April 12, 2010

Enclosed is your statement for the first quarter of 2010.

For the quarter, equity investors saw total returns of 5.39% for the S&P 500, 4.82% for the Dow Jones Industrial Average and 5.91% for the technology-oriented NASDAQ.
For the quarter, fixed income investors saw total returns of 0.19% for the 1-year Treasury Index, 1.70% for the 5-year Treasury Index, 1.05% for the 10-year Treasury Index, and the 10-year BB-corporate bonds had total returns of 3.81%. The positive equity and fixed income returns reflect the support provided by various governmental agencies around the globe. Ultimately this support must be withdrawn; neither the governments nor markets function effectively with them. To do this in a timely and orderly fashion will require governmental competence and good fortune; let's hope they have both.

At Academy, we believe the best investment opportunities exist in difficult periods. Significant drops in prices have us following the saying: "When the going gets tough, the tough go shopping." But the recent rise in prices has slowed our shopping considerably, causing your portfolio to have significant cash (money market funds and U.S. Treasury holdings). We realize we are not paid to hold cash, particularly since the level of today's yields on cash are so low as to appear a computer error. Nevertheless, we anticipate the uncertain times ahead of us will provide some excellent shopping, especially if the withdrawal of governmental support is not well executed.

The spring quarter's letter regularly addresses the businesses of the stocks which were newly purchased over the prior year. By that time, dust from the prior year's activity has settled, stories have moved from the headlines to the back page and we can reasonably discuss the prospects for these new additions. Before we discuss them, it is important to note that because we manage individual portfolios but write a general letter, not all of these stocks may be in your portfolio.

We are interested in the purchase of great companies at reasonable prices, but much of the time we have to settle for the purchase of reasonable companies at good prices. We define a company's greatness by its ability to resist capitalism's relentless competition to zero profits. Ideally, this is a conservatively-financed company with a product or service that is 1) highly and permanently desirable, 2) unique, with no close substitute and 3) global, without extreme dependence on any one area or currency. Unfortunately, there are few ideal companies, but the four we purchased in 2009 come close.

In alphabetical order, they were: Becton, Dickson and Co., Nestle, Philip Morris International, and Proctor & Gamble.

Becton, Dickson and Co. (BDX) is a medical device and diagnostic tool company based in New Jersey. BDX went public in 1962, but was actually started and co-managed in 1897 by Becton and Dickson until 1948 when management was assumed by younger Becton and younger Dickson. (Such multi-generational partnerships are unusual; we hope this one is an omen for a long holding period on our part.) As an early provider of needles and syringes, BDX grew to dominance in the medical device industry, generating over $7 billion in revenues with almost 60% of those coming from outside the U.S. BDX is conservatively-financed, well-managed and has medical products that are desirable and often capable of being branded (one example introduced in 1918 is their ACE bandage which means “All Cotton Elastic”).

Nestlé (NSRGY) is a food company based in Vevey, Switzerland. NSRGY has an unusual stock symbol because it is an American Depository Receipt (ADR). ADRs are used to trade non-U.S. stocks on U.S. stock exchanges. Founded in 1866, NSRGY was founded by Charles Page, an American consul in Zurich and Henri Nestlé who created food for babies unable to breastfeed as well as milk chocolate. NSRGY grew from its dominance in milk-related products into beverages (think of the famous Nescafe), then foods, and finally into wellness products.   With over $100 billion in revenues, NSRGY has over 70% of its sales from outside the U.S. In addition to being as conservatively-financed as one might expect from a Swiss company, NSRGY effectively manages over 7,500 well-known products.

Philip Morris International (PM) is a tobacco company operated in Switzerland, but headquartered in New York. PM was founded in 1847 when Philip Morris began selling cigarettes on London’s Bond Street. By 1881, PM was a public company and ultimately came to dominate the cigarette business with its Marlboro brand. In 2008, PM was spun off from Altria, giving us an opportunity to purchase this highly-profitable and conservatively-financed company. PM has sales of about $60 billion with 100% of those revenues coming from outside the U.S. As a final note, we want to emphasize that our ownership is not to promote the use of tobacco products, but the result of our investing discipline.

Procter & Gamble (PG) is a consumer-staples company based in Cincinnati, Ohio. PG was founded in 1837 by William Procter and James Gamble to make candles and soap. The partnership was suggested by their mutual father-in-law because both candles (Procter’s specialty) and soap (Gamble’s) used lye, thereby demonstrating the value of listening to one’s in-laws! From these humble beginnings, PG now has revenues of about $80 billion with a line of brands that are recognizably American even though more than 60% of their sales are derived from non-U.S. markets.

Based on these companies, it might appear that we screen for businesses started in the nineteenth century. That’s not the case, but it does highlight an important fact. We prefer long periods of ownership, ideally spanning decades. In order to own a business for a long time, it must be a business that is likely to be around for a long time or as they say, “to finish first, you must first finish.” The addition of four new “finishers” in one year is significant. For comparison, last year we did not add any new companies, preferring to add more shares of the businesses we already owned instead. That is typical of us, so it is likely that we will purchase more shares of these new companies as market volatility permits.

We hope this letter helps you understand our process. We want you to stay informed and feel comfortable about our investing discipline.   If you’re new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Sue Compton at our office. In addition, our website (at www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management