

# TUIA Module 5: Value Investing



Long ago, Ben Graham taught me that Price is what you pay; value is what you get. Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down.

(Warren Buffett)

Presented By:

Anthony Merola  
amerola@theowlfund.com

# Agenda

- I. Investing Strategies
- II. Conception of Value Investing
- III. Fundamental Analysis
- IV. Concepts of Value Investing
- V. Value Traps
- VI. Q&A

# Equity Investing Strategies

## 1. Growth

- a) Sales/Earnings grow at above average rates and typically trade at far higher valuations than the general market
- b) Sometimes valued off of “Eyeballs,” “MAUs,” “Price to 2025 EPS”

## 2. Value

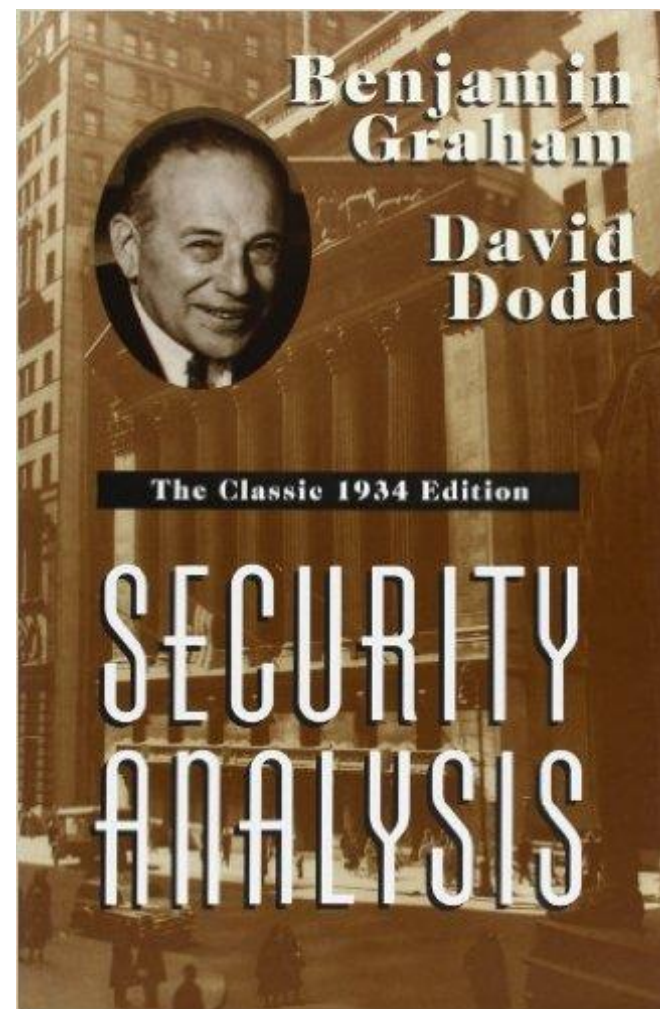
- a) Investing in companies that unjustly trade at lower than intrinsic value
- b) Starts with a bottom-up approach
- c) Typically, these stocks trade at below average valuations relative to comps and the market

## 3. Growth at a Reasonable Price (GARP)

- a) Mix of value and growth. Want to buy companies with relatively “low” valuations that also have great growth prospects

# Benjamin Graham

- The “Father of Value Investing”
- Warren Buffet’s professor
  - Second most influential person in Buffet’s life
- Invest on fundamental analysis
- Company’s trading below intrinsic value
- Defensive vs Enterprise Investor



# What are Fundamentals?

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# Fundamentals



- Corporate Earnings
- Profitability Metrics
  - Margins, ROE, ROA, ROIC, etc.
- Leverage
  - Debt/EBITDA, Credit Rating, Interest Coverage
- Supply/Demand
- Cash Flow Generation
- Historical or vs. Industry



# Defensive Investor Criteria

- Adequate Size
  - Sales >\$100 million
- Strong Financial Condition
  - Current Ratio >2.0
  - Long-Term Debt <Working Capital
- Earnings Stability
  - No earnings deficit for 10 years
- Dividend Record
  - Uninterrupted payments for the last 20 years



# Defensive Investor Criteria

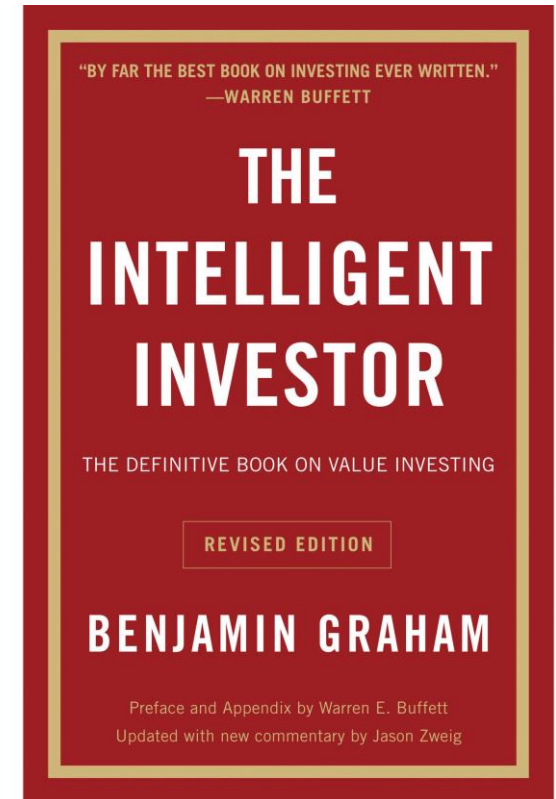
- Earnings Growth
  - 3% CAGR over last 10 years
- Price/Earnings Ratio
  - Should be below 15x average earnings over past 3 years
- Price to Book
  - Less than 1.5x book value
- Product of P/E and P/B
  - Less than 22.5x





# Enterprise Investor Criteria

- Financial Condition
  - Current Ratio >1.5
  - Debt <110% of working capital
- Earnings Stability
  - No earnings deficit in the last 5 years
- Dividend Record
  - Some current dividend
- Earnings Growth
  - 3% CAGR over past 10 years
  - EPS for last year is greater than EPS from 5 years ago
- Price
  - Less than 120% of net tangible assets



# Concepts of Value Investing



## 4 Questions Guide the Value Investing Process

1. How is the stock undervalued?
2. Why is the stock undervalued?
3. What is going to bring the stock back to fair value?
4. What is fair value?

**\*We also look for stocks with Economic Moats\***

# How is the Stock Undervalued?

- Valuation Multiples determine undervaluation
  - Answers, “How much are you willing to pay for \$1 worth of future earnings?”
  - P/E, P/B, P/FCF are some examples
- Compare valuation to historical average and current situation
  - A stock can be undervalued relative to:
    - Itself
    - Its peers
    - Its industry
- Watch out for “value traps”

# Why is the Stock Undervalued?

- Justify why the stock is undervalued and not a value trap
- Why would a stock be undervalued?
  - Sales/Margins/Earnings missed estimates
  - Negative industry/end-market sentiment
  - Losing a key customer
  - Supply chain restraints
  - Lawsuits, recalls, regulations, accounting violations
  - Bad acquisition
- What is causing a company to miss estimates? Is this consistent?

# Catalysts – Back to Fair Value



- A recent or projected event that will “trigger” or drive growth in the company’s share price
  - Will lead to multiple expansion
- Key Characteristic: Market Uncertainty
  - Not yet priced into the stock
  - Having a strong conviction here is what makes you “different” than the market
- Examples of Catalysts:
  - A merger or acquisition that allows a company to grow or enter new business area
  - Removal of a low profitability business line to grow margins
  - Management change/Strategic positioning
  - Removal/Change of “depression” factors
  - Industry tailwinds

# What is Fair Value?

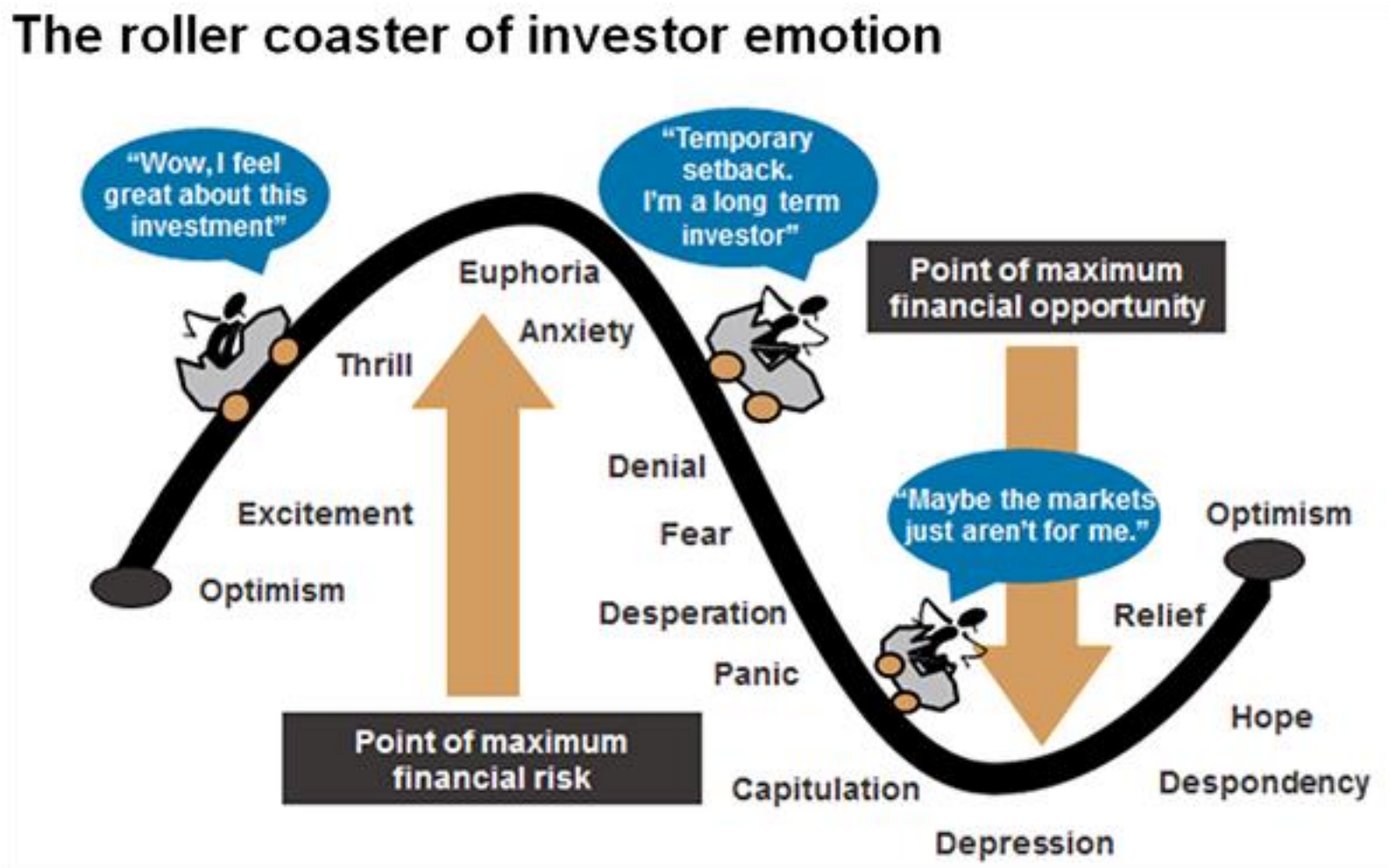
- Simply put, fair value is your **Target Price**
- How do you come up with fair value?
  - Find a target multiple
    - Comparable company valuation
    - Valuation to itself
    - Discounted Cash Flow valuation
- We will have a valuation module – it's quite an extensive topic

# Ex: GameStop Valuation



# Life-Cycle of an Investment

## The roller coaster of investor emotion





# Value Traps

- Company's that appear undervalued on a multiple basis
- They're trading cheap for a reason!!
- Consistent stock price declines
- Potential Reasons:
  - Inability to grow earnings/cash flow
  - Secular industry headwinds
  - Lack of innovation/Poor management team
  - Deterioration of economic moat
  - Fundamental change to the company's business model
  - Investing at wrong point in business cycle



# Questions?



# Assignment

- Pick a company that you believe is UNDERVALUED
- Justify why it is undervalued answering the 4 questions.
- Don't worry about a price target. Instead, identify moats and risks of the company