

Thoughts from

Hanson Investment Management Inc.

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Hanson Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.

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Random Gleanings . . .

Why eliminating taxes on dividends is a good idea . . .

For me it's less a tax issue than a capital allocation one. Many companies argue that it is not productive to pay dividends when the payment is taxed both at the corporate and the individual level. They have a point. So companies hold on to the dividend payment and reinvest back in the business. This is often very good. Companies develop new products or build new plants and improve their operation. But then they often go on an empire-building spree acquiring companies using the savings from the dividend and additional borrowings. These acquisitions work out surprisingly poorly as a cover story in *Business Week* in October pointed out. The conclusion then was that 61% of large company purchases destroy shareholder value. Companies over-pay for acquisitions, they over-estimate cost savings and then they dither about integration and get too focused on cost-cutting.

It seems to me if we got back to a system where companies regularly pay out 40 to 50% of their earnings, everyone would be better off. Investors would receive a more significant part of their total return up front in cash and companies would be saved from the temptation of going off and making ill-advised acquisitions. The cynic in me says let's not

focus on the taxes I save on dividends but on the much greater loss corporations (and shareholders) would avoid.

Want to know how to find the best car in the world?

You could go to *Consumer Reports* or you could just take a look at the streets of Kabul, Afghanistan. Robert Harbison, a staff photographer for *The Christian Science Monitor*, reported in the November 18, 2002 edition that nine out of ten cars on the streets of Kabul are Toyotas. Nine out of ten! That is incredible. What is the deal? Harbison reports these are high mileage cars (typically Corolla wagons with small diesel engines) that cannot be driven legally anymore in Japan. The sturdy autos are ideal for the wretched roads of Afghanistan, pocked by landmines and Soviet tanks.

I saw an early indication of how good Toyotas really are when I was traveling through East Africa in the 1960s. The indestructible car of choice then was the Land Rover but everywhere I went they were driving Toyota Land Cruisers. The locals had obviously figured out that Toyotas, then not as famous as now, were indeed indestructible and cheap to boot. So if you want to know where to find the best car in the world, go to the end of the line and see what they are driving.

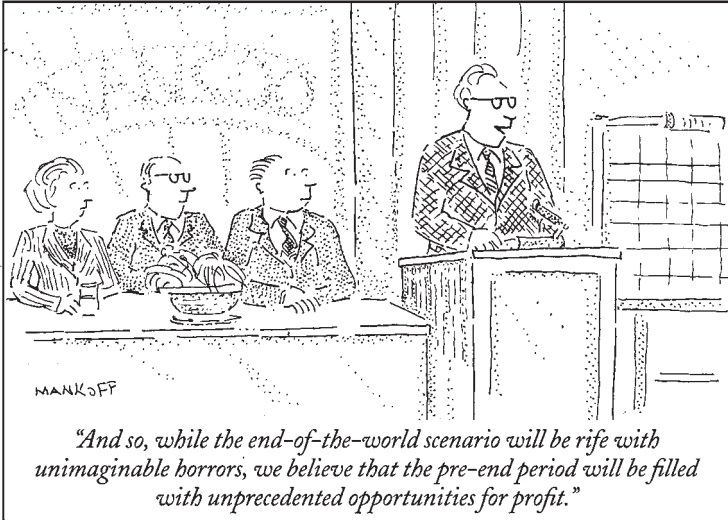
WHY MERGERS GO WRONG

Companies sabotage their deals by making the same basic mistakes again and again:

- ▶ Overpay by offering a sizable premium, which hands the bulk of future economic gains from the merger to shareholders in the target company
- ▶ Overestimate likely cost savings and synergies, setting themselves up for poor performance and shareholder disappointments in the future
- ▶ Dither over integrating operations after the merger, frustrating customers and employees and delaying capturing potential benefits
- ▶ Obsess about cost-cutting, damaging the business by giving short shrift to maintaining revenues and keeping top salespeople

Data: BusinessWeek

Wall Street and the World in the Cartoons . . .



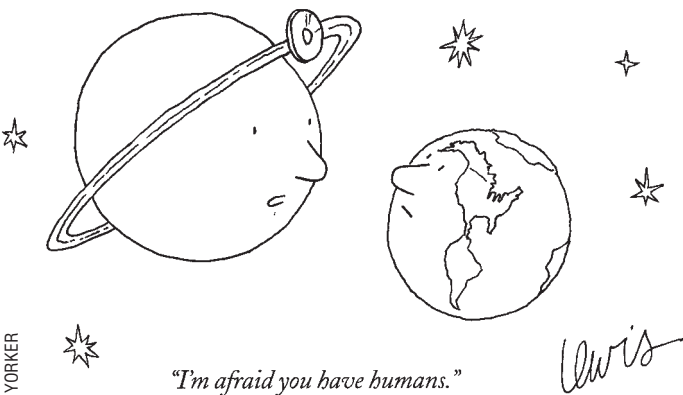
NEW YORKER



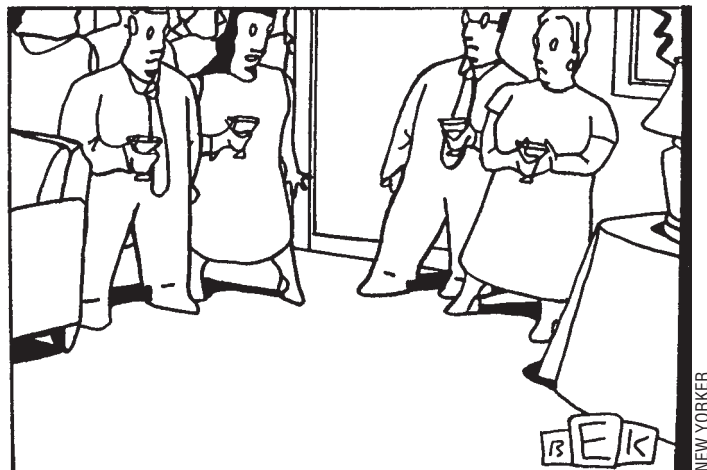
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NEW YORKER



NEW YORKER



"No matter how bad things are, we manage to keep our sense of spending."

NEW YORKER

The U.S. Economy . . . Every downtown carries the seeds of recovery . . .

IT IS EASY TO BE DISCOURAGED today. The economy is sluggish at best, the broad market has lost nearly half its value in just three years, the world economy is treading water and international conflict and terrorism are daily events.

But keep in mind that we are prone to be too optimistic and too aggressive in the upswings and too pessimistic and too cautious in the downturns. The world is very uncertain now and economies are sputtering but as David Hale of Hale Investment Advisory notes in a recent piece in *Barron's*, the U.S. economy has grown an impressive 3% the past year in spite of terrorist attacks, a market decline equal to 90% of gross domestic product, huge corporate scandals, a global recession and the strong prospect of war in the Middle East. The glass half full story now is that our economy is truly resilient.

And going forward the surprise might be that we are a lot closer to the bottom than we think. The two keys to the economy and the stock market this year are corporate profits and a pick-up in business spending. The consumer has done all the heavy lifting for the economy recently. Nothing seems to have put off spending – not job losses, not economic uncertainty and not an increase in debt. But we need a pick-up in business fixed investment to really get the economy going again.

This pick-up may be close at hand. *Take a look at the chart to the right.* It indicates that cash flows are rebounding and business investment seems to have bottomed out. And productivity has performed extremely well. Productivity is the increase in output per worker hour. High productivity allows companies to pay higher wages and produce better profits, often without having to increase prices.

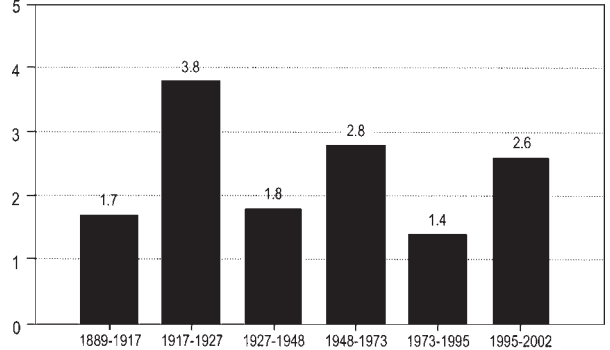
U.S. companies are exhibiting an incredible ability to squeeze more out of less today. The *Wall Street Journal* in a

story on November 19 featured a Tennessee furniture maker that is figuring out how to make and deliver custom furniture more quickly. Foreign competition primarily from Asia accounts for 10 to 15% of upholstered furniture and this percentage is growing rapidly. The key to holding the line in the U.S. is to produce and deliver more quickly. England Inc in Tennessee has cut the time between order and delivery by one-third to one-half by moving more quickly, by being more disciplined with orders and by pressing suppliers. The net effect is England's orders are up, productivity has increased and employment is strong. Cheap labor in emerging markets is a compelling story but an equally compelling story is how companies here are working smarter and more efficiently. Robert Bartley, the Editor Emeritus of the *Wall Street Journal*, recently penned a piece reflecting on his tenure

on the editorial page. "What I have learned over thirty years is that in a society, rationality wins out, progress happens and problems have solutions – in that kind of society optimism pays." The message today is that negative news affects us negatively and we are focusing now on all the downsides. But the real story is how well the economy has done in the face of tremendous challenges and how well we are accommodating change and adapting to it. Don't bet against the resilience of the U.S. economy.

LONG WAVES OF PRODUCTIVITY

Labor Productivity
Percent Change, Annual Rate



Source: Federal Reserve Board

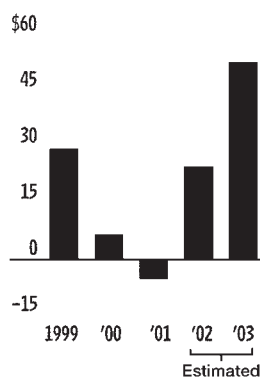
Source: Merrill Lynch

HEALING PROCESS

The economy may be turning the corner, judging by the outlook for the nation's 64 largest nonfinancial investment-grade companies.

Cash flow rebounds...

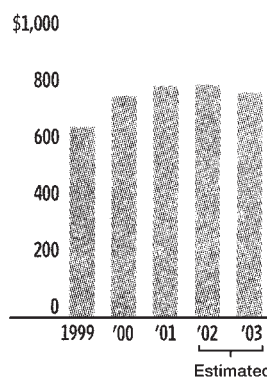
Free cash flow*, in billions



*Cash flow minus capital spending

Debt is headed down...

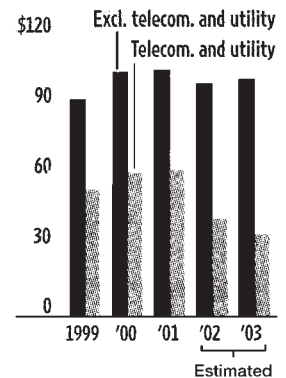
Debt, in billions



Source: Morgan Stanley estimates based on companies' stated plans

Investment bottoms out

Capital spending, in billions



Source: Wall Street Journal

Investment Trends . . .

The Changing Face of Global Brands . . .

QUICK, CLOSE YOUR EYES and try to list three of the world's top ten leading brands. *Now take a look at the chart below.* My guess is that most of us did pretty well on this little quiz. After all, leading brands enjoy broad popular appeal and by definition are well recognized.

But what other factors contribute to a strong brand? In addition to being familiar, a leading brand must deliver proven value. Leading brands are quality products consumers can rely on and trust over time. Importantly, this trust leads to repeat purchases and the ability to charge premium prices. Why can Starbucks charge \$3.50 for a Café Latte? While many of us are still scratching our heads, I think it is because consumers know they will get a consistently excellent cup of coffee. Without a doubt, brand development is critical to surviving in today's increasingly competitive global marketplace.

Research firm Interbrand and investment bank JP Morgan compiled the Top Ten list by evaluating how much each brand was likely to contribute to a company's future sales and earnings. Coca-Cola, probably the world's first truly global brand, continues to head the list. Most primarily produce consumer products, although conglomerate General Electric made the ranking.

Today, all of the Top-Ten are based in developed countries and only two have home offices outside the United States. But my guess is that this list is going to look quite different twenty years from now. While not large by comparison, many of the world's most promising brands hail from developing countries. Consider the following examples.

CORONA:

This familiar Mexican beverage, controlled by family owned Modelo, is the world's 5th largest beer brand with about \$3.2 billion in annual sales.

Attention to product quality and extremely effective marketing campaigns are the keys to the beer's success. Today, Corona is the top selling imported beer in over eight countries including the US and Canada.

CEMEX:

Cemex is the third largest, and most profitable, cement producer in the world with over \$7 billion in sales. While cement is not a product most people are intimately familiar with, a number of factors suggest that this brand is likely to gain recognition. First, Cemex is an efficient global producer operating in over 33 different countries. Importantly, the company does a good job understanding the diverse needs of its customer base from individual homebuilders to large industrial contractors.

HAIER:

Haier (pronounced high-er) is China's largest appliance manufacturer with \$7 billion in annual sales and 13

manufacturing plants worldwide. While still somewhat unknown in the United States, this will change soon. Haier recently built a \$30 million plant in Camden, South Carolina and is now selling appliances through such well-recognized channels as Lowe's, Wal-Mart and Home Depot. The company expects to double U.S. sales by 2005 to \$1 billion by rolling out new products such as freezers, flat panel television screens and DVD players. The company's low R&D and manufacturing costs suggest pricing pressure in these markets could heat up. This will be tough for competitors but a boon for consumers.

Until now, China has been particularly unsuccessful in building global brands. This is slowly changing as political acceptance of market based practices gains ground. Further, the country's entrance into World Trade Organization is bound to encourage greater brand development as Chinese companies are forced to compete with foreign competition. Other Chinese brands to keep an eye on include television manufacturer Konka and computer firm Legend. America Movil, Latin America's largest cell-phone provider also looks interesting as do Indian firms Tata Group and Infosys. Tata is a large Indian conglomerate with interests in trucking, utilities, engineering and software while Infosys is one of the world's largest contract software engineering firms.

Global brands are not built over night and the above firms will no doubt face many obstacles in their efforts to build recognition. Firms making the new Top Ten list will have to combine in-depth knowledge of local markets with global brand development strategies. But the playing field is changing and new competitors are stepping on to the field. The game should be an interesting one to watch.

— Anne Williams Doremus, CFA

The World's 10 Most Valuable Brands

RANK	BRAND	2002 BRAND VALUE (\$BILLIONS)
1	COCA-COLA	69.6
2	MICROSOFT	64.1
3	IBM	51.2
4	GE	41.3
5	INTEL	30.9
6	NOKIA	30.0
7	DISNEY	29.3
8	MCDONALD'S	26.4
9	MARLBORO	24.2
10	MERCEDES	21.0

Source: Business Week