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INVESTMENT NOTE

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Hermes Sourcecap: Porsche is on the inside track to VW profits

Porsche manufactures powerful, stylish consumer cars. More appealing to us, however, is that its stock provides cheap exposure to Volkswagen, says Chi Chan, Co-Manager of the Hermes Sourcecap Eurozone Strategy.

Car giant: In 2009 the two auto makers struck a deal: their manufacturing operations merged, Volkswagen (VW) took control of the Porsche business and Porsche gained a 50.7% share in VW. This turned Porsche into a holding company with a majority stake in the owner of Audi, Seat, Skoda, Bentley, Ducati, Bugatti, Lamborghini and, of course, VW. But its stock trades at a heavy discount to the value of its stake in VW.

Pole position: VW has capitalised on its scale and diversity of brands to become one of the world's largest and most profitable auto makers. To achieve this, it created a series of common chassis that are used to manufacture different cars across its brands. For example, the Skoda Octavia, Seat Leon, VW Golf and Audi A3 are built upon the same chassis, so VW can order larger quantities at a bulk discount. Common engine-mounting cores also make it possible to adapt to greater demand for either petrol or diesel engines. This innovation, called Modularer Querbaukasten (modular transverse matrix, MQB), is transforming global auto manufacturing – and VW is at least two years ahead of the field. This is precisely the type of enduring and profitable change that we seek in companies.

Perception and reality: Many drivers seek qualities associated with particular marques. VW is careful to ensure the characteristics of each brand – from body design, entertainment system and dashboard functionality – make the desired impression and that structural commonalities are not obvious. This careful differentiation underpins the segmentation that boosts its market share and profitability.

Brand power: Skoda attracts value seekers, Seat targets younger motorists, VW is synonymous with quality and Audi is an entry point to the premium market. Just as the same chassis underpins popular cars for all of these brands, the Audi R8 provides the core of Lamborghinis and the new Porsche Macan – the first 50,000 of which were sold even before a test drive was taken – is based on the Audi A5. This combination of manufacturing efficiency and brand potency has helped increase VW's profits after tax by 26.8% in the year to 31 March 2014.

Owner in name only: Porsche's majority interest is primarily economic, as Lower Saxony, the state where VW is headquartered and is the biggest private-sector employer, has a 20% stake enabling it to block takeover attempts and strategic moves that could undermine local working conditions. This means business as usual for VW. Creating the perception that its cars are unique while simplifying manufacturing is its breakthrough. Gaining exposure to this at a 30.7% discount through Porsche stock is how our investors benefit.

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Notes to Editors:

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