

Syllabus

FINC_444(0)-61: Value Investing (VI)

Spring 2018, Evanston

Tuesdays 1:30pm-4:30pm

Venue: KGH2120

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Course Objective and Description

This course develops a framework for making long-term investment decisions based on value investing principles.

Warren Buffett is one of the most successful investors in post-World War II history. This course will introduce you to the traditional Buffett, Graham and Dodd style of value investing *as it has evolved over time*. Value investing involves a lot of thinking and watching, but very little trading and long investment horizons. Compare this to another extremely successful investor, James Simons, whose statistical arbitrage strategies require high frequency trading and short investment horizons. If you are investing for yourself, value investing is easier to implement.

We will discuss the methods used to identify and evaluate potential investment opportunities. For every security you buy or sell, other investors taking the opposite position. You need to understand why you are right and they are wrong. The learning objectives are: (a) Searching for potential investment opportunities in a world where security prices may deviate from fundamental value; (b) The use of standard value investing tools like asset value, earnings power value, and competitive advantage (moat); (c) Risk management through margin of safety and circle of competence; (d) Presenting the analysis effectively in an organized manner; and (e) Developing the ability to effectively work in teams and complete group projects.

While this course will introduce you to the principles of value investing, it cannot teach you to be an extraordinarily successful investor. No course can. Value investing can take many forms, and if you are to be a successful value investor, you must invest time and effort to develop your own style. Buffett did not become great by mimicking his mentor, Ben Graham.

The course will consist of a series of formal lectures, presentations and discussion of cases. Students are expected to work in groups to complete write ups and supporting exhibits on the homework assignments for in-class discussion. In each class, groups will be randomly assigned questions from the homework assignment due on that class to present their analysis. This analysis will be discussed by other groups. It is mandatory for all students to be present during

the presentations/discussions of the homework valuation case exercises. Missing more than two presentations/discussions will bring down the student's grade by one point. In addition, students are expected to work in groups for the preparing the final stock selection/valuation project, where they will apply the principles learned in the course.

Prerequisites

The course requires a thorough understanding of finance principles at the level taught in **FINC-431 (FIN II) or FINC-440 (ACF)**.

Readings

Required Books: (GKSV) Bruce Greenwald, Judd Kahn, Paul D. Sonkin and Michael Van Biema, "Value Investing: from Graham to Buffett and Beyond," John Wiley, New York, 2004. (Paperback) **(GK)** Bruce Greenwald and Judd Kahn. "Competition Demystified: A Radically Simplified Approach to Business Strategy," Portfolio, Penguin Group, New York, 2007. **(YL)** Yefei Lu, "Inside the Investments of Warren Buffett, Twenty Cases", Columbia Business School Publishing, 2016.

Optional Books (Read on your own): Benjamin Graham, Updated with new commentary by Jason Zweig, "The Intelligent Investor," 4th edition, Harper Collins, New York, 2011 (historical perspective on value investing). Aswath Damodaran, "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset," John Wiley and Sons Inc., New Jersey, 2012 (*nice reference book on valuing assets*). Pedersen, Lasse Heje. "Efficiently Inefficient: How Smart Money Invests and Market Prices Are Determined," Princeton University Press, 2015 (excellent introduction to various trading strategies). Mohnish Pabrai, "Dhandho Investor: The Low-Risk Value Method to High Returns," John Wiley & Sons, 2007 (interesting examples showing how the author had benefited from adhering to value investing principles). Michael Lewis, "The Big Short: Inside the Doomsday Machine," W.W.W. Norton and Company, New York, 2011 (nice illustration of managing risks through *due diligence*, *circle of competence*, and *margin of safety* – and understanding why you may be right and the market may be wrong). Joel Greenblatt, "You Can Be a Stock Market Genius: Uncover the Secret Hiding Places of Stock Market Profits", Simon and Schuster, 1999 (nice discussion of special situations investing). Joel Greenblatt, "The Little Book that Still Beats the Market", John Wiley & Sons, 2010 (nice introduction to stock screening). Peter Lynch, "One up on Wall Street: How to use what you already know to make money in the market", Simon and Schuster 1989 (a nice way to identify your circle of competence). Seth Klarman, "Margin of Safety: Risk Averse Investment Strategies for the Thoughtful Investor", HarperBusiness, 1991 (*one of the best books*).

Course Packet (Some of the cases and articles will not be in the course packet and will be made available through Canvas): Cases: MVK Exchange Offer, Trump Entertainment Resorts, Liz Claiborne, Hudson General, MEMC, Numeric Investors (*HBS Case*), Veringung Hamburger

Schiffsmakler und Schiffsagenten d.V (VHSS – *HBS Case* on Valuing Ships), Buffett's Alpha (article by Andrea Frazzini, David Kabiller, Lasse H. Pedersen), Hanesbrands Inc. (Analysts views from Gurufocus, Morningstar, Value Line; CFRA Industry Survey on Apparels and Luxury Goods), Excel Valuation Model by Marco Sammon.

Lecture Notes: Will be handed out in class. Other readings will be posted on Canvas as needed.

Guest Lecture

There will be two guest lectures: Dr. Todd Pulvino, Founder, CNH Partners, and Senior Partner and member of the Leadership team at AQR. Barry Pasiko, Managing Member, Hazelton Capital Partners.

Course Grade (100 points)

There will be 6 homework valuation exercises that each require a one/two page write up plus supporting exhibits. These will form the basis for in-class discussion (60 points, group grade).

Class participation will be graded (10 points, individual grade). You are expected to attend all classes and participate in the discussions. The class participation grade will be assigned primarily based on a student's involvement and contribution to both presentation/discussion and critique of the homework cases.

There is a final stock selection/valuation project in which each group will identify a potential value investing opportunity. Each group will write a report, explaining how they applied value investing principles to identify the stock. The report will also contain an analysis of the firm's competitive position, industry analysis, valuation of the firm's equity, risks associated with growth if any, managing the risk, and recommendations (buy, hold or sell). The group must justify the recommendation and explain why the group's valuation differs from the market price. (30 points, group grade)

All assignments should be submitted on Canvas before the start of class in which the assignment is due.

Peer Evaluations

Two peer evaluations will also have to be completed and submitted by each student individually, one for the homework case exercises, and one for the final stock selection project, and emailed to me on the last day of class. You will not assign a grade to yourself. You will assign a grade of 100% to each of the other group members if they all contributed equally. If all group members participated equally, all members of the group will receive the same average grade. If you think one or more members did more/less than others, then allocate grades between 70% and 130% to group members in a way that the group average is 100%.

The Kellogg Honor Code applies.

Tentative Schedule

1. Tuesday April 3, 2018

Lecture 1: Introduction to Value Investing and value investing styles.

Lecture 2: Buffett's style 1: What he says and what he does. Read Chapter 9 (GEICO), Chapter 12 (Capital Cities/ABC), Chapter 13 (Salomon Inc) Chapter 14 (Coca-Cola) in **YL**.

2. Tuesday April 10, 2018

Lecture 3: Buffett's Alpha (by Frazzini, Kabiller and Pedersen.) Float: a source of long term permanent capital. Read "Taussig Capital: The Big Idea"

http://www.taussigcapital.com/the_big_idea/index.html

Lecture 4: Financial Crisis: opportunities and risks. Read Michael Lewis, "The Big Short: Inside the Doomsday Machine."

Homework Case 1: VHSS Case, due on Tuesday April 17 2018

3. Tuesday April 17, 2018

Case discussion: VHSS.

Lecture 5: Introduction to Merger Arb and Convertible Bonds. Read Chapter 3: Texas National Petroleum Company in **YL**, and Joel Greenblatt, "You can be a stock market genius".

Homework Case 2: MVK Exchange Offer, Tuesday April 24, 2018

4. Tuesday April 24, 2018 (Todd Pulvino, CNH Partners/AQR)

Case discussion: MVK Exchange Offer case analysis

Lecture 6: Asset Value & Earnings Power Value & Hidden Values

Homework Case 3: HGC Case. Due on Tuesday May 1, 2018

5. Tuesday May 1, 2018

Case discussion: HGC

Lecture 7: Asset Value & Earnings Power Value & Competitive Advantages. Read Chapters 1-5 in **GKSV** and Chapters 1 and 2 in **GK**.

Homework Case 4: Trump Entertainment Resorts, due on Tuesday May 8, 2018

6. Tuesday May 8, 2018

Case discussion: Trump Entertainment Resorts

Lecture 8: Intangibles, industry/competition analysis. Read Chapters 4, 6 and 7 in **GKSV** and Chapter 4 in **GK**.

Homework Case 5: Liz Claiborne, due Tuesday May 15, 2018

7. Tuesday May 15, 2018 (Barry Pasikov, Hazelton Capital Partners)

1. Presentation by Barry Pasikov followed by class discussion: “Hidden in Plain Sight – Hanes Brands Inc (HBI), a potential 3X in 5 years?”. Read Value Line and Morningstar reports on HBI, S&P Industry report on Apparels, Write-up on using a 3stage valuation model in Excel by Marco Sammon and Gurufocus report on HBI.

2. Case discussion: Liz Claiborne

3. Lecture 9: Valuing Growth. Read Chapters in 3, 5, 6 in **GK**, “Overpriced Winners” (Daniel, Klos, and Rotke – available on Canvas)

Homework Case 6: MEMC due on Tuesday May 22, 2018

Read Numeric Investors case – do not submit

8. Tuesday May 22, 2018

Case discussion: MEMC (and Numeric Investors)

Lecture 10: Where to look for value – some initial screens. Read Joel Greenblatt, “The Little Book that Still Beats the Market”. [Stock screens for Value and Momentum by Marco Sammon]

9. Tuesday May 29, 2018

Final Stock Valuation Project: Group Presentation and Discussion -- I

Note that there is a change in the schedule. Since there will be about 10 plus groups, we need two classes for group presentations. Each presentation will be for about 25 minutes.

10. Tuesday June 5, 2018

Final Stock Valuation Project: Group Presentation and Discussion II

Written report due by 5:00 pm on Monday June 11, 2018