

**Our guest:**  
**Carmignac Gestion**

Carmignac is an independent fund management company created in 1989. Assets under management are \$16.5 billion with \$13 billion in equities and \$3.5 billion in fixed income. U.S. equities account for \$6 billion. Their client base consists mostly of institutional clients. 100% of assets under management are invested in Carmignac's own mutual funds. In the last few years the firm has been voted France's best international fund manager by the leading financial weekly magazine, *La Vie Financière*. The firm focuses on a company's earnings, cash flow and book value. In addition, importance is given to past performance, sector outlook and management strength. Companies with high forecasted growth rates are favored. Their portfolio is concentrated, focusing typically on only 40 stocks. They have an investment time horizon of one year or more. Positions held are constantly monitored on a performance basis relative to its peers.

*Rajesh Varma has been at Carmignac (which has a 10 person investment team) since 2002 and runs the firm's Infotech and Innovation Funds. He is personally responsible for \$248 million and oversees a further \$709 million. Rajesh has a degree in electrical engineering/computer science and an MBA from The University of Michigan. He is originally from India. Prior to Carmignac, he worked at Fidelity in Hong Kong, Asian hedge funds (including one that he set up), Montgomery Asset Management in San Francisco as well as a private equity firm—Eurazeo – part of the Lazard Group, in Paris.*



While the largest investors in Paris have traditionally been subsidiaries of the well know financial groups, a number a specialist investors such as Carmignac and Comgest are now challenging the likes of: BNP Paribas, Crédit Agricole Asset Management (CAAM), Groupama, Natixis and SG Asset Management.

**Is managing money in Paris any different to London or other European cities ?**

"Paris is easier to get around than London. In 10 minutes I can go anywhere. In London you are surrounded by other fund managers, analysts and hedge funds so there's a lot of 'noise'. Here I can concentrate on the bigger picture, and worry less on the day to day volatility."

**Has the number of corporates coming to Paris increased in the five years you've been at Carmignac ?**

"It has increased. I can see six companies a week. I can meet an analyst or a corporate every day. That's partly because back in 2002 we managed only \$1.5 billion whereas we now manage over \$16 billion. Also, we take large positions so shareholdings are in the \$100 million to \$150 million range."

**How do you screen stocks ?**

"Initially I look at the sector. I need to have an idea of where the sector will be in five year's time. If there is sector potential, I look at price to cash flow. And PEG (PER divided by earnings growth) I don't look at the p/e, because the PER is a relative number... it means nothing without understanding the long term growth potential. The cash flow yield is very important to me. The quality of the balance sheet is a focus. I also look at off balance sheet liabilities. I also focus on whether the product is a commodity. I do

invest in "commodities" if there are high barriers to entry. I like the alternative energy space and used to be invested in solar stocks but they became overvalued so I sold. I now hold the companies that make polysilicon as there are barriers to entry as it costs a lot and takes some time to set up a polysilicon plant.

I also won't buy unless I've spoken to management. Ideally I like to meet management face to face but I also do video conference calls. Meeting management is absolutely vital in understanding the strategy. My greatest problem with U.S. companies is that they are short term driven because of the hedge funds. They forget about the long term."

**Do you have any market cap constraints ?**

"I don't buy microcaps – anything less than \$100 million as they are too risky. I also look at liquidity closely.

**What is the average size of a Carmignac holding ?**

"A position is generally between 1.5 – 2.5% of the fund. If a company has no earnings, the position will not be larger than 1.5%. I maintain position limits simply because it is a way of controlling volatility. The sectors of technology, biotechnology, and alternative energy are extremely volatile, and so even if there are companies that I have a lot of conviction in, I am not willing to 'bet the farm' so to speak. My goal is long term absolute performance but with minimal volatility."

### **What's the average length of holding ?**

"There is no average length but I'm a long term investor with a two to three year time horizon at least. If something becomes more than fairly valued I sell it. My turnover is 40% this year. It was higher last year. If a stock does well I might trim the position. That is, if it was 2.5% of the fund and it becomes 3%, I will reduce it back to 2.5%. On the other hand, if it falls - and it falls due to short term considerations such as missing a quarter - and I still believe in it, I might enlarge the position from 2% to 2.5% again.

I focus on long term secular growth. I do not buy cyclical companies where you've got to be in and out at the right time. I like to buy a stock and put it to one side."

### **How do you measure your performance ?**

"My Infotech fund is benchmarked against the MSCI Global Tech Index. The Innovation fund which consists of biotech, tech, alternative energy and water utility stocks is benchmarked against the MSCI Carmignac Innovation index. 40% of the Innovation fund is invested in healthcare but technology healthcare/biotech, and not names like Merck, J&J etc, because I believe these companies are more marketing companies than real innovators."

### **Current favored holdings? What do you like about them ?**

"Within the US, I hold Adobe, Corning and Seagate and all three companies have done well this year. Corning is a great long term holding which I've held since 2004. It's a \$50 million position. It makes glass for flat screens. There are only three companies that make glass for flat screens and Corning is the leader. Flat screens have continued to come down in price yet the glass component hasn't so Corning has continued to increase its margins because of increased demand for the final product. It is also one of the largest polysilicon producers in its joint venture with Dow. It is minting money with this joint venture. Corning is 2.5% of my Infotech fund.

Cogent is another company I favor as I expect huge growth in content over the internet. Therefore companies which compress content or lock content or companies who own the infrastructure are well placed. Cogent is a major player in the space but nearly went bust. It is the second largest access holder in the world and most of its fiber is empty which means it has lots of capacity for new content. It has EBITDA margins of 90%. It charges \$10 per megabyte whereas Verizon charges around \$30. The stock is up 130% year-on-year. I still expect the stock to double or treble. We need companies like this - no choice. It's a long term story.

NDS is another holding. It encrypts and decrypts content. It is at the front and back end of content. It's only up 12%

this year but it is a long term story. I look at where it will be in five years. So I look for global leaders no matter where they are listed."

### **Worst investment ?**

"2006 was my 'annus horribilus'. I got burnt in Japan and I had no big cap names in the US and yet they went through the roof. I didn't have Apple or IBM. I got burned by small and mid cap names in the US and by Japan."

### **Can you short stocks ?**

"I can't short stocks in spite of the fact we're an absolute performance fund. However, I can buy options so I have bought calls in HP, Cisco, Apple and IBM. They went up and I converted. IBM is the only name of the four I don't hold."

### **How have hedge funds changed the investment management industry ?**

"They've increased volatility. Back in '88, if a stock was up or down 1% it made headline news. Now a stock can go down 15% and nobody blinks. I've worked in a hedge fund but I never used leverage. Hedge funds have forced management, particularly US management, to be much more short term. Hedge funds have therefore had a huge impact on a company's strategy. Real hedge funds do their jobs when they short stocks that are overvalued but hedge funds have caused an inordinate amount of damage elsewhere - look at the damage done to the South East Asian economies a couple of years ago."

### **Outlook for US equities versus world markets ?**

"I've been shocked by the performance of the US market this year. I didn't expect it to do so well. I do expect some kind of correction in the US market but I don't look at indices, I look five years ahead at specific sector and stocks."

### **Do you get as much access as you'd like ?**

More and more US companies are coming to Paris. This is for two reasons. Carmignac is bigger than it was and we have a reputation for being long term investors. Also, US companies increasingly want to create a geographically diversified investor base. This is partly to offset volatility created by hedge funds in the US."

### **Who do you like to see - CEO, CFO or IR ?**

"If it's a biotech company I like to see the CSO, the CFO is less of an issue. If it's a technology company I like to see the CTO and CFO, i.e., one step down from the CEO."

### Best companies at IR ?

"None of the big US tech names come here – they can't be bothered. The large biotechs are good though. We regularly see Genzyme, Amgen, Celgene and Gilead. They all come through and realize that Carmignac is a long term holder and not a fly-by-night hedge fund. We also see smaller technology companies like Nuance and Citrix. Nuance is a leader in speech technology and Citrix I first met at the NASDAQ conference in London. Meetings with these companies really add value."

### Is language an issue for US companies visiting Paris ?

"No – all fund managers in Paris speak good English otherwise they wouldn't have a job. They might have a lousy accent but they speak English!"

### Performance

	31/12/2002	29/09/2007	Performance
Infotech	8.1	29.77	+64%
MSCI Global Tech	55.89	81.733	+46%
Innovation	207.55	341.48	+64.5%
MSCI Carmignac Innovation	37.521	47.75	+27.3%