Value Investing

EMBA

Fall – 2018

Syllabus – Provisional

TANO SANTOS

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Teaching assistant: TBA

You should contact the teaching assistant with any questions throughout the course. All email communications with her or me should have “Value Investing – EMBA – Fall – 2018” 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). Please do let me know whether you want to meet. We will typically arrange to meet right before class or after it, at the end of the day.

Questions about any of the homework should be submitted to the teaching assistant. As before all emails should feature “Value Investing – EMBA – Fall – 2018” 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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<td>7. Firm Valuation Model</td>
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<td>Financial Accounting</td>
<td>1. The “accounting equation”</td>
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<td></td>
<td>2. Revenue and expense recognition</td>
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<td>3. Resources and obligations – measurement and disclosure</td>
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<td>Global Economic Environment</td>
<td>1. Risk Management</td>
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<tr>
<td></td>
<td>2. What is Gross Domestic Product and how is it measured?</td>
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<td>3. What causes inflation?</td>
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<td>4. What causes changes in exchange rates?</td>
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<td>5. What are the causes of business cycles?</td>
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<td>6. What are the effects of monetary policy?</td>
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<td>7. What are the effects of fiscal policy?</td>
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<td>8. What is the role of financial markets in the economy?</td>
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<td>Managerial Economics</td>
<td>1. Barriers to entry</td>
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<td></td>
<td>2. Moats</td>
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<td>3. Maximization and thinking on the margin</td>
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<td>4. Analyzing complex decision-making under uncertainty</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
CONTENTS

Lecture Note 1: Introduction and overview

- The premises of value investing
- Why does it work?
- The framework

Lecture Note 2: Asset Values and Earnings Power Values

A. Asset Values
   - The balance sheet
   - The valuation of tangible and intangible assets
   - Other adjustments
B. Earnings Power Values
   - The income statement
   - Expenses related to growth activities
   - Other adjustments
C. Comparing asset and earnings power values
   - Three cases
   - Management and barriers to entry

Lecture Note 3: Search

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

Lecture Note 4: Strategic Analysis

- Sources of competitive advantage
  - Supply based
  - Demand based
- Performing Strategic Analysis
  - The firm
  - The industry
  - 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: Value: Evidence and quantitative strategies
• Building quantitative strategies
• Value strategies
• The value premium and the value premium puzzle
• Other quantitative strategies: momentum

Lecture Note 7: Assessing management and managerial decisions
• Management and barriers to entry
• The types of managers
• Management and capital allocations: The importance of acquisitions

Lecture Note 8: Behavioral foundations of value investing
• Two types of risk
  1. External risks
  2. Internal risks: overconfidence, extrapolation, self-attribution, ...
• Protecting yourself against behavioral biases: Organizational repairs

Lecture Note 9: Risk management
• Managing the risks: Stocks
  o Permanent impairment of capital and the margin of safety
• Managing the risks: Portfolios
• Managing the risks: Macro-risks
• Taking advantage of crises

Cases
• Hudson General – 1998
• Magna – 2008
• Dollar General – 2018
• Walmart – 2018
• Intel – 2018
• Amazon – 2018
• Deere – 2018
• Nestle – 2018
METHOD OF EVALUATION

The grade will be based on:

1. 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. There will be three cases due in class. Please email the teaching assistant in the morning of the corresponding day the case is due that day. It is a group project so only send one email per group.
3. A valuation exercise project to be assigned the last day of class and that will be two weeks after the end of the class. Please email a pdf of your project to the class TA.
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
     - What are the critical assets the firm owns?
     - Are the missing intangibles important?
     - Are there any off-balance sheet liabilities that compromise the viability of the company?
   - Earnings power values
     - Is the measure of current earnings a good measure of sustainable earnings?
     - Are there any relevant corrections that need to be made to current earnings to arrive at a reasonable measure of sustainable earnings?
     - Are there cyclical components to earnings?
     - What is the appropriate discount rate?
   - Growth
     - Is the company reinvesting?
     - Are they reinvesting in segments with high return on invested capital?
     - Are they returning cash to investors at the expense of profitable growth?

4) Would you invest in this company?