: Yakult Honsha Business Mix (2009)



Source: Company data, Credit Suisse estimates.

Exhibit 311: Yakult Honsha Geographic Mix (2009)



Note: Japan includes pharmaceuticals

Source: Company data, Credit Suisse estimates.

## Brand Development Stage: Transform & Proliferate

Exhibit 312: Yakult Is Still Expanding into Emerging Markets

### Checklist to Emerge:

- Brandable Industry
- New or Underserved Market
- New Technology
- Differentiated Product
- Production Innovation
- Distribution Innovation
- Connection with Core Consumer
- Effective Marketing Strategy as a Brand
- Authentic Brand Intangibles
- Sufficient Marketing Investment
- Reliable Product/Service Quality
- New Product/Service Category
- Effective Management & Leadership
- Robust Sales Growth in Core Market
- Product Evolution & Investment

### Checklist to Transform & Proliferate:

- Continued Investment in the Brand
- Reliable Product/Service Quality
- Leadership/Management Strong
- Perpetual Innovation
- Power Player
- Aspirational Marketing Machine
- Continued Sales/Market Share Growth
- International Growth
- Loyal Core Customer
- Success in Category Extensions
- Anticipate Challenges from Competitors
- Know When to Say 'No'
- Avoid Non-Core Acquisitions

### Checklist to Dominate:

- Robust International Presence
- Dominant Market Share
- Ownership of Category/Mindshare
- Loyal Customer Base
- Preserve Relevance to Core Customer
- Quality Consistent
- Maintain Focus on the Brand
- Leadership does not Ossify
- Cash Flow Generation in Core Markets
- Leverage Overhead/SG&A with Scale

Source: Company data, Credit Suisse estimates.

## Growth Strategies & Opportunities

### Expansion into China Market

Yakult began operations in China in June 2002 in Guangzhou, expanding with sales bases in Shanghai in 2005 and Beijing in 2006. Consolidated subsidiary Shanghai Yakult and other units expanded coverage to Tianjin, Suzhou, Hangzhou, Qingdao, Wenzhou, and Yantai. In 2009, the company announced it had begun sales in Weihai in May, Wuhan in July, and Taizhou in August.

As the firm has expanded its sales area each year, its operations in China have posted operating losses since the firm's first moves in the country in 2002. However, management now expects its China business to turn in operating profit of around ¥1 billion in fiscal 2010.

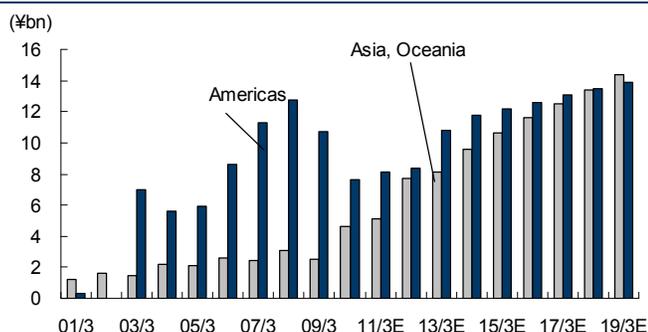
The company does not disclose individual sales or operating profit figures for its China operations. This complicates quantitative analysis, and suggests that the high marks the market has given Yakult for its China business are based on qualitative considerations. We believe growth for Yakult's sales volume in China is outpacing growth in other parts of Asia, and that China will be a core earnings engine for the firm over the long term.

However, Yakult is investing for the future with its work in China. We believe positive operating profit contributions from bases the firm established earlier will be offset by increased sales and promotional spending at new units, so we do not expect a brisk surge for earnings from China to lift overall consolidated earnings. We understand some corners of the stock market anticipate operating profit of ¥1 billion from China in fiscal 2010 to rise sharply to ¥2-3 billion from fiscal 2011. However, we believe that when Yakult announces its projections for fiscal 2011, its outlooks for operating profit from China might not anticipate a sharp rise for earnings.

**Operating Profit Outlooks for Asia/Oceania Depend on When the Company Wants to Start Seeing Returns**

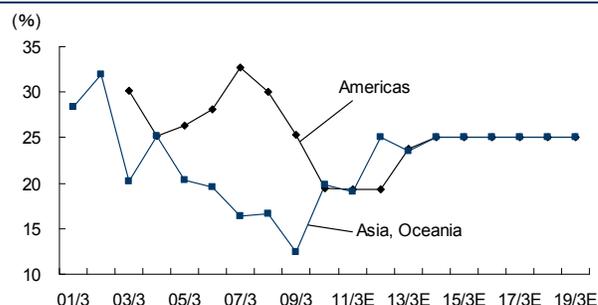
We believe that the timing at which the company ends forward-looking investment in China and other areas and begins focusing on returns that lift operating profit depends entirely on the company. It is difficult to anticipate when earnings could grow, as the firm's guidance is lacking. We believe operating profit from Asia (including China) and Oceania will be on par with that from Mexico and the Americas in about ten years (fiscal 2019). (See Exhibit 313 and Exhibit 314.)

**Exhibit 313: Operating Profit in Americas, Asia, and Oceania**



Source: Company data, Credit Suisse estimates.

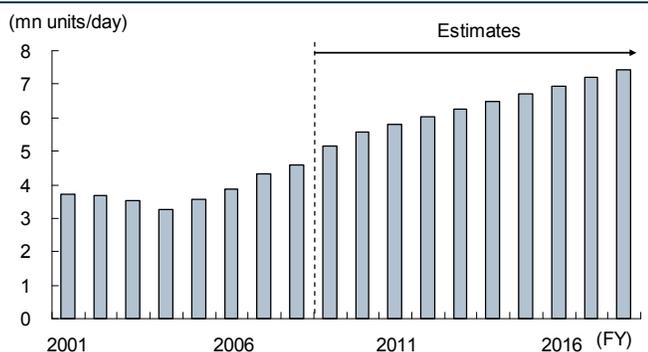
**Exhibit 314: Operating Profit Margin Estimates by Region**



Source: Company data, Credit Suisse estimates.

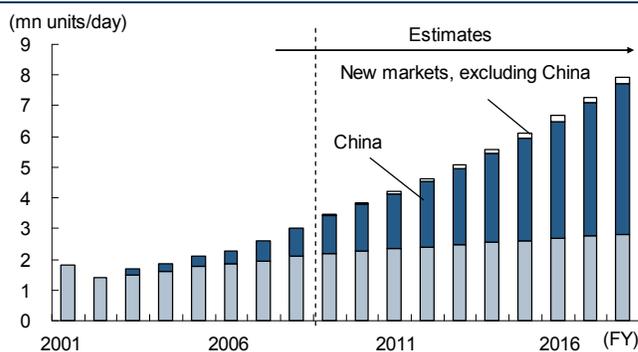
The operating profit margin for Asia/Oceania, where the company is investing in its future, was 12% in fiscal 2009. This lagged the margin of 25% for the Americas, where the company has developed a steady demand base, but if Yakult begins focusing on returns from its investments in China around fiscal 2013, we believe the operating margin for Asia/Oceania would rise to about the same level as that for the Americas. In the long term, we believe growth for sales volume will put operating profit for the two regions at roughly the same point. (See Exhibit 315 and Exhibit 316.)

**Exhibit 315: Sales Volume Assumption for the Americas**



Source: Company data, Credit Suisse estimates.

**Exhibit 316: Sales Volume Assumption for Asia and Oceania**



Source: Company data, Credit Suisse estimates.

## Major Catalysts

### Strengthening Overseas Business

The company's policy is to market its mainstay product *Yakult* throughout 45 countries by year-end fiscal 2011 versus 31 countries as of October-end 2008. Since its expansion into Taiwan in 1964, the company has continuously sought expansion in other countries, primarily into developing countries where preventive medicine is needed owing to poor sanitary conditions. From 1991, it then began full-fledged global expansion and expansion into developed countries, such as those in Europe. Since 2001, the company has accelerated the creation of a global brand through M&A activity, and is expanding marketing to an increasing number of countries toward this end.

#### Exhibit 317: Yakult Honsha's Planned Overseas Expansion

	Countries and area already under expansion	Countries and area under consideration by FY3/11		Long-term expansion
Asia, Oceania	Taiwan, Hong Kong, Thailand, South Korea, Philippines, Singapore, Indonesia, Malaysia, Australia, New Zealand, Brunei	Indochina	Viet Nam(Ho Chi Minh, Hanoi, Da-nang), Cambodia	Laos, Myanmar
		India	Delhi, Mumbai, Bangalore, Chennai, Calcutta	
		Middle East	UAE, Qatar, Bahrain, Oman, Saudi-Arabia	Jordan, Yemen, Kuwait
Europe	UK, Ireland, France, Spain, Luxembourg, Belgium, Germany, Austria	Italia, Czechoslovakia, Portugal, Poland, Greece		Russia, Ukraine, Romania, Slovakia, Belarus, Turkey, Former Yugoslavia
America	US, Brazil, Argentina, Mexico, Uruguay	North America	Canada	—
		Central America	Belize, Guatemala, El Salvador	Honduras, Nicaragua, Costa Rica, Panama
		South America	Peru, Chile	Colombia, Ecuador, Venezuela, Paraguay, Bolivia
China	Guangzhou, Shanghai, Beijing	Hangzhou, Ningbo, Tianjin, Suzhou, Xiamen, Qingdao, Jinan, Wuhan, Shenyang, Chengdu, Zhengzhou, Changsha, Changchun		

Source: Company data, Credit Suisse estimates.

### Expansion of Sales of *Elplat*

Yakult gained approval for expanded application of *Elplat* as an adjuvant on August 20, 2009, and for its use in the combined drug *Xelox* on September 18, 2009. *Xelox* is a combination of *Elplat* and the orally administered drug *Xeloda*, which is convenient, as it can be administered on an outpatient basis, and doctors might switch away from *Folfox* to *Xelox*. Meanwhile, approval for use as an adjuvant leads us to the rough estimate that the number of patients using *Elplat* could double.

## Key Risks

The risks to the company are the following.

1. **Currency fluctuations.** Yakult's consolidated earnings are exposed to currency fluctuations. Furthermore, different cultures could result in unexpected regulation and legislation being implemented or revised that could pose problems with respect to the operation of Yakult's business.
2. **Risk of product safety.** As the company's operations fall under various regulations such as the Food Sanitation Law and Pharmaceutical Affairs Law, unforeseen circumstances with respect to its products could have a major impact on earnings and its financial condition.
3. **Fluctuations in raw material prices.** Yakult's earnings could be negatively affected by a sharp rise in raw material prices for the company's milk product probiotic drinks owing to tight supply/demand.

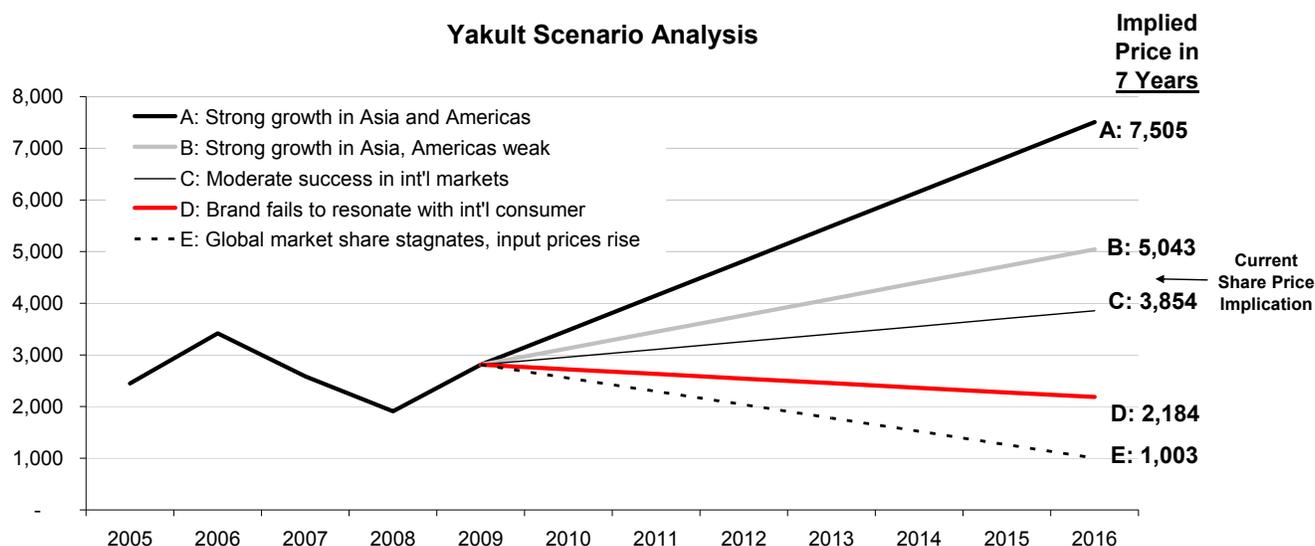
## Financial Statements and Comparable Valuation

Our ¥2,450 target price is based on a sum-of-the-parts analysis, applying a fiscal 2011 P/E of 20x for the food and beverage (F&B) segment and 59 for the pharmaceutical segment. Our assumption of a P/E multiple of 59 for the pharma business is based on an average PEG ratio of 3.1 (average fiscal 2011 P/E of 18x ÷ forecast average annual midterm EPS growth of 5.8% through fiscal 2014) for the pharma sector (our coverage universe) and forecast midterm EPS growth of 19% for Yakult's pharma segment.

**Exhibit 318: SOTP Valuation for Yakult Honsha**

	Food and beverages	Pharmaceuticals	Total
Operating profit(¥mn)	20,500	13,700	34,200
Net profit(¥mn)	7,253	4,847	12,100
Theoretical PER(x)	20.0	59.2	-
Theoretical market cap.(¥mn)	145,349	287,069	432,418
Outstanding shares(mn)	-	-	175.9
Theoretical share price(¥)	-	-	2,450
Theoretical PER of pharma business			
Pharma average PER(x)			18.0
Pharma average EPS growth rate(%)			5.8
Pharma PEG ratio			3.1
Yakult pharma EPS growth rate(%)			19.1
Theoretical PER for Yakult(X)			59.2

Source: Company data, Credit Suisse estimates.

**Exhibit 319: Current Stock Price Embeds Conservative Expectations (Prices in JPY)**

	2009E	2016 Scenario Analysis				
		A	B	C	D	E
Sales	285,000	420,000	380,000	343,124	300,000	300,000
Growth CAGR	-	6%	4%	3%	1%	1%
EBIT margin	8%	14%	12%	12%	10%	6%
Interest other expense	5,200	4,900	4,900	4,900	4,900	4,900
Tax rate	45%	40%	40%	40%	40%	40%
Sharecount	173	173	173	173	173	173
<b>EPS</b>	<b>57.4</b>	<b>187.6</b>	<b>144.1</b>	<b>128.5</b>	<b>87.4</b>	<b>45.6</b>
Growth CAGR	-	18%	14%	12%	6%	-3%
P/E Multiple	48	40	35	30	25	22
<b>Implied Price, 2016E</b>		<b>7,505</b>	<b>5,043</b>	<b>3,854</b>	<b>2,184</b>	<b>1,003</b>
Implied 7-yr return		172%	83%	40%	-21%	-64%
CAGR		15%	9%	5%	-3%	-13%

Source: Company data, Credit Suisse estimates.

**Exhibit 320: Yakult Trades at a Premium to the Group Owing to Above Average Growth Potential**

	Ticker	Price	Mkt Cap	Enterprise Value	Sales	EBIT Margin	L-T Growth	2009	2008	EPS				P/E	P/E	P/E	3-Yr Avg	EV-to-Sales
								Stock Perf	Stock Perf	FY07	FY08	FY09E	FY10E	CY08	CY09	CY10	P/E	P/E
<b>Yakult</b>	<b>2267-JP</b>	<b>2,755.00</b>	<b>\$5,194</b>	<b>\$5,322</b>	<b>\$2,971</b>	<b>5%</b>	<b>-</b>	<b>43%</b>	<b>-9%</b>	<b>96.32</b>	<b>65.75</b>	<b>63.97</b>	<b>79.21</b>	<b>41.9</b>	<b>43.1</b>	<b>34.8</b>	<b>-</b>	<b>1.8</b>
Nestle	NESN-CH	52.40	\$177,482	\$193,575	\$103,263	21%	-	24%	-15%	2.58	2.91	3.11	3.45	18.0	16.9	15.2	-	1.9
Danone	BN-FR	43.25	\$38,240	\$51,658	\$21,157	14%	-	8%	-33%	2.56	2.57	2.60	2.88	16.8	16.7	15.0	-	2.4
Procter & Gamble	PG	63.42	\$184,296	\$217,811	\$79,029	22%	9%	-2%	-16%	3.14	4.26	4.14	4.07	14.9	15.3	15.6	15.5	2.8
Average								15%	9%	19%	-18%			22.9	23.0	20.1	15.5	2.2

Source: Company data, Credit Suisse estimates.

## Exhibit 321: Yakult Honsha—Financial Data

(¥ mn)	FY3/07	FY3/08	FY3/09	FY3/10E	FY3/11E	FY3/12E	FY3/13E	FY3/14E
<b>Income statement</b>								
Sales	273,009	317,335	293,490	285,000	294,800	305,100	316,200	329,800
Operating profits	23,893	22,502	16,743	18,900	21,300	26,300	31,100	36,800
Non-operating income or expense								
Net interest income or expense	2,950	3,623	2,733	2,300	2,300	2,500	2,700	3,100
Equity in earnings of affiliates	3,447	3,218	1,451	2,000	2,000	2,000	2,000	2,000
Royalty income	2,696	2,559	494	100	100	100	100	100
Others	622	-424	3,930	-100	-200	-200	-200	-200
Total	9,715	8,976	8,608	4,300	4,200	4,400	4,600	5,000
Recurring profits	33,607	31,479	25,352	23,200	25,500	30,700	35,700	41,800
Extraordinary income or expenses	-1,931	2,567	-12,207	-2,000	0	0	0	0
Pre-tax profits	31,677	34,045	13,145	21,200	25,500	30,700	35,700	41,800
Taxes	13,190	13,149	-2,642	8,100	10,000	12,200	14,200	16,700
Minority interests	-3,681	-4,220	-4,464	-3,200	-3,400	-3,500	-4,500	-4,900
Net profits	14,805	16,675	11,324	9,900	12,100	15,000	17,000	20,200
Depreciation	10,135	13,168	13,750	15,300	15,800	15,500	15,500	17,400
Capex	18,138	30,009	24,094	20,500	23,500	22,000	18,900	12,700
EBITDA	34,028	35,670	30,493	34,200	37,100	41,800	46,600	54,200
<b>Balance sheet</b>								
Current assets	165,580	184,659	162,402	163,400	170,400	182,700	195,200	219,600
Cash	77,109	81,172	66,352	69,900	74,200	83,800	93,300	113,900
Notes and accounts receivable	48,426	49,199	48,590	47,200	48,800	50,500	52,300	54,600
Marketable securities	257	258	0	0	0	0	0	0
Inventories	30,548	34,879	31,213	30,300	31,400	32,400	33,600	35,100
Others	9,240	19,151	16,247	16,000	16,000	16,000	16,000	16,000
Tangible assets	101,590	116,077	131,320	137,600	146,400	154,000	158,500	154,900
Investment securities	70,053	70,393	51,126	53,100	55,100	57,100	59,100	61,100
Goodwill	1,457	1,164	722	700	700	700	700	700
Other assets	15,859	12,275	16,331	16,000	16,000	16,000	16,000	16,000
Total assets	354,539	384,568	361,901	370,800	388,600	410,500	429,500	452,300
Current liabilities	67,773	88,991	93,627	93,200	93,900	94,700	95,600	96,700
Notes and accounts payable	26,183	23,791	22,845	22,200	22,900	23,700	24,600	25,700
Interest-bearing debt	9,026	29,591	36,979	37,000	37,000	37,000	37,000	37,000
Others	32,564	35,609	33,803	34,000	34,000	34,000	34,000	34,000
Long-term liabilities	25,560	29,574	41,308	41,000	46,000	52,000	52,000	52,000
Long-term debt	1,673	4,472	4,388	4,000	9,000	15,000	15,000	15,000
Others	23,887	25,102	36,920	37,000	37,000	37,000	37,000	37,000
Minority interests	24,916	28,721	21,317	24,500	27,900	31,400	35,900	40,800
Shareholders' equity	236,289	237,282	205,648	212,100	220,800	232,400	246,000	262,800
ROE(%)	6.5	7.0	5.1	4.7	5.6	6.6	7.1	7.9
<b>Cashflow statement</b>								
Operating cash flow	25,724	25,177	37,559	35,800	28,800	31,800	31,800	36,700
Investment cash flow	-24,939	-34,408	-25,029	-20,500	-23,500	-22,000	-18,900	-12,700
Financing cash flow	-2,073	14,486	-3,208	-11,800	-1,000	-200	-3,400	-3,400
Cash and cash equivalent	70,999	74,894	62,665	66,200	70,500	80,100	89,600	110,200
Free cash flow	785	-9,231	12,530	15,300	5,300	9,800	12,900	24,000
<b>Per share info.</b>								
EPS(¥)	84.9	95.9	65.8	57.4	70.2	87.0	98.6	117.2
BPS(¥)	1,356.7	1,376.4	1,195.6	1,230.3	1,280.8	1,348.1	1,427.0	1,524.4
DPS(¥)	18.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0

Source: Company data, Credit Suisse estimates.

## Exhibit 322: Yakult Honsha—Assumptions for Earnings Estimates

(¥ mn)	FY3/07	FY3/08	FY3/09	FY3/10E	FY3/11E	FY3/12E	FY3/13E	FY3/14E
<b>Sales</b>								
Breakdown by business segment								
Food and beverages	233,138	271,134	244,191	238,500	243,500	247,000	251,300	255,100
Pharmaceuticals	25,698	31,003	35,235	36,600	41,400	48,200	55,000	64,800
Campto (Japan)	4,611	4,434	3,374	3,700	3,700	3,700	3,700	3,700
Campto (North America)	0	722	153	0	0	0	0	0
Campto (Europe)	3,259	3,092	5,208	2,700	2,500	2,300	2,100	1,900
Campto (Other)	352	384	224	200	200	200	200	200
Elplat	16,231	20,542	22,982	26,000	31,000	38,000	45,000	55,000
Others	1,245	1,829	3,294	4,000	4,000	4,000	4,000	4,000
Others	14,262	15,198	14,063	9,900	9,900	9,900	9,900	9,900
Total	273,009	317,335	293,490	285,000	294,800	305,100	316,200	329,800
Breakdown by area segment								
Japan	210,802	240,841	217,948	212,200	215,200	220,200	225,700	233,600
Americas	34,428	42,417	42,385	39,000	42,100	43,700	45,500	47,100
Asia and Oceania	14,766	18,552	20,232	23,400	27,100	30,700	34,300	38,200
Europe	13,102	15,523	12,923	10,400	10,400	10,500	10,700	10,900
Total	273,009	317,335	293,490	285,000	294,800	305,100	316,200	329,800
<b>Operating profits</b>								
Breakdown by business segment								
Food and beverages	26,105	23,294	17,133	20,100	20,500	23,300	25,800	28,000
Pharmaceuticals	9,414	11,159	12,110	11,400	13,700	15,900	18,200	21,400
Others	223	289	533	400	400	400	400	400
Eliminations	-11,849	-12,241	-13,033	-13,000	-13,300	-13,300	-13,300	-13,000
Total	23,893	22,502	16,743	18,900	21,300	26,300	31,100	36,800
Breakdown by area segment								
Japan	19,842	18,045	16,720	19,700	21,400	23,500	25,500	28,400
Americas	11,250	12,720	10,733	7,600	8,100	8,400	10,800	11,800
Asia and Oceania	2,426	3,085	2,504	4,600	5,100	7,700	8,100	9,600
Europe	2,223	891	-181	0	0	0	0	0
Elimination	-11,849	-12,241	-13,033	-13,000	-13,300	-13,300	-13,300	-13,000
Total	23,893	22,502	16,743	18,900	21,300	26,300	31,100	36,800
<b>FX</b>								
¥/BR (Brazil)	53.88	61.19	57.51	51.00	51.00	51.00	51.00	51.00
¥/MP (Mexico)	10.71	10.78	9.34	7.00	7.00	7.00	7.00	7.00
¥/AP (Argentina)	38.07	37.99	32.63	25.00	25.00	25.00	25.00	25.00
¥/US\$ (US)	116.40	117.70	102.82	90.00	90.00	90.00	90.00	90.00
¥/HK\$ (Hong Kong)	14.98	13.33	13.21	12.68	12.68	12.68	12.68	12.68
¥/S\$ (Singapore)	73.52	78.33	73.06	67.62	67.62	67.62	67.62	67.62
¥/Rp (Indonesia)	0.0128	0.0129	0.0107	0.0100	0.0100	0.0100	0.0100	0.0100
¥/A\$ (Australia)	88.05	99.01	88.03	79.43	79.43	79.43	79.43	79.43
¥/MR (Malaysia)	31.79	34.33	30.91	27.99	27.99	27.99	27.99	27.99
¥/RMB (China)	14.60	15.50	14.87	14.38	14.38	14.38	14.38	14.38
¥/Eur (Eurozone)	146.85	161.96	152.04	130.00	130.00	130.00	130.00	130.00
¥/£ (UK)	215.52	235.95	190.54	163.10	163.10	163.10	163.10	163.10
¥/NT\$ (Taiwan)	3.58	3.59	3.27	3.00	3.00	3.00	3.00	3.00
¥/₩ (Korea)	0.1227	0.1267	0.0952	0.0800	0.0800	0.0800	0.0800	0.0800
¥/P (Philippines)	2.30	2.58	2.33	2.07	2.07	2.07	2.07	2.07

Source: Company data, Credit Suisse estimates.

**Companies Mentioned (Price as of 22 Feb 10)**

361 Degrees International (1361.HK, HK\$5.82)  
 Abbott Laboratories (ABT, \$54.40, NEUTRAL, TP \$59.00)  
 ABC-Mart (2670, ¥3,015, OUTPERFORM [V], TP ¥3,150, MARKET WEIGHT)  
 Abercrombie & Fitch Co. (ANF, \$35.65, OUTPERFORM [V], TP \$49.00)  
 ABSA Group Limited (ASAJ.J, R133.80, NEUTRAL, TP R150.00)\*  
 Acer Inc. (2353.TW, NT\$90.60, OUTPERFORM, TP NT\$91.60)  
 Activision, Inc. (ATVI, \$10.55)  
 Adidas AG (ADSG.F, Eu37.05)  
 Advanced Bionics Corporation (Not Rated)  
 Advanced Micro Devices, Inc. (AMD, \$7.79, NEUTRAL [V], TP \$9.00)  
 Affinity Technology Group. Inc.  
 African Bank Investment Ltd (ABLJ.J, R30.90)  
 Agricultural Bank of China (Not Rated)  
 Ahold (AHLN.AS, Eu8.99, OUTPERFORM, TP Eu10.50, OVERWEIGHT)  
 Air China (0753.HK, HK\$6.85, NEUTRAL [V], TP HK\$5.30)  
 Alibaba.com Limited (1688.HK, HK\$17.26, OUTPERFORM [V], TP HK\$25.00)  
 Almarai Co (2280.SE, SRIs178.50, OUTPERFORM, TP SRIs197.40)  
 Alteon, Inc. (ALT, \$.06)  
 Amazon.com Inc. (AMZN, \$118.01, NEUTRAL [V], TP \$130.00)  
 American Eagle Outfitters, Inc. (AEO, \$16.43, NEUTRAL [V], TP \$16.00)  
 Ameristar Casinos, Inc. (ASCA, \$15.13)  
 Anheuser-Busch Companies, Inc. (BUD, \$68.58)  
 Anheuser-Busch InBev (ABI.BR, Eu36.58, OUTPERFORM, TP Eu43.00, OVERWEIGHT)  
 Ann Taylor Stores Corp. (ANN, \$15.84, NEUTRAL [V], TP \$16.00)  
 Anta Sports Products Limited (2020.HK, HK\$10.80, OUTPERFORM [V], TP HK\$13.00)  
 Apple Inc. (AAPL, \$200.44, OUTPERFORM, TP \$275.00)  
 AT&T (T, \$25.02, NEUTRAL, TP \$27.00)  
 Audi AG (NSU.GR, Eu551.30)  
 AutoZone, Inc. (AZO, \$164.24, OUTPERFORM, TP \$182.00)  
 Avon Products, Inc. (AVP, \$30.37)  
 Baidu Inc (BIDU.OQ, \$507.15, NEUTRAL [V], TP \$423.00)  
 Bajaj Auto Limited (532977, Rs 1748.40)  
 Bank of China Ltd (3988.HK, HK\$3.81, OUTPERFORM, TP HK\$5.44)  
 Bank of Communications (3328.HK, HK\$7.92, NEUTRAL [V], TP HK\$9.19)  
 Bank Sarasin (BSAN.S, SFr37.45, NEUTRAL, TP SFr36.00, OVERWEIGHT)  
 Beijing Yanjing Brewery Co. Ltd. (000729, )  
 Best Buy (BBY, \$36.40, OUTPERFORM, TP \$50.00)  
 Best Western International, Inc. (Not Rated)  
 Beverly Hills Bancorp inc. (BHBC, \$0.186)  
 BIM (BIMAS.IS, TRY68.50, OUTPERFORM, TP TRY69.00)  
 BJ's Wholesale Club Inc. (BJ, \$35.60, UNDERPERFORM, TP \$31.00)  
 Blockbuster Incorporated (BBI, \$.40)  
 BMW (BMWG.F, Eu30.26, UNDERPERFORM, TP Eu32.00, MARKET WEIGHT)  
 Boeing (BA, \$63.97, NEUTRAL, TP \$57.00)  
 Borders Group, Inc. (BGP, \$1.52, NEUTRAL [V], TP \$1.00)  
 Boston Market Corporation (Not Rated)  
 Boston Scientific Corp. (BSX, \$7.87, NEUTRAL, TP \$8.50)  
 Bright Dairy & Food Co.,Ltd (600597.SS, Rmb9.75, UNDERPERFORM [V], TP Rmb3.00)  
 Bristol-Myers Squibb (BMY, \$24.68, NEUTRAL, TP \$24.00)  
 Bulgari (BULG.MI, Eu5.66, UNDERPERFORM [V], TP Eu5.40, MARKET WEIGHT)  
 Burberry Group (BRBY.L, 634.00p, NEUTRAL, TP 640.00p, MARKET WEIGHT)  
 Capitec Bank (CPIJ.J, R80.75, OUTPERFORM, TP R90.00)\*  
 CarMax Inc. (KMX, \$20.17, NEUTRAL [V], TP \$23.00)  
 Carrefour (CARR.PA, Eu34.08, NEUTRAL, TP Eu30.00, OVERWEIGHT)  
 Casino Guichard (CASP.PA, Eu59.10, UNDERPERFORM, TP Eu46.00, OVERWEIGHT)  
 China Citic Bank (0998.HK, HK\$5.31, OUTPERFORM [V], TP HK\$7.22)  
 China Construction Bank (0939.HK, HK\$5.86, OUTPERFORM, TP HK\$8.54)  
 China Dongxiang (3818.HK, HK\$4.94)  
 China Eastern Airlines - H (0670.HK, HK\$2.88, UNDERPERFORM [V], TP HK\$1.56)  
 China Hongxing Sports Limited (CHXS.SI, S\$.16, NEUTRAL [V], TP S\$.16)  
 China Mengniu Dairy (2319.HK, HK\$23.30, NEUTRAL [V], TP HK\$19.60)  
 China Merchants Bank - H (3968.HK, HK\$18.82, NEUTRAL [V], TP HK\$20.07)  
 China Minsheng Banking Corporation (1988.HK, HK\$7.66, NEUTRAL [V], TP HK\$8.28)

China Resources Enterprise (0291.HK, HK\$27.05)  
 China Southern Airlines - H (1055.HK, HK\$2.98, UNDERPERFORM [V], TP HK\$3.00)  
 Chipotle mexican Grill, Inc. (CMG, \$103.64)  
 Christian Dior (DIOR.PA, Eu 72.88)  
 Cisco Systems Inc. (CSCO, \$24.30, OUTPERFORM [V], TP \$32.00)  
 Clorox Co. (CLX, \$61.02, NEUTRAL, TP \$65.00)  
 Coach, Inc. (COH, \$36.56, NEUTRAL [V], TP \$36.00)  
 Coca-Cola Enterprises (CCE, \$19.27, OUTPERFORM, TP \$26.00)  
 Coca-Cola Femsa SAB de CV (KOF, \$63.80, NEUTRAL, TP \$63.00)  
 Cochlear (COH.AX, A\$64.40, NEUTRAL, TP A\$69.00)  
 Colonial BancGroup Inc. (CNB, \$.02)  
 Colruyt (COLR.BR, Eu175.00, NEUTRAL, TP Eu162.00, OVERWEIGHT)  
 Columbia Sportswear Company (COLM, \$45.46)  
 Continental (CONG.DE, Eu32.54, OUTPERFORM [V], TP Eu52.00, MARKET WEIGHT)  
 Cooperative Bankshares Inc. (COOPQ, \$0.0001)  
 Costco Wholesale Corporation (COST, \$60.79, OUTPERFORM, TP \$65.00)  
 CROCS, Inc. (CROX, \$7.73)  
 CVS Caremark Corporation (CVS, \$34.22, OUTPERFORM [V], TP \$37.00)  
 Daewoo Motor Sales Corp (004550.KS, W7,400)  
 Daimler (DAIGN.DE, Eu31.40, OUTPERFORM [V], TP Eu47.00, MARKET WEIGHT)  
 Dairy Farm International (DAIR.SI, \$6.25, OUTPERFORM, TP \$4.63)  
 Danone (DANO.PA, Eu43.24, OUTPERFORM, TP Eu46.00, OVERWEIGHT)  
 Dean Foods Company (DF, \$14.86, NEUTRAL, TP \$16.00)  
 Delhaize (DELB.BR, Eu56.69, NEUTRAL, TP Eu47.00, OVERWEIGHT)  
 Dell Inc. (DELL, \$13.36, NEUTRAL [V], TP \$12.50)  
 Digital Angel Corp. (DOC, \$.63)  
 Dillard's Inc. (DDS, \$17.01, UNDERPERFORM [V], TP \$10.00)  
 DISH Network Corp. (DISH, \$19.89, OUTPERFORM [V], TP \$22.00)  
 Donatos Pizzeria, LLC (Not Rated)  
 EADS (EAD.PA, Eu 15.04)  
 eBay Inc. (EBAY, \$23.28, NEUTRAL [V], TP \$25.00)  
 EFG International (EFGN.S, SFr15.00, OUTPERFORM [V], TP SFr15.00, OVERWEIGHT)  
 Electronic Arts Inc. (ERTS, \$16.31)  
 ESPN, Inc. (Not Rated)  
 Esprit Holdings (0330.HK, HK\$55.65, OUTPERFORM [V], TP HK\$67.00)  
 Family Dollar (FDO, \$32.36, OUTPERFORM, TP \$35.00)  
 Fast Retailing (9983, ¥15,280, UNDERPERFORM [V], TP ¥14,000, MARKET WEIGHT)  
 Fazoli's Restaurants, LLC (Not Rated)  
 FedEx Corporation (FDX, \$82.36, NEUTRAL [V], TP \$87.00)  
 Fiat (FIA.MI, Eu8.24, OUTPERFORM [V], TP Eu11.50, MARKET WEIGHT)  
 Finlay Enterprises, Inc. (FNLY, \$.00)  
 First National Bankshares Corporation (Not Rated)  
 FirstRand Limited (FSRJ.J, R18.05, UNDERPERFORM, TP R19.50)\*  
 Ford Motor Co. (F, \$11.21, NEUTRAL [V], TP \$10.00)  
 Fortunoff (Not Rated)  
 Fossil, Inc. (FOSL, \$36.21)  
 Four Seasons Hotels & Resorts (FS, \$82.00)  
 GAM Holding (GAMH.VX, SFr11.72, NEUTRAL [V], TP SFr13.00, OVERWEIGHT)  
 Gap, Inc. (GPS, \$19.77, OUTPERFORM, TP \$28.00)  
 General Electric (GE, \$16.25)  
 General Mills (GIS, \$72.29, OUTPERFORM, TP \$78.00)  
 General Motors Corp. (GM, \$.56)  
 Global Sources Ltd. (GSOL, \$6.74)  
 GN Store Nord (GN.CO, DKr32.40, UNDERPERFORM [V], TP DKr32.00, OVERWEIGHT)  
 Goldman Sachs Group, Inc. (GS, \$156.71, OUTPERFORM, TP \$235.00)  
 Google, Inc. (GOOG, \$542.80, OUTPERFORM, TP \$700.00)  
 Green Mountain Coffee Roasters Inc (GMCR, \$81.19)  
 Grupo Famsa (GFAMSAA, \$2.02, NEUTRAL [V], TP \$1.40)  
 Guangdong Hualong Groups (600242.CH, ¥7.37)  
 Guess Inc. (GES, \$40.62, OUTPERFORM [V], TP \$55.00)  
 H.J. Heinz Company (HNZ, \$45.93, NEUTRAL, TP \$50.00)  
 Harry Winston Diamond Corporation (HWD, \$9.97)  
 Hartmarx Corp. (HMX, \$.01)  
 Hennes & Mauritz (Hmb.ST, SKr436.00, NEUTRAL, TP SKr400.00, MARKET WEIGHT)  
 Hermes International (HRMS.PA, Eu97.91, UNDERPERFORM, TP Eu75.00, MARKET WEIGHT)

Hewlett-Packard (HPQ, \$50.56, OUTPERFORM, TP \$65.00)  
 HF Financial Corp. (HFFC, \$10.00)  
 Hilton Hotels (HLT, \$47.48)  
 Home Depot (HD, \$30.32, OUTPERFORM, TP \$36.00)  
 Honda Motor Corp. (7267, ¥3,180)  
 Hugo Boss (BOSG\_p.F, Eu 24.10)  
 Hyatt Hotels Corp. (H, \$30.93)  
 Hyundai Motor (005380.KS, W117,000, UNDERPERFORM, TP W84,000)  
 Indian Hotels (IHTL.BO, Rs87.20)  
 Inditex (ITX.MC, Eu42.58, UNDERPERFORM, TP Eu28.00, MARKET WEIGHT)  
 Industrial & Commercial Bank of China (1398.HK, HK\$5.56, OUTPERFORM, TP HK\$7.37)  
 Infomedia (IFM.AX, A\$27)  
 ING Group (ING.AS, Eu6.92, OUTPERFORM [V], TP Eu8.95, MARKET WEIGHT)  
 Intel Corp. (INTC, \$20.87, OUTPERFORM [V], TP \$30.00)  
 InterContinental Hotels (IHG.L, 911.00p, OUTPERFORM, TP 1074.00p, MARKET WEIGHT)  
 International Business Machines (IBM, \$126.85, NEUTRAL, TP \$130.00)  
 Intuit (INTU, \$31.87, NEUTRAL, TP \$33.00)  
 J Crew Group Inc. (JCG, \$40.18, OUTPERFORM [V], TP \$45.00)  
 Jack In The Box, Inc. (JACK, \$20.04, OUTPERFORM [V], TP \$24.00)  
 JC Penney (JCP, \$27.93, NEUTRAL [V], TP \$33.00)  
 Johnson & Johnson (JNJ, \$63.49, NEUTRAL, TP \$71.00)  
 Johnson Controls, Inc. (JCI, \$30.60, OUTPERFORM [V], TP \$33.00)  
 Julius Baer (BAER1.VX, SFr33.64, OUTPERFORM [V], TP SFr48.00, OVERWEIGHT)  
 Kellogg Company (K, \$52.86, OUTPERFORM, TP \$61.00)  
 Kia Motors (000270.KS, W21,250, NEUTRAL [V], TP W18,000)  
 Kodak Imaging Network, Inc. (Not Rated)  
 Kohl's Corporation (KSS, \$51.13, NEUTRAL, TP \$60.00)  
 Kraft Foods, Inc. (KFT, \$28.95, OUTPERFORM, TP \$35.00)  
 Krispy Kreme Doughnut Inc (KKD, \$3.37)  
 Kweichow Moutai Co. (600519.CH, ¥166.75)  
 Lego Holding A/S (Not Rated)  
 Li Ning Co Ltd (2331.HK, HK\$24.70, OUTPERFORM [V], TP HK\$27.60)  
 Littelfuse, Inc. (LFUS, \$36.20)  
 Lockheed Martin (LMT, \$76.94, NEUTRAL, TP \$75.00)  
 L'Oreal (OREP.PA, Eu 74.93, UNDERPERFORM, TP Eu 65.00, MARKET WEIGHT)  
 Lsb Bancshares, Inc. (LXBK, \$2.35)  
 Lululemon Athletica Inc. (LULU, \$28.32, NEUTRAL [V], TP \$19.00)  
 LVMH (LVMH.PA, Eu80.08, OUTPERFORM, TP Eu85.00, MARKET WEIGHT)  
 Macy's Inc. (M, \$18.47, NEUTRAL [V], TP \$15.00)  
 Magellan Health Services, Inc. (MGLN, \$39.04)  
 Magnit (MGNT.RTS, \$66.50, OUTPERFORM [V], TP \$60.00)  
 Mahindra & Mahindra (MAHM.BO, Rs993.50, NEUTRAL [V], TP Rs1014.49)  
 MAN (MANG.DE, Eu53.95, UNDERPERFORM [V], TP Eu47.00, MARKET WEIGHT)  
 Marks & Spencer (MKS.L, 328.40p, UNDERPERFORM, TP 340.00p, MARKET WEIGHT)  
 Marriott International (MAR, \$27.36)  
 Marvel Enterprises (MVL, \$54.08)  
 MasterCard, Inc. (MA, \$224.24, OUTPERFORM [V], TP \$260.00)  
 McDonald's Corp (MCD, \$64.77, OUTPERFORM, TP \$71.00)  
 Mead Johnson Nutrition Co. (MJN, \$46.68, OUTPERFORM, TP \$54.00)  
 Medco Energi Internasional Tbk (MEDC.JK, Rp2450.00, NEUTRAL [V], TP Rp3800.00)  
 MedcoHealth Solutions (MHS, \$62.40, OUTPERFORM, TP \$74.00)  
 Medtronic (MDT, \$42.87, OUTPERFORM, TP \$52.00)  
 Medtronic (MDT, \$43.66, OUTPERFORM, TP \$52.00)  
 MercadoLibre Inc. (MELI, \$40.93)  
 Metro (MEOG.F, Eu38.82, OUTPERFORM [V], TP Eu46.00, OVERWEIGHT)  
 Microsoft Corp. (MSFT, \$28.73, OUTPERFORM, TP \$36.50)  
 Molson Coors Brewing (TAP, \$40.86, NEUTRAL, TP \$53.00)  
 Morrison (William) (MRW.L, 298.90p, OUTPERFORM, TP 340.00p, OVERWEIGHT)  
 Natura (NATU3, \$19.18, UNDERPERFORM, TP \$21.20)  
 Naturade Inc. (NRDCQ, \$0.0010)  
 NEC (6701, ¥246, NEUTRAL [V], TP ¥235, MARKET WEIGHT)  
 Nedbank Group Limited (NEDJ.J, R123.00, OUTPERFORM, TP R145.00)\*  
 Nestle (NESN.VX, SFr52.40, OUTPERFORM, TP SFr60.00, OVERWEIGHT)  
 Netflix Inc. (NFLX, \$65.27, UNDERPERFORM [V], TP \$31.00)  
 News Corporation (NWSA, \$13.49, NEUTRAL [V], TP \$15.50)

Nike Inc. (NKE, \$64.31, OUTPERFORM, TP \$75.00)  
 Nintendo (7974, ¥24,480)  
 Nissan Motor Co. (7201, ¥754)  
 Nokia Corporation (NOK, \$13.48, UNDERPERFORM [V], TP \$12.60, MARKET WEIGHT)  
 Office Depot (ODP, \$6.65, UNDERPERFORM [V], TP \$4.00)  
 Orleans Homebuilders (OHB, \$0.84)  
 Palm Inc. (PALM, \$9.11, NEUTRAL [V], TP \$10.00)  
 Panasonic Corporation (6752, ¥1,304)  
 Patek Philippe S.A. (Not Rated)  
 PayPal, Inc. (PYPL, \$20.22)  
 Peak Sports Products Co.Ltd. (1968.HK, HK\$4.96, OUTPERFORM [V], TP HK\$6.30)  
 PepsiCo, Inc. (PEP, \$62.41, OUTPERFORM, TP \$76.00)  
 Philip Morris International (PM, \$49.75, OUTPERFORM, TP \$57.00)  
 Phillips-Van Heusen (PVH, \$42.50, NEUTRAL [V], TP \$47.00)  
 Pier 1 Imports Inc. (PIR, \$6.14)  
 Polo Ralph Lauren (RL, \$81.31, OUTPERFORM [V], TP \$120.00)  
 Post Office (Not Rated)  
 PPR (PRTP.PA, Eu84.05, NEUTRAL [V], TP Eu72.00, MARKET WEIGHT)  
 Pret A Manager Holdings Ltd. (Not Rated)  
 Pringle of Scotland Ltd. (Not Rated)  
 Procter & Gamble Co. (PG, \$63.42, OUTPERFORM, TP \$74.00)  
 PSA Peugeot Citroen (PEUP.PA, Eu20.06, UNDERPERFORM [V], TP Eu21.00, MARKET WEIGHT)  
 Puma (PUMG.DE, Eu214.85)  
 QCR Holdings Inc. (QCRH, \$9.43)  
 Reebok International (RBK, \$58.99)  
 Renault (RENA.PA, Eu31.89, OUTPERFORM [V], TP Eu43.00, MARKET WEIGHT)  
 ReplayTV (Not Rated)  
 Research In Motion Limited (RIMM, \$69.65, OUTPERFORM [V], TP \$95.00, MARKET WEIGHT)  
 Revlon (REV, \$15.93)  
 Richemont Secs (JSE) (RCHJ.J, R3766.00)  
 Rick's Cabaret International (RICK, \$14.02)  
 RMB Holdings (RMHJ.J, R29.22, NEUTRAL, TP R24.40)\*  
 Rolls-Royce (RR.L, 525.50p, OUTPERFORM, TP 580.00p, MARKET WEIGHT)  
 Ryohin Keikaku (7453, ¥3,935, OUTPERFORM, TP ¥4,200, MARKET WEIGHT)  
 Safeway Inc. (SWY, \$23.79, OUTPERFORM, TP \$27.00)  
 Safran (SAF.PA, Eu15.23, NEUTRAL, TP Eu14.00, MARKET WEIGHT)  
 SAFT (S1A.PA, Eu29.40)  
 Sainsbury (SBRY.L, 332.40p, UNDERPERFORM, TP 300.00p, OVERWEIGHT)  
 Samsung Electronics (005930.KS, W767,000, OUTPERFORM, TP W940,000)  
 SanDisk Corp (SNDK, \$29.02)  
 Sanyo Electric (6764, ¥145)  
 Sara Lee Corporation (SLE, \$13.61, NEUTRAL, TP \$14.00)  
 Sara Lee Corporation (SLE, \$13.71, NEUTRAL, TP \$14.00)  
 Savola Group (2050.SE, SRIs35.90, NEUTRAL, TP SRIs31.00)  
 Scania (SCVb.ST, SKr98.55, UNDERPERFORM [V], TP SKr65.00, MARKET WEIGHT)  
 Sears Holding Corp. (SHLD, \$95.66, UNDERPERFORM [V], TP \$60.00)  
 Seventh Continent (SCON.RTS, \$8.00, UNDERPERFORM, TP \$6.25)  
 Sheraton Hotels & Resorts  
 Shimamura (8227, ¥7,830, OUTPERFORM [V], TP ¥9,200, MARKET WEIGHT)  
 Siemens (SIEGn.DE, Eu65.00, OUTPERFORM, TP Eu78.00, UNDERWEIGHT)  
 Solar Thin Films inc. (SLTZ, \$0.428)  
 Sonova Holding (SOON.S, SFr133.50, OUTPERFORM, TP SFr155.00, OVERWEIGHT)  
 Sony (6758, ¥3,200)  
 Sony Corporation (SNE, \$34.78)  
 Soriana (SORIANAB, \$2.72, OUTPERFORM [V], TP \$3.40)  
 Southwest Airlines Co. (LUV, \$12.50)  
 Spar Group (SPPJ.J, R72.24, UNDERPERFORM, TP R45.00)\*  
 Standard Bank Group Limited (SBKJ.J, R106.74, NEUTRAL, TP R120.00)\*  
 Starbucks (SBUX, \$22.68)  
 Starbucks (SBUX, \$22.90)  
 Sun Entertainment Holding Corp. (SETHF, \$0.19)  
 SUPERVALU INC. (SVU, \$15.68, NEUTRAL [V], TP \$14.00)  
 Swatch Group (UHR.VX, SFr302.70, OUTPERFORM [V], TP SFr350.00, OVERWEIGHT)  
 T. Rowe Price Group (TROW, \$49.55, OUTPERFORM [V], TP \$63.00)  
 Target Corporation (TGT, \$50.64, OUTPERFORM [V], TP \$58.00)

Tata Motors Ltd. (TAMO.BO, Rs704.00, OUTPERFORM [V], TP Rs817.77)  
 Tata Steel Ltd (TISC.BO, Rs573.00, UNDERPERFORM [V], TP Rs425.00)  
 TD Ameritrade Holding Corp. (AMTD, \$17.40, NEUTRAL, TP \$18.00)  
 Tesco (TSCO.L, 422.55p, OUTPERFORM, TP 400.00p, OVERWEIGHT)  
 Tesla Motors Inc. (Not Rated)  
 Teva Pharmaceutical Industries (TEVA, \$59.45, OUTPERFORM, TP \$60.00)  
 Texas Instruments Inc. (TXN, \$24.30, NEUTRAL, TP \$24.00)  
 The Cheesecake Factory (CAKE, \$23.34, NEUTRAL [V], TP \$24.00)  
 The Coca-Cola Company (KO, \$54.83, OUTPERFORM, TP \$62.00)  
 The Coca-Cola Company (KO, \$55.38, OUTPERFORM, TP \$62.00)  
 The Northwestern Mutual Life Insurance Company (Not Rated)  
 Tiffany & Co. (TIF, \$43.51, OUTPERFORM [V], TP \$52.00)  
 Timberland Company (TBL, \$18.59)  
 Tingyi (0322.HK, HK\$17.66, NEUTRAL, TP HK\$18.40)  
 TJX Companies, Inc. (TJX, \$39.18, OUTPERFORM, TP \$43.00)  
 Tod's (TOD.MI, Eu48.49)  
 Toray Industries (3402, ¥490, NEUTRAL, TP ¥470, MARKET WEIGHT)  
 Toshiba (6502, ¥457, OUTPERFORM [V], TP ¥620, MARKET WEIGHT)  
 Toyota Motor Corp. (7203, ¥3,340)  
 Tractor Supply Co. (TSCO, \$53.45)  
 Trader Joe's Company (Not Rated)  
 Travelodge Hotels, Inc. (Not Rated)  
 Tsingtao Brewery H (0168.HK, HK\$36.45)  
 UBS (UBSN.VX, SFr14.77, OUTPERFORM [V], TP SFr20.00, MARKET WEIGHT)  
 Under Armour, Inc. (UA, \$25.94, OUTPERFORM [V], TP \$35.00)  
 Uni-President Enterprises (1216.TW, NT\$35.20, OUTPERFORM, TP NT\$37.70)  
 VeriSign Inc. (VRSN, \$24.32, OUTPERFORM [V], TP \$28.75)  
 Verizon (VZ, \$29.00, NEUTRAL, TP \$30.00)  
 VF Corporation (VFC, \$76.71, OUTPERFORM, TP \$90.00)  
 Virgin Group Ltd. (Not Rated)  
 Virgin Media (VMED, \$15.44, OUTPERFORM [V], TP \$21.00, OVERWEIGHT)  
 Visa Inc. (V, \$86.91, OUTPERFORM, TP \$100.00)  
 Volkswagen (VOWG\_p.F, Eu65.74, OUTPERFORM [V], TP Eu83.00, MARKET WEIGHT)  
 Volvo (VOLVb.ST, SKr61.90, UNDERPERFORM [V], TP SKr45.00, MARKET WEIGHT)  
 Vontobel (VONN.S, SFr32.65, NEUTRAL, TP SFr33.00, OVERWEIGHT)  
 Wacoal Holdings (3591, ¥1,054)  
 Wal-Mart Stores, Inc. (WMT, \$53.83, NEUTRAL, TP \$53.00)  
 Walmex (WALMEXV, \$4.82, NEUTRAL, TP \$4.10)  
 Walt Disney Company (DIS, \$31.12, OUTPERFORM, TP \$36.00)  
 Warnaco Group, Inc. (WRC, \$41.63, NEUTRAL [V], TP \$45.00)  
 WellPoint, Inc. (WLP, \$59.44)  
 Whitehall Jewellers, Inc. (JWL, \$.79)  
 Whole Foods Market (WFMI, \$33.92, NEUTRAL [V], TP \$33.00)  
 William Demant (WDH.CO, DKr396.00, OUTPERFORM [V], TP DKr425.00, OVERWEIGHT)  
 Wimm-Bill-Dann Foods (WBD.N, \$22.00, UNDERPERFORM [V], TP \$8.50)  
 Wi-Tron Inc. (WTRO, \$0.0007)  
 X5 Retail Group (PJPq.L, \$30.07, NEUTRAL [V], TP \$22.00)  
 Xerox Corporation (XRX, \$9.24)  
 Xtep International Holdi (1368.HK, HK\$5.42)  
 Yahoo Inc. (YHOO, \$15.38, NEUTRAL [V], TP \$20.00)  
 Yakult Honsha (2267, ¥2,755, NEUTRAL, TP ¥2,450, MARKET WEIGHT)  
 Yum! Brands, Inc. (YUM, \$33.58, OUTPERFORM, TP \$41.00)  
 Zale Corp. (ZLC, \$2.56)  
 Zhejiang Netsun Co. Ltd (002095.CH, ¥34.35)

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