# Analyzing the Past to Predict Future Returns



**Juan Uguet de Resayre** is Founder of Augustus Capital, which was founded in 2013, and is Fund Manager at MG Valores. He joined BBVA & Partners in 2007 as a partner and head of a new team. Mr. Uguet de Resayre was CIO at Ibercaja Gestion — the asset management arm of a leading Spanish saving bank — since 2000, with full responsibility for mutual and pension funds having 9... More

**Carlos Val-Carreres** is Founder of Augustus Capital, which was founded in 2013, and Fund Manager at MG Valores. Mr. Val-Carreres has teamed with Mr. Uguet de Resayre since he joined Ibercaja Gestion in 2002 as a fund manager of European equities and total return funds — 1.5 billion euros of assets under management... More

**TWST: Give us some background on Augustus Capital and tell us why you decided to form that company.**

**Mr. Uguet de Resayre:** We were working for BBVA Bank before 2013. We were partners of a JV with that bank that was called BBVA & Partners. The bank decided to stop that JV and they wanted us to get into their asset management of the company. We really wanted to remain independent, and so we Carlos Val-Carreres and myself then decided to start Augustus Capital.

To do so, we had two options: We could launch a new fund with no seed capital, which is something really difficult. Or we had another option, which was to open a family fund, which is actually the fund that we are managing now, Lierde SICAV. This used to be a closed end fund owned by my family and we had around EUR 40 million in that fund. So we used that fund as seed capital and we opened it for outside investors. This is briefly the history of our company.

**TWST: The Fund has been up 1424% (Average annual return of 16.4%) since inception in 1994. In your opinion, what are the drivers of the success of the fund?**

**Mr. Uguet de Resayre:** As I mentioned before, I started to manage the Lierde fund in 1994 when it was still a family fund. I have managed it for about 21 years so far. The entire time I have managed it, I have always applied the same criteria to the investments based on the analysis of the Return on Capital Employed (ROCE) and its sustainability. Actually, I started my career as a company analyst in 1992, and I always say that I am not an asset manager, I'm an analyst.

Carlos, my colleague since 2002, and Marta, who has just joined the company one year ago, we, the three of us have the same philosophy. That philosophy is that you have to focus on the fundamentals of the company. We try to apply the same criteria, which is to buy companies with high return on capital employed and assure that these returns are going to be sustainable in the future. So we spend the majority of our time analyzing the history of the companies. We look at five to ten years history through the annual reports of the companies (we analyze the evolution of revenues and margins, the quality of the top management, the capital structure, etc.), to find out why these companies have such a high return on capital employed and try to forecast on whether they will be able to maintain those returns in the future. We consider that analyzing the past is the best starting point to predict future returns.

To sum up, I think our success is related to the fact that we maintain that same philosophy, which is fundamental analysis, we look deeply at the annual reports of the companies, we calculate the returns on capital employed of the companies to see if it is higher than the Cost of Capital, and we try to see whether those returns are going to be sustainable in the future (existence of sustainable barriers to entry -i.e. brands, patents, high market shares in a low margin industry, differential human capital, etc.-; reduced exposure to technological or regulatory changes, structural trends, new materials, etc.)

**TWST: You like companies that you say "create wealth." Does that go back to the issue of return on capital?**

**Mr. Uguet de Resayre:** In order to create wealth, you need to have companies that through the cycle, their return on capital, it's higher than the cost of capital. This is the basics for us. The higher the return on capital over the cost of capital, the better the performance of a company is going to be. That is, of course, true. But at the same time, you need to find companies that not only can accomplish these criteria, but also that are priced at an attractive level. We focus on the return on capital employed or the excess return over the cost of capital as well as the value that we think the company has. So it's not a matter of having low or high multiple. Some companies have very high multiples like PEs or EV/EBITA and are very cheap and some companies have very low PEs or very low EV/EBITA and are very expensive. The relationship between return on capital employed and EV to capital employed is the key for us.

**TWST: Where do you get new ideas? I know they are generated internally, but how do you find a new idea for the fund?**

**Mr. Uguet de Resayre:** We have several ways of finding ideas, but the main one, I would say, is through the screening. There are about 10,000 companies listed in Europe and we do screenings for issues such as return on capital employed 4 points above the cost of capital. So, let's say we get 200, 300 companies in that criteria. After that, we'll start doing some research. We build the model of the company, we talk to the companies, we try to talk to some analysts that are a positive on the names, analysts that are negative on the company, we talk to competitors, we do some reading of specialized magazines or information that we can reach and at the end, we have a short list of, let's say, 50 to 60 companies. Then we try to see if the price is right. If all those things line up, then we buy it. It is a process that is not very complicated, but takes some time. Of course, we also get information from other resources. We read the Wall Street Journal, we read Barron's, we read The Economist, we read online stories, we read blogs, we read all those kinds of things. We also get good ideas of products that you see every day in the market or in the street or traveling or whatever, and that makes us look at things. But at the end of the day, the main source of ideas is our screening process.

**TWST: You have four Spanish property companies in the portfolio. Is there something right now about that sector, about property or real estate in Spain that you particularly like?**

**Mr. Val-Carreres:** This is an interesting phenomena, because real estate is not actually a sector that we focus on most of the time, so it is not a usual situation that we would have four property companies in the portfolio. This reflects something specific that is going on in the current period. We live in Spain, we understand very well how the situation of the economy here is, how the situation of the real estate market is and we have taken advantage of that. We have studied the whole real estate sector here and we found it very, very cheap. The prices in Spain for real estate assets fell more than 50% since the peak in 2007. Now we are seeing that there is a recovery is going on. The rental prices are starting to recover, and real estate prices are starting to recover as well. Foreign investors are starting to look at the Spanish market. Many of these foreign investors, such as insurance companies, pension funds, mutual funds, do not have any exposure to the Spanish real estate market, but now see that there is an opportunity. We see it as a big opportunity. We took advantage of that to take a position in names like Merlin Properties, LAR España, and Realia. But this is something temporary. We think that we can make 20% to 30% in those names and after that, we will sell those names and we will focus in the criteria that I mentioned before, which is return on capital employed and creating wealth. This methodology cannot be applied to the real estate market, but we do see this particular situation as a short term opportunity that we want to take advantage of.

**TWST: Do you focus on specific cap size? Are you finding more opportunities in one are versus the others?**

**Mr. Val-Carreres:** Currently, approximately 50% of our fund is invested in companies with more than $5 billion market cap, which, for us, is large caps. And 50% in medium and smaller caps. For the long term, we think your returns are much higher if you are invested in small caps, because the potential to grow is higher and they are less covered than the larger cap names. We generally maintain close to a 50-50 mix between the large caps and the medium/small cap names.

**TWST: Can you give me a couple of names in your portfolio that explain the process you were talking about?**

**Mr. Val-Carreres:** We have a very diversified portfolio. We usually have between 50 and 60 names in the portfolio at any one time, and we put around 1%-3% in each name. We don't have any one name that dominates the portfolio – we won't have a name that has 10% of the portfolio, for example. To give you an example of a name we like, I will talk about one in the automobile sector. In that sector, we like very much Valeo, which is a French company. In logistics, we like another French company, a small cap name, which is IDL Logistics. In IT services, which is one of the sectors that we like the most, we especially like an Italian Company called Reply. In another sector that we like a lot is automation and we have the Swedish company, Hexagon that we like very much. All of these companies have very high return of capital and have created a lot of wealth, and that is why we like them.

**TWST: You mentioned that you like the IT sector. Why do you like that sector so much right now?**

**Mr. Val-Carreres:** We like everything related to externalization/outsourcing of a company, which is a major trend we are seeing right now. At least in Europe, we had a situation where the economies were not growing very fast. So the companies decided to take measures to cut costs, and part of that was by externalizing some parts of the company like logistics or IT services. So those are two sectors we like very much, logistics and IT, because they are two areas where companies are still focusing in reducing costs. So far, these two businesses are growing 2% or 3% above the European GDP. This year, the European GDP is going to grow 2%. These two areas are growing by 5%, so that is the main reason we are attracted to those areas.

**TWST: Why do you sell a holding out of the portfolio?**

**Mr. Val-Carreres:** Once we decide to buy a company, we know the price at which we would buy it and we know the price at which we would sell it. So we calculate the value of a company in advance and then we put in our models and in our portfolios, then we put an alarm on the holding. Once the price reaches 5% of the target value, then we take a look at it and decide what we are going to do. If everything is still the same, and we still have the same value on it, we will sell it. Sometimes we will take another look and re-evaluate the company because something has changed to change the value, like if it is growing faster than we thought or the company is taking more market share or something else. If that happens, we will raise the target price and we will not sell it, but we will keep it in the portfolio. But generally the reason we will sell something is because it has reached the value we assigned to it.

**TWST: Do you have stop-losses?**

**Mr. Val-Carreres:** No, we don't have stop-losses. One thing that makes us different from other portfolio managers is that we try to be very close to the companies in which we invest. If suddenly there is a company that starts to fall and we don't see any reason for that fall, we will try to call the companies and understand if something has changed or if things are going as we expected. If we do that, and do more research, and find that there is nothing wrong and we do not think this is a long-term fall, then we will actually buy more. We never sell our stock just because it's falling or because the monthly report is going to look ugly for our investors and some people are going to panic. We don't do that.

**TWST: You focus on the bottoms up fundamentals of the stocks. But, as you noted, you do take advantage of short-term opportunities such as the real estate situation in Spain. What is your overall macro outlook and what are your expectations for growth?**

**Mr. Uguet de Resayre:** We are very micro-focused, looking at each company individually. Of course, we also have an idea of what is going on in the economy, but we are not really worried about these. Our fund is long-only, and we are always at least 80% invested. That means we have to be almost fully invested whether the economy goes well or whether it goes badly. But having said that, we think that Europe is recovering, the GDP in Europe is going to be around 2% next year and the global economy is going to grow close to 3%. This is important because the profits from European listed companies depend more on the global growth than on the European growth itself because, Europe is a very open market. The companies export a lot to the rest of the world, probably more than US companies export in general, and so the profit rely more on the global growth than in European growth. This means that the profits in Europe are going to grow, let's say, between 10% to 13% for 2015 and 2016 for both years. Additionally, the valuations in Europe are very cheap compared to the US and compared to other financial assets. That all makes us very positive about the performance of Europe this year and next year. We are not as positive in terms of US market outlook. The US market is already expensive based on normalized earnings. We don't really see too much upside for the US market. In Europe, profits are starting to move up and based on normalized earnings we are still seeing more than 20% upside from here to the end of 2016, which makes Europe a lot more attractive.

**TWST: Thank you.**

**Mr. Uguet de Resayre & Mr. Val-Carreres:** Thank you.