



The Hedgeweek Interview: Francisco García Paramés and Álvaro Guzmán de Lázaro Mateos, Bestinver Asset Management, Madrid: Adhering to military-style discipline with regards to required IRR

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Francisco García Paramés and Álvaro Guzmán de Lázaro discuss the characteristics that distinguish Madrid-based Bestinver, which is preparing to launch a new hedge fund.

HW: What is the background to your company and your funds?

FP/AM: Bestinver was founded in 1987 as a family office with 90% of managed assets owned by the Entrecanales family (Acciona's majority shareholder). The success of our mutual funds has turned Bestinver into a company where more than 90% of AUM belongs to external clients. We currently manage more than EUR 3.9 billion worth of assets through 6 mutual funds, 32 Sicavs and 3 pension funds.

We began investing in Spanish equities in 1993 and in the past 13 years have achieved an average annual return of 22.17%. In 1998, we began investing in international equities, posting an average annual return of 13.23% over 8 years. We have been awarded 42 other prizes from the most prestigious mutual fund rating agencies.

Due to the returns achieved and especially given the solid performance of our Funds and Sicavs during the stock market crash of 2000-2002 - in 2002 our Spanish equities fund obtained an 8% return compared with a 28% fall on the IBEX- our client numbers have swelled to more than 25,000, whilst we currently have the largest Spanish equity fund.

NAME	2006 Return	TYPE	ASSETS	INCEPTION DATE	Average annual return since creation	Total accumulated return since creation	AUM (€, MN)
MUTUAL FUNDS							
B. Renta	3,23%	Mixed fixed income	Max 10% Global & Spanish equities	18 oct 95	4,85%	67,44%	129,57
B. Mixto	11,41%	Mixed equities	50% Spanish equities	27 jun 97	13,17%	212,76%	186,76
B. Mixto Internacional	1,60%	Mixed equities	40% International equities	21 jul 06	-	1,60%	14,95
Bestinfond	13,27%	Euro equities	45% Spanish & 55% Intl equities	13 ene 93	21,78%	1382,12%	694,06
B. Internacional	11,68%	Global equities	International equities	2 dic 97	13,19%	194,62%	938,13
B. Bolsa	18,12%	Spanish equities	Spanish equities	2 dic 97	19,41%	376,54%	900,68

HW: What is the background to the managers of the funds?

FP/AM: Francisco is the Chief Investment Officer and brings 16 years of experience to this role. After obtaining an Economics degree from the Universidad Complutense and his MBA at IESE (in 1989), he joined Bestinver, where after 2 years as an analyst of Spanish stocks, he began managing portfolios and funds. Self-taught, his management style is based on the strict application of the principles of value investing within a framework of detailed knowledge of the Austrian theory of economic cycles.

Alvaro, the Portfolio Manager, has 10 years of experience. He has worked in Arthur Andersen, Bunker Trust and as equity analyst in Value Management (a company founded by a former employee of the legendary Peter Lynch), Beta Capital and Banesto Bolsa. He is also a professor of fundamental analysis at the Spanish Institute

of Financial Analysts (IEAF) and at the IEB (Stock Exchange Study Institute). He managed private portfolios between 1997 and 2003 with outstanding results.

They jointly manage domestic and foreign funds.

HW: Which fund managers do you respect most?

FP/AM: Warren Buffet, Peter Lynch, Charles Munger, John Templeton, John Neff, Walter Schloss, Mario Gabelli, Daniel Russo, Felix Zulauf, Bill Miller, Van Otterloo and Marc Faber.

HW: How and where do you distribute the funds? What is the profile of your current and targeted client base?

FP/AM: We distribute our funds in Spain. They are not commercialised abroad but foreign investors may subscribe to them through us.

Our target investor is one who shares our investment philosophy, is patient, and is looking for medium- to long-term investment.

HW: What is the investment process of your funds?

FP/AM: The process involved in implementing our strategies is the following:

1. Selective screening from a variety of sources, e.g. broker research, industry publications, press etc.
2. Analysing the history of the company until the present day
3. History of the sector/competitors
4. Careful examination of the latest 10 years of accounts.
5. Finding out about the incentive system for executives.
6. The identity of shareholders, their role and their involvement in decision-making.
7. Listening to what former employees say.
8. The historic positions of the regulator if it is a regulated business.
9. How competitors' view its executives.
10. Talk to/meet company managers.
11. The history of M&A activity involving the company and its rivals.
12. Observe how managers allocate capital.
13. Study the Return on Capital Employed (ROCE).
14. Broker industry and peer group research.
15. Discounted cash flows.
16. Valuation and price target determination.

This is not a static process. Monitoring the companies in which we invest is an ongoing process, and target prices can vary according to different factors that can affect the valuation of the company, such as the publication of news, information from the company or its rivals, broker reports, etc. We also follow the companies for a long time, sometimes many years, before investing.

HW: How do you generate ideas for your funds?

FP/AM: There are various possible sources for our ideas:

- Specialist financial press
- Other non-specialist reading material that can provide ideas for good businesses
- Brokers' reports
- Conversations with company managers and employees.
- Conversations with rival companies
- Visits from the company itself
- Conversations with other value managers
- Research by analysis houses

Finding ideas is not a problem. It is not a question of lacking ideas but of how to distribute the time to analyse them.

HW: What is your approach to managing risk?

FP/AM: For us, risk is not measured by volatility but by the real possibility of losing money. Volatility is not necessarily a problem: the more a market falls, the more opportunities there are to find undervalued stocks.

The most important means of managing risk is to assess the competitive advantage of the companies in which we invest. If we think they have competitive advantage, and it turns out they do not, then the risk becomes ours. Therefore, the only factor we 'measure' is the possibility of a permanent impairment of value in any of the stocks.

HW: Has your performance been as per budget and expectations? Do you expect your performance or style to change going forward?

FP/AM: We do not set targets for returns. Our only objective is that our clients continue to achieve a return on their money and grow to reasonable levels, allowing us to continue operating in accordance with our investment policy.

We have a strict management style and this will not change. It is not just a style but a philosophy and we think that the only way to achieve sustainable returns going forward is by investing in undervalued companies that are trading at a large discount to their intrinsic value. We are very disciplined when it comes to making investments and we employ the same strict analysis process to each and every one of the companies that we analyse.

HW: What opportunities are you looking at the moment?

FP/AM: Attempting to predict market behaviour is a complicated task that requires a great deal of dedication; even then, forecasts rarely prove accurate. We do not spend any of our time trying to understand where the market is going in the next twelve months. It is not our job. Accordingly, we prefer to seek out solid and undervalued companies, as they will certainly outperform the market regardless of its performance.

Any undervalued company that is a good business, a competitive edge over its rivals, with a strong management team and transparent information can represent an opportunity for us.

HW: What differences you from other managers in your sector?

FP/AM: The following characteristics distinguish Bestinver managers from its rivals:

- The ability to invest completely independently. No restrictions are placed to the management team with regard to investment decision-making. We are not subjected to the limitations of investing by following a benchmark. Nor are we restricted with regard to the sectors in which we invest: we may invest in any security, regardless of its liquidity. Decisions are taken directly by the managers without the need for investment committees.
- Patience. Returns on investments do not always come in the short term, they must be given time. If we find an investment that we consider attractive, and we decide to invest, we maintain the investment for as long as necessary, provided nothing occurs that alters our valuation of the company. The most important thing is to wait, and we are qualified to wait. We have sometimes spent years buying shares in the same company and this requires a great deal of patience.
- An excellent management team. We not only share the same investment philosophy, we also dovetail perfectly when working as a team.
- Our work is part of our lives. We enjoy our work. Management is not just a job but a constant challenge that requires many hours of reading and constant attention to all the factors that can affect the valuation of companies. At Bestinver we have found a way to dedicate all our time to what we really enjoy and to do so freely and independently.
- Absolute confidence in our work. We trust our investments to Bestinver, since we trust our work and our ability to generate excellent returns in the long term. Accordingly, we regard our funds as the best investment option for our money.
- Competitive advantage. It would be best defined by:
 1. Adhering to a military-style discipline with regards to our required IRR.
 2. Valuation skills.
 3. Fund managers' firm commitment to their investment management role.

HW: Do you have any plans for new products in the near future?

FP/AM: The Synergy Small Caps fund, which we have been co-managing with four other European fund managers since 2003, has been approved for distribution in Spain and we will begin distributing it exclusively in less than one month.

We are also preparing the launch of a hedge fund, taking advantage of the new Hedge Funds legislation in Spain. The fund will have the following features:

- Long-only fund
- Identical investment philosophy (value investing approach)
- Greater concentration of risk
- Use of moderate leverage.