

Rodrigo Lopez Buenrostro Discusses His Investment Approach

We had the pleasure of speaking with MOI Global instructor Rodrigo Lopez Buenrostro, investment principal at KUE Capital, about his investment philosophy.

MOI Global: Tell us about your background and interest in investing.

Rodrigo Lopez Buenrostro: My interest in value investing had been silently building since I was a kid. My grandmother and father were the first people to teach me the difference between value and price. I recall observing them buy simple goods and negotiating with the seller on the value of the good. Their sense of the value of things was embedded in their behavior toward the seller and it wasn't until later that I noticed the implicit message behind this back and forth: essentially they had combined their good judgement with the accumulation of empirical evidence that provided them with a fairly accurate sense of value which served them as the anchor to negotiate with the seller who was selling at market price.

If you come to think of it, this is not quite different than how the stock market works. An investor must have a good sense of value, through financial statement analysis as well as good judgement, in order to accept or decline Mr. Market's daily offerings of a stock.

I took these teachings to heart and began to apply them in university in Mexico City. In Mexico, you can open a brokerage account until you are 18 years old and I remember opening an account with \$500 to trade stocks as soon as I was able to. I wanted to learn how to translate my growing sense of value of a company into numbers. What frameworks were the most useful? How do you determine the value (not the price) of a company? I decided to study a double degree in Accounting and Business Administration at ITAM, one of the most respected business schools in the country. I sought out finance courses as much as possible and even took some extra classes in the Actuary department. For my graduating thesis I decided to study the hedge fund industry as it was an elusive industry I knew little about but was attracted to it. Specifically, my hypothesis was to test the viability of launching a hedge fund in Mexico. This research piece represented my first contact with the institutional investment management world.

My first formal job was in Investor Relations where I started to build relationships with sell-side analysts and buy-side investors. I then transitioned to investment banking at BBVA where I was the channel between the companies and the equity markets and learned how to create models and sell stories. The main reason I chose the equity department at BBVA was to discover the way IPOs were set. How does a bookrunner set the initial price for a previously private company? What is behind this number? After a promotion within the bank, I started to look forward and recall what really passioned me: investing. I looked around and realized that the asset management business in Mexico was too limited and I wanted to invest globally not only in my home country.

So I took my four years of technical work experience, college hedge fund thesis, and my insatiable drive to learn and applied to business schools in the US. I was fortunate enough to get accepted in 2013 at my first choice: University of Chicago Booth School of Business. Since day one I focused 100% in Investment Management (IM). I wanted to meet everybody who was recruiting for the same industry, I participated in all recruiting and social groups related to investing: Warren Buffett Club, Hedge Fund Group, Student Managed Investment Fund (SMIF), you name it. As I was proactive outside the classroom I was more so inside. I actually never cared about the MBA concentration I

would achieve: I just signed up for the classes that I thought would make me a better investor.

Frankly, the people that most helped me make the formal transition to my career in investing were my classmates. I recall four or five of us would often get together at somebody's apartment and just talk stocks. We would pitch each other ideas and challenge each other's assumptions in a collegial environment. Although we were ultimately fighting for the same jobs we all knew that if we helped each other out we would all be better in the future. I am humbled to say that I continue to have these great conversations with the same friends to this day in a scheduled call once a month.

I landed an enviable internship at a small hedge fund called Castle Union (most recently renamed to SW Investments) in Chicago for the summer of 2014. My portfolio manager would give me a ticker each week and I had to come up with a recommendation for each. Steve, my PM, taught me the value of independent thinking and to be different if you want to achieve different results from the market.

During my second year at Booth I really enjoyed mentoring the first years who were coming into IM and sharing what I had learned. Recruiting for full-time was a bit easier and I had already developed a pretty decent network of investors in and outside of school. I ultimately received two offers: one from a reputable mutual fund in Chicago and two, from a family office in Mexico called Kue Capital.

After a thorough self-reflection I decided to accept the offer at my current firm, Kue Capital, in 2015. Today, I am part of their asset management division where I spend my time pitching stocks for a public mutual fund we launched as well as vetting managers for a potential investment. Although I have a challenging time management issue, I believe that these symbiotic responsibilities are very enriching. On one hand I am constantly looking at stocks and pitching them for the mutual fund as well as implementing our internal investment process. On the other hand, I study and learn from many great investors, whether they are hedge fund managers or private equity principals, and in some cases develop a close relationship with them. I believe both projects will ultimately help me in my continuous and never-ending pursuit of becoming a better investor.

What are Kue Capital's investment criteria? How have they evolved over time?

We simply try to find great businesses at great prices. This is easily said than done and it does require a team that follows the same philosophy as well as an investment process that serves as our north star in order to find these investments. We have a general rule that the minimum IRR we seek is 14% in USD across an economic cycle (five to seven years). We try to find a balance between the art and science of investing because we don't want to fall prey to the biases that sometimes haunts investors. Approaches such as "we will never invest in bank stocks" or "we will only invest in companies where insiders have at least 5%" are mantras which makes your investment universe easier to swallow but may lead the investor to miss out on interesting opportunities.

The most important mindset we cherish is ownership. All members of the team are invested in our mutual fund with their personal money and therefore approach a new investment idea different than perhaps a traditional buy-side analyst at a large shop. We are the largest LPs in our fund. The question ends up being, would I like to own this company? Is the margin of safety enough for me? Having this initial mindset helps look for good investments and compounding companies that we would like to hold on forever.

How do you generate new investment ideas?

We have several sources of new investment ideas. We are subscribed to value investor newsletters and the whole team is constantly reading investing material throughout the week. However, I would say that the bulk of new ideas we generate comes from the network of investors we have created. We are

constantly in contact with investors that we like and in some cases we actually invest as a limited partner in their funds.

As we read investment letters and have the opportunity to interact with the investment teams of several of these funds we naturally get interested in some of their ideas. In some cases, these funds serve as a bouncing board, especially if they are short one of the stocks that we are long. Once we identify companies that we like we start with a first dive on the company and present it to our Investment Committee.

How important is management in your research? How do you assess whether management is good or bad?

Quite a bit actually. Another important lesson I learned from my summer internship at SW Investments was that incentives matter, and they matter a lot. Within our investment memo template we actually have a separate section on management and how they are aligned with minority shareholders.

I have found that one of the most valuable SEC filings is the proxy statement where the company describes how they compensate their top management. We also look for skin in the game, at least for the CEO.

How do you find the balance between aggressively sizing your best ideas versus diversifying enough to control drawdowns?

More than risk of drawdowns, we focus on risk of losing our capital. As part of our investment process we define three buckets for our investments: mid conviction, high conviction, and opportunistic.

Mid conviction ideas have a position size of 4-6% and high conviction ideas go from 7-10%. The conviction level is defined by the quality of the business as well as the margin of safety.

Furthermore, the opportunistic bucket includes investments that can range from 1-3% depending on how attractive we find the opportunity. Generally, the stocks in the opportunistic bucket are deep value stocks with a margin of safety above 40% and they often are not high quality business nor have admirable management teams. For this bucket, we set a pre-defined entry and exit price that we closely monitor in order to avoid losing our capital in the investment.

The mid and high conviction ideas tend to be more long-term compounders that we think are trading at attractive prices relative to intrinsic value.

Tell us about one or two of your biggest investment mistakes. Is there a company you would have liked to buy?

I have many investment mistakes. Actually, before I get into two of my notable mistakes I have created a habit of writing about my failures and successes on my investment diary. Every time I get into or out of an investment I take a moment to record my entry/exit price, the date and the reason why I was buying/selling the security. I am confident this will help me (and hopefully my team as well) to figure out what are my biases; where am I good and bad at investing and what turns out to be the real driver of my positive/negative returns.

Violin Memory

I invested in VMEMQ in August 2014 at approximately \$15 per share. VMEM is a B2B company that designs and manufactures computer data storage products. I was excited about the stock because one

of my PMs from my hedge fund internship was bullish on the stock and had issued a detailed investment memo on VIC (Value Investors Club).

His thesis was compelling, arguing that 1) the proprietary flash array technology pioneered by VMEM was the top performing offering in an industry where flash memory drives were displacing traditional spinning hard disks, and 2) strategics such as HP, Dell, IBM, Samsung were hungry for flash arrays and there were signs of a potential bidding war for VMEM's assets, and thirdly 3) VMEM's newly appointed CEO was incentivized to sell the company as part of his compensation package. I sold all my shares at less than \$2 per share right before it filed for Chapter 11 in December 2016.

The two lessons learned here were 1) always do your own research work! Don't blindly buy into someone else's thesis. I vaguely understood what the company did and how the competitive landscape was behaving. 2) Although VMEM had an amazing technology it ultimately lacked scale and a robust sales force. This was the main cause for the cash flow drain and they were not able to solve it on time. When you invest in a small cap tech company make sure they have the distribution figured out!

Precision Castparts

I am now going to talk about an error of omission. During my last months at Chicago Booth in the spring of 2015 I was recruiting and my star long pitch was Precision Castparts (PCP). In March 2015 it was trading at \$210 per share. This stock price implied that the market was expecting PCP's FCF to grow at merely 0.1% in the following five years. Furthermore, PCP was trading at a 30% discount to its historical EV/ Invested Capital ratio, a similar level to that of 2008.

I pitched the stock for well over three months to several buy-side asset management firms with the objective of getting a job. I was more concerned on making sure my five-page thesis was solid rather than putting my money where my mouth was. On 8/10/2015, BRK announced it was acquiring PCP for \$235 per share or according to my estimates 18x P/E or 5% FCF yield. In my humble opinion I think Buffett acquired PCP at a very good price given the business' high RONIC of more than 20% and a clear path for PCP to increase its market share per new plane built in a couple years.

I was too focused on getting my dream job that I forgot one of the basic principles of investing: eat your own cooking.

What great investors do you admire and why?

Howard Marks: I have always admired the soft gaze that Howard frequently goes into when asked a difficult question. It seems as if he rethinks the answer to the question even though he has decades of experience investing. I read this as Howard's acceptance that there is no one golden answer in investing and that he may have changed his mind. He seems to go back to his investment foundations, adds what he has learned in the past few years, all in just a couple seconds, and gives his answer. This continuous self-reflection and humility is a virtue I aspire to have.

Another aspect I admire from Howard is his writing capabilities. It is a true achievement to be good at investing AND transmitting his experience through the written art. I think that a person's writing skills are correlated to their reading habits and clearly Howard has been able to master both these skills.

Li Lu: If you haven't read his book "Moving The Mountain" it is a definite must. His personal story reflects the courage and natural leadership he showed before and during the Tiananmen Square events in 1989 in Beijing. I aspire to have his mental stamina and am humbled with his endless pursuit of the truth and freedom. His leadership has also been applied to investing. His very successful fund called Himalaya has had impressive and consistent results since inception in 1997 in a market that he

knows well and is misunderstood in the western world. He is one of the few examples I have encountered that really tries to think independently and spends hours reading and writing in his office every day.

Share with us a couple of books that you have read recently and have given you new insights into becoming a better investor.

[*The Art of Learning*](#), by Josh Waitzkin

I read this book twice, back-to-back and in both instances I was marveled by one of the many insights of the book: Investment in loss. This book is basically the story of how Josh Waitzkin, the author and multiple national chess champion as well as world champion in Tai Chi Chuan, discovered that the driver of his success was having the right learning mindset. Beyond his intellectual genius, he claims that the best way to become a better person/investor/chess player is to invest in loss. This means that one should embrace failure as a mean to become better. It means to look for the hardest competitor in your field and compete with him/her because at the end you will become better. This is directly applicable to investing. The best way to learn is to lose money. Obviously we all try to lose small amounts of money while gain large amounts (risk reward 101) but the whole process of losing at something is very enriching if you know how to channel it internally. Don't hesitate to pitch an unloved stock because you are afraid of not beating your benchmark or hurting your ego. Do your best, pitch the stock and if it turns out to be a poor investment learn from it and try again: each time I guarantee you will improve.

[*Accounting for Value*](#), by Stephen Penman

This book, written by Columbia University professor Stephen Penman, makes a magical interconnection between value investing and accounting. Note the play on words with the title. One of the trends I have noticed in my years in the investment management industry is that we all get carried away with the economics' approach to valuing a company. Metrics such as EBITDA and "economic value add" have been stretched too far in my opinion that we have forgotten the essence of accounting and the reason why GAAP accounting exists in the first place. This book has helped me return to my accounting background and tie it with a logical and conservative valuation framework that uses accounting as its ally and not tries to adjust it.

Rodrigo Lopez Buenrostro works at Kue Capital where he invests to preserve capital over time. He pioneered the asset management division within the firm and divides his time between equity research and manager selection with a global mandate. Previously, Rodrigo worked as a summer equity analyst at SW Investments, a value-focused hedge fund in Chicago. He began his professional career as an Investment Banker at BBVA. Rodrigo is also an MBA graduate from Chicago Booth '15 where he earned a concentration in Analytic Finance and was actively involved in the Investment Management community. He studied Business and Accounting at ITAM (Mexico Institute of Technology) for undergrad where he wrote his thesis on hedge funds and started to invest personally. Rodrigo has always had an interest in finding the real value of assets while negotiating with Mr. Market, reading, and volunteering at NGOs to teach basic concepts related to investing.