

Dear Investor Friends,

- We now manage €82 million in our two Funds, 70 in PEA and 12 in Grand Large.
- We generated excellent returns in 2004: 30% and 24%.
- <http://www.boursorama.com/opcvm/palmares.phtml>, then show the 3-year performances. We all wish Sextant PEA a happy birthday, which, with its 160% return, is not the best fund in the world. We didn't want to speculate on derivatives. It gets better at www.morningstar.fr.
- AXA and Superman¹ both gave Sextant a birthday present: two buyouts, one for Camaïeu and one for the Marionnaud convertible².
- We should once again thank the managers of our favourite companies. With them, we are always pleasantly surprised, especially when they announce bad news. Their stock prices fall, and for us it's sales season. We are like the under-50 housewives at Camaïeu on 12 January – thrilled! A slowdown at Vet'Affaires? The incredible Lesguer brothers are on the watch. A strategic error at Gifi? No problem, the Ginestet family is in command. The IT consulting market is in a crisis? Well, we have Luc de Chammard and his fantastic team at Neurones to find a great solution. A company that doesn't make mistakes, that never receives a blow, doesn't exist. With our Super Managers at the lead, we know that the dark clouds have a silver lining. And because, in this January letter written in February, we missed the chance to wish you a Happy New Year for 2005, we and all our Super Bosses and your favourite Funds, want to wish you a Happy 2006, 2007, 2008....

2004 SUMMARY

A fault confessed is half redressed

A public flogging, being required to wear a suit and tie, being forced to return to Omaha and grovel before Kiewit Plaza? We are willing to do anything so as to never repeat the same mistakes we made in the first half of 2004. We mentioned them briefly during our newsletter last June. We have tried to analyse them with hindsight; to understand why and how we made those bad decisions. As usual, we found enlightenment by reading the grand masters. Let's listen to one of best among them, the great Charlie Munger, who gave a well-known speech to students at the University of Southern California in 1994 (Be warned, this is American English, which may be difficult to decipher!).

The model I like, to sort of simplify the notion of what goes on in a market for common stock, is the pari-mutuel system at the race track. If you stop to think about it, a pari-mutuel system is a market. Everybody goes there and bets, and the odds change based on what's bet. That's what happens in the stock market.

¹ Superman is the nickname given by the Chinese to Mr. Li Ka-Shing, a Hong Kong businessman who has apparently been quite successful.

² At the last minute, and to celebrate Saint Apolline day, a buyout was announced on Parcours that will involve 8.7% of Sextant PEA's assets and 6.5% of Sextant Grand Large.

Any damn fool can see that a horse carrying a light weight with a wonderful win rate and a good post position, etc., etc., is way more likely to win than a horse with a terrible record and extra weight and so on and so on. But if you look at the odds, the bad horse pays 100 to 1, whereas the good horse pays 3 to 2. Then it's not clear which is statistically the best bet using the mathematics of Fermat and Pascal [you know them, of course, don't you?]

And then the track is taking 17% off the top. So not only do you have to outwit all the other betters, but you've got to outwit them by such a big margin that on average, you can afford to take 17% of your gross bets off the top and give them to the house before the rest of your money can be put to work.

Given those mathematics, is it possible to beat the horses using only one's intelligence? Intelligence should give some edge, because lots of people who don't know anything go out and bet lucky numbers and so forth. Therefore, somebody who really thinks about nothing but horse performance and is shrewd and mathematical could have a very considerable edge, in the absence of the frictional cost caused by the house take.

Unfortunately, what a shrewd horseplayer's edge does in most cases is to reduce his average loss over a season of betting from the 17% that he would lose if he got the average result to maybe 10%. However, there are actually a few people who can beat the game after paying the full 17%....

And the one thing that all those winning betters in the whole history of people who've beaten the system have is quite simple: they bet very seldom.

It is not given to human beings to have such talent that they can just know everything about everything all the time. But it is given to human beings who work hard at it, who look and sift the world for a mispriced bet, that they can occasionally find one. And the wise ones bet heavily when the world offers them that opportunity. They bet big when they have the odds. And the rest of the time, they don't. It's just that simple.

That is a very simple concept. And to me it's obviously right, based on experience not only from the pari-mutuel system, but everywhere else. And yet, in investment management, practically nobody operates that way. We operate that way; I'm talking about Buffett and Munger. And we're not alone in the world. But a huge majority of people have some other crazy construct in their heads. And instead of waiting for a near cinch and loading up, they apparently ascribe to the theory that if they work a little harder or hire more business school students, they'll come to know everything about everything all the time. To me, that's totally insane. The way to win is to work, work, work, work, and hope to have a few insights.

How many insights do you need? Well, I'd argue that you don't need many in a lifetime. If you look at Berkshire Hathaway and all of its accumulated billions, the top ten insights account for most of it. And that's with a very brilliant man. Warren's a lot more able than I am and very disciplined, devoting his lifetime to it. I don't mean to say that he's only had ten insights. I'm just saying that most of the money came from ten insights.

So you can get very remarkable investment results if you think more like a winning pari-mutuel player. Just think of it as a heavy-odds against game full of craziness with an

occasional mispriced something or other. And you're probably not going to be smart enough to find thousands in a lifetime. And when you do get a few, you really load up. It's just that simple.

When Warren lectures at business schools, he says, "I could improve your ultimate financial welfare by giving you a ticket with only 20 slots in it, so that you had 20 punches, representing all the investments that you got to make in a lifetime. And once you'd punched through the card, you couldn't make any more investments at all. Under those rules, you'd really think carefully about what you did, and you'd be forced to load up on what you'd really thought about. So you'd do so much better."

Biblical simplicity, no? The great prophets always speak simply. We don't like hearing them (in general, outside of investing, it's dangerous to be a prophet, it can even do you a lot of harm!) because their main message is always difficult to swallow: success requires hard work, discipline, and a willingness to question your own beliefs. An easy ride is not on the agenda.

Caught off-guard by the huge number of subscriptions in the beginning of 2004, we acted like someone who loves betting on horse racing, and who has been given €100 to spend every Sunday afternoon (assuming the races take place on Sunday afternoons, to be honest I don't really know, I never bet on the races). We placed too many bets, without first conducting thorough research and waiting patiently for a winning opportunity. Experienced investors, but novice fund managers, we were led astray by the inflow of new subscriptions. We were afraid of not winning, of seeing our short-term performance diluted by a large amount of cash in the portfolio. We had to invest at any price, not miss anything on the upside. We were also influenced by our excellent results in 2002 and 2003, which incorrectly led us to believe that investing was a child's game.

Of course, errors of judgement are inevitable, reproducible, and excusable. But less acceptable are errors caused by a lack of discipline and hard work.

"The bad news about 2004 is that we made lots of mistakes. But the good news about 2004 is that we made lots of mistakes." – Julien Lepage

We are sincerely sorry for our errors that probably cost you around €100 per unit in the Sextant PEA Fund. That is the bad news. But the good news is that despite all that, we still delivered a solid return, and can move forward in the future. We haven't been killed, so we must be stronger. The good news is also that (a posteriori, granted, but still...) our mistakes were relatively crude and largely due to a new situation that rattled us a bit psychologically. Better prepared, calmer, we probably would have reacted differently. It's a great business, asset management; we learn something new every day!

You can't always go wrong

However, we did make some good decisions in 2004. Buying Camaïeu at €66, for example, or Vet'Affaires at €50. Starting a nice position in Jacquet Industrie. Buying the Marionnaud convertible when the company re-listed in mid-December. Acquiring a 10% stake in Altamir at €90. And other nice stories that we hope to be able to tell in a few years.

2005 Outlook

This new year has gotten off to a good start for our Funds. Mid-caps and internet companies have performed quite well since 1 January. We are always a bit more cautious when the market is euphoric, and are realising some capital gains on stocks whose valuations seem hard to justify. As you know, we prefer to focus our portfolios on what we truly believe in, and for that we need cash available so as to grab opportunities as they arise. Around 50% of Grand Large is cash, and around 20% of PEA.

In 2005 we will return to our good habits, going out in the field and testing products. Julien Lepage will visit Leroy Merlin (on Sunday, because we are professionals, we work during the week) where he will examine the products and services offered by four of Sextant PEA's companies. Sophie will return to Vet'Affaires to buy knickers and bras at €1.

There's snow at Tignes; I have personally taken it upon myself to test the Compagnie des Alpes installations (during the week, because on Sunday I'm also headed to Leroy Merlin). I'll come back to the office and during my lunch break, play a round of Solitaire, learn about the latest make-up techniques on Aufeminin.com, and have a small chat on Doctissimo about my cholesterol. I'll cancel my subscription to La Recherche magazine (interesting, but way over my head) and replace it with Voila (more photos, less text, a holiday for my brain cells), all in only a few minutes and without any additional fees thanks to the ADL Partner Hotline (+33 08 92 68 10 98). Then, I'll end the day by reading through a few annual reports. Julien is not as disciplined, he reads his magazines (yes, from ADLP as well) at his desk. Que Choisir, for example, in which he researches consumer opinions about the products of listed companies. To thank him for his loyal service, we may offer him a company car in June; perhaps he can test Renault's latest (his favourite car manufacturer), the incredible Logan at the unbeatable price of €5,000.

Your Funds' assets and management team

Your Funds are actively managed by five people. It's a lot for managing €80 million, but we are getting ready for a controlled growth in our assets under management. Our unique methods will let us take full advantage of our teamwork, which is why in 2005 we plan to continue looking for new partners, and to expand our research horizon. We have already invested in a Chinese company, PetroChina. After winning from coast to coast, why not go around the world?

Amiral Gestion, a corporate citizen

With a great deal of success, and a fair amount of luck, we generated comfortable profits in 2004. And being generous, we will give a large part of it to the French government. But we have a duty to go further. We follow the example set by great companies (such as VM Matériaux, and closer to us, Financière de l'Echiquier), and feel it is important to tell you about it. For 2004, we will donate €30,000; each of our six partners will give €5,000 to the charity of his or her choice.

Talk to you again soon,

François

