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Searching for Brand Value

Since brand equity takes time and capital to develop, it is no surprise that developed market brands dominate the global landscape.

The rise of the Latin American middle class has given birth to a new breed of consumer, buying high-end cosmetics, premium beers and branded snacks. Manhattan's streets and Miami's malls attest to the strength of demand among the higher-end Latin American shoppers, who take advantage of price and proximity to stock up on Apple electronics, Abercrombie & Fitch polo shirts and Michael Kors watches at discounts reaching in excess of 50% relative to local prices in their home country.

Despite this thirst for increasingly higher-end goods, Latin America has historically struggled to build regional and international brands. In the "Top 100 Most Valuable Global Brands 2014" survey by Millward Brown, not one Latin American name makes the list. It is a list dominated by developed market household names, from Google to Prada, Coca Cola and Tesco. Since brand equity takes time and capital to develop, it is no surprise that developed market brands dominate the global landscape. However, there is a healthy smattering of emerging market brands in the top 100, from tech giants Tencent and Samsung, through banks including China's ICBC and Russia's Sberbank, to telecom operators South Africa's MTN and Russia's MTS. Latin America, meanwhile, is conspicuous by its absence.

We believe that over time Latin American brands will likely emerge, and our research constantly seeks to identify companies where brand equity is growing and undervalued. While it can be a challenge to fill Latin American portfolios with names directly comparable in size to developed market leaders such as Disney, BMW and Siemens, we have alternatives. For Wal-mart and Starbucks in the US, read Walmex and Alsea (regional operator of the Starbucks, Burger King and Domino's Pizza brands) in Latin

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The top brands from Latin America in WPP's annual regional BrandZ survey published in 2014 have been dominated by the beer category.

America. For Visa and SAP in the US and Europe, read Brazilian merchant acquirer Cielo and Chilean IT solutions provider Sonda.

The top brands from Latin America in global advertising firm WPP's annual regional BrandZ survey "The Top 6 Brands from Latin America" published in 2014 have been dominated by beer names — Corona, Skol, Aguila and Brahma — with Chilean retailer Falabella and Brazilian personal care product manufacturer Natura completing the top 6. Technology, telecoms, fast food and banks are notably absent, though it may only be a matter of time before the regional bellwethers in these sectors catch up with some of their international peers — we try to position our portfolios to capture these trends. In the financial sector, one of the most compelling long term investments within Latin America, banks like Itaú, Credicorp and Banorte have started to leverage their significant distribution networks and brand equity to cross-sell insurance, mortgage and pension products to a wider client base. The multi-billion dollar brand value boasted by banking giants such as Wells Fargo and HSBC is a convincing template.

The Top Six Brands from Latin America

RANK	BRAND	CATEGORY	BRAND VALUE 2014 $M	BRAND VALUE 2013 $M	BRAND VALUE % CHANGE 2014 VS 2013
1	Corona	Beer	8,025	6,620	21%
2	Skol	Beer	7,055	6,520	8%
3	Falabella	Retail	5,187	5,611	-8%
4	Aguila	Beer	3,676	3,903	-6%
5	Brahma	Beer	3,585	3,803	-6%
6	Natura	Personal Care	2,236	3,707	-40%

Source: Brandz/Millward Brown
Most Valuable Global & Latin American Brands 2014

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BRANDZ™ Top 100 Most Valuable Global Brands 2014

	Brand	Category	Brand value 2014 $M	Brand contribution	Brand value % change 2014 vs 2013	Rank change
1	Google	Technology	158,843	3	40%	1
2		Technology	147,880	4	-20%	-1
3	IBM	Technology	107,541	4	-4%	0
4	Microsoft	Technology	90,185	4	29%	3
5		Fast Food	85,706	4	-5%	-1
6	Coca-Cola	Soft Drinks	80,683	4	3%	-1
7	VISA	Credit Card	79,197	4	41%	2
8	at&t	Telecoms	77,883	3	3%	-2
9	Marlboro	Tobacco	67,341	3	-3%	-1
10	amazon.com	Retail	64,255	3	41%	4
11	verizon	Telecoms	63,460	3	20%	1
12		Conglomerate	56,685	2	2%	-1
13	WELLS FARGO	Regional Banks	54,262	3	14%	0
14	Tencent 腾讯	Technology	53,615	4	97%	7
15	中国移动 China Mobile	Telecoms	49,899	3	-10%	-5
16	UPS	Logistics	47,738	4	12%	-1
17	ICBC 中国工商银行	Regional Banks	42,101	2	2%	-1
18	MasterCard	Credit Card	39,497	3	42%	2
19	SAP	Technology	36,390	2	6%	0
20	vodafone	Telecoms	36,277	3	-9%	-3
21	facebook	Technology	35,740	4	68%	10
22	Walmart Save money. Live better.	Retail	35,325	2	-2%	-4
23	Disney	Entertainment	34,538	4	44%	3
24	AMERICAN EXPRESS	Credit Card	34,430	4	46%	4
25	Baidu 百度	Technology	29,768	4	46%	8

Source: Valuations include data from BrandZ™, Kantar Retail and Bloomberg.

Brand contribution measures the influence of brand alone on earnings, on a scale of 1 to 5, (5 highest).

Think Big, Start Small

Okslen store in SoHo, New York

Havaianas vending machine in Sydney, Australia

The origins of today's household global brands are often a combination of the remarkable and the mundane, from Nike's birth as Blue Ribbon Sports selling Japanese shoes to US track and field athletes from a car trunk in 1960's Oregon, to Zara's rise from Galician dress maker to the world's most successful apparel retailer (Inditex), over a similar 40-50 year period.

Many of the most exciting brands in Latin America are treading similar paths as they push for scale. Sunglasses and accessories maker Chilli Beans has now grown to a network of 550 stores across South America, the US, Portugal and the Middle East, and surf & beach wear brands including Mormaii and Osklen are reaching foreign markets, including the US and Japan, having started life as single-stand outfits on the beaches of Southern Brazil.

Concha y Toro: Manchester United sponsor

As yet, many of these brands are still closely held or in their early stages, developing product, brand loyalty and distribution networks. Within our investable universe, selected brands have achieved some level of global recognition, such as Havaianas sandals (owned by parent company Alpargatas), which has evolved from being a simple product aimed at the Brazilian lower class, to its current status as a fashion item sold in kiosks, department stores and even vending machines across the developed and emerging world to publically listed Chilean wine producer Concha y Toro, one of Manchester United's core sponsors via its Casillero del Diablo brand, a household name in any UK supermarket.

Other brands are reaching critical mass in the US and Europe, such as Gruma (Mexico), widely viewed as the world's leading producer of tortillas and a direct play on Hispanic population growth north of the border, with Hispanics expected to account for $2 trillion or 14% of total US consumer spending by 2027 (Source: Entravision

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The bulk of Latin America's brand equity remains local. Companies such as Lojas Renner (women's wear), Liverpool (department stores) and Odontoprev (dental insurance) offer attractive, branded products in various markets.

& US Census Bureau, 2014). Moving in the opposite direction are developed market brands such as Coca Cola and Santander, both of which occupy relevant positions within the regional Latin American investment universe, via their local subsidiaries Coca Cola Femsa (part of Coke's global bottling system), and Santander's Chilean, Mexican and Brazilian arms, all listed on their respective local equity markets. Possibly the highest quality consumer staples company in the region has been brewer Ambev, the Latin American subsidiary of European giant ABI, with its Latin American brand portfolio spanning US household names such as Budweiser alongside core local brands including Skol and Quilmes.

Bozzano Shaving products in Rio de Janeiro drugstores

The bulk of Latin America's brand equity remains local. Companies such as Lojas Renner (women's wear), Liverpool (department stores) and Odontoprev (dental insurance) offer attractive, branded products in various markets. In the $6 trillion Latin American economy of 600 million people with high urbanization rates of over 70%, the local potential is sufficient for many of these brands to offer outsize growth opportunities into the next decade.

For the local equivalents of Procter & Gamble, Unilever and General Mills, Latin American investors have companies such as Hypermarcas and Nutresa. Step in to any of Brazil's 67,000 pharmacies and you will be greeted by an impressive display of Hypermarcas brands, from established local OTC pharmaceutical names including Engov and Benegrip, and branded generics under the Neoquimica umbrella, to a wide range of household consumer brands including Bozzano (shaving products) and Zerocal (sweetners). Similarly, a trip to any Colombian supermarket or Mom & Pop store will find customers filling their baskets with a multitude of Nutresa brands including Jet (chocolates), Sello Rojo (coffee), Zenú (cold cuts) and Doria (pasta). Our familiarity with these markets helps us identify where the true brand equity lies.

Brand Equity Lies Beyond the Obvious

Branded gas stations are often in better locations thereby attracting customers. Yet the economics still work despite higher real estate costs.

Our preference for companies with high levels of existing and potential brand equity has led us to some unexpected places within Latin America.

The first is Brazil's 39,000 gas stations, of which 42% are unbranded and independently owned (known locally as 'white flag stations') (Source: JP Morgan, 2014). Yet these 42% account for only 21% of total fuel sold by volume, indicative of the potential for improved efficiency as the industry consolidates. The importance of brand here is not immediately obvious; however analysis has shown that the return on investment of a mid-sized branded gas station reaches on average 17%, significantly above a non-branded equivalent of 13%. Adding services, including branded drugstores and food outlets, can add up to 20% in revenues for any given gas station.

White flag gas stations purchase their fuel for redistribution to the customer from wherever they choose, meaning the lowest price. In contrast, branded operators are forced by the regulator to buy only from the distributor with which they have an established partnership, resulting in a higher resale price. So why does the consumer pay a premium for refuelling at a branded gas station? The answer is twofold. Firstly, the brand gives the customer confidence in the quality of the fuel he is buying. Secondly, location and convenience; branded gas stations are often in better locations thereby attracting more customers. The economics still work despite higher real estate costs since the fuel distributor will partly finance construction, reducing up-front capital requirements for the operator, while in return, the gas station will reimburse the distributor with a royalty of up to 5-8% of revenues.

Investors in Latin America have been able to capture this upside via both Ultrapar and Cosan, owners of gas station brands Ipiranga and Raizen (Shell) respectively. Cosan, via Raizen and its assets acquired from Esso and in its partnership with Shell, is targeting market share gains up to 24% within 3 years (Source: JP Morgan, 2014), from

the current 18%, by acquisition and then conversion of white flag stations, with significant margin upside. Cosan estimates that it takes around 6 months for this margin gain to be realized as higher value products such as Shell V Power gain share of wallet and convenience stores are upgraded.

Sadia & Perdigao ready meals and cold cuts in Rio de Janeiro supermarkets

Processed protein is the second theme we highlight in this hunt for less conventional brand equity investment opportunities. Not as sexy a story as the likes of LVMH and Facebook, we admit, but every bit as interesting and full of potential. As the country's largest food producer as of 2014, Brasil Foods, or BRF, has been capitalizing on its strong brand recognition in its home markets with brands such as Sadia, Perdigão and Chester, in cold cuts, hamburgers, pizzas and pasta, boasting market shares of between 53-63%. Both domestically and abroad, BRF is shifting towards a model of branded processed foods with less reliance upon sales of pure commodity protein. Its next leg of growth is in markets such as the Middle East, North Africa and Saudi Arabia as it looks to expand its portfolio of locally based processed food brands, often in partnership with existing regional players. By 2015 we anticipate BRF to deliver 35% of non-domestic revenues from branded processed foods, up from 25% at present. The upside for investors may be quantifiable as the company moves from low return commoditized businesses towards higher margin processed branded products. In developed market terms, BRF is becoming more of a global brand like Nestle or Danone and less of a domestic name such as Tyson or Pilgrim's Pride, delivering higher return on invested capital (ROIC) and meriting higher valuation multiples as a result.

Distribution – Finding that Consumer

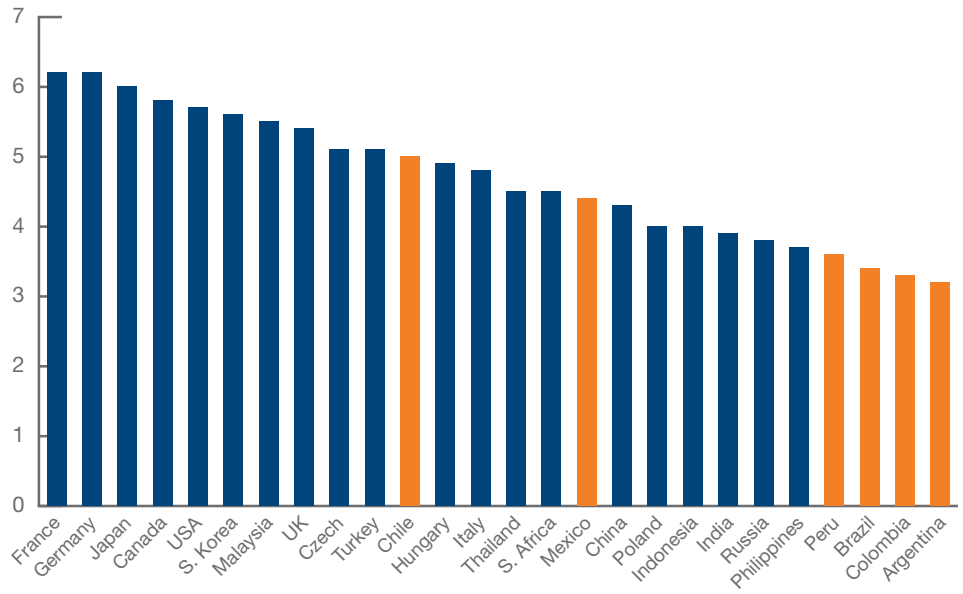
The Mexican commercial real estate sector is a compelling opportunity where we continue to see upside.

So the brands exist. What about getting them to the customer? In a region where the cost of capital is high, working capital management is critical and 'just-in-time' delivery is highly prized, we see distribution networks as extremely valuable assets. Route to market is critical, and made difficult by Latin America's substandard physical infrastructure. Those companies best positioned to overcome the difficulty of finding the customer have a material competitive advantage, and we show a preference across Latin America for those businesses with a captive market that they can protect and grow.

This starts with the physical real estate assets — shopping malls, warehouses and logistics networks. The Mexican commercial real estate sector is a compelling opportunity that we find attractive and continue to see upside.

Quality of Infrastructure (Selected Countries)

(1=extremely underdeveloped, 7=extensive & efficient)



Source: 2013-14 World Economic Forum & HSBC

Akin to US REITs (Real Estate Investment Trusts), the Mexican Fibras are tax-efficient investment vehicles that raise capital to invest in commercial real estate, and which then distribute a high proportion of their rental income as dividends. Relatively new companies like Fibra Uno seek to capture a relevant part of the distribution value chain by controlling both industrial and logistics warehouses and retail properties, which are leased to national and international tenants. Thanks to superior access to capital, professional know-how and first-mover advantage, REITs like Fibra Uno and developers like Vesta offer high double-digit annual growth rates, supported by industry consolidation and higher bargaining power as prime retail and logistics assets gain value. The higher up in terms of income bracket, the higher retail landlords can charge tenants for the privilege of desirable locations.

JK Iguatemi, São Paulo — prime mall space capturing value at the high end of the Latin American consumer boom

In Brazil, mall operators like Iguatemi and Multiplan have built up portfolios of prime retail properties in the country's major cities – São Paulo, Rio de Janeiro and Belo Horizonte – providing global and local brands with desirable locations to reach the target customer. In Iguatemi's new JK mall in São Paulo, the likes of Dolce & Gabbana, IWC and Christian Louboutin occupy stores next to local brands Arezzo, H.Stern and Noir, with these local names beginning to compete in the mid-range segments. Household international brands are now seeking to grow fast in the country, regardless of the seasonal difference with the Northern Hemisphere, and for top tier brands, only prime retail locations will do, transferring a significant portion of value and bargaining power to the owner-operators of the real estate.

Distribution power, along with brand equity, is another reason we find the Latin American financials sector attractive. 'Bancarisation', or increasing penetration of financial products, is a secular growth theme that we anticipate to continue into the second half of the decade, as higher income levels

In Mexico and Peru, the opportunity for banks to increase lending amongst retail clients is significant.

translate into higher demand for savings, investment and insurance products. Having an existing captive customer base should translate into low hanging fruit for the banks as they cross-sell to long-standing depositors, and BB Seguridade encapsulates this trend. The Brazilian insurer and insurance broker controlled by Banco do Brasil currently reports a penetration rate (percentage of its existing depositor base that also hold an insurance, pension plan or premium bond product) of less than 14%, relative to greater than 30% for competitor Bradesco (Source: BB Seguridade, 2013). Though this statistic is slightly impacted by a lower-end depositor base, the growth potential is highly compelling.

In Mexico and Peru, the opportunity for banks to increase lending amongst retail clients is significant, and we see long-term investment potential in companies such as Credicorp and Banorte for this reason. To reach the same level as Brazil in terms of consumer credit to addressable disposable income (addressable disposable income excludes adults earning below a minimum threshold, and are therefore not considered bankable), Mexico would have to grow consumer credit by 70%, and Peru by 140% from current levels, according to research by Credit Suisse. In Peru, the physical distribution network is still substandard, with only 9.4 branches per 100,000 addressable adults, versus 19.2 in Chile and 15.9 in Brazil, and with credit to addressable disposable income at only 14% in Peru (versus 33% in Brazil and 26% in Colombia), we see room for a structural increase in both deposits and loans across the Peruvian economy. Distribution, via the branch network, is a crucial, yet undervalued and underestimated, asset within this emerging economy, and though we are entering an era of global mobile banking and remote access, the physical network in Peru and Mexico is far from complete.

For food producers and fuel distributors, reaching the customer is equally important. BRF boasts a fleet of more than 8,700 trucks, travelling in excess of 48 million km per month as it reaches its national customer base. Thirty three distribution centers and forty three transhipment points make up the company's domestic logistics backbone, which it is now trying to replicate in foreign markets. Recently announced deals with Alyasra (Kuwait), AKF (Oman), and Federal Foods (UAE) have strengthened BRF's distribution capabilities across the Middle East as the company shifts its overseas business from a pure commodity business to a more value-add branded strategy with local production and distribution capability.

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