

## March 2010 *CGI Value Focus Coach*: Value Voices Interview with Plan Maestro

Dear Member:

Welcome to our first installment of the **Value Voices Interview Series**. We begin today with Plan Maestro, author of the excellent [Variant Perceptions](#) blog.

We hope you'll enjoy Plan's wise words and thanks for being a Value Focus member.

Best wishes,  
Ragu and Jeff

### Background

**[Jeff Annello](#): To start, tell me about your background. What were you doing before you got into investing?**

**[Plan Maestro](#)**: I was a management consultant and then worked for eight years as director of corporate strategy for a couple of Latin American groups.

**JA: Has this experience as a consultant and an operator come in handy during your investing career thus far?**

**PM**: Sure, having a peripheral view of several industries, having the analytical capability to go in depth, understanding management and change, and making tough decisions under uncertainty in a short amount of time.

You also learn a lot about good industries and businesses. I did research and analysis on **Wal-Mart** (WMT), Aldi, **Coca-Cola** (KO), Heineken, South African Breweries, MBNA, State Farm, **Banco Santander** (STD), **Banco Bilbao Vizcaya Argentaria** (BBVA), **Magna** (MGA), **Toyota** (TM), **Thor Industries** (THO), and Clayton Homes. Also about some companies you have never heard

about, like Pollo Campero, Banco Popular, Citrosuco, Falabella, Metalsa, or **Coca-Cola FEMSA** (KOF).

But even more important, it helped me develop what I consider an edge on successful turnarounds and understanding investments from a business perspective.

**JA: How did you become interested in investing?**

**PM**: I have this childhood memory of my dad worrying about a possible devaluation. The government did devalue and he was not a happy man since he knew he would not find work for years but at least he had protected his savings buying dollars. If you are from Latin America you learn early on, like in *Million Dollar Baby*, to *always* protect yourself.

On a family dinner soon afterwards, an uncle came bragging: he had bought stocks, with debt, in dollars, and he had closed it all just one week before the devaluation. I suppose I had my first investment thought: that was stupid on so many levels.

More recently, I was surprised after reading Warren Buffett's early partnership letters that I had missed the investor, after studying the businessman for several years, and realized that it was the natural next step. And after you get a couple of successes...

**JA: How did you go about learning the craft of investing? What books, resources, or people were your earliest influences?**

*PM:* One of my grandfathers loved investing. He had stories of both world wars, the great depression, all the social upheavals including the rise of middle class and [Salvador] Allende. But he was an optimist and was convinced that the stock market would keep going higher.

His type of stock was your widows and orphans: companies that would survive the worse, with a heavy emphasis on dividends, and buying at the points of pessimism. Even though he was a salary man, he managed to raise six children, send them to the best schools and colleges, and leave a decent inheritance after being retired for more than 40 years.

Regarding books, I tried to make sense of the 1982 crisis but could not find much at the beginning. To put some context, unemployment was higher than 30% and we were close to a revolution. Our Treasury Secretary, former head of the largest bank, had to nationalize the banking system. Then he was fired and sent to jail—a story that makes a nice bizarro world to Hank Paulson's.

The first book that made any sense was Keynes's *General Theory [of Employment, Interest and Money]*, and chapter 12 is still a must read. Another good one is Jenaro Prieto's *El Socio*, a novel published in 1929—remind you of

anything? It was recently made into a very bad Whoopi Goldberg film.

**JA: I'm fascinated by your background. What was it like living in a state close to the edge of revolution?**

*PM:* This was a military dictatorship and the year was 1984. The situation was very similar to *1984* the book but with a government that could not completely suppress opposition.

The media was censored, we had violent manifestations in the *poblaciones* at historical dates, large weapon stockpiles were found, and there were rumors of exiled communist leaders getting into the country. But it all ended with the unsuccessful murder attempt of [Augusto] Pinochet in an ambush when a rocket bounced off his car without exploding. After that people got scared and the most peaceful sectors managed to negotiate somewhat of a transition.

**JA: Wow. So, tell me about an early investment you made. How did it go?**

*PM:* My first investment was a fictional one. With a friend in college we entered a national stock picking competition. The country was in a boom after a surprisingly smooth return to democracy.

We decided to be ultra contrarians, since there was no prize for second place, and invested in one day CDs while everyone else was buying stocks. We went every day to the stock exchange to place our order and ended up winning by a large margin and appearing on national TV. I did not learn much about stocks, but I did learn about discipline, thinking differently, and being skeptical of the media.

The first real investment was AntarChile, a stock that you can find in Third Avenue's current portfolio. AntarChile's only asset was his

controlling share of Copec, a public company (60% pulp and paper, 25% gas retail, and 15% fishmeal). It was the bottom of the pulp cycle and through AntarChile you were buying Copec at a 40% discount. Copec was one of the global lowest cost producers and had made large forest investments that the market was not giving its fair value.

AntarChile was the investment that paid for my MBA. I was surprised by the almost 3x in a year and maybe it was counterproductive for the future: it looked so easy.

**JA: That's a great story about your national TV appearance. It sounds like your first investment, AntarChile, was a fairly large one for you. I wish my first had gone as well! Did you originally find it through Third Ave?**

*PM:* Well, there are some bad investments too but I would need a beer and an off-the-record.

**[JA: Hah! Wouldn't we all...]**

At the time, I did not know any famous investor and it took me a while to buy my first stock. Having worked already for more than a year in the investment department of an insurance company, I can tell you that everyone knew about the thesis but few acted. There were two fears:

(1) Pulp prices could go even lower. A possibility, but who cares when you are buying the lowest cost producer two years into a recession.

(2) Most of these controlling holdings traded at large discounts. This is more interesting. There were still memories of 1982 and Ponzi schemes with pyramid structures, increasing levels of leverage, and abusive practices against minority shareholders. Similar to Goldman Sachs Trading in 1929.

It is a mystery. The market had this made-up rule: holding companies trade at 30%+ discounts, even conservative ones with concentrated portfolios and low leverage as AntarChile.

**JA: Some analysts have even argued that Berkshire Hathaway is getting so large that it should be discounted. I'm not sure I totally understand the argument, either.**

**So, how have you improved as an investor over time?**

*PM:* That's a tough question because I did not consider myself an investor until recently. First, I did not have the capital, so my salary was more important. And second, I thought that the secret was to have cash, wait for the earthquake, go to the epicenter, and look for survivors. That is not a strategy for all seasons.

For example, in 1993 I bought commodities (pulp and paper, and salmon), for the Asian crisis I could not buy because I was a poor recent MBA, and after the Internet bubble I bought eBay, Amazon, Yahoo.

Only the last years I have gained the confidence of stretching myself to look for turnarounds and special situations. I have the edge of having firsthand knowledge and data on how firms think and react, and why they succeed or fail. The thing was how to make that knowledge practical. And in that sense, I believe I have become an investor.

**JA: Does the "wait for the crash and then sort out the survivors" mentality remain a part of—albeit not your entire—philosophy in any way?**

*PM:* Without a Bretton Woods there is always some country struggling with sudden injections and/or reversals of foreign capital like Latin America in the '80s. I am not an economist so I will not argue for or against it.

Right now I am studying **Allied Irish Banks (AIB)** (that has a nice percentage in **M&T Bank (MTB)**) and Coca-Cola Hellenic (Greek bottler with operations across Eastern Europe). Always looking but waiting for the panic.

It also has pushed my investment philosophy to look for very cheap because I know that in the next five years, Mr. Market is going to give me another wonderful opportunity. So the opportunity cost of just having cash is high.

**JA: Do you like to read books? What are your favorites?**

*PM:* I am a heavy consumer of non-fiction, history books in particular. I am the type of person that has read Thucydides more than once and likes the comfort that human nature has not changed.

More recent authors, I would recommend Barbara Tuchman's *The Guns of August* and in finance Ron Chernow's *The House of Morgan*. In fiction, *1984* is the best book of the 20th Century. I am a sunny kind of fellow.

On investing and business, I just reviewed Adrian

Slywotzky's *The Art of Profitability*, which has some nice recommendations.

**JA: Can't say I've read Thucydides! 1984 was a good book, though. I remember enjoying Orwell back in high school.**

**How did you get into writing online?**

*PM:* Writing in message boards and sharing ideas on email was time consuming. I thought that writing them once and linking to the blog would be better. I was very wrong.

But it had its benefits, the access to a community and to develop the discipline to write ideas in a way that you can convince other people. And the readers have nice ideas too. Now that I am getting to like it, I am planning on having a Tips section, like Greenbackd or Old School Value, but to discuss turnarounds and cyclical instead of asset plays and growth opportunities.

**JA: Plan, what are your professional goals?**

*PM:* For the next five years, to raise an investment partnership. After that, who knows. I do not have a master plan (but it would be nice to have an insurance company).

## Philosophy and Process

**JA: About your investment philosophy, what are your main tenets?**

*PM:* (1) Buy only with an upper hand against the big institutional investor (crashes, forced selling, or under the radar)

(2) Look for downside protection (stable cash flows, substantial cash, underpriced assets, no debt, or good liabilities)

(3) Never pay fair value and always keep looking for the cheapest

(4) The credit cycle is your major enemy and your major friend

(5) Remember: *never pay fair value*

**JA: Of the prominent investors we all follow, whose investment style is yours the most closely aligned with?**

*PM:* Been always a fan of Peter Lynch and I have devoured his books more than once. I like how he adapts his thinking to the specifics of the situation. More recently, I have stumbled upon

David Tepper in several of my ideas.

**JA: I've always been a fan of Peter Lynch too. His writing seems to make sense. What parts of his philosophy have been the most influential to you?**

*PM:* As you have probably noticed, I like his framework to classify investments (turnaround, asset play, stalwart, slow grower, fast grower) and how he uses it to describe what to buy, when to buy, when to increase the position, when to sell, and the signals and metrics along the way.

When I reread *One Up on Wall Street*, after several years, a bulb went on and realized that I had something to add to turnaround plays.

**JA: That's interesting because few investors have the level of self-awareness to know where their circle of competence lies.**

**How do you think about portfolio management? Do you consider yourself a concentrated or more diversified investor and why?**

*PM:* I think the most important question in risk management is how you position yourself against the credit cycle. The amount of diversification depends on the number of ideas, how cheap they are, and their defensiveness against the cycle.

**JA: I'm interested by your credit cycle idea. Can you expand upon that a bit? How do you take steps to (1) figure out where we are in the cycle and (2) protect against downdrafts in the cycle?**

*PM:* I do not want to be overly precise; it is more a worry than a prediction. The historic answer was whenever Paul Volcker got worried. But that will probably not work going forward. So I think the answer is: it is all about the financial sector.

My concern is when the financial sector loses its mind. When their balance sheets grow too fast,

the financing is short term, the loan standards deteriorate, their covenants are too light, and their collateral gets risky. Banks in particular are too fragile and critical a sector so if you have an earthquake, it will be with tsunami included.

That is Tom Russo's Cape Buffalo: the only Savannah animal when faced you should run from instead of staying put. You do not want to be fully invested, concentrated in few ideas, in sensitive economic sectors, with high financial and operating leverage when that moment comes.

The experience of working a lot with financial institutions is an advantage and I am thinking on an early warning system but nothing to brag about. Having gone through several bubbles you learn to see them. Is there a better training than 2008, Jeff?

**JA: I totally agree. Living through 2008 as an investor was a formative experience. Not only did we see the financial system melt down, but many prominent value investors failed to protect their clients' capital. If you didn't learn about yourself as an investor during that period, you probably never will.**

**Besides long equities, what else do you put in your portfolio? Do you ever short stocks or buy bonds, mutual funds, or derivative instruments like options?**

*PM:* I do like to see the whole capital structure and check market neutral pair trades to capitalize on ridiculous capital structure mispricings (ie: Freddie Mac preferreds vs common), but I prefer to limit potential losses with puts. I do not like traditional shorting very much for all the known reasons.

On the long side, I have used covered calls when

it gets close to my target price, volatility is high and I am in no rush to deploy capital. I have also found that to buy LEAPS in some of the turnaround plays that I like reduces the capital at risk while keeping the upside if volatility is low. [Citibank recently, or **ATP Oil and Gas Corp** (ATPG) Jeff :)]

After reading the very good books like Gregory Zuckerman's *The Greatest Trade Ever* and Seth Klarman's *Margin of Safety*, I am also open to hedge my portfolio with puts or CDSs at the top of the credit cycle when spreads are thin but you need a larger fund for that.

**JA: How do you find investment ideas?**

*PM:* The usual stuff. Continuous reading, focusing one sector at a time to cross pollinate. Hearing investors' conferences to get up to date on what is going on the industry and its worries, then use filters on the sector to find cheap ideas. I also check day-lows looking for selloffs in my target sectors and insider buying.

Ideas that I find cheap enter a wish list that is reviewed each day waiting for selloffs, and that is when I start the in-depth analysis.

**JA: Okay, so you've found an idea. Bring us through your process of investigating the opportunity and deciding "yes, I'll buy it" or "no, this is not a good investment."**

*PM:* First I ask myself if it is cheaper than my better opportunity. If it is not, I just add it to the wish list and wait for a selloff before considering it. If it is cheaper, I want to understand the reason (eg, management screw-up, forced selling, market misperception), looking for situations where as a buyer I have the upper hand and the seller is either misinformed or constrained.

After that, I start to look for anything that can

provide me with downside protection (long-term contracts, mispriced assets, substantial cash, nonrecourse debt, lowest cost, wide moat, hedges). Then I start to think of scenarios where it can go wrong and check for catalysts of when things could go right. If there are potential holes, dig deep, dig deeper.

I try to balance my portfolio in terms of offensive vs defensive, types of catalyst (event-driven, market-driven), types of investment (turnarounds vs cyclicals), sectors, and a sensibility to macro factors (inflation vs deflation). Then lastly, I put all that in the context of the credit cycle.

**JA: Have you ever rejected what seemed like a very good idea from the bottom up because of macro considerations or the credit cycle? If so, did it pay off?**

*PM:* I usually went to cash when the next party got started having reaped the rewards of the previous hangover. I did not look back and tuned out of the market keeping only peripheral vision to follow the excesses. For example, I sold all internet stocks some months after the **Google** (GOOG) IPO and do not remember having regrets.

The time that I decided not to pay attention did not play that well. The only stock that I kept going into the crisis was Thor Industries, a dominant RV manufacturer. No debt, plenty of cash, very profitable, growing leader, and gaining share, most of the competition just surviving and indebted, and demographics on its back.

It looked like the perfect moat investment but in a cyclical business. And it was in my circle of competence having talked with them, their competition, and their distributors for an internal project and all the manufactured home industry too.

So I understood the importance of financing and the risks of bad debt, but I thought that a crisis would make Thor stronger, like Clayton. So for the first time I decided to do the hold in buy and hold. The result? The process was not pretty. The outcome was bad but could have been worse, and the future may be rosy but I would not repeat the experience again.

**JA: What sources do you spend the most time reading? Where do you focus your time?**

*PM:* Same old: investor conferences and company presentations, 10Ks, conference call transcripts, Google alerts, day and 52w lows, blogs, and non-idea searching stuff until something grabs my attention.

**JA: What role does “scuttlebutt” play in your investment process?**

*PM:* I do not talk much to management because in general I like situations where management is not that important for the thesis. People like to blame management too much for stock price problems. However, most of the time it is about an organization reaching roadblocks like the one-man rule that I talked about in my blog. In those cases, management is and is not the problem.

Anyway, I am constantly reading and asking about the sectors of my interest. And when I am after a company, I move all stones including understanding the competition, clients, and suppliers (another good source of ideas).

**JA: For those readers who may not have read the blog post, can you expand on your “one-man rule”?**

*PM:* To go from starting a company to building an organization is a recurring challenge. If the entrepreneur does not know his limitations he will keep solving all the company issues with creativity and improvisation and not building processes and controls. If the company is successful and grows fast, this organization can rapidly be insufficient and catastrophic small errors can happen (quality errors, regulatory problems, errors in financial statements, etc).

I like this type of turnaround because when a company is small, it is a much easier turnaround and very often all you need is to bring in professional management to put some discipline. Usually the stock is obliterated and given that most probably is a small cap, it is under the radar of large institutions giving the investor time to follow the turnaround before prices show its progress.

**JA: Where do you need to improve as an investor?**

*PM:* (1) Keep it simple: I'm too attracted to the complex.

(2) Expand the edge in turnarounds and cyclicals with more analytics.

(3) And my wife tells me that I should spend more time with the family.

## Investments and Business

**JA: What would you consider your most successful investment to date and why?**

*PM:* Historically, AntarChile; the first love is never forgotten. More recently, **WellCare Health Plans (WCG)** since it was one of the first big wins in

terms of thinking about how to invest in turnarounds after a couple of false starts. I followed the company for several months before investing, even though Bruce Berkowitz and Mohnish Pabrai had bought big positions early on

after their FBI raid. It demonstrated correct and independent thinking.

**JA: When did you finally make your WellCare investment?**

*PM:* When it went below \$10, I bought an initial position. It was too cheap and safe to ignore. But I really added to it when the delinquent financial statements were made public. They were having problems moving cash from the subsidiaries to the holding, so it was important to have confirmation that the situation was under control and also wanted to check their reserves for the inevitable fine. I like that about turnaround investing: there is time to close the loop.

**JA: What has been your least successful investment? Why?**

*PM:* **RHI Entertainment (RHIE)**. It demonstrated incorrect and dependent thinking, so I hope it is the last time I invest in a turnaround without following the framework and also the last time I follow a famous investor blindly. Where is my beer and the off-the-record?

**JA: What is it about complex situations that attract you to them?**

*PM:* The intellectual challenge of cracking a puzzle and thinking that I know something that the market does not. The problem is you can always make mistakes and also the market may take its time to get to your point of view. Think Michael Burry buying CDSs on subprime CDOs in 2004. He was right, but he could have missed something, and it took years for the market to come around.

Look, for example, to the Freddie Mac pair trade that I mentioned. Those posts are some of the least popular in Variant Perceptions. Everyone that I mention the trade to answers with a quizzical look. I think things will become clear in a

couple of years, and in the interim the Obama administration and Congress will play delay tactics because they do not have options. So, should I keep the trade or wait for a year or two? I think the preferreds are so cheap and there are reasons for that (FDIC liquidating the positions of failed banks) that I am staying put. But it is something to keep under review.

**JA: Assuming you were offered a fair price, if you had to choose one stock to buy for the next 30 years, which business would it be and why?**

*PM:* The Buffett question... To tell you the truth I am very skeptical of moat investing going forward so I do not pay fair price for any stock.

I just reference Bill Ruane's pick in the '90s: **Eastman Kodak (EK)**. Or Buffet's pick in the '80s: **The Washington Post (WPO)**. Five years ago I probably would have said **eBay (EBAY)**. Fifteen years ago maybe **Dell (DELL)** or **Microsoft (MSFT)**.

Even a great business like Coca-Cola is under threat: noncarbonated is gaining share, **PepsiCo (PEP)** as a group is gaining share, Wal-Mart and retailers are increasing their power, and private label and low price copycats are also gaining share in developing countries. The competitive forces are just too strong.

There is a recent study by Deloitte: the Shift Index. The only industries that are defending themselves are *regulated*, where there is some control of the level of competition and innovation. Where are Buffett and Berkowitz investing recently? HMOs, railroads, utilities, defense, insurance, and banking for the most part.

But my concern with most of these industries is that you need good capital allocation for the excess cash flow. I prefer situations where I do

not depend on smart management, especially on a 30-year timeframe.

I recommend Richard Foster and Sarah Kaplan's book *Creative Destruction* that shows the performance of long-term survivors. From 1917 to 1987, only two survivors beat the 7.5% stock market—**General Electric (GE)** and Kodak—and a large part of the rest has perished.

**JA: Very interesting answer. I think it's important to recognize that almost no business can survive for a long period without good management. From my vantage point, the "ham sandwich" business doesn't really exist – even Coke almost killed itself more than once due to bad management.**

*PM:* I am still scratching my head over the \$4 billion Glaceau acquisition at the top of the market. Maybe someday someone will explain to me what vitaminwater® is.

**JA: What do you believe has changed in the world that will pierce the strength of moats going forward? How has competition accelerated?**

*PM:* You might regret asking that of a former management consultant. I should probably answer with the overused "Happy families are all alike; every unhappy family is unhappy in its own way" but instead I will recommend *Unstoppable* by Chris Zook. I would not buy the book, but if you can borrow it or read the introduction at amazon.com it makes some nice points.

By the way, I am not saying that I do not believe in good businesses. In turnarounds, a good business can pardon many sins. My point is that it is getting more difficult to detect who will still be king of the hill after a 30-year period on a consistent basis. I much rather buy very cheap.

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There you have it. We thank Plan so much for his time and hope you enjoyed this interview. Stay tuned for more Value Voices interviews and as always if you have any questions, join us on the Member [Forum](#).

Thank you for being a *Value Focus* member.

Best wishes,  
The Value Focus Team

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