

## Excellent Translation

*While the intellectual origins of value investing may be American, Spain's Francisco García Paramés has proven that its principles travel quite well.*

Only 27 and one year out of business school, Francisco García Paramés was tapped in 1991 to take over the tiny money management business of Spanish construction company Acciona when the unit's chief investment officer – his boss – left the company. “It was very much what you call a trial by fire,” he says.

Paramés' results at the helm of Bestinver Asset Management, which now manages €3 billion, have been nothing short of world-class. Bestinver's largest fund, which invests primarily in Europe, has earned an average 15.9% per year since inception in 1993.

Today he's primarily mining his existing portfolio for ever more attractive bargains, in such areas as auto manufacturing, energy, technology-product distribution and diversified holding companies. [See page 2](#)

### INVESTOR INSIGHT



**Francisco García Paramés**  
Bestinver Asset Management

**Investment Focus:** Seeks companies in understandable businesses that are cyclically out of favor, as well as those with multiple business units that are collectively mispriced.

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### BESTINVER

Asset Management

YEAR	BESTINFOND	BENCHMARK
1993	43.91%	46.67%
1994	5.28%	-11.70%
1995	10.33%	12.30%
1996	41.01%	38.96%
1997	41.02%	42.22%
1998	29.03%	37.19%
1999	-10.90%	16.22%
2000	13.03%	-12.68%
2001	20.47%	-6.39%
2002	8.17%	-23.10%
2003	38.20%	27.44%
2004	29.89%	18.70%
2005	28.53%	22.58%
2006	26.70%	16.76%
2007	-2.23%	-0.78%
10/31/2008	-36.90%	-33.54%
<b>Return since 1993</b>	<b>922.80%</b>	<b>306.77%</b>
<b>Annual average return</b>	<b>15.86%</b>	<b>9.29%</b>

Note: The benchmark is a weighted average of the IGBM and MSCI World Index

For more information, please visit [www.bestinver.com](http://www.bestinver.com)

# Investor Insight: Francisco García Paramés

Francisco García Paramés, Álvaro Guzman de Lázaro and Fernando Bernad of Spain's Bestinver Asset Management describe how they value beaten-down cyclical, why they don't invest too far from home, the "two layers of undervaluation" they see in holding companies, and why they see mispriced value in BMW, Repsol, Alba, Cofide and Esprinet.

You've characterized your start in investing as an "accident." Why?

**Francisco García Paramés:** After getting an MBA in 1990 I went to work for the large industrial conglomerate Acciona, which was and is controlled by the Entrecanales family. I was hired to work in mergers and acquisitions, but that operation was reorganized after three months so I then found a position as an analyst in Acciona's very small investment management business, Bestinver. At the time we invested only in Spain and 90% of the money was Entrecanales family money. I ended up taking over that business a year later after the fund manager above me announced he was leaving.

Around the same time, I read Peter Lynch's *One Up On Wall Street*, which described a way of thinking about investing that was exciting and made a lot of sense to me: Invest when no one else is. Keep things simple. Invest only in things you understand. Invest based on normalized earnings. Be afraid when too much capital is going into a sector, and interested when capital is going out and returns can improve. From that, I read everything I could about investing – especially from Warren Buffett and Benjamin Graham – and was hooked.

The scale and breadth of what you do has obviously expanded, but has your strategy changed much in the past 18 years?

**FGP:** No. We focus on very basic things. Is the business model understandable and is it likely to be essentially the same ten years from now? Are competitive advantages sustainable or temporary? Can we reasonably estimate the normalized level of free cash flow? Do we have an advantage by taking a longer-term view? Are the shares trading at a significant discount to our estimate of intrinsic value?

Probably the main reason the stocks we buy are mispriced is the time horizon of most investors. We follow Warren Buffett's lead in saying we'd like our time horizon to be forever.

How do you define your geographic circle of competence?

**FGP:** I once heard someone say that for every 2X kilometers you are away from where you are investing, you should divide the quality of your assessment in half. We agree with that, so focus first on Madrid, then the rest of Spain, then Western Europe. The top five countries in our broadest portfolio are Spain with 20%, Germany with 13%, 10% each in France and Switzerland, and 7% in Italy.

We've found over the years that European markets are much less efficient than those in the U.S. Right now we have less than 5% of our portfolio in the U.S., and it's really lower because our largest holding that trades there, Virgin Media [VMED], operates in the U.K.

Are there any differences in your research or decision-making processes from country to country?

**FGP:** The process is the same. In every market we speak at length with those inside and outside the company, including suppliers, customers and competitors. We focus primarily on cash-flow accounting, so any differences in non-cash accounting treatments aren't that relevant to us.

**Álvaro Guzman de Lázaro:** There are big differences in tax rates, which we adjust for. An EBITDA multiple of 10x means something very different in Italy, where the corporate tax rate is 40%, and Switzerland, where it's 25%.

We also take into consideration what we call attitudes toward capitalism. For



**Fernando Bernad, Alvaro Guzmán de Lázaro, Francisco García Paramés**

## Repaying a Debt

Although he's now one of the more celebrated investors in Europe, Francisco García Paramés remembers well toiling in obscurity and relying largely on the writings and public pronouncements of distant U.S. investors such as Warren Buffett and Peter Lynch for investing intellectual sustenance. "Who could ask for better role models?" he says.

Paramés last year sent Buffett a letter, thanking him and offering up an investment idea or two in Europe. Buffett personally responded, asking Paramés to be on the lookout for private companies in Spain that Berkshire Hathaway might be interested in buying. "I felt honored to be asked," says Paramés. He's making plans to attend his first Berkshire Hathaway annual meeting next year in Omaha.

With a track record that compares favorably with the cream of the American fund manager crop over the past fifteen years, is Paramés looking to raise his profile in the U.S.? "We've never been particularly aggressive in marketing ourselves, especially in the U.S." he says. "That might change, but for now it's complicated – we think you maybe have too many lawyers."

example, there's a very low risk of being squeezed out at an unfair price if you own 13% of a company in the U.K., but that could happen in Switzerland, where the laws are less shareholder-friendly. That doesn't really change the analysis, but it does impact how we assess risks.

#### Do macro views drive your investing strategy at all?

**FGP:** Not a lot, but there are broader views that can influence how we invest. For example, we're avid followers of the Austrian-school economists, who have done an excellent job of explaining economic cycles and how the expansion of credit leads to overinvestment, bubbles and then crashes. That thinking kept us out of financial stocks over the past four or five years, because we believed there was a credit bubble in the U.S., Spain and elsewhere.

Another view we have today is that Chinese growth is sustainable, because it's based on savings and on productivity growth. That makes us more optimistic about global economic growth than others who are so worried about the U.S. economy might be – which translates at least indirectly into how we estimate normalized earnings.

#### Is your aversion to financials a temporary or permanent condition?

**FGP:** Because of the difficulty in analyzing them, we do have a more permanent bias against leveraged financial companies. It's hard enough to understand from the outside what's going on inside a company, but it's even more difficult when there's so much leeway in how loans are underwritten and accounted for. We think that flexibility puts shareholders at much higher risk.

#### What types of companies tend to appeal to you?

**FGP:** We've had good success with retailers, which are generally easy to understand and have fairly clear competitive advantages or disadvantages. We also

often find opportunity in holding companies, for which we're maybe more willing to do the work necessary to value each individual piece, even when the businesses are very different. Holding companies are particularly interesting now because for some odd reason the discounts to the sum of the parts usually increase in bad markets, even as each part individually becomes more undervalued. That provides two layers of undervaluation.

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### ON TODAY'S UPSIDE:

**Our global portfolio in June 2007 had an aggregate upside to our targets of 64%. At September 30, that was 189%.**

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In general, we tend to find companies in cyclical industrial or even commodity businesses attractive, when we believe they're at the low part of the cycle and when other investors are running away from them.

#### Describe, using a current example, how you value such cyclical companies.

**Fernando Bernad:** Smurfit Kappa [SKG:ID], which is a leading paper-based packaging company based in Ireland, is a good example. It operates primarily in Western Europe and Latin America, and while its industry has consolidated and the bigger players are becoming more rational, the business is still cyclical and demand is weakening now just as several capacity projects are near completion. The stock, which IPO'd in early 2007 at €16.50 per share, is now below €2.

We value stocks like Smurfit Kappa on normalized, mid-cycle earnings, which in this case we base on the per-ton profit at which the marginal producer makes a reasonable return on capital employed. Above that return, new capital would be invested in capacity and prices would be driven down. Below that return, over time, capacity would be taken out of the

business and prices would move up. On that basis, we estimate Smurfit Kappa's normal annual EBITDA to be €950 million. Taking out run-rate levels of interest, depreciation and taxes, we arrive at an annual free cash flow of around €300 million. It was higher than that in 2007 and will be lower next year, but that's what we believe is the sustainable level.

The company's market value is today around €390 million, so the stock trades for about 1.3x normal free cash flow. It's certainly true that cyclical headwinds can significantly erode the company's earnings, but we view a period of poor results as the "price" to pay for being able to invest at an extremely attractive valuation.

**FGP:** The biggest issue here is the debt, which is high. We believe the company is not at risk of breaking its covenants and it doesn't have any big payments due until 2011. Even in a worst-case economic scenario, we think the its assets are saleable and that such sales would more than cover the outstanding level of debt.

#### Is Smurfit Kappa representative of the unusual values you're finding today?

**FGP:** We track for all our funds the aggregate upside we see from current prices to our target prices. Our Bestinfond portfolio [including both Spanish and non-Spanish stocks] at June 30 of last year had an aggregate upside to our targets of 64%. By September 30 of this year, that upside had risen to 189%. That's by far the highest it's been since we started counting it this way six or seven years ago.

Today we're investing very little in new companies, but are actively redeploying capital in our existing portfolio. That's generally a big part of what we do. If a stock's value doesn't change and the price moves up or down, we often trade based on that. When a 50%-upside stock goes up 20%, we'll take money out of it and put it into higher-upside situations we know equally well. This is a competitive advantage for us in Europe, because our funds only pay 1% capital-gains taxes.

What's interesting is that the target prices for our portfolio companies have gone up around 10% since June of last year, so the businesses are for the most part fine. But the share prices have come down so much that the value gap we see has gotten very wide.

**How do you arrive at the multiples of normalized free cash flow you use to calculate target prices?**

**FGP:** In probably 90% of the cases we use 15x. That has been the average for American stocks over the past 200 years and it results in a roughly 6.5% free-cash-flow yield, which is quite reasonable if risk-free interest rates are 4-5%.

We rarely use discounted cash flow to calculate target prices. We just don't think it's worth the effort except for very stable businesses such as toll roads or utilities.

**Do you have any cap-size bias?**

**FGP:** People like to say we focus more on small-cap companies, but we've always been completely agnostic about the size of the companies we'll invest in. All things being equal, we'd rather have more liquidity than less, but any bias we have toward small or large caps will be a function of where we're finding the most attractive prices at any given time.

**How does a small company like Ibersol [IBRS:PL], a Portuguese restaurant operator, even get on your radar screen?**

**FGP:** We know Portugal very well and had actually owned shares in this company ten years ago, so it wasn't surprising that we noticed it. They have a variety of restaurant chains in the country, most of which are fast-food brands like Pizza Hut, KFC and Burger King.

What we like is that the business is very easy to understand and we also think will be counter-cyclical as more people eat hamburgers and pizza than go to fancy dinners. In the first half of this year, like-for-like sales were up 9%. We first started buying when the shares were around €10, against our target price of

around €20. The shares have fallen to €5.40 but our target price hasn't changed, so now it's even more interesting.

**How do you arrive at absolute and relative position sizes?**

**FGP:** European laws for our types of funds don't allow us to be overly concentrated. In our broader portfolio, we generally have 60-70 stocks at a time. The

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## ON DCF MODELS:

**We just don't think it's worth the effort except for very stable businesses such as toll roads or utilities.**

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relative size of each position is primarily a function of how big the gap is between the market price and our target price, while also taking into consideration our degree of confidence in our valuation and the amount of leverage. We think Smurfit Kappa is eventually a ten-bagger, but we'll have less of it than something else we think is only a five-bagger if that five-bagger has much less debt.

**Turning to more specific ideas, what's the investment case today for automaker BMW [BMW:GR]?**

**FGP:** Like Toyota in the mass market, BMW in the luxury segment is widely recognized as one of the best-run car companies in the world. We think that has something to do with the fact that both companies still have significant family ownership and have always invested heavily in technology, engineering and design. In fact, many of the companies we own have large family ownership, which tends to make them more likely to take a long-term perspective.

BMW has for years been taking share in the luxury end of the market, at the same time luxury cars are taking a greater share of the overall auto market. This of

course means nothing to investors today, who are treating BMW like any other member of a troubled industry.

**Is that not without cause?**

**FGP:** BMW was overly aggressive in its U.S. leasing business and recently took a nearly €1 billion writeoff as a result. That problem is likely not over, but the company's capital position remains very strong, so it should have no trouble riding out any further credit issues. On the sales side, BMW's unit sales in the U.S. were down only 5% in October, while most other companies were down significantly more. That's only one month and we're expecting things can get worse, but it shows the strength of the company's product lineup and brand.

The story here is not what the results are this year and next year. We wouldn't call it a complete makeover, but the company is making considerable effort to improve its operating efficiency, which should pay off when the economy improves. It's making its manufacturing more efficient, improving processes and taking out people. Always considered a favorite of suppliers, it's starting to put more pressure on them to lower prices and improve delivery. The research and development budget is likely to be streamlined.

**What impact do you expect all that to have on operating margins, which have been flagging in recent years?**

**FGP:** The decrease in margins up to 2007 has been entirely due to the dollar's weakness – 25% of revenues come from the U.S., but much less of their manufacturing costs are there – and higher R&D and capital spending than usual. These last two items are not something normally to complain about and we think those investments will pay off later on, particularly from improved manufacturing efficiency and the rollout of more fuel-efficient cars.

As they roll out new models in 2010 and beyond, the company expects to consistently earn 8-10% operating margins,

which is around what it would have earned in recent years without the impact of the dollar and the incremental investment spending. We're basing our valuation on 7% normalized EBIT margins – anything higher would just be icing on the cake.

**How are you valuing the shares, trading recently at €19.15?**

**FGP:** Within two to three years, we conservatively estimate that BMW will generate around €56 billion in revenues, up from around €52-53 billion this year. With an EBIT margin of 7%, no net interest expense and taxes of around €1 billion, that would result in normalized free cash flow of €3 billion. Put a 15x multiple on that – where it has traded many

times in the past – and the operating business is worth €45 billion.

Adding roughly €5 billion in cash and €5.5 billion in book value for the financing operation, we come to an overall value for the company of around €56 billion. That's more than €90 per share.

**That's quite a premium to today's price. What do you see as the biggest risks?**

**FGP:** The biggest long-term risk is that the BMW brand fades enough that normalized margins are maybe only 4%. But even at 4% margins, we calculate that the company earns enough for the shares to be worth around €40. So instead of 4x our money we earn 2x – I can live with that. That's why this is our largest holding.

**What is the market missing in Spanish energy company Repsol [REP:SM]?**

**AGL:** We believe Repsol has unique assets, with far more value in its various parts than the market is recognizing.

The biggest business is a highly integrated system of refineries – which are close to consumption centers – and a network of 3,500 service stations. The company has a roughly 50% market share in Spain, with significant economies of scale, not to mention well-developed contacts with the government. It's an almost impossible-to-replicate system today.

We've followed this refining and marketing business for years and its normal run rate of free cash flow – making no grand assumptions – is around €1.5 billion per year. At a 15x multiple, which is conservative given the strength of the business, that's worth €22.5 billion, or around €18 per share.

**With the shares trading at €14.85, that's a pretty good start.**

**AGL:** Right. So what do we get for free? Repsol also owns 30% of Spain's natural-gas-distribution monopoly, Gas Natural, which is a listed company in Spain. This is an extremely profitable business, as the government has allowed it what we think are excess returns to support the building of a full infrastructure throughout Spain. Even assuming profitability falls to a more sustainable level, again with a 15x multiple of free cash flow, we value Repsol's 30% stake in Gas Natural at around €6 billion, or €5 per share.

The company has a rather small chemical business which is very integrated with the refining business. Its product mix is roughly 70% commodity chemicals and 30% specialty chemicals. We value this business at 10x the normalized annual EBIT of €400 million, which is the same as 15x free cash flow with a 30% tax rate. That's another €4 billion in value, or a bit less than €3.50 per share.

The company's upstream businesses are primarily in Argentina, Trinidad and Tobago and in northern Africa. Leaving Argentina aside for the moment, the rest

**INVESTMENT SNAPSHOT**

**Bayerische Motoren Werke**  
(Frankfurt: BMW:GR)

**Business:** Global manufacturer and marketer of luxury automobiles and motorcycles, operating more than 150 countries. Brands include BMW, Mini and Rolls-Royce.

**Share Information**

(@11/25/08, Exchange Rate: \$1 = €0.77):

<b>Price</b>	<b>€19.15</b>
52-Week Range	€16.00 - €43.62
Dividend Yield	5.5%
Market Cap	€12.28 billion

**Financials (TTM)**

Revenue	€55.26 billion
Operating Profit Margin	5.3%
Net Profit Margin	4.1%

**Valuation Metrics**

(Current Price vs. TTM):

	<b>BMW</b>	<b>S&amp;P 500</b>
P/E	5.5	16.3

**BMW HISTORY**



**THE BOTTOM LINE**

Having invested heavily in new-product development and in improving operating efficiency, the company is well-positioned to prosper as global automobile-market growth eventually resumes, says Francisco Paramés. At a 15x multiple of normalized free cash flow of €3 billion, plus cash and financing assets, the shares would trade above €90.

Sources: Company reports, Bestinvest, other publicly available information

of the upstream business has reserves of roughly 1 billion barrels of oil equivalent. Based on the contracts in place with the various governments, the reserve mix of gas and oil and other factors, we value these reserves at \$18 per barrel. This makes no assumption about oil and gas prices – any upside from price increases would go to the home governments anyway. Using \$18 per barrel equivalent, the asset value to Repsol comes to €13 billion, or €10 per share.

In Argentina, Repsol owns oil and gas in the ground, a refining system integrated with its own production and a gasoline retail business. There is clearly country risk here, as controls on energy prices make it difficult to make money and promote very bad consumer usage habits. Even worse, given the government's plan

to nationalize private pensions, there is fear of expropriation.

Assuming the worst, this business is worth nothing. Assuming nothing changes and using the valuation at which Repsol recently sold 20% of its Argentine business to a local entrepreneur, this business is worth at least \$10 billion, which translated into Euros comes to another €5-6 in value per Repsol share.

After taking out roughly €4 per share in corporate overhead and taxes, our sum-of-the-parts value for all of Repsol comes to around €38 per share.

**We're assuming the market is particularly worried about Argentina.**

**AGL:** No question. But even if you assume Argentina nationalizes Repsol's

business there and pays nothing for it, we value the overall company at more than twice the current share price.

One edge we think we have is in understanding the value of the refining and marketing business in Spain. This is a truly unique asset that we don't believe the market is recognizing.

**FGP:** Here I would add that there could be a short-term catalyst. Repsol's largest shareholder, with a 20% stake, is the Spanish holding company Sacyr Vallehermoso, which is suffering from too much debt in its construction businesses. There is a fair chance that the government will allow a transaction in which that stake or all of Repsol is sold – either of which would clearly unlock the value of the company's assets.

Tell us about one of the holding company bargains you see today, Corporación Financiera Alba [ALB:SM].

**FGP:** Alba primarily holds two assets: a nearly 25% stake in Grupo ACS, a diversified industrial and construction company, and a 23% stake in Acerinox, one of the leading global manufacturers of stainless steel. Both of these companies are publicly traded and using only the quoted prices today, Alba shares should be trading around €50 – twice the current price of just under €25.

That's about as straightforward as it gets.

**FGP:** But that's not all. We have valued both ACS and Acerinox separately and believe each is significantly undervalued. Using our target prices for each of those, Alba's target share price is closer to €77.

ACS [ACS:SM] was originally a construction company that took the money it made from the Spanish building boom and smartly diversified over the years into a wide variety of industrial services, concessions, logistics and environmental businesses. Its operations have spread far beyond Spain and total annual revenue is more than €20 billion.

The ACS valuation is rather complicated. We go through each business and

INVESTMENT SNAPSHOT

**Repsol**

(Madrid: REP:SM)

**Business:** Exploration, development, refining and marketing of oil and natural gas, with primary operations in Spain, Argentina, Trinidad and Tobago and northern Africa.

**Share Information**

(@11/25/08, Exchange Rate: \$1 = €0.77):

<b>Price</b>	<b>€14.85</b>
52-Week Range	€12.56 - €27.91
Dividend Yield	6.7%
Market Cap	€18.13 billion

**Financials** (Through 9/30, annualized)

Revenue	€65.71 billion
Operating Profit Margin	10.2%
Net Profit Margin	5.2%

**Valuation Metrics**

(Current Price vs. TTM):

	<b>REP</b>	<b>S&amp;P 500</b>
P/E	5.1	16.3

REP HISTORY



THE BOTTOM LINE

The market is significantly undervaluing the company's diverse and relatively unique assets – particularly its integrated Spanish refining and marketing operation – says Álvaro Guzman de Lázaro. Based on a detailed sum-of-the-parts analysis, he believes the fair value of the shares, after taxes and overhead, is around €38 per share.

Sources: Company reports, Bestinver, other publicly available information

value it based on our estimates of free cash flow and appropriate multiples, always checking against things like book value or other measures of private-market value. To be conservative, we've used cash flow numbers that may be well below current levels. For example, we've reduced EBITDA by 20% in the construction business, because we expect public-works spending in Spain to go down. In going through this exercise for all the businesses, adjusting for debt and taxes, we believe ACS is worth around €16.2 billion overall, which makes Alba's share of it worth approximately €55 per share.

Acerinox [ACX:SM] is the most-efficient stainless-steel producer in the world, with factories in the U.S., Spain, South Africa and under construction in Malaysia. It was first to integrate from

the melting of the steel, to the hot rolling and then to the cold rolling. More competitor plants are catching up, but that takes time.

Because of its efficient manufacturing, Acerinox has the best margins in the industry. In our valuation we use an average sustainable EBITDA margin per ton of €200, which is below what the company has averaged over the last many years, but it takes into consideration that competitors like Mittal and ThyssenKrupp are learners and that margins will erode slowly over time. At a margin of €200 per ton, that translates into €700 million in annual EBITDA for the whole company. After maintenance capital spending, interest costs and taxes, that leaves them with free cash flow of €400 million. At a 15x multiple, all of Acerinox is worth €6

billion, which translates into €22 per share in value for Alba.

**Why do you think the market is getting this so wrong?**

**FGP:** It sounds relatively simple to do this kind of analysis, but a lot of homework goes into understanding all the different businesses in all the different countries. I guess many investors don't bother to do the work.

These companies are all extremely well managed, with no debt at the holding company or subsidiary levels. They are all buying back shares. We don't understand the current market values at all, which is why Alba is our best idea in Spain today, making up 9% of our Spain-only fund.

**Do you see similar upside in Italian holding company Cofide [COF:IM]?**

**FB:** We believe Cofide is even more undervalued than Alba. The businesses are quite different, but the analysis is fairly similar.

Cofide's only asset is a 50% share in CIR, a diversified operating company controlled by the De Benedettis, one of the wealthiest families in Italy. CIR consists of four different businesses, two publicly traded and two private, that we value separately to arrive at an overall value for Cofide.

The largest business operates gas-powered electricity plants in Italy, as well as some smaller wind-generation and solar-power assets. Given the relatively stable nature of the business, this isn't that difficult to value, especially because the company just raised additional capital from long-time partner Verbund, Austria's leading electricity producer, at an implied valuation for the entire company of €3.7 billion. We're more conservative in our valuation and arrive at a value of €2.7 billion, €700 million of which is attributable to Cofide.

Another privately held business runs hospitals, nursing homes and rehabilitation centers in Italy. It is performing quite well and is well-positioned as the frag-

**INVESTMENT SNAPSHOT**

**Corporación Financiera Alba**  
(Madrid: ALB:SM)

**Business:** Spanish holding company with two primary publicly traded assets: industrial and construction conglomerate Grupo ACS and stainless-steel maker Acerinox.

**Share Information**

(@11/25/08, Exchange Rate: \$1 = €0.77):

<b>Price</b>	<b>€24.94</b>
52-Week Range	€20.06 - €51.60
Dividend Yield	0.5%
Market Cap	€1.56 billion

**Financials (2007)**

Profit from Holdings	€599.5 million
Net Profit Margin	95.6%
EPS	€9.25

**Valuation Metrics**

(Current Price vs. TTM):

	<b>ALB</b>	<b>S&amp;P 500</b>
P/E	2.9	16.3

**ALB HISTORY**



**THE BOTTOM LINE**

The stakes this holding company owns in its two primary assets – at those companies' current market values – are worth twice the current share price, says Francisco Paramés. Based on the estimated share prices at which those two portfolio companies should trade on a normalized basis, he puts Alba's target value at closer to €77.

Sources: Company reports, Bestinvest, other publicly available information

mented healthcare industry in Italy continues to consolidate. Without going into detail, we value Cofide's piece of this business at €125 million.

The two publicly owned businesses are L'Espresso [ES:IM], one of the leading media companies in Italy, and Sogefi [SO:IM], a leading European supplier of automotive filters and suspensions. We believe L'Espresso is undervalued by the market because of the current weak economic environment and on a normalized basis is worth maybe 2x its current market cap, or €1 billion. That translates into €250 million in value for Cofide.

We have known Sogefi for many years and consider it even more dramatically undervalued. (We own the stock separately as well in our global fund.) The auto business is obviously going through a dif-

ficult period – which is why Sogefi's stock is down so much – but the company has a healthy mix of original-equipment and replacement businesses, and its reported numbers have been relatively solid as a result. Our target value for the shares is €780 million, with Cofide's share worth almost €220 million.

Adding it all up, that's nearly €1.3 billion in estimated asset value for a company whose market value is €220 million.

**Is there any risk the De Benedettis will try to take other shareholders out cheaply?**

**FB:** We never say never, but Rodolfo De Benedetti [son of patriarch Carlo De Benedetti and CEO of CIR] is a smart, serious businessman with an excellent track record of performance and of acting

in all shareholders' interest. The company pays special dividends when it has excess cash. It will spin off businesses to try to uncover value. We're confident our interests are aligned with theirs.

**Is Italian technology-product distributor Esprinet [PRT:IM] another cyclical turnaround bet?**

**AGL:** In many ways, yes, but there is also an operational-turnaround side of the story as well.

Esprinet distributes in Italy and Spain a wide range of information technology products – up to 25,000 SKUs [stock keeping units] – including computers, servers, networking systems and software. The two big U.S.-based companies in the same business are Ingram Micro and Tech Data.

In Italy the company is the dominant player, with more than 30% of the market, twice the level of any competitor. While everyone else in the market is at best barely breaking even, Esprinet's normal EBIT margin is 3-3.5%. Part of that is attributable to having the best Internet ordering system – which enables them to process up to 90% of their orders online – but it's also a function of doing the thousands of small things right that well-managed companies in low-margin businesses do. On the operational front, they are probably unbeatable in Italy.

Even at a bad time for IT spending, the Italian business has been quite resilient. Esprinet's profits are down 8% year-to-date in Italy, while competitors are down much more than that. After-tax, we estimate normalized free cash flow in Italy to be around €35 million per year. With a 15x multiple, we value that business at €525 million, or €10 per share.

**That's already two-and-a-half times the current share price of just under €4. Is the Spanish business as unimpressive as the Italian one is impressive?**

**AGL:** The company launched in Spain in 2006, and the stock got bid up into the mid-teens per share as everyone seemed to assume they'd very quickly replicate

**INVESTMENT SNAPSHOT**

**Cofide**

(Milan: COF:IM)

**Business:** Holding company controlled by Italy's De Benedetti family, with ownership positions primarily in energy, media, health-care and auto-parts businesses.

**Share Information**

(@11/25/08, Exchange Rate: \$1 = €0.77):

<b>Price</b>	<b>€0.31</b>
52-Week Range	€0.29 - €1.11
Dividend Yield	4.9%
Market Cap	€221.2 million

**Financials (2007)**

Profit from Holdings	€42.1 million
Net Profit Margin	76.7%
EPS	€0.045

**Valuation Metrics**

(Current Price vs. TTM):

	<b>COF</b>	<b>S&amp;P 500</b>
P/E	5.0	16.3

**COF HISTORY**



**THE BOTTOM LINE**

In a bad market this holding company illogically trades at a higher discount to its net assets, at the same time those portfolio assets themselves are more undervalued, says Fernando Bernad. His sum-of-the-parts analysis of Cofide's holdings results in an estimated asset value that is nearly six times the current market value of its shares.

Sources: Company reports, Bestinvest, other publicly available information

their success in Italy. But the first year was pretty much of a mess, as they stumbled in integrating the acquisitions they'd made, the Internet ordering system didn't work right away and customer service suffered.

We believe that as of the first quarter of this year the operational problems in Spain have been mostly resolved. But no matter how lean and mean they are there, the problem now is the country's very tough environment for technology spending. Esprinet, Ingram and Tech Data each have around 20% of the market and no one is making any money. That's likely to be true through 2009 as well.

But if you look out, say, three years, the Spanish economy will recover and the overall IT market will likely grow at a faster rate in Spain than elsewhere in

Europe. With the operational problems solved, we expect Esprinet to be the first to make money in Spain. The company thinks they'll do much better than this, but on around €700 million in revenue we assume they can earn at least €10 million in after-tax free cash flow in Spain by 2011. At only a 10x multiple that would be worth €100 million, or €2 per share.

The beauty of the story is that based on a proven, wide-moat business in Italy, we think we have a nearly three-bagger from the current stock price. That means we have a free option on what could very well become the best IT distribution company in Spain. In the meantime, we're collecting a 4% dividend yield and could see additional benefit from a share buyback plan authorized last May.

**In general, how would you describe your sell discipline?**

**FGP:** It's driven by what we described earlier, which is a constant comparison to alternatives. As the discount to our target changes – either because the market price changes or the target price changes – we respond. We want to own less of a stock as it gets closer to our target price and more of another stock as it gets further away from our target price. This is easier to do when we find so many large discounts among current portfolio companies, which we already know so well.

We've sold recently Heidelberger Druckmaschinen [HDD:GR], a leading manufacturer of sheet-fed printing machines. As we've learned more about the structural challenges facing its business, our target value for the company has come down. It's still quite undervalued, but not enough relative to the many better alternatives we have.

**Can you generalize about situations in which you've made mistakes?**

**FGP:** It's pretty simple: when we haven't done our homework. Sometimes that's been because we were overconfident about what we already knew, but it also has been a result of stretching ourselves too thin. One reason we focus now on 60-70 stocks is because we think that's a number we can know very well with the resources we have.

**Francisco, this may be a rather trite question, but has your life changed at all since surviving the plane crash in 2006?**

*[Editors' Note: In March 2006, Paramés and several colleagues were on board a plane that crashed in northern Spain's Tajonar mountains, killing the pilot and a top Bestinver executive. Paramés suffered burns and a broken ankle.]*

**FGP:** No, I can't really say my life has changed at all. I've always considered myself privileged to live the life I do, making a living doing something I enjoy very much. That's as true today as ever. **VII**

**INVESTMENT SNAPSHOT**

**Esprinet**  
(Milan: PRT:IM)

**Business:** Distributor of broad range of computers, software, networking equipment and other information technology products, with primary operations in Italy and Spain.

**Share Information**  
(@11/25/08, Exchange Rate: \$1 = €0.77):

<b>Price</b>	<b>€3.98</b>
52-Week Range	€2.10 - €9.09
Dividend Yield	3.9%
Market Cap	€208.6 million

**Financials** (Through 9/30, annualized)

Revenue	€2.19 billion
Operating Margin	1.8%
Net Profit Margin	0.8%

**Valuation Metrics**  
(Current Price vs. TTM):

	<b>PRT</b>	<b>Nasdaq</b>
P/E	9.0	17.6

**PRT HISTORY**



**THE BOTTOM LINE**

With its industry-leading market share and margins, the company should earn normalized free cash flow in Italy of €35 million per year, says Álvaro Guzman de Lázaro. A 15x multiple on that business would result in a share price of around €10, he says, leaving any upside from Esprinet's fledgling Spanish business available as a free option.

Sources: Company reports, Bestinver, other publicly available information