Syllabus (tentative)

FINC_444(0)-41: Value Investing (VI)  
Winter 2019, Evanston  
Tuesdays 6:30pm-9:30pm  
Venue: KGH L110  

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Course Description

This course is an introduction to value investing: the principles, concepts, and tools.

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 frequent trading and short investment horizons.

We will discuss the methods used to identify and evaluate potential investment opportunities. For every security you buy or sell, the Market is taking the opposite position. You need to understand why you are right and the Market is giving you an opportunity. The learning objectives are: (a) Searching for potential investment opportunities in an Efficient Market where individual security prices fluctuate around fundamental value offering rewards to those with the necessary skills at random periodic time intervals; (b) The use of standard value investing tools like asset value, earnings power value, and methods for evaluating competitive advantage; (c) Risk management by understanding and staying within your circle of competence, having adequate margin of safety, and position limits; (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 have to invest time and effort to develop your own style. Buffett did not become great by mimicking his mentor, Ben Graham.

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:**


**Recommended Books:**

The material you would have learned in Kellogg Strategy classes will be useful in evaluating potential value investing opportunities. I will not assign specific reading material from the books given below. You may read the chapters you find relevant in the books listed below at your own pace during the course.

**Evaluating Business Strategies:**


**On Buffett’s Investments**


*Course Packet (including cases/articles that will be made available through Canvas):* Hudson General Corporation, Trump Entertainment Resorts, Liz Claiborne, MVK Exchange Offer, MEMC, Valeant/Bausch Health Companies

**Grading**

Your grade will be based on the following.

- 2% class survey, 3% syllabus check quiz, 30% for best 3 of 4 group homework assignments, 20% for 2 individual homework assignments, 30% for the stock selection
and evaluation project to be done in groups, 5% for peer review, 10% for class participation.

- Groups: I will assign students to groups at the end of first week of classes.

**Class survey:** The required class survey is due by the end of the first week of classes or 24 hours of gaining access to Canvas whichever is later. You will complete this survey on Canvas. You will full credit if and only if you complete the survey on time.

**Syllabus check:** The required syllabus check is due by the end of the first week of classes or 24 hours of gaining access to Canvas whichever is later. You will complete the syllabus check on Canvas. This is a graded assignment testing your familiarity with course rules and expectations. You need to complete the survey on time in order to get credit for the syllabus check assignment.

**Class participation & attendance/Self Evaluation:** No later than the end of Week 10 all students must complete a participation self-assessment where you will be asked to evaluate your participation according the following guidelines: 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 discussions in class and through the Canvas discussion forums. You will get an A if you arrived late or missed no more than 2 classes, notified me in advance when missing a class or arriving late, regularly volunteered comments or asked questions that other students found valuable. You will get a B if you arrived late or missed no more than 2 classes, but failed to notify me in advance when missing a class or arriving late and occasionally volunteered comments or asked questions that other students found valuable.

**Homework assignments:** All assignments should be submitted on Canvas before the start of class in which the assignment is due and should be uploaded as a pdf (single file) by one member of the group. Answers to homework assignments should be 3 to 5 written pages plus supporting figures/tables. Do not repeat facts from the case. Case questions are provided to guide you in your analysis. Your report should incorporate answers to the questions, but not necessarily in a question-answer format. Individual assignment must be your work only.

**Stock Selection and Evaluation Project:** There is a final stock selection/valuation project in which each group will identify a potential value investing opportunity. Each group will prepare an Interim Report (due on Canvas by the due date/time), power point file of the Final Presentation (due at the beginning of class when the final presentation is due), and a Final Report (due by 5:00 pm on Monday, 18 March 2019), explaining how they applied value investing principles to identify the stock, 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.

**Peer Evaluations:** No later than 5pm on Monday 18 March 2019, all students must complete a peer review, where you will be asked to evaluate the contribution made by each of your group members with respect to the group homework assignments and the group stock selection and evaluation project. Students who do not complete the peer review report on time will not receive any credit for the peer review component of their own grade.
Additional rules regarding assignments and submissions

- Late submissions will receive no credit. This is non-negotiable. If you have a question regarding deadline, you should get it resolved before the deadline so that you can complete the assignment by the due date.
- Only pdf files can be uploaded into Canvas. I have had problems with formatting etc. with Word files, and you will have to save your Word document as a pdf file before uploading to Canvas. Note that I will not be collecting Excel files. Even though your submission may include cells from a spreadsheet, handing in an Excel file is not considered a sufficient answer. It should be clear to me (or your intended audience post Kellogg) both what your answer is, and how you arrived at it. I should understand your numerical answer and your logic and methods and how you arrived at your answer and conclusion.
- All students within a group will receive identical scores on group homework assignment submissions. Responsibility for submitting the desired answers by the deadline is the joint responsibility of the entire group, regardless of how the group determines the allocation of the work among the group members.

Additional Availability
Outside of class, post your questions on the discussion board, and I will post my response by the next business day. Course related questions sent to me directly would be posted on the discussion board with attribution. Students are welcome to post replies where applicable. I am also available to meet with students by appointment. To schedule an appointment, send an email to me at rjaganna@kellogg.northwestern.edu

Classroom Etiquette
As you may be aware, Kellogg has established a series of guidelines to make sure that the classroom environment enhances the learning experience for all students. Please take time to familiarize yourself with the revised Classroom Etiquette code in the link below:
https://www.kellogg.northwestern.edu/policies/etiquette.aspx

In particular:
1. I expect you to attend every class. If you are unable to attend a class for an unavoidable reason, you must notify me in advance. There is material discussed in class that is not found elsewhere. Students missing class are expected to speak with classmates about the material that was missed. I do not allow use of Ketchup or any other recording devices.
2. I expect you to be ready to begin class on time.
3. I expect you to stay for the entire class.
4. Cell phones should be turned off.
5. I expect you not to use electronic devices for non-class purposes (i.e., email, web-surfing, etc.) during class.

Honor Code
The Kellogg Honor Code mentions, “All students enrolled in a course offered by the Kellogg School of Management agree to abide by the Kellogg Honor Code.” If you are unsure of what this means, please read the honor code. You can find it in the link below: https://www.kellogg.northwestern.edu/policies/honor-code.aspx

In particular, the following are considered honor code violations:
1. Consulting materials distributed in any past Kellogg Value Investing course.
2. Discussing cases with any individuals – including former students – other than those students in your current case group.
3. Sharing course materials with anyone at any time.
4. Using material on the web or from books, journals, magazines, and other publications in your homework assignments or in your project reports without attribution.

**Access to Course Information via the Web**

Lectures and Homework assignments and some of the course readings will be available on the course Canvas page. However, answers to homework assignments and class discussions will not be made available through Canvas. Grades will be entered in the electronic gradebook.

**Other**

All course materials are the intellectual property of the instructor. You may not distribute materials electronically or in any form to anyone – inside or outside Kellogg. In particular, you may not share course materials with other students or with your employers after graduating from Kellogg.

**Tentative Schedule**

1. **Tuesday, 8 January 2019**

   Session 1: Value investing in an efficient market & Value Investing Styles.
   
   Session 2: Some tools.
   
   
   **Readings:** GKS B: Part I (An introduction to Value Investing) – 1 & 2; Part II (Three Sources of Value) - 3, 4, 5. CD: Chapter 1-3 (Strategy, Markets and Competition; Competitive advantage I and II)
   
   Recommended: II: Chapter 1 (Investments vs. speculation: results to be expected by the Intelligent Investor); Chapter 12 (Things to consider about Per-share earnings), Appendix 1 (The superinvestors of Graham – and – Doddsville)
   
   Homework 1 due in class on Tuesday 15 January 2019
   
   Hudson General Corporation (HGC) case, (individual assignment)
2. **Tuesday, 15 January 2019**

Session 3: Discussion of HGC case and examples of hidden assets

Session 4: Reading 10-Ks

   Management discussion, financial statements, notes to financial statements. Equity method vs consolidation, intangible assets, goodwill, deferred taxes, R&D, SG&A, depreciation & CAPEX, employee stock options, hidden liabilities, risks, etc.


Homework 2 due Tuesday 22 January 2019

   TER Enterprises case, to be done in groups

3. **Tuesday, 22 January 2019**

Session 5: Discussion of TER Enterprises case.

   Six Flags emergence from Chapter 11 in 2011, what was different?

Session 6: Intangible assets, Franchise, Competitive Advantage, Moat

Readings: **GKSB**: Chapter 7: Inside Intel - The value of Growth within the Franchise; Chapter 9: Warren Buffett: Investing is Allocating capital. **II**: Chapter 20 on Margin of Safety, Appendix 7 on Technological companies as investments

Homework 3 due in class on Tuesday 29 January 2019

   LIZ Claiborne case, to be done in groups.

4. **Tuesday, 29 January 2019**

Session 7: LIZ Claiborne case discussion.

   LL Beans, GAP, Ralph Lauren, what was/is different?

Session 8: Some examples stock selections

Interim report on Stock Selection Project due Tuesday 5 February 2019

   Interim Report on Stock Selection Project: Each group to present an interim report giving a short list of four or five candidate stocks that they have short listed and how and why they were selected.
Reading: Value Line and Morningstar reports on HBI; Gurufocus report on HBI. S&P Industry report on Apparels. GKSV: Chapter 8: Constructing the Portfolio: Risk, Diversification and Default strategies; Chapter 16: Paul D Sonkin: Small is beautiful, especially when it’s ugly.

5. **Tuesday, 5 February 2019 (guest lecture by Barry Pasikov)**

Session 9: Barry Pasikov on HanesBrands.

Session 10: Introduction to Merger Arb and Convertible Bonds.


Homework 4 (to be done individually) due Tuesday 12 February 2019

- MVK Exchange Offer case, to be done individually (not in groups).

6. **Tuesday, 12 February 2019 (Guest Lecture by Todd Pulvino)**

Session 11: Todd Pulvino will guide the discussion on MVK Exchange Offer case

Lecture 12: Value opportunities in growth stocks

Valuing growth – growth needs investments. Understanding good and bad strategies – examples: Crowne Cork & Seal, Telecom Italia, Apple, Roll International Corporation, Cisco,

Homework 5 due Tuesday 19 February 2019

- MEMC case

Readings: **GKSB**: Chapter: 10 – 13: Mario Gabelli (Discovering and Unlocking the Private Value); Glenn Greenberg (Investigate, Concentrate and Watch that Basket); Robert Heilbrunn (Investing in Investors).

7. **Tuesday, 19 February 2019**

Session 13: MEMC case discussion

Session 14: Opportunities and risks following disruptions

Reading: **II**: Chapter 5, 6 and 7: The defensive Investor and common stocks & the Portfolio Policy, Chapter 14 & 15; Stock Selection. Chapter 8: The Investor and Market Fluctuations. **GKSB**: Chapter 13- 14: Seth Klarman: Distressed Sellers, absent buyers, Michael Price: Discipline, Patience, Focus and power

Homework 6 due on Tuesday 5 March 2019

- Valeant Pharmaceuticals/ Bausch Health Companies Inc. case
8. Tuesday, 26 February 2019

Session 15: Valeant/Bausch Health Companies

Lecture 16: Another tool – relative valuation. Example: Patni case

9. Tuesday, 5 March 2019

Session 17: Some topics


Session 18: Review – summing up what we learnt in the course

10. Tuesday, 12 March 2019

Final Stock Valuation Project: Group Presentation and discussion

Written report due by 5:00 pm on Monday, 18 March 2019
Optional Readings:

- 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).
- 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).