AMIRAL GESTION

Sextant Newsletter – April 2004 – Pilgrimage to Omaha

Dear Investors,

The assets managed by Amiral Gestion have grown incredibly since the start of the year. We currently manage €63 million; 56 in Sextant PEA and 7 in Sextant Grand Large. Clearly, this makes our job a bit more difficult. Sextant PEA has gained almost 100% in the past two years. It is the best-performing fund in the category eligible for French equity savings plans (PEAs). The second-best fund in the category has advanced 40% in the same period, whereas the CAC 40 has dropped 20% since May 2002. Unfortunately, given the large quantity of assets that we now manage, in the future we won't be able to outperform by such a wide margin, neither with respect to the index, nor with respect to our peers.

Looking at 2004, the year has gotten off to a smashing start. Sextant Funds are up over 15%, and are at the top of their respective categories (French Equity and Flexible Mixed International). The CAC 40, with a modest gain of 1%, is far behind. We are neck-and-neck with the most talented fund managers in Paris. Not bad, isn't it? Going forward, we simply want to avoid losing money, beat the indices over the long-term, and be one of the best mutual funds in France. But our single goal remains absolute performance with a minimum of risk. If we don't achieve it, there will be no excuses; no one else to blame our failure. In fact, we work in an ideal environment:

- Our team is close to the ideal number of people for making good decisions. We have three managers who are 100% dedicated to investments. We have one intern, and one invaluable assistant who frees us from administrative tasks. We don't do marketing, and we don't solicit customers. Indeed, we don't have any customers. You, like us, are investors in Sextant Funds, which is much more meaningful because it means we have the same interests.
- We have greater room to manoeuvre than our fund manager peers. We don't have a hierarchal structure making us deliver reports to bosses on subjects they know nothing about. We can't be sacked if we underperform the CAC over one or two years (thus freeing us from the pressure to "beat the index"). And most importantly, we are not constrained by marketing targets, such as not straying more than 2% or 3% from the index, or investing only in growth stocks or a specific sector.

In summary, we are not bound by restrictions that have nothing to do with generating great returns, or which would prevent us from making sound decisions.

News about your Fund management team

There have been a few changes amongst your Fund managers. One departure, Véronique Ragagnon, and one new arrival, Julien Lepage. Julien has actually been contributing to the Sextant Funds' strong performance for quite some time. He has been advising us from afar, both as a benevolent unit holder and as a broker. Many investments have been made at his recommendation, including Gifi, Vet'Affaires, Renault, L'Oréal, and Artprice. With Julien on our side, who is brilliant in the more cerebral sports, we could challenge Berkshire Hathaway to a game of bridge, which is, along with golf, an area where we might stand a chance against Warren Buffett. But as far as investing is concerned, we prefer to remain his humble disciples.

The return of the dot-com bubble?

Sextant Funds are heavily invested in internet companies, which might worry you for several reasons:
1. The prices of internet stocks have skyrocketed in the past few months (as much as 1700% in 18 months for LDLC.com; that's enough to scare anyone, isn't it?)
2. The press is talking about a new bubble that is ready to burst.
3. You remember the collapse in tech stocks that occurred during 2000-2001.
But rest assured, we are still very pleased with our investments, and are keen to strengthen our positions in our favourites. Here is why. In 1999-2000, we saw that the internet was an incredible technological revolution, but we didn't know the sector well enough to invest. There were two questions which we did not have answers to.
1. What business models would be profitable? Advertising-based? But honestly, at that time, who looked at online adverts (indeed, who even had internet access)? Internet service providers (ISPs)? New ones were popping up every day, and were practically giving money away to lure in customers. The prevailing logic at the time was, the more a future subscriber is worth, the more should be spent now to acquire him. So, as this business became more popular, future subscribers were worth more and more, and ISPs were haemorrhaging more and more money. In other words, as an ISP's stock prise rose, it had a greater risk of going bankrupt. Nothing more to understand. In summary, we couldn't have known which business models would be profitable, short of being internet visionaries.
2. Of the companies with profitable business models (something we still had not defined!), which, among the dozens of new start-ups that launched every day, would survive? Warren Buffett compared the situation with the automobile industry in the early 20th century. The automobile revolutionised the century, but anyone investing in a car manufacturer in 1900 ran the risk of losing huge amounts of money. There were hundreds of manufacturers in 1900, and most of them went bankrupt in only a few years. Of course, with the internet, it only took a few months. Men were immediately separated from the boys. We did our homework, and saw that the companies which succeeded were those with excellent long-term growth potential. And when everyone else lost faith, we bought. Today their stock prices have soared. Or, more accurately, "re-soared." But a sharp increase in an ridiculously low price isn't very meaningful. For example, Auféminin.com is up 15X from its lowest level. Okay, so what? If its price had been even lower at the end of 2001, the increase would have been even more dramatic. Should you sell if you gain 100% or 2000%? A moot point. We only sell when a company is clearly overvalued. An excellent company will always go further than you expected, because its stock price is backed by hard-working men and women who haven't finished surprising you.

We believe the market has still not gotten a firm handle on how to value internet companies. It has been trying for several years, with the disappointments we are all aware of (too expensive, then a gift, and now finally stopping to think about it). At Amiral Gestion nobody knows how to value an internet company, and we have never even tried! We look at the sector from the other direction; what needs to happen so that the value of an internet company becomes significantly greater than its stock price? In 2000, that would have required a re-parting of the Red Sea. But Israeli archaeologists proved that that didn't happen. In 2002, that would have required Anne-

Sophie Pastel[1] crossing the Channel on foot, with the sea closing in all around (note that in this case, French engineers proved that this is indeed possible). Today, the situation is not quite as extreme. It requires creating pessimistic scenarios, in which the prices are genuinely too high, and optimistic, reasonable scenarios in which the opposite is true. But if the internet is a true revolution, then fasten your seat belts for take-off.

Recently, and for the first time in two years, our favourite stocks tumbled considerably, even more than the index or other stocks in our portfolios. But we are delighted, because this means we can buy more stock at a good price. And all our recent research has only lent more support to our convictions.

A few investment ideas

People sometimes reproach us for not talking more openly about what we do, but that is because our portfolios are highly concentrated and we often strengthen our positions. If the prices are attractive, of course. But for prices to remain attractive, they mustn't go up, which means that nobody else should buy the stock. Simple, no? But the AMF[2] (which used to be the COB[3], the police that forbids us from heading off to South America with your money) requires us to disclose the crossing of certain regulatory thresholds (5%). So if we tell the police about it, we can certainly tell you about it as well.

Altamir (price €85; target €200 in 3 to 5 years): Better than Sextant PEA?
Altamir is a venture capital company that invests primarily in unlisted companies. The company was founded and is managed by Apax Partners. Altamir has a few interesting characteristics:

- Like the Sextant Funds, Altamir does not pay a capital gains tax, nor a corporate income tax. Altamir is a closed fund, whereas our funds are open. This means that when you purchase a Sextant Fund unit, the unit is created, and we give it to you against cash (it's a bit like a capital increase). However, with Altamir, you purchase a share that must be sold by an agent; as a closed fund, Altamir cannot create new units.
- You don't pay any capital gains tax on this investment, provided that you declare your share purchase to the tax authorities and commit to holding your shares for at least 5 years (the form is available on the company's website, www.altamir.com). The same for reinvested dividends. So it has the same advantages as PEA, except that you are not required to place the shares in an equity savings plan.
- Altamir invests at least 50% of its assets in unlisted companies. So it would be a good diversification vehicle for a Sextant investor, especially since the portfolio contains several nice, weakly-valued internet stocks.
- Altamir is managed by Apax Partners fund managers, who are graduates of the French Polytechnic Institute, Harvard, or HEC. Their average IQ is much higher than that of your humble Sextant managers. They also have a great deal more experience (30 years, as opposed to our average of 18.5).

[1] Anne-Sophie Pastel is the CEO of Auféminin.com.
[2] *Autorité des Marchés Financiers*, the French financial markets authority.
[3] *Commission des Opérations de Bourse,* the French stock market regulator which was merged with other regulators in 2004 to become the AMF.

- You can invest in Altamir at a lower (or even much, much lower) cost than Sextant PEA. First, because there are no subscription fees, only a broker's commission. But more importantly, because Altamir's share price is 15% to 20% less than its declared net asset value (price = 85; declared NAV = 109). Note that Sextant PEA is valued every week at an NAV calculated from stock market prices; there is no discount.
- In reality, Altamir's NAV is much higher than 109. We estimate it between 150 and 180! Altamir's declared NAV actually factors in a 20% to 30% discount for its stock in listed companies. For example, Altamir owns Hubwoo stock, as do the Sextant Funds. But we value it at €4 per share, whereas Altamir values it at only €2.8! Its investments in unlisted companies are valued either at their purchase price, sometimes with provisions, or at a 40% discount to comparable listed companies. What really interests us about Altamir, is that if the business plans are not followed, the provisions of 25% to 100% are exceeded (e.g., if Altamir pays 100 for a share with a 25% forecast, it values the share at 75). But no internet company manages to meet the goals of its business plan! Almost all suffer enormous losses at start-up. So large provisions have been exceeded. But unlike listed stocks, there has not yet been a recovery in prices. Investing in Altamir is akin to buying listed stocks today at March 2003 prices! For example, we believe Altamir's equity in Rueducommerce.com (a competitor of our listed friend, LDLC) is valued in its books at around €1.2 million (the purchase price), but we value it at least €4 million!

Still ADLP (price €10; target €20 to €30)
It seems that nobody is paying attention to this great company. A couple of days ago, I subscribed to Zurban magazine with a 50% discount for 6 months (50 cents per issue!). It took me 30 seconds by calling +33 08 92 68 10 98**. And as a bonus, the charming operator offered me a brand new alarm-clock/radio personal stereo! ADLP posted strong sales (as always) for the first quarter of 2004, up by over 18%. In addition, the company has a positive cash flow, strong growth, little or no competition, an international expansion underway, which naturally weighs on its accounts, and is not being tracked by brokers. All of which we love!
Key figures: ADLP market cap is €24 million, at a share price of €10. We estimate its subscribers to be worth between €50 and €60 million. At the end of 2003 the company had €2.5 million of cash, which means that it generated €50 to €60 million of value (the subscribers) without going into debt! In 2004, ADLP France should have net earnings of about €3.4 million, for a P/E ratio of 7. But the company is growing internationally, and that costs money. Its declared earnings will be lower, but still largely positive. If any of its new countries does as well as France, we will hit the jackpot. If all the countries are a disaster, we will still hit the jackpot (the company will stop its international business development, focus on France, and pay large dividends). The only real negative scenario would be if the new countries do not do well, and ADLP management is too slow to realise it. A painful scenario, but again one in which we don't see how we could lose a lot of money in the long-term.

The lesson of the Samurai
"Many are those who will give advice, but few are those who will accept it with gratitude, and even fewer are those who will follow it. After the age of 30, man becomes generally impermeable to guidance. And when guidance no longer reaches him, he rapidly becomes full of pride and self-interest. For the rest of his days, he adds impudence to foolishness, which causes his

irreversible fall. This is why it is indispensable to find someone capable of discernment, and to bind yourself to him in order to receive his teachings." (Hagakure, The Book of the Samurai)

At Amiral Gestion, we are all over 30; impudence and foolishness lie waiting for us. But as you know, we have discovered our teacher, and we seek to bind ourselves to him (we love you Warren!) and receive his teachings. He delivers his message of wisdom every year in the Berkshire Hathaway Annual Report, which we read and re-read religiously. This year, rather than waiting to receive it in the post, we sent a member of our team to go retrieve it in person, far from home, in the land of absolute outperformance.

Pilgrimage to Omaha

Simple to understand yet difficult to put into practice, Warren Buffett's philosophy is our investment Bible. We follow his teachings as his disciples, and as true disciples, we sometimes question our teacher, or even betray him. I have already told you about a few of the times we strayed; there have been others. Despite our promises. Not all of them cost us, because sometimes we got lucky. But that is not a reason. So in order to atone for his mistakes, François Badelon was sentenced to spend a weekend in Omaha, Nebraska. He was ordered to bow down before Kiewit Plaza4, tour the sage's house three times on his knees, buy a Louis XV chest of drawers at Nebraska Furniture Mart, admit his French nationality in the heart of the American Midwest, and sing in unison with 20,000 other shareholders, the tune so loved in Omaha, "Berkshire, Berkshire Hathaway" by Susie Buffett (a lady with more money than you and the Beatles put together).

The lessons learned on this trip? Discipline, discipline, always discipline. Following Buffett's philosophy can be a bit frustrating and tiring. It is tempting to just cast it aside, follow the advice of the first guru that comes along, and take our chances with the latest market fad (everyone else is making money, why not me?). But no, we need to be patient and work. Invest, not speculate. "What you learn from history, is that people don't learn from history" (WB live in Omaha). Why not? Probably because people look for similar situations, whereas they should be looking for similar models (mathematical models that is, not role models). One of the most famous models in history and the most important to recognise is that of a charismatic (too charismatic) leader:

"It is therefore necessary to be suspicious of charismatic leaders, or rather, of those who seek to convince us with other tools than reason: we must be cautious about delegating to others our judgment and our will. Since it is difficult to distinguish true prophets from false, it is as well to regard all prophets with suspicion. It is better to renounce revealed truths, even if they exalt us by their simplicity and their splendour, or if we find them convenient because we can acquire them gratis. It is better to content oneself with other more modest and less exciting truths, those one acquires painfully, little by little and without shortcuts, with study, discussion and reasoning, those that can be verified and demonstrated."

So there you have it, stated once again. Work and be patient; don't speculate on the first idea that comes along. But this time, it is not Buffet speaking. It is Primo Levi, in his admonitions to Italian students in *If This is a Man*. Other recommended reading to help better understand or

[4] The office building where Warren Buffett works, Kiewit Plaza

recognise this danger include *Hitler* by Ian Kershaw, *The Man Who Tried to Buy the World: Jean-Marie Messier and Vivendi Universal*, by Martine Orange and Jo Johnson, (published in France as *Une Faillite Française*), and Good to Great, a management book by Jim Collins.

Talk to you again soon!

François