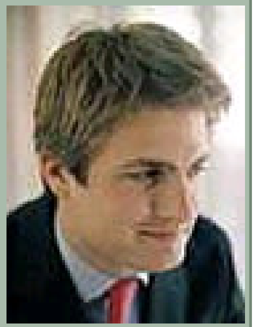
Our guest:
Aberdeen Asset Management



Despite the multiplication of hedge funds, there still are many true long term investors in the market. Aberdeen Asset Management is one of the largest. Once a stock has been selected for the European funds and as long as it keeps its quality characteristics, it could very well remain in our portfolio for 15 years, says Bertie Thomson, European portfolio manager.

Bertie Thomson has been a Pan-European fund manager at Aberdeen for 6 years, following his graduation from Edinburgh University. He is a CFA charterholder.

How would you describe Aberdeen Asset management?

Aberdeen Asset management is a UK-based specialist asset management company, founded in 1983. Aberdeen has been listed since 1991 on the London Stock Exchange. It is a global organization managing (as of the end of October 2008) some €141 billion in assets, of which 45.2% in equities (€63.7 billion). The firm has three main hubs located in London, Philadelphia and Singapore. The UK-based equity teams invest in Europe (€7 billion in assets), Emerging markets (€5.9 billion) and globally (€6.3 billion).

How is the European equity team organized?

The European equity team comprises 18 investment professionals; all are fund managers and analysts at the same time, together managing all of the clients' assets and writing research. The team works from two locations, London and Edinburgh, with the European mandates managed from London and the European portion of the global mandates out of Scotland. All of our fund managers are generalists although we have some sector specialization between each member, so in a meeting you will see a variety of different faces.

How would you describe your investment process?

We are long term investors; we hold positions for a time horizon of 3 to 5 years. Over 80% of the money is managed on behalf of institutions, i.e. pension funds, local authorities, mostly British. Once we have chosen to hold a company in the portfolio we usually stick to it, which does not mean we will not reduce or increase the size of the position over time according to opportunities in valuation. There are some stocks that we haven't taken profit in for a very long time. Ideally we would like to hold a stock for 15 years! If we can buy a company when it is at the bottom left of our screen and see it grow steadily over time, 20% per year; that is ideal. We are not into hot ideas, things that are supposed to double over the next six months; we want steady growth.

We are very much research-driven. We use sell-side research only as background reading because most, if not all, of it is biased. We have a very disciplined process that we follow and it is very important that we practice that religiously but we are open-minded and pragmatic.

We are bottom-up (i.e. stock pickers) although we also use a measure of top-down analysis. We screen our stocks based first on quality and then valuation filters. We want to invest in understandable businesses run by people that we can trust, in attractive industries, and for the long term. Attractive industries are ones that are conducive to a buy and hold strategy, with long-term growth potential and attractive dynamics. We view good growth and value as the two sides of the same coin. Finally, we do not want to overpay for companies.

We are low-risk investors and have very tight risk controls across the organization; for the portfolio itself, we look at quantitative risk analysis, but we see our risk mainly as buying a bad company which we hope to avoid thanks to the very large amount of research and background work that we do. An uninvestable company is one where we do not like the industry, we don't like the way it is managed, we can't understand how they make money, and we do not trust management.

How are your portfolios structured?

We have a benchmark for the Pan European funds, the FTSE Europe, which we use to measure our performance; we are benchmark aware but we are not benchmark-driven. We are absolute return investors; we do not look at the index to decide our weightings in stocks or even sectors.

Our unconstrained Pan-European fund, the main one, will have 40-45 holdings. For clients who want lower risk, we have a fund with over 60 holdings. We have no restrictions in terms of market capitalization; for small companies it is more about liquidity. We normally start a position at 1.25% of the portfolio and it can go up to 5% but typical positions range from 1.5% to 2.50%. We can end up owning large chunks of companies, because we are not constrained by the benchmark. In practice we have sector and country over- and underweight positions relative to the index, but they are a consequence of our choice of companies.

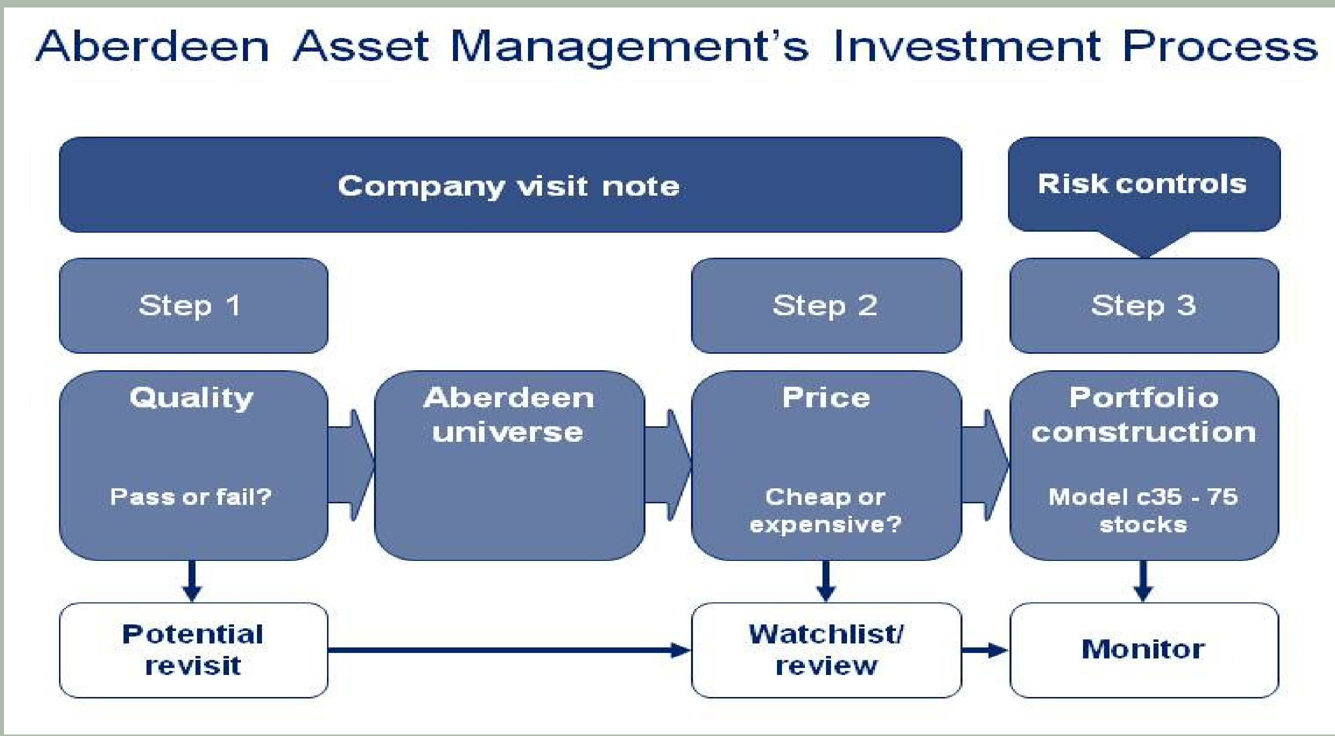
What are the metrics you use?

We have quite a holistic approach to valuation; we use the traditional multiples: P/E, P/book value, P/cash flow, and EV/EBITDA as a starting point. We also use some rudimentary DCF analysis as well as sum of the parts analysis; we have also started using CF return on investment from Holt. We see all these as tools in the toolbox but are not particularly wedded to any of them. We try to add as much color to each investment as we can; we do not say things like: “We will hold only companies with a P/E ratio less than 10”. If there was one specific way to make money and you had to be dogmatic about it, all the fund managers would be out of business. It is quite simple stuff, but investment should not be difficult.

How well is France represented in your funds?

We are underweight France currently but it is only a function of what companies we like. As I said before, we have no specific macro-issues for countries; our process is really focused on companies. We have more money in the UK than elsewhere but we tend to see the whole of Europe as one.

There are very good companies and very good managers in France and we have overweight positions in a few of them. As elsewhere, there are also a few bad French companies, that are run for their managers instead of their shareholders, or that are not in attractive industries, with low growth prospects or that we can’t understand.



How important is it for you to meet companies?

A typical equity manager spends much of his/her time visiting companies. We constantly monitor them and we have committee meetings at regular intervals checking price movements, news and results. Corporate access is very important for us; we need to visit each company in our universe at least twice a year so we can write detailed research that gets circulated within the team and discussed at weekly meetings.

The stocks that are selected then go into our model portfolio that contains between 35 and 75 stocks. That is a very rigorous bottom-up process, with due diligence and lots of company meetings. I probably have about 100 company meetings a year, and that is over a thousand for the team. We prefer one-on-ones but we will also do group meetings. We frequently travel to each of the countries within the region.

France is not a bad place to do business; it has its issues but it is not a worse place to do business than Germany or Spain for instance. There are labor issues but the best run French companies have been able to overcome these obstacles.

What are the French companies held in your portfolio and why?

The first company that comes to mind is Gaz de France-Suez.

It has strong domestic and international positions in the energy markets, a strong balance sheet, and there are still lots of benefits to come through from the merger. It is just a great asset.

There are a few other names we like: Saint-Gobain, Total, Air Liquide,… Saint-Gobain has been oversold, we think it is well managed, it has interesting market positions; we think it’s been misunderstood.

Total is very understandable, very well managed, has good assets. Air Liquide may not be the sexiest stock in the world but it is a long term generator of value.

How important are good investor relations for you?

Rating a company's IR is not really part of our process but we cannot invest in a company unless we see them twice a year so it is very difficult for us to invest in a company that won't see us. Some companies have traditionally been very bad at meeting investors and it is a real problem.

Roadshows are very important but also the ability to interact with companies. I am not very worried about how nice the website is as long as the information is clear and timely, and we can see the company and have a dialogue with them regularly.

In IR and corporate access, over time I observe that good companies only get better while bad companies stay where they are. There are still a few companies out there in that group where management thinks they own the company. In some cases, they do, but in many other cases, they don't.

The companies that are open-minded enough to see that shareholders are the owners of the company and that we are the representatives of the shareholders, are the ones we want to invest in. It is this shareholder friendly attitude that comes through the Investor relations function that we like.

IR and Corporate governance are closely related and both are important for us. We vote at AGMs, and have a specialized team for that. Conversely, good IR and corporate governance does not necessarily mean we are interested to invest in a company if the fundamentals are not there. You have very badly managed companies in uninteresting sectors with excellent IR and corporate governance.

Is it an absolute requirement to meet management rather than IR?

We need to see management; we have nothing against IR people but we want to speak to the guy who is actually managing the company rather than the guy who knows what to say. That being said, the French companies that we own have very good investor relations teams. Generally, when we make contact with the companies, it takes some time to break the ice and to develop a rapport with the IR team, but as the relationship progresses, they become proactive in contacting and informing us.

I see differences between French and UK IR practices. The UK companies are trying to be too much like the US in many respects in the way they treat investors and it shines through in corporate governance and Investor Relations. The French companies are more relationship-based so it may take a bit longer to "crack a relationship" but once it is done I see no issues.

How do you manage corporate access?

We pay for access through brokers, but indirectly, because we give them trades. We have an internal scoring system that allocates points to investment banks for meetings; a meeting with a CFO will get them more points than a meeting with the IR team. Every quarter we will then allocate percentages of our commissions to each investment bank based on that. But using investment banks is not optimal, and independent access providers like Phoenix have a positive role to play in reestablishing relationships between companies and their long-term shareholders.

Too many of these investment banks try to mess with corporate access; they will try to give preferential treatment to some of their bigger clients, over the existing shareholders. We have seen instances where they gave one-on-one meetings to a hedge fund that pays them a lot of money and tell companies that we Aberdeen do not want to see them, as we later found out. There are lots of different conflicts of interest between the parties involved, so that using external parties such as Phoenix or going direct is normally the most laudable.

Which companies would you like to see more in London? Do you have any suggestions for companies?

We have good corporate access with most of our companies. The main thing they could do would be to organize more "capital markets days" or "investor days" at their offices. For instance, Saint-Gobain could do them more often (the previous ones were excellent), and the auto companies do not seem to ever do any of those. That would be a very good idea. These days are quite useful to deepen and develop your understanding of a company as well as your relationship with them.

What are the most visible changes in the market since you started your career?

The rise of hedge funds is the most striking and interesting aspect. There are a lot of short term investors out there. There seems to be a lot more noise than there was and I guess it helps the sell-side because they get more trading and more commissions.

The credit crunch and the lack of cheap funding and prime brokerage services looks like redressing that and I think only the big hedge funds will remain and the small or underperforming ones will continue to die away. On the other hand this volatility creates opportunities to buy some good companies when for instance one of them comes out with an "okay" set of results but hedge funds and the sell-side seem to spin it in in such a way that they are seen negatively and the company gets oversold.

That can provide an opportunity to buy cheaply. And in the same way if there is a stock that gets promoted a lot by the same short-term investors and becomes expensive that creates a selling opportunity.

This does not detract us from our long-term strategy and our clients accept that. Some investment managers change their investment styles very often and quickly, for instance some people might have liquidating stocks a few months ago and then built up cash positions but then there was a rally and by doing so they might have been left behind.

But at the same time it means we have to be mindful of this sort of noise, do even more research, speak to companies even more, because these sharp moves in the stock prices prompt our clients to worry and call us. Investor relations are quite useful in cases like that.

What is your current view of the markets?

I think investors need to separate the stock market from the economy. It is clear to us that the economic picture is going to be very gloomy for most of 2009. Economically and on some of the corporate levels there is still a lot of bad news to come out. Asset quality and impairments at some of the banks is probably going to be a feature of the year, with a few more bankruptcies and some of the late cyclical sectors starting to suffer, with maybe some order book cancellations, in the capital goods sector for instance.

But we are starting to see some areas of opportunity in the European market context. The market sell-off that we have seen has been largely indiscriminate, except maybe for the usual defensive sectors like pharmaceuticals, telecoms, some of the food producers and some of the supermarkets. These kinds of companies have held up well so we might see some profit taking there.

In the other sectors there are some very good companies that fit our criteria but that we do not hold that are becoming more interesting from a valuation perspective. In both our existing holdings and new companies we are looking at potentially adding to over 2009.

I am thinking especially of some cyclical companies that have been beaten up pretty badly but still have good growth characteristics. Two French examples are Schneider, once we have seen their new strategy presented, and L'Oréal, which is a top play in its sector with a very good exposure to emerging markets.
And some of the others I mentioned and that we already own like GDF-Suez and Saint-Gobain, that are very good value if you have a longer-term investment horizon.

We still think that equities as an asset class offer good possibilities longer-term and our clients share that view.

But "we can afford to be greedy" and wait for the right time because there is still a lot of bad news to come out.

Some sectors are going to be changed for ever, not least the banking sector and the auto sector. Almost everything that we have known so far about the history of the way these companies perform, the strategies they pursue and the way they hold up or don't in a down cycle is all being thrown out the window in the current period. 2009 will be an interesting time, full of opportunities, and full of a lot of change; these businesses will have to change and push through some of the restructuring programmes that they had always wanted to do but maybe not been able to do.

Testimony to the long-term nature of our investment strategy, we have not made big changes to our portfolio in the last six months but some of the weaker names have been recycled, particularly in the auto sector. The dust has yet to settle in this sector, and things are changing very quickly. For instance, will any of the auto makers be able to take out capacity? Volume is drying up but their capacity is still there.

As for banks, we still like banks but they have to be the good quality banks with good funding and that are conservatively run, with a conservative view of risk, not too much investment banking, decent, "boring" loan growth models, nice loan to deposit ratios, decent capital and exposed to attractive geographies. They are good beta plays on the economy.