Value Investing

Tano Santos

David L. and Elsie M. Professor of Finance MBA -

Spring 2020 – Term A  BIDDING SYLLABUS

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You should contact the teaching assistant with any questions throughout the course. All email communications with the TA or me should have “Value Investing – MBA – Spring – 2019 ” in the subject line.

Office Hours and communication with me: I will respond to emails within 24 hours (make sure the subject line is as above, otherwise we risk losing your email in the endless river that is my Inbox). I will have office hours after class but if you want to meet me at any other time we can schedule it. Please do email Caroline Reichert, at Heilbrunn, to cr2917@gsb.columbia.edu and she will get back to you with the time at which we can meet. Please write “MBA Value Investing – Meeting with Prof. Santos” in the subject line.

Questions about any of the homework should be submitted to the teaching assistant. As before all emails should feature “Value Investing – MBA – Spring – 2019 ” in the subject line.
RECOMMENDED COURSE MATERIAL

Required Textbooks

There is one required textbook:


Other important references

The Intelligent Investor: The Definitive Book on Value Investing. A Book of Practical Counsel (Revised Edition) [with comments by Jason Zweig and introduction by Warren Buffett].

Other interesting books that immediately come to mind are:


There are two books in the intersection of accounting and valuation that are useful supporting material


REQUIRED PREREQUISITES AND CONNECTION TO THE CORE

Co-requisite: Capital Markets

The learning in this course will utilize, build on and extend concepts covered in the following core courses:

<table>
<thead>
<tr>
<th>Core Course</th>
<th>Connection with Core</th>
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<tbody>
<tr>
<td>Corporate Finance</td>
<td>1. Cost of Capital</td>
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<td>2. Valuation</td>
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<td>3. Financing Options</td>
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<td>4. Time value of money</td>
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<td>5. Opportunity cost (of capital)</td>
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<td>6. The Capital Asset Pricing Model (CAPM)</td>
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### Course Description & Objectives

This course aims to familiarize the student with the principles and techniques of value investing, the investment philosophy pioneered by Graham & Dodd during their years at Columbia Business School. This will be done through a combination of formal lectures, in class valuation discussions (see below) and presentations by leading investors.

The areas covered will include:
1. The fundamental assumptions and approaches to value investing
2. Designing strategies for searching efficiently for value investing opportunities
3. Techniques for assessing fundamental value in a robust way
4. Risk management for the value investor

| Financial Accounting | 1. The “accounting equation”  
2. Revenue and expense recognition  
3. Resources and obligations – measurement and disclosure |
|----------------------|---------------------------------------------------|
| Global Economic Environment | 1. Risk Management  
2. What is Gross Domestic Product and how is it measured?  
3. What causes inflation?  
4. What causes changes in exchange rates?  
5. What are the causes of business cycles?  
6. What are the effects of monetary policy?  
7. What are the effects of fiscal policy?  
8. What is the role of financial markets in the economy? |
| Managerial Economics | 1. Barriers to entry  
2. Moats  
3. Maximization and thinking on the margin  
4. Analyzing complex decision-making under uncertainty  
5. Decision-based cost analysis  
6. Pricing with market power  
7. Market segmentation and other advanced pricing strategies  
8. Understanding market competition and equilibrium thinking (in the short-run)  
9. Market equilibrium thinking (in the long-run) and barriers to entry  
10. Strategic interaction among firms and Nash equilibrium |
| Strategy Formulation | 1. Trade-offs, value-added, efficiencies  
2. Creation of value vs. value capture  
3. Competing firms  
4. Competition and Complementors  
5. Strategic interaction analysis  
6. Diversification and scope  
7. Ethics & IBS  
8. Behavioral and evidence-based strategy  
9. Management |
CONTENTS

Lecture Note 1: Introduction and overview
  • The premises of value investing
  • Why does it work?
  • The framework

Lecture Note 2: Asset Values
  • The balance sheet
  • The valuation of tangible and intangible assets
  • Other adjustments
  • Walmart: Asset Value

Lecture Note 3: Earnings Power Values
  • The income statement
  • Expenses related to growth activities
  • Other adjustments
  • Walmart: Earnings Power Value
  • Comparing asset and earnings power values
    o Three cases
    o Management and barriers to entry

Lecture Note 4: ESB: A Primer
  • Sources of competitive advantage
    o Supply based
    o Demand based
  • Performing Strategic Analysis
    o The firm
    o The industry
    o The value chain

Lecture Note 5: Growth and Value
  • The problem of growth
  • Thinking in the space of returns
  • Calculating the expected return
    o Cash-flow yields
    o Future earnings growth
Lecture Note 6: Quantitative Strategies

- Building quantitative strategies
- Value strategies
- The value premium and the value premium puzzle
- Other quantitative strategies: momentum

Lecture Note 7: Search

- The importance of knowing where to look
- Techniques
  - 13Fs
  - Screens
  - Special situations

Lecture Note 8: Assessing management

- Identification problems
- What managers do
- Management and barriers to entry
- Assessing management: Tools

Lecture Note 9: Behavioral foundations of value investing

- The two types of risk
  1. External risks
  2. Internal risks: overconfidence, extrapolation, self-attribution, ...
- Protecting yourself against behavioral biases: Organizational repairs

Lecture Note 10: Risk management

- Managing the risks: Stocks
  - Permanent impairment of capital and the margin of safety
- Managing the risks: Portfolios
- Managing the risks: Macro-risks
- Taking advantage of crises

Cases: Valuation cases are central the class. The cases are Walmart – 2019, Dollar General - 2019, Nestle – 2019, Nike – 2019, Deere-2019 and Intel-2019. In addition there will two cases from the US financial crisi, on from the US (Magna-2009) and the other from the Eurozone crisis (Ferrovial-2012). Finally, if time permits we will cover Viscofan-2019 and Goodyear-2019. They may change depending on whether there is an interesting situation for us to consider.
METHOD OF EVALUATION

The grade for both the Value Investing class and the Value Investing with Legends class will be based on:

1. (10%) Class participation: I will select names at random at the beginning of class and then call on you. This is intended simply to elicit participation and attention.

2. (20%) There will be four cases due in class. Please submit your projects in canvas before class on the day that the case is due. It is a group project so only submit one project per group. The four cases are: (dates are from Spring 2019)
   - Dollar General – due February 5th
   - Intel – due February 14th
   - Nike – due February 21st
   - Deere – due February 28th

3. (70%) A valuation exercise project to be assigned the last day of the Value Investing class, March 7th. We will announce the due date in class.

NOTES

1. Groups: There will be assigned for you at the beginning of the class.

2. Please consult the Grid, which is posted in canvas.
Case questions

1) The firm
   • What does the company under study do?
   • What are the reporting segments?
   • Does the firm compete with the same firms across all reporting segments?
   • Is the firm reasonably managed?
   • Suppliers, customers?

2) The industry
   • Who are the firm’s competitors? Complementors?
   • Do all the firms in the industry have similar reporting segments?
   • Is the industry changing?
   • Are there any barriers to entry in the industry in which it operates?
   • Were there any barriers to entry that are now getting undermined by technological disruption?

3) Valuation
   • Asset values
     o What are the critical assets the firm owns?
     o Are the missing intangibles important?
     o Are there any off-balance sheet liabilities that compromise the viability of the company?
   • Earnings power values
     o Is the measure of current earnings a good measure of sustainable earnings?
     o Are there any relevant corrections that need to be made to current earnings to arrive at a reasonable measure of sustainable earnings?
     o Are there cyclical components to earnings?
     o What is the appropriate discount rate?
   • Growth
     o Is the company reinvesting?
     o Are they reinvesting in segments with high return on invested capital?
     o Are they returning cash to investors at the expense of profitable growth?

4) Would you invest in this company?