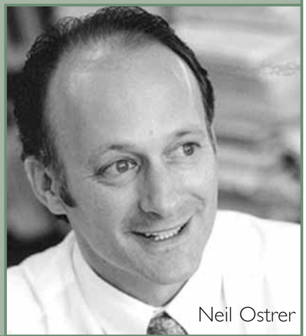
Phoenix
INVESTOR RELATIONS

Our guest: Marathon Asset Management

London-based Marathon Asset Management was founded in 1986 and is an owner-managed global equity investment firm. The firm manages $42 billion in equity assets. The investment philosophy is long term and contrarian with a focus on industry capital cycle analysis. Stock picking is based on bottom-up research. The firm conducts extensive meetings with companies in order to assess the quality of their businesses as well as executive motivation and compensation. Marathon frequently invests in out of favour sectors undergoing systematic consolidation which gives the appearance of value style investment.


Neil Ostrer

Cambridge educated Neil Ostrer is one of Europe's largest long-only active investors in European equities. He is responsible for $18 billion of European equity assets. He's been managing European equities since 1981. Ex GT Asset Management, he co-founded Marathon in 1986 along with Jeremy Hosking and Bill Arah.

How do you measure your performance?

Our clients mostly use the MSCI Europe but occasionally the FT Europe. In 2006 we outperformed the MSCI Europe (in dollars) by an estimated 6.69%.

Historical out-performance over MSCI Europe (in US dollars)	
Last three years	+3.18%
Last five years	+4.30%
Last seven years	+6.23%
Last 10 years	+3.45%
Last 15 years	+5.11%
Since inception (19 yrs)	+5.31%

What investment constraints do you have?

We don't have formal constraints but observe what the client requires in terms of risk control. The typical institutional client normally has tracking error requirements between 3 and 6% and we are currently nearer the low end. In the bubble period, we were as high as 8% as we wanted to track differently as we thought market conditions were very dangerous.

Do you have any market cap restrictions?

There are no real formal restrictions but as a large investor with $18 billion under management there is obviously a limit to what you can do in terms of small cap. If I had a portfolio of small caps my tracking error would be through the roof. If I have too much in one sector and nothing in another that would push my tracking error up too. If you are managing $18 billion you can't buy $500 million companies. I have $18 billion and typically have 100 holdings so my average holding size is $180 million. Royal Dutch Shell would be larger than this while a smaller company with a market cap of as low as $2 billion would be smaller. That's the way I get my risk.

How do you screen stocks?

This is where the whole Marathon process is different. Of course we screen but it's not the way we would describe our process. We describe our process very much in a qualitative way. We have two key drivers to our investment process – one is what we call the capital cycle which we've written a book about (Capital Account). It's all about how capitalism interacts with stock markets and how stock markets are the conduit for capitalism and how industries raise money and lose money and therefore what makes stocks go up and down dependent on that process. So a lot of our work is trying to assess, anticipate or understand and interpret the capital cycles for various industries. So if there's a lot of consolidation within an industry or there are a lot of companies going bust we think that's quite good as there's less capital in that industry for a given set of returns. By the same token, if an industry is raising lots of money and there are lots of IPOs and prospectuses and investment bankers are getting excited and there's lots of hype, then we get very worried as we think there's too much excess in this industry so returns are going to fall as there's too much capital going into it. That's the essence of the capital cycle process.

So for instance, if financials were all very flush with cash and banking profits were very high we'd be worried but a lot of people would think that was great. We'd be worried that they had too much money and would squander it and the returns would decline and the stock market will look through that as it looks ahead. Capital cycle analysis gets quite complicated as some industries have capital constraints, some have barriers to entry and some are monopolies or oligopolies. We love things that have the ability to continue to generate high returns because of barriers to entry.

The second key driver is quality of management. We very rarely invest in companies when we haven't met management. It is such a key criteria analysing or assessing the people you are investing in and meeting them and asking them various questions.

Any sectors you wouldn't invest in?

No obvious ones but there are sectors which at certain times look lousy. Over the long term the airline industry has been pretty lousy because the capital cycle doesn't work well. There's too much capital; governments put in capital through the back door and bankrupt airlines are allowed to fly around etc. That means the capital cycle is not working properly. The auto industry is a good example of a lousy capital cycle as at the commodity end of the industry, the companies don't go bust, and they don't close plants as politicians don't want them to close plants, so profitability is not the key driver. So there are industries where the capital cycle is telling you it's not a terribly attractive industry to invest in but there will be points in the auto industry cycle, for example, where you think, that's not so bad and a little bit of improvement goes a long way. Look at Fiat right now. Things got so bad they had to get sorted out and the changes at Fiat overrode what is a fairly negative capital cycle for the whole industry because we know that Ford and General Motors are virtually bust.

Average length of a holding?

Typically we hold stocks for several years. We buy and hold for the long term. We are not traders. We are great believers in long term performance and not trying to trade out of something because it looks 10% too expensive. We want a long term position in a company and to have a long term relationship with management.

Which investment managers do you admire?

Within the European arena, Anthony Bolton of Fidelity is a very superior investor. A totally different investor who I also think is very capable is Crispin Odey (of Odey Asset Management). John Armitage, who founded Egerton Capital, is also a very good investor as is Luca Bechis of Richmond Partners. There are many others.

Any sectors of European market you currently favour?

Probably the very boring big stocks as they haven't done anything, they haven't got any speculation from private equity and they are often in sectors that haven't done very well like telcos, pharma and some financials which I'm still underweight. Big boring consumer product companies. Things that are defensive. Even big companies like the big oils, who even with the oil price, have not done very well.

Marathon's current sector weightings relative to MSCI Europe	
Consumer discretionary	Double weight
Industrials	Double weight
IT	20% overweight
Materials	20% overweight
Healthcare	Slightly overweight
Consumer staples	Neutral
Financials	Underweight
Pharmaceuticals	Underweight
Energy	20-30% underweight
Telecoms	30% underweight
Utilities	Very underweight

What about French companies more particularly?

I don't tend to look at things geographically anymore but there are some good French companies and some bad ones. There are the typical old style French companies that are protected, can't be taken over and don't run themselves purely for shareholder value. Then there's the more dynamic company that is probably owned by a family and is run much more for shareholders. Looking through my portfolio, although it's been through a difficult period, I think Carrefour is run for shareholders. AXA, although it is big and boring, is run for shareholders. Thales is run for shareholders although there's obviously a big political angle. We also own Sanofi and Danone. Danone has done very well and I think it's a good business. Because it's smaller than the giants like Nestle and Unilever it manages to be a bit more dynamic and focuses on the growth categories like water, yoghurt and health drinks and so forth. So I wouldn't categorise it as an old-style French company even though it has that structure. A topical one right now is Credit Agricole which is raising money for no good reason as far as I can tell. Companies that are very obviously immune to takeover, they have these massive boards and believe in growth for growth's sake. When you meet management you get the impression that they are interested in planting the flag and becoming the largest in the industry – those types of companies. Unfortunately, Lafarge has the image of an old-style French company that grows for growth's sake although last time I saw management they were very keen to emphasise that they've changed.

How many companies do you meet a year?

I'm in a team of three and we meet over 400 companies a year. Not all are one-on-one meetings, sometimes we attend group presentations but a lot are one-on-ones given the funds we have under management. Access is not quite as good as it might be given that brokers don't like the fact that we don't trade. This is where independents like Phoenix come in; you and the companies, I assume, would like long term investors whereas brokers want people who trade. So I'd always like better access.

Would you approach a company directly to get access?

Once we've met a company we email them and thank them for the meeting and make sure we have that contact and that they know we are large, long term investors and we would maybe like to meet them again. After a meeting we make sure we develop that contact so we don't have to depend on brokers and commission driven type of meetings. We will get in touch with companies directly but it's not always easy as companies don't always know who they should be meeting which is where independents come in.

Which European companies are the best at IR?

Most companies in which we are invested come and see us regularly and are quite responsive as we've built a relationship and are long term holders. Also, our $200 million positions help! BNP is very good at IR. We've been a long term investor in BNP Paribas and we are close to senior management and they are very good. Within the same sector, another shareholding, Barclays are not so good ironically.

Who do you like to meet from a company?

We'd always like to see the CEO but the CFO is often a very good alternative. It depends on the company. If it's BP you're not going to get the CEO and the IR are very informed and capable but at smaller companies the IR can't always handle what you want. It depends on the size and sophistication of the company.

Any tips for French companies wanting to increase their UK shareholder base?

They should use independent people who can deliver them to long term investors who will hold their shares and be interested in their long term strategy rather than their quarterly results. Brokers don't drive them towards long term investors, they drive them to those who pay brokers most and that's not going to be very good for the company in the long run. Companies should want people who will be in their shares for the long term so one of my biggest tips for IROs is to identify who are the long term investors and who you would want on your shareholder register and try and develop a rapport even if they don't want to be an investor immediately. If you develop a rapport, they may become an investor. I know it's a lot of work but that's what IR is all about. Try and avoid people who are short term investors or who are just as likely to short your shares as go long and who will probably waste your time and not focus on the things that you want an investor to focus on. In particular I think the obsession with short term earnings is very unhealthy.

Phoenix Investor Relations
Tel: +32 2 626 10 50
www.phoenix-ir.com