Sextant Newsletter – April 2005

Dear Investor Friends,

Sextant PEA has gained 13% since the start of the year, and Sextant Grand Large is up 11%.[1] We now manage €101 million of assets, mostly under Sextant PEA (€89 million), with the rest under Sextant Grand Large (€12 million, for the math wizards. On the radio this morning I heard an interview with the "greatest human calculator." He can calculate the 13th root of a 200-digit number in his head in less than five minutes. His next goal is to learn 40 spoken languages in less than two years. So 89+12=101. For now, at Amiral Gestion, we'll leave it at that).

€101 million. That's quite a hefty sum of money. And it is not exactly what we had expected. Luckily, over two years ago, we took the advice of a Capital Group[2] fund manager and started organising ourselves so that we could effectively manage that much money, and more. He told us, "Always be ready to manage 4 times more capital than you have." And we listened! We now have a team of seven people completely devoted to managing our Funds. We are completely ready for the future.

TEAMWORK: A BAD IDEA THAT WORKS

In the stock markets, good ideas are by definition those that you have a hard time convincing others of. A stock is undervalued because the market doesn't realise its true potential. Under management by consensus, you have to win an entire management committee over to a controversial idea, which is usually impossible. However, this management style works great for buying stock at a high because everyone already knows about it!

So how can we reap the benefits of teamwork? Why is it that something implemented so widely by all the best companies can't be adapted to our line of work? We found the beginnings of an answer by listening to one of the masters of our business, which as it so happens, is the famous Capital Group.

Imagine for a moment that you are a fund manager, and that every week you have lunch with the five best fund managers in Paris. These brave people tell you about what they are buying, why, their information sources, et cetera, et cetera. After lunch, you calmly return to your office where you are free to do whatever you want. You can follow your friends and buy their picks, or do nothing. That is how it works at Capital. For over 50 years, they have been hosting luncheons,

[1] At 22 April 2005
[2] "No investment organisation in the world has ever done so well for so long for so many clients as The Capital Group Companies. It is one of the world's largest investment management organizations, consistently earns the admiration of clients and competitors, and decade after decade achieves superior long-term investment results." Taken from "Capital, the story of long term investment excellence" by Charles D. Ellis

sharing their viewpoints and stock picks with other managers, and returning to their desks to do exactly what they want. The best ideas are shared, debated, criticised (sometimes passionately), but a manager's initiative and creativity is not stifled by a wimpy consensus committee.
We shamelessly set up a similar system. Sextant PEA is divided into five sub-portfolios, one of which has…. a single stock (a high-quality Belgian company). The other four have between 5 and 30 stocks.
We all love competition, and of course everybody wants to win. We all aim to be the best, generating a lot of money for you, and each hopes the others will deliver excellent returns as well.

So there you have it, the Samurai told us to find a master and listen to him. We actually listen to quite a few people, but we follow the words of Capital's fund managers.

Fortune tellers and the price of oil[3]

Thierry Desmarest is Total's CEO. Last year, he predicted oil would cost between $30 and $35 per barrel in 2005. Goldman Sachs just published a report stating that oil could see peaks of $100 per barrel. At Amiral Gestion, we have our own forecast for oil prices; our forecast is that we have no forecast. We simply hope to earn loads of money by investing in oil companies. Here's why.

In 2004, after the take-off in oil prices, we thought that oil companies would be expensive. First surprise, we found companies with P/E ratios of between 6 and 10. We also thought that financial analysts would be using higher oil prices in their earnings models. Second surprise, they were using $30 per barrel for 2005 forecasts, and $25 for the long-term. But at that time, oil was hovering around $40-$45!

We tried to understand this strange phenomenon, and we interviewed oil industry managers. They said they were basing their ROI models on $25 per barrel for the long-term. Actually, this is fairly logical. Imagine you are in the game (the oil game, not modelling). You present your boss with a plan to invest $300 million in a hypothetical oil field in Brazil. You want to take precautions, build in a safety margin. Anything can happen, even $10 per barrel. So you make your projections using a price of $25. Especially since you still have to trade through a seller. The Brazilian government, for example. You have to explain that you are taking risks; that it can't cost too much because the price of oil could come back down. That is all perfectly normal. But what is less normal is to value existing, already trading fields using $25 per barrel while the price is actually $40, and seems to be clearly trending upwards (in 30 or 60 years, you will have a hard time convincing me that there is still a plethora of black gold on this planet).

[3] At the time of writing, North Sea crude is at $55 per barrel

Financial analysts can't make personal predictions. It is too risky. And they know all too well, as do we and as do fortune tellers, that they have a fifty-fifty chance of getting it wrong. So to play it safe, they stick to the average, to what the market says. But the market is Mr. Desmarest. Who could claim to know more than he does when it comes to oil? Certainly not us. If you think about it, what is the job of Total's CEO? To sell oil? Definitely not; that wouldn't deserve such a high salary. Selling oil is the easiest thing in the world. Everyone wants it, and the market is perfectly coordinated. No, his job is to buy oil. This means that financial analysts are building their models based on what people who are in the business of buying oil tell them. And when you buy, you negotiate, and when you negotiate, you claim that it is too expensive.

We like win-win bets. We buy stock in oil companies. If the price of oil climbs, analysts will revise their forecasts upwards and we will win (because stock prices should go up). If oil stays where it is, analysts will revise their forecasts upwards and we will win (because stock prices should go up). If oil falls, analysts will revise their forecasts upwards and we will win (because stock prices should go up). If oil completely collapses, (50% at $25) analysts will not change their forecasts and we won't win. We could even lose a bit of money in the short-term. If oil sinks below $10 per barrel, we will read the Code of the Samurai, under "Using your Japanese sword when you have seriously lost face."

Sextant PEA and Sextant Grand Large have 10% of their assets invested in Statoil. We are also shareholders of PetroChina, Petrobras, and Maurel & Prom.

The Amiral Club: Medcost on 11 May

You are invited to our next Amiral Club meeting on 11 May, at 12:30 pm. We don't know yet exactly where you will have this opportunity to listen to and talk with the CEO of Medcost. Even if he isn't the "greatest human calculator," Laurent Alexandre is still a fascinating guy. He's a surgeon, a Ph.D. in healthcare economics, a graduate of the prestigious French National School of Administration (ENA)…. and a few years ago he launched the Doctissimo website. Medcost was one of our first investments. At €0.60, there weren't exactly swarms of people interested in this company. We sold it at between €2 and €3, only to unceremoniously buy it again at €5. But you can't always be wrong; today the stock is up to almost €7, and we think it still has a lot of potential.

The meeting's location will depend on your replies and the conference room that we are able to find. Please confirm your attendance as soon as possible, as there probably won't be enough room for everyone! This will also be the last "free lunch." In fact, our company, and especially our Funds, have moved to the next level. This newsletter is sent to almost 1,000 people! Imagine if everyone decided to come; chaos! Nonetheless, this contact with our investors has been very fruitful. We've met oil specialists in Norway, consumer good specialists, automobile industry specialists, etc. And you have had the chance to meet top-notch company executives; some of you were even able to secure good investments in the companies present (Camaïeu at €35 in early 2004, Aufeminin at €1 in 2002, Neurones at €2.7 in 2002). This is why we don't want to loose you! We felt it best that, in order to improve our relationship, rather than being anonymous investors, you became our customers.

Talk to you again soon,

François Badelon