COMMENTARY

October 3, 2008

Dear clients and colleagues:

Economic data released this week continue to show serious sign of deterioration. Manufacturing activity and jobless claims in the U.S. achieved levels that had not been seen in 7 years. Although the $700 billion rescue plan could be approved Friday, banks' reluctance to lend money has paralyzed the interbank market, lifting the Ted spread to more than 360 basis points.

While this lack of liquidity is penalizing the whole economy, we believe the real pressure will be on highly leveraged companies who will find themselves squeezed with a higher cost of fund. Well established companies with strong balance sheets will receive more attention and should thus be less impacted.

In this environment of poor confidence and economic frenzy, we would definitely favour defensive names. Historically, consumer staples has been a sector that reacted well during unstable market phases. For the month of September, its performance within the Russell 2000 Index was flat compared to the -8.1% return for the core index. Our current exposure to the sector is close to 8.5%, twice the exposure of our benchmark.

One of the companies we own in this sector is Baron de Ley, a Spanish producer of premium quality wine. Main brands include Baron de Ley, Coto de Imaz and Casa Mayor. It owns 598 hectares of producing land in the regions of Rioja and Cigales. Baron sells in the domestic and foreign markets. The group has been successful in expanding its business outside Spain. While turnover grew by 7% per annum in the past 3 years, exports generated a 13% growth rate. Today, exports represent 40% of sales.
Baron's balance sheet is extremely solid; it has been debt free since 2006, and shareholders' equity represents more than 80% of its total assets. Moreover, Baron is a real cash flow creator: €30 million in free cash flow last year. For this year, we forecast that cash flow will continue to growth.

We like the fact that the management uses a portion of the free cash flow to remunerate shareholders. Baron adopted a buyback policy up to 5% of its outstanding capital per year. We believe Baron offers an interesting potential for long-term appreciation and a certain level of protection against capital erosion. For the month of September, the stock posted a positive return of 1.6%.

Baron de Ley: www.barondeley.com (BDL on the Madrid Exchange).

Market cap: €295 million, P/E (TTM): 13x, P/E (2010): 11.5x, EV/Sales (TTM): 2.9x, EV/EBITDA (TTM): 7.1x, Debt/EBITDA: 0.2x, Expected sales growth: 4%, Insider ownership: 30%, Free cash flow yield: 8%.

Our target price, using a 7.5% discount rate, is €60 for an expected return of 35%.

Regards,

David Savignac
Assistant portfolio manager