COMMENTARY

February 4th, 2011

Dear clients and colleagues,

We are already in the second month of the year. January saw US indices post their best return since 1984.

The news has been dominated by the rapidly unfolding events in North Africa; first Tunisia, which saw its authoritarian government fall in less than two weeks; and now Egypt. Yemen and Jordan have already announced important changes. Geopolitical risks remain an unknown and investors must assess those risks when choosing companies.

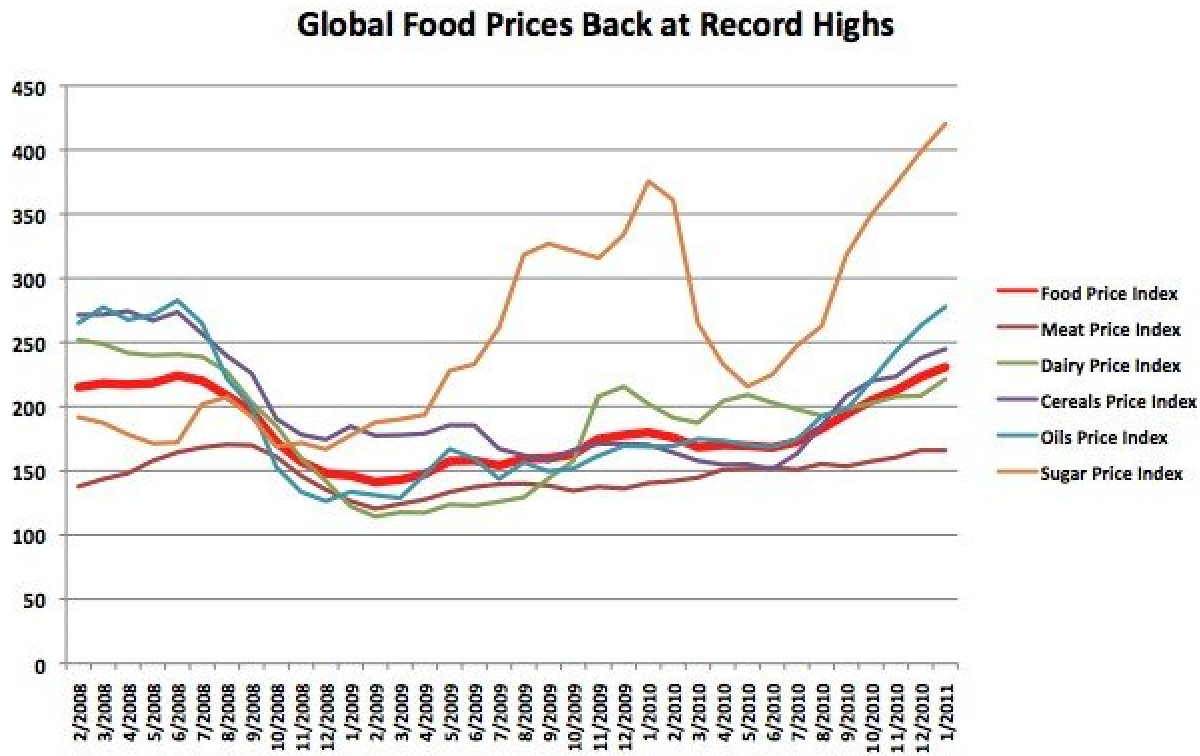
These events and strong economic data from around the world have pushed the price of oil as well as most commodities to multi-year highs.

Earnings releases for the last quarter of 2010 are in full swing and earnings growth has been very strong. However, many companies have warned that rapidly rising raw materials prices will threaten margins in 2011. Some companies have already announced substantial price increases. Electrolux, the large appliance maker, announced price increases of 8% for North America for its Electrolux and Frigidaire products. Carpetright, Europe's largest retailer of flooring and carpets, announced an increase to consumers of 15%.

Some economists in Europe are now worried that Europe and possibly the US might see a period of low economic growth coupled with inflation – in other words, stagflation. The last time we saw a similar situation was in the 70's.

The bond market is still not pricing in long-term inflation for developed markets. Market participants argue that food and energy are volatile and that the indicator they are watching is wage growth. However, today's real yield on 5-year TIPS (Treasury Inflation-Protected Securities) is negative -0.1% compared to an average of 1.5% in the last century. The bond market seems to have lost its fundamental value judgment.

One item that has received a lot of press recently is food inflation. Global food prices are back at record highs and that may have serious negative consequences for emerging market economies where food is an important part of people's budgets. These countries are trying to prevent social unrest by imposing price controls orby hoarding which creates even more price pressure. Only Fed reserve chairman Bernanke seems to think that food inflation does not matter.



Food and Agriculture Organization of the U.N.

In the portfolio we have a few companies that may be affected by the rise in food prices.

Vitasoy (345 HK), www.vitasoy.com, is a Hong Kong-based soy drinks, tofu, juices and dairy-milk products manufacturer that markets its products around the world. Vitasoy will be negatively affected by the rise in food prices as soybeans are 3%, sugar is 6% and milk powder is 9% of its costs. The impact should be compensated by volume growth.

Greggs (GRG LN), www.greggs.co.uk , is the leading bakery retailer in the UK with over 1400 shops, serving over one million customers each day. Greggs will be negatively affected by the rise of energy and commodity costs. The company will try to offset those costs by increasing selling prices as well as increasing efficiency. For example, the company is now offering breakfast, leveraging brand and store infrastructure. We will pay close attention to the situation.

Autogrill (AGL IM), www.autogrill.com, is the leading provider of food and beverage and retail services for travelers, operating mainly in airports and highways. The company is facing inflation by raising prices and increasing efficiency.

Baron de Ley (BDL SP), www.barondeley.com, is a leading Spanish producer of premium wines. Grape prices have actually come down in the last few months, a result of good harvests. A positive for the company.

Casey's (CASY US), www.caseys.com, owns 1542 convenience stores in the Midwest, selling various items from gasoline to pizza. The company will be negatively affected by rising commodity prices. However, its gross margin on prepared food is higher than 60% and the Midwest does benefit as a whole from rising commodity prices.

Finally, the company in the portfolio which will be the most positively affected by the rise of food products is Vilmorin, the company we will profile this week.

Vilmorin (RIN FP - €89.55), www.vilmorin.info

Founded in 1742, France based Vilmorin is the 4th largest seed company in the world. The company is the leader in Europe and number two worldwide for vegetable seeds (green beans, tomatoes, carrots, etc.). The company sells over 500 varieties with over 30 new product launches each year. It is one of the top three players worldwide for field seeds (straw cereals, sunflower, rape, corn, cotton, etc). In North America, it is growing its market share for corn with its AgReliant venture. Finally, the company also markets garden product seeds (flowers, vegetables, etc.) as well as tree seeds. One out of two trees in France originated from the company seeds.

Target Market Size

The seed industry is an important market with an estimated production value of US$22bn currently with strong secular growth drivers. With the ever increasing demand coming from the growing world population, the increased production of meat based proteins (which require a lot of cereals as inputs), and with the production of biofuels. The solution will be to increase the surface area cultivated, but more importantly, to increase yield. And that is where the seed players benefit.

Competitive advantages

- Vilmorin enjoys a strong market position in Europe, which it is leveraging in Eastern Europe and Russia.
- Important intellectual property portfolio.
- High R&D budget, 12% of its sales.
- Interesting product pipeline, 2nd generation GMO Corn, GMO Wheat.
- Good image; the controversy surrounding Monsanto is helping Vilmorin gain market share.

Growth strategy

- International markets are now 45% of the sales of the company.
- South America, Argentina, and Brazil as well as Asia, India and China are priorities for the company.
- Wheat is still an infant market for seeds compared to corn. The company is a leader in hybrid and GMO wheat.

Competition and Risks

Despite its size, almost €1 Billion in sales and R&D budget close to €150 million, the company is dwarfed by the top 3 players, Monsanto, Dupont and Bayer.

Development of new genetic modified seeds and the expansion into new markets is not without challenges. Finally, the extreme volatility in grain and vegetable prices affects the decision of farmers to use seeds.

Valuation

Based on a WACC of 8.5% and a terminal growth of 2.5%, our target price is € 150.

Market cap: €1541 million, P/E (NTM): 19x, EV/EBITDA (NTM): 7.5x, Net debt: €250 million, Expected sales growth: 7%, Dividend yield: 1.6%. Gross margin, 40.5%, Ebitda margin, 20.5%.

Have a good week.

The Global Alpha Team