

## Inside this issue:

CSIMA Conference	P. 3
Philippe Jabre	P. 4
Arnold Van Den Berg & Jim Brilliant	P. 12
Pershing Square Finalist Pitches	P. 22
Eric Rosenfeld	P. 32
Women in Investing	P. 37
H. Kevin Byun	P. 38
Moon Lee Prize	P. 45

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Issue XXI

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**Philippe Jabre**

## Philippe Jabre—Following the Steps to Investment Success

Philippe Jabre '82 is the founder and Chief Investment Officer of Jabre Capital Partners, which runs three investment funds – a multi-strategy fund and two long-only funds. Prior to launching his own firm in February 2007, he was a top money manager at GLG Partners. Jabre Capital Partners recently won

(Continued on page 4)

## Century Management—The Value of Discipline



**Arnold Van  
Den Berg**

Arnold Van Den Berg founded Century Management in 1974. He is a principal of the firm, the Chief Executive Officer, co-Chief Investment Officer, and a portfolio manager. Arnold has no formal college education but gained his market knowledge through rigorous self-study, tremendous dedication, and over 45 years of industry experience. Prior to starting Century Management, he worked as a financial



**Jim  
Brilliant**

(Continued on page 12)

## Eric Rosenfeld—The Evolution of an Activist

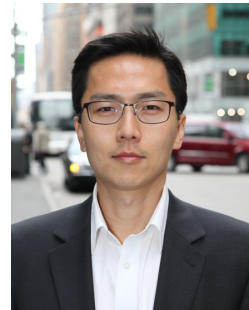


**Eric Rosenfeld**

Eric Rosenfeld is the President and Chief Executive Officer of Crescendo Partners, a New York based investment firm focused on activist investing. Prior to forming Crescendo in 1998, he held the position of Managing Director at CIBC Oppenheimer and its predecessor company Oppenheimer & Co., Inc. for fourteen years.

(Continued on page 32)

## H. Kevin Byun—Special Situations Investing



**H. Kevin Byun**

H. Kevin Byun '07 founded Denali Investors in 2007. The firm employs an opportunistic special situations and value oriented framework. Denali seeks to identify catalyst-driven situations that will unlock value. He was a triple major at Rice University and has an MBA from Columbia Business School.

(Continued on page 38)

## Welcome to *Graham & Doddsville*



Heilbrunn Center Director Louisa Serene Schneider '06. Louisa skillfully leads the Heilbrunn Center, cultivating strong relationships with some of the world's most experienced value investors and creating numerous learning opportunities for students interested in value investing. The classes sponsored by the Heilbrunn Center are among the most heavily demanded and highly rated classes at Columbia Business School.



Professor Bruce Greenwald. The Heilbrunn Center sponsors the Value Investing Program, a rigorous academic curriculum for particularly committed students that is taught by some of the industry's best practitioners.

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We are pleased to bring you the 21<sup>st</sup> edition of *Graham & Doddsville*. This student-led investment publication of Columbia Business School is co-sponsored by the Heilbrunn Center for Graham & Dodd Investing and the Columbia Student Investment Management Association (CSIMA).

For this issue we spoke with five unique investors covering a range of different perspectives and investment styles.

**Philippe Jabre** recounts how he began his career in convertible arbitrage and how his firm, Jabre Capital Partners, searches the world for attractive investments.

**Arnold Van Den Berg and Jim Brilliant** emphasize the value of discipline in investment management, and explain the importance of building a framework and mental database around your experiences to improve decision making.

**Eric Rosenfeld** shares his evolution as an activist investor and how his firm, Crescendo Partners, identifies potential investments. Eric also delves into Canadian laws and how they facilitate shareholder activism.

**H. Kevin Byun** discusses the nuances of special situations investing and how he searches for opportunity in spin-offs, liquidations and transformative M&A actions. He also discusses some of the opportunities he sees in the market today.

This issue also contains pictures from the 17<sup>th</sup> annual CSIMA Conference, which took place on February 7<sup>th</sup> at Columbia University, featuring Bill Ackman and Joel Greenblatt as keynote speakers.

Lastly, this issue includes the finalist pitches from the Pershing Square Challenge which took place on April 23<sup>rd</sup>.

With this being our final issue as editors of *Graham & Doddsville*, we want to reflect for a moment on our time shepherding this publication. It has been a privilege to act as stewards of the legacy of value investing at CBS and to share the insights of such talented investors with our readers. These interviews will be among our fondest memories at Columbia Business School. We leave *Graham & Doddsville* in the highly capable hands of Matt Ford and Peter Pan. Apparently we have to grow up now, but we look forward to reading the interviews they conduct in future issues. We are deeply grateful to those investors we interviewed during our tenure – none of this would be possible without their willingness to share their wisdom. Finally, we thank you, dear reader, for your continued interest, loyalty, and suggestions.

- *G&Dsville* Editors



Julia Kimyagarov, Louisa Serene Schneider '06, and Marci Zimmerman at the 2014 Moon Lee Prize Competition



The first-place team and judges at the 2014 Pershing Square Challenge



## 2014 CSIMA Conference at Columbia Business School



The audience listens as Bill Ackman answers student questions with a mix of candor and humor.



Student conference coordinators Joe Fleury '14, Taylor Davis '14 and Ivan Dias '14 deliver opening remarks.



Kyle Bass (L) of Hayman Capital speaks on the Best Ideas Panel with Tom Gayner (R) of Markel Corporation.



Mark Cooper moderates the Behavioral Investing Panel with William von Mueffling '95, James Montier, Michael Mauboussin and Kent Daniel.



Bruce Greenwald moderates a discussion with Joel Greenblatt.



Bill Ackman discusses his GSE investments.



**Philippe Jabre**

## Philippe Jabre

(Continued from page 1)  
**EuroHedge's Management Firm of the Year award for 2013. Mr. Jabre received an MBA from Columbia Business School in 1982 and serves on the Board of Overseers.**

**Graham & Doddsville (G&D):** Can you start by talking about how you became interested in investing?

**Philippe Jabre (PJ):** I was at Columbia Business School from 1980-82 and part of the interest came from classes I was taking in international investments. I was also reading a lot of books which helped me grow into it. Of course you don't know at age 20 or 22 that you're going to be successful, but gradually it evolved into what I'm doing now.

**G&D:** And were you investing before Columbia?

**PJ:** I did invest. I lost my shirt. I borrowed money and told my investors I'd share in both losses and profits. It's not like hedge funds today where profits are for the manager and losses are for the client. It cost me a fortune. So when I left Columbia Business School, I had lots of debt. But for me, the lesson behind it was important. It was a steep learning curve. My time at Columbia Business School was a great learning experience in how you can maximize your losses.

**G&D:** When you were at Columbia, were there any professors who were particularly influential for you? Or any courses that stood out in your mind?

**“Today, students are much more prepared and focused when they start school. I don't even know if there was an investment club when I was at Columbia in 1980.”**

**PJ:** In the first two semesters, you don't know all the classes that exist. And by the last two semesters, you try to catch up as much as you can. There was a guy named Francis Finlay, an Englishman who was teaching investments. Professor Adler had a course on international trade. I was fascinated by anything linked to international investments.

Today, students are much more prepared and focused

when they start school. I don't even know if there was an investment club when I was at Columbia in 1980. Maybe there was...I had no clue.

**G&D:** And when you graduated, where did you start your career?

**PJ:** I joined JPMorgan in New York for an internship in asset management for nine months. And that was very useful because it was my first contact with the real world of managing equities, bonds, convertible bonds, and warrants.

Then, after the nine months, I went to Paris to work for a bank named BAll, which later became a subsidiary of BNP. It was still in the very early days for investments. In those days, the stock market would open and have only one quotation a day. So I was in Paris managing money for international clients while the whole French domestic market was not allowed to invest offshore. Those were the early days in 1983. Things have progressed a lot.

**G&D:** You started in convertible arbitrage – how would you say convertibles investing has changed since when you started in the 1980s?

**PJ:** In the early 1980s, people used to value converts as a substitute for stocks. Now people value

(Continued on page 5)

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## Philippe Jabre

(Continued from page 4)

them on implied volatility compared to historical volatility and there is more of a credit markets aspect to it. In the earlier days, we used to have broker loan rebates. If you put your shorts and longs with them, they would give you a credit. So let's say the two year treasury was at 6%, they would give you 6% plus the coupon on the bonds less the dividend on the stock (if any). So we were looking at convertible arbitrage with a 3-5% positive carry on the trade. Converts were excessively cheap at the time. They priced in very little value for optionality and didn't accurately price the potential for the stock to explode or to collapse. Black Scholes was very good at pricing short-term options—three or six or nine months. It was not good at all for 3-5 year optionality because you had a different set of data. And so, for ten years, it was a very profitable environment to invest in. Today you have convertible bonds coming with 0-1% coupons and already pricing in large implied volatility. The market is just much more efficient.

**G&D:** How would you describe your investment philosophy?

**PJ:** I'm currently running three funds. One is a multi-strategy fund which has a convertible arb portion, a long-short equity portion, and then a smaller section

of event driven, emerging markets, foreign exchange, and fixed income. Then I'm running two long funds or absolute return funds where I buy cheap stocks or convertibles. So the same trades that I do in the hedge fund, I can do in the long funds but I just don't hedge them.

***"One needs to take a view. If you take no view, you make no money."***

The reason why I have those three products is because I always look for the catalyst. If you fully hedge a convertible bond by hedging the credit, selling the stock, and locking in the implied volatility, you make no money if you have a hedge. So people like myself look for catalysts on stocks – earnings, events, positive or negative surprises. This is why I've developed long-only expertise. It brings additional layers of information on why a stock should go up or down and

what are our expectations.

I think the real game today becomes optionality. Where we can make money is on the increase in volatility if the stock has sharp moves up or down. One needs to take a view. If you take no view, you make no money.

**G&D:** How was it moving from convertibles into equities and other types of investments?

**PJ:** Convertibles are made of four variables. On the fixed income side, it's made of credit and the interest rate. So one needs to know what is happening there on the macro side. And on the equity side, it's made up of an option on an underlying stock. So basically when you look at convertible bonds, you have to be familiar with what's happening with interest rates, credit spreads of your underlying instruments, the valuation of the stock, and the value of the optionality.

At times, the first two variables, interest rates and credit, get their days of glory like in 2008 or 2011 when interest rates were under pressure and credit spreads exploded. But in eight years out of ten, all you need to worry about is your stock valuation. Today, companies have a lot of cash and interest rates are at zero, so there is nothing to hedge there. The real hedge is on the equity part. So over the years we

(Continued on page 6)

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## Philippe Jabre

(Continued from page 5)  
developed knowledge on the equity side. That's how we became investors in stocks.

**G&D:** Can you talk about deciding to start Jabre Capital?

**PJ:** Before you start a hedge fund you have to follow the right steps. I always tell people it's the same as if you are a doctor, architect, or lawyer opening a practice. I first joined a bank, then after ten years I joined Lehman Brothers. Then, with a group of four partners, we spun off from Lehman Brothers and created GLG. And then after that, I created my own fund. You follow the steps so people will follow you.

I remember after business school I wanted to create my own fund at age 25. My father told me if you want to lose money, go lose money at other people's expense. You can't become a fund manager unless you've lost a lot of money and survived. So JabCap was a normal evolution when I started it seven years ago. A lot of clients followed because I had a very good track record at my prior funds over the previous fifteen years and that made it easier. But you need a track record and you need to have clients. The barriers to entry are very high today and what people look for is a track record and the experience of managing money unsupervised. And that's a very difficult

concept that you learn with time.

**"Before you start a hedge fund you have to follow the right steps. I always tell people it is the same as if you are a doctor, architect, or lawyer opening a practice... You follow the steps so people will follow you."**

**G&D:** What are the challenges for someone who might want to start their own fund today?

**PJ:** It's getting much harder for a number of reasons. First, banks used to be a platform where you would get exposure to a variety of areas. So you could do capital markets, M&A, you could be a trader or an arbitrageur. It used to be like a school. And then the brightest would have their own book and then after a few years with a track record they could set up their own fund.

Today, you don't have that. Banks don't really provide that platform anymore. So to develop that track record, you might go to a long-only manager, which is a very different world. Or you would need to go to a hedge fund, spend 6-7 years doing analysis, and then manage a pool of capital as part of a larger hedge fund.

Ten or fifteen years ago, you might need \$20-40 million to cover the costs of starting a hedge fund. Today, that number is probably closer to \$100 million because regulations and controls are much more intense and, as a result, you need a lot of people just for compliance. So it's become much harder, which is good for funds that already exist because the barriers of entry are getting even higher. We can maintain a higher alpha because banks don't really speculate anymore, many hedge funds have closed down over the past five or six years, and there are very few newcomers. So whoever has survived in our industry is able to develop high margins, at least on stocks. If you look at fixed-income or at algorithmic traders, the performances are much lower because there is a huge amount of money there. Most became too big and the market doesn't give them the same opportunities. So it's a rotation and, for the moment, it is much harder

(Continued on page 7)

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## Philippe Jabre

(Continued from page 6)

for young people to create a hedge fund. I think people need to have at least 8-12 years of experience, so maybe by age 37-40 you start to think about setting up your own fund. But it takes time and it's much harder than before.

**G&D:** Can you talk about how the Jabre Capital team is organized?

**PJ:** I have an investment team of 15-17 people working with me out of a fund with about 50 people. I have analysts looking after certain geographies – one looking at Asia and Japan, two looking at Europe, and one focused on the US. Then I have product specialists. So I have a credit person, and a person who trades converts and a research specialist for converts. Then I have an event-driven team with a specialist in risk arbitrage, a specialist in emerging markets, and a series of traders for the US, Europe, and Asia. These traders and specialists bring interesting situations to my attention or to the attention of the other fund managers. By organizing this way, and covering different strategies and products worldwide, we have great flexibility. Sometimes we buy value stocks, other times we buy growth stocks. Last year, for example, we bought a lot of Chinese internet stocks and gambling stocks in Macau. These investments were quite new in our portfolios.

There's always something happening or an area in which the market is not focusing enough attention. This presents interesting opportunities, and our agility can help us outperform because in the bigger investment management firms, they have fund managers specialized by area. They have a value guy, a growth guy, a mid-cap guy, or a guy who only does oil and gas. It is hard for these guys to be up to speed on all areas. Things slip, and this is where a hedge fund can be a bit faster – faster to recognize, faster to buy, faster to sell, faster to understand. I think that's what we do.

**“A hedge fund can be a bit faster – faster to recognize, faster to buy, faster to sell, faster to understand.”**

**G&D:** Can you walk us through a past investment that you think illustrates your investment approach?

**PJ:** Earlier in the year,

people asked me if we were investing in Russia. I told them the fund had no emerging markets exposure and no intention to add any. They asked what it would take to change my mind. I said if you have a collapse in valuation, then we will jump. Several weeks ago there was a collapse so I went and bought Russia. I put 10% of the fund there. Colleagues who cover emerging markets said you're crazy. But I said why? I told you I would invest when things collapse. They have collapsed. There are names that trade around 3x P/E. They said yes but everyone is selling. I said it is already in the price, just give it time. You can't invest based on news stories of what Obama and Putin discuss on their phone calls. You need something based on valuation and you need to forget about the noise.

A second example would be our Japan investments. In November 2012, I was invited by a bank to make a presentation in Japan for institutional investors. Two weeks after my visit, the parliament was dissolved and there was talk of a new government. I've followed Japan over a long period of time so I knew what the implications of that might be, and thanks to that experience, I immediately went overweight a market where I previously had no exposure. Japan was thought of as a market that was going nowhere in those

(Continued on page 8)



Students talk with Bill Ackman at the 2014 Pershing Square Challenge.

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## Philippe Jabre

*(Continued from page 7)*

days. In December 2012, our equity book was up 10% because I was quite early compared to others in understanding the changing dynamic in Japan. And that positioning worked out very well in 2013.

Another example: in 2009, everyone hated banks in America. But I heard the CEO of Citigroup and the CEO of JP Morgan talk in Q1 2009 about how their banks were making money, not losing it. And that was the biggest signal to buy US banks that I ever saw. We bought a lot of them in the US and we finished the year up 80%.

A similar thing happened in Europe. Last June, European banks were trading at 60% of book value and suddenly the ECB came in very strongly to support them. And so we bought a lot of ETFs on the European financials and they ultimately went up 60% or so.

Having the cash, having the openness of mind, not being caught with bad investments – all of that was important.

So the key thing is to find things that have done nothing for ages and suddenly there is an event that you need to be the first to understand or appreciate. And this is where you have a huge opportunity to outperform. Last year, our equity fund, which is unlevered and has a maximum exposure of 130,

made 50% net of fees. The main thing was to have Japan and Europe going from an underweight to a market-weight position during an extraordinary period. So you have to recognize you are in that type of extraordinary period and deploy money ahead of others.

***“The key thing is to find things that have done nothing for ages and suddenly there is an event that you need to be the first to understand or appreciate how things will change.”***

**G&D:** Can you talk about any investments that didn't work as well or where you learned from a mistake?

**PJ:** In 2011, I had a very difficult year because the market was going up and

down 10% every month. For eight months in a row, we had volatile moves up or down. So you either had the feeling that the market was going to collapse or that the market was going to go up. The S&P finished flat on the year but it cost most active fund managers money because of the volatility.

But in addition to that, I had exposure to mining and inflation-protection stocks in 2011. That cost the fund a lot of money because all the industrial materials, mining, and gold stocks really struggled. It was one of those periods where you had to experience your stock going to zero before it bounced back.

Even though we will implement a stop-loss when we have a bad investment, 2011 became the worst time to stop-loss you could think of because we would stop-loss an investment and the market would go right back up. But in 2008 when we did stop-loss, the equity fund finished up for the year because after I lost 10%, I went out of the market in the equity funds. Then I bought bonds the last three months and the fund finished up 2%. So as much as that model of stopping your losses works in extraordinary periods, it can hurt you a lot when the market is going through erratic moves but with no definitive trend. And so the conclusion is that when you start to lose money, you

*(Continued on page 9)*

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## Philippe Jabre

(Continued from page 8)

should get smaller and trade less, because you can't catch the market properly.

Over the past 15-18 months, it's been a much easier market because every dip was an opportunity to buy. So one could increase leverage and create great performance. All of this was exactly the opposite of 2011. The lesson is that you need to identify the cycle and the trend and try to apply the right investment strategy according to the trends.

**G&D:** Aside from stop-losses how do you think about risk management, position sizing, and the amount of cash that you hold?

**PJ:** The big difference between someone that comes from asset management and someone who comes from a trading environment in a bank is the sizing of the portfolio. I have met so many traders who put too much weight on some ideas and if the idea doesn't work, they find themselves either stopping them lower down or not generating any return because they missed the more interesting ideas. Since I come from a more traditional investment management background, we're more diversified and have very strict limits on how long or how overweight we want to be in some situations when we find great, cheap opportunities. And we're

very disciplined. If we go through a period where we're down 10% in a stock, we're very disciplined about cutting exposure because there's something wrong that we don't understand.

**"The world is full of investors that miss the big move because they overreacted to headline news or to short-term profits."**

The combination of these constraints helps us survive difficult periods and gives us the cash to take advantage of better periods. I took a stop-loss in my long fund in the summer of 2008 and moved money into fixed income bonds. And in early 2009, the equity market stabilized and we had the cash to buy cheap banks and cheap growth stocks. It was the most extraordinary

period we ever had because we had the cash and investors behind us.

Take that strategy we followed compared to value funds which got very badly hurt in 2008 because cheap stocks got cheaper, and some even went bankrupt. A lot of value funds got decimated by sticking to their model of buying cheap stocks like Bear Stearns, Lehman Brothers, or Countrywide. So it was a very difficult period and the thing that helped was the stop-loss.

But now we're okay, there's no more systemic risk in the market where we face extraordinary dangers.

**G&D:** Would you rather hire someone who has a trading type of background or a traditional asset management type of background?

**PJ:** Asset management. An asset manager will survive cycles provided they have a good trader behind them to protect them. I think finding a good manager who understands valuation is much more valuable than finding a good trader because over the years, that's how you avoid buying too early and selling too early. The world is full of investors that miss the big move because they overreacted to headline news or to short-term profits.

(Continued on page 10)



Scott Ostfeld '02 of Jana Partners speaks at the 2014 CSIMA conference.

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## Philippe Jabre

(Continued from page 9)

In 2013, for example, fund managers of my generation were able to make 40-60% type returns, because we had a price target for what

***“The challenge now is to buy the right stock, because if you bought a Cisco or Intel or an IBM, you went nowhere. So you have to identify the right stock, the right sector, and the right growth story so that you don't waste your money on underperforming names.”***

we owned and would stick to it. The younger generation of managers, on the other hand, would tend to realize their investments much faster, making 10-15% and then moving on. But doing that, you miss the big move when a stock like

AIG goes from 28 to 50 in a straight line in a year. When that happens, you feel stupid if you buy it at 28 and sell it at 35. But you need experience to avoid making that mistake.

So I think what you need is a good fundamental fund manager and an excellent trader. You need both to have experience because the market is continuously repeating and the key is to figure out what type of period we are in and where we are in it. That's the most important challenge.

**G&D:** You mentioned the cycle. What is your typical time horizon for investments?

**PJ:** Since the macro situation stabilized in June 2012 when the ECB decided to do whatever it takes to stabilize the euro, we moved from a risk-on/risk-off macro environment where correlation was very high to a stock-picking environment where correlation is very low. In the period before, it was very hard because the market was not reacting to fundamental valuation. It was reacting to the possible breakup of the euro, to sovereign downgrades, to the shutdown of the US government, to a possible crisis in China. It was more of a macro, high-correlation market. So it was very hard to hold on to stocks before. But since June 2012, people like us who pick stocks have had a much smoother

period to buy and hold compared to that period. The challenge now is to buy the right stock, because if you bought a Cisco or Intel or an IBM, you went nowhere. So you have to identify the right stock, the right sector, and the right growth story so that you don't waste your money on underperforming names.

**G&D:** What metrics do you focus on when evaluating stocks?

**PJ:** First, you have to look at the macro because if you buy a great stock in a horrible environment, you make no money. For example, Japan has the right environment right now because you have central bank monetary stimulus and a weakening of the yen. So you need to have a macro view which will help you develop a micro view. What we do is look sector by sector and analyze which sectors to focus on and which ones to avoid based on where we are in the cycle and the macro backdrop.

Then each sector will have a different metric. If you want to buy financials, you'll want to understand Tier 1 capital ratios and price-to-book metrics. If you look at real estate, you need to understand cap rates, price to NAV, and trends in real estate. If you look at export companies, you need to understand foreign currency exposure. So they will all be

(Continued on page 11)

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## Philippe Jabre

(Continued from page 10)  
different and you have to know which ones matter for a given sector.

**G&D:** Are there other current ideas you think are interesting?

**PJ:** Oh yes, you should buy Japan. Nobody believes the government can sustain their current policies, so the market puts a very small premium on the success of their policy. Even the Japanese themselves do not trust the government to sustain it. If they keep on trying, we could have the Nikkei going to 16,000-18,000 with the Yen at 110 to the dollar. A lot of reforms that might happen, like corporate tax cuts, labor liberalization, or pension funds redirecting investment into stocks, could very easily help the equity market there continue to do well. Another one is China. There are a lot of macro funds that are short Chinese shares. But if the Chinese authorities stimulate, we could see the Chinese market up another 10%.

A hedge fund has the capacity to look ahead. We could be wrong but if we're right, we can make a lot. If I'm wrong on Japan, I think we'll see the Nikkei go from 14,000 to 13,000. But if I'm right and they implement these reforms, I see it going from 14,000 to 18,000. So it's all a risk-reward situation.

**G&D:** Before we end, do

you have any parting words of advice?

**“People have to make sure that they're not ahead of their own experience and then have to avoid being too scared to make the jump when the time is right.”**

**PJ:** If people want to join the hedge fund world, they need to really develop fundamental analysis skills and these skills should be developed within large organizations. They shouldn't be in a rush. Things happen when they should occur. If I had started my own hedge fund in 1996 instead of 2006, I would not have had the same success. So people have to make sure that they're not ahead of their own experience and then

have to avoid being too scared to make the jump when the time is right. So you need to have a very cool head and take advice. Look around you – what are the right steps to create your own best path? I think a lot of people suffer from leaping too early or too late into an area in which they want to work.

My advice is: work really hard but don't be in a rush to create your own hedge fund. A hedge fund is like finishing school. You first need to go to university to get practice, to get training, to lose money at someone else's expense, to develop your own expertise, to develop a track record, and then if you're still interested and motivated, you can try to think how to start your own fund.

**G&D:** Excellent. Thank you for taking the time to speak with us, Mr. Jabre.

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**Arnold Van Den Berg**

## Arnold Van Den Berg & Jim Brilliant

*(Continued from page 1)*  
**advisor/consultant for Capital Securities and John Hancock Insurance.**

**Jim Brilliant has been with Century Management for 27 years and is a principal of the firm, the co-Chief Investment Officer, Chief Financial Officer, and a portfolio manager. Jim is a member of the Century Management Advisory Committee. Jim attended Pierce College where he studied Finance.**

**Graham & Doddsville (G&D):** Can you each tell us about your introduction to investing and how you first became interested?



**Jim Brilliant**

**Arnold Van Den Berg (AVDB):** My introduction to investing began when I was working for a financial firm, and they were selling insurance and mutual funds. I got very excited about the mutual funds, as the market was doing really well in late '68 and early '69. I thought that after all of my travels I had finally found the field that I'd like to devote my life to. I started getting people, mostly friends of mine and friends of people I knew, involved in mutual funds.

Just about the time I got going, stocks and mutual funds went into a bear market from 1969-74. I was very, very distraught. By '72 and '73, I was doing a lot of soul searching about what was going on and what went

wrong. I was reading and researching and one day something caught my eye that changed my whole way of thinking. As I was reviewing the companies and the people who did well and who did poorly in this market, I noticed that some of the better performing firms and better performing money managers all had a connection with Benjamin Graham's investment approach. I thought, "Geez, I wonder what this philosophy is all about?" I started studying and eventually met a gentleman named Mark Franklin who became a mentor to me, and he was a big Graham fan. After I felt that I understood the philosophy, I studied everything I could get my hands on. I decided that rather than depend on mutual funds, I would start my own investment firm. That was how I got involved in the investment field and it eventually led me to start Century Management.

**Jim Brilliant (JB):** My first introduction to investing was when I was a teenager. Every Sunday my dad would pull the stock tables out of the newspaper, and his simple method was to chart the stock prices, tracking the trading range of that stock from high to low over time. At that time, I was shoveling snow and cutting grass and had kind of a neighborhood business where I'd saved some money. I decided, "Well, that looks pretty good. Let me try my hand at it." The

first stock I ever bought was Commonwealth Edison when I was 15 years old.

**"One day something caught my eye that changed my whole way of thinking...the better performing firms and better performing money managers all had a connection with Benjamin Graham's investment approach."**

I made money on it and that turned me in the direction of businesses, and understanding that my intellectual power is far more profitable than my labor power. I made more money on that stock than I did cutting grass. It certainly opened my mind to the importance of expanding the mind and using that as the way to wealth.

**G&D:** Can you talk a bit about the founding of Century Management and why you started it?

*(Continued on page 13)*

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## Arnold Van Den Berg & Jim Brilliant

(Continued from page 12)

**AVDB:** I was able to get a good grasp of the value philosophy, but the problem was I didn't have any credentials or formal education. I didn't have any money either, but I did have a dream. I was sitting with one of my clients and I told him about my dream of starting my own investment company. I was working out of my studio apartment at the time, and he said, "Oh Arnie, you can't do this out of your apartment. You've got to get an office. You've got to get a business going." I said, "The problem is I don't have much money."

Anyway, a long story short, after lunch he offered to help me get my business going, rent an office and buy some furniture. It was about \$2,500 at the time; in today's money that's about \$17,000. I decided I'd go out and I'd get an office and start my business. I do not recommend that people start that way. That's the way I did it, but I didn't have much choice other than to continue selling products, and I didn't want to do that. It was many years of struggling, of building a clientele, of developing a reputation and track record. I started in September of 1974 and the market bottomed three months later, which gave me a boost with the few clients I had.

That six year bear market leading into 1974 was just torture. Every day we would come in and the market would just grind

down. While the environment eventually created tremendous opportunities, the sentiment was extremely negative. You had 12-15% inflation, you had a market that dropped 45%, and you had small cap stocks that dropped 75%. Everybody was bearish. People didn't even want to talk about the stock market because they had been burned so badly. My thought was that either the world was going to end, and a lot of people thought it would, or I was going to make a lot of money. People are always predicting the end of the world, but the only things that end are the people; the world keeps going. That was the founding of Century Management.

**G&D:** How has Century evolved over time? Are there particular processes you have implemented that you think lead to better results for clients?

**AVDB:** I think the most important thing in the market, as in almost any endeavor, is discipline. It is one of the things I learned as an athlete when I was young, and I became very good at it. Remaining disciplined is something that we try really hard to do in this business.

One of the things we've tried hard to implement here is that when we're looking at a company, we look at the qualitative risk. How good is the business? How good is the

management? Then we have a strict quantitative approach as well. The most important thing is to identify the potential pitfalls – what are the flaws? How low can this stock go if things don't work out?

**G&D:** Do you think

***"The most important thing in the market, as in almost any endeavor, is discipline."***

discipline is teachable or is it something the people you hire inherently have?

**AVDB:** Oh no! I think discipline is very teachable. If you don't learn it by yourself the market will teach it to you, but you will learn it one way or another. It's kind of like what one of my favorite authors, James Allen, said, "You either learn by wisdom and knowledge, or by suffering and woe, and you continue to suffer until you learn."

**G&D:** Moving on to your investment philosophy, you mentioned Ben Graham, you just mentioned both the qualitative and quantitative aspects of companies. How would you characterize

(Continued on page 14)

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## Arnold Van Den Berg & Jim Brilliant



First-place winner Patrick Stadelhofer '14 with Paul Orlin and John Friedland '97 at the 2014 Moon Lee Prize Competition.

(Continued from page 13)  
your investment philosophy?

**JB:** We have three primary tenets to our investment philosophy. The first one we call recognizing and capitalizing on value gaps. That's really just finding companies where the price of the stock is disconnected from the underlying value of the business. You're probably familiar with Ben Graham's quote, that in the short run the market's a voting machine and in the long run it's a weighing machine. To us, what he was really describing was how the prices of stocks often get disconnected from their underlying value due to volatility in the market. We are searching for opportunities where that price disconnect occurs.

The other part of our investment philosophy, as Arnold mentioned, is that all of our valuation is anchored on what we call a worst case analysis. The idea is that we handicap what we think the company's stock is going to sell for during times of extreme duress. The duress could be a recession, it could be an industry problem, or it could be a company problem, but focusing on that worst case analysis helps us identify what we think is the proper margin of safety. What we have found over the years by doing this is that companies and industries tend to have repeatable patterns, in terms of valuations, through a cycle. That is also one of

the reasons why studying history is so important.

Arnold kind of mentioned this in terms of discipline, that expertise in any field is largely driven by a mental database of experiences and patterns that are recognized by having lived through different environments. To us, studying history is really important. We go back through 20 years of the company's history, or as far back as we can get the data. We look at all aspects of the business and we want to understand its drivers, what makes it tick. In particular, we break down the company to see how each segment performs during the entire business cycle and how the market will price that company during these extreme events, either during extreme downturns or extreme upturns.

At the end of all this, we put together what we call our valuation structure, where we have a worst case price based on the company being in extreme duress. Then we look at a sell point, and that is where we forecast a full cycle recovery in earnings and multiples, and derive our sales price based on that. And finally we want a margin of safety. That margin of safety is what drives our buy point. We'll buy the stock based on a margin of safety and we use a reward-to-risk ratio to determine that.

By way of example, if we

have a stock that has a worst case of \$8 and a sell point of \$20, if it were a small cap stock, we'd want a minimum of a 5:1 reward to risk. So in that case, we can only pay \$10 to buy the stock. If it were a big cap stock, then we're looking for a 3.5:1 reward-to-risk ratio. These can be slightly adjusted based on industry and the nature of the stock. Once we've done this, we take all of our stocks and put them into a dashboard, which is just our master Excel worksheet that has all the valuations. Then we sort by reward-to-risk, and this is what really drives the framework for our portfolio. Sorting through that reward-to-risk helps us make our buy and sell decisions and portfolio-weighting decisions.

**G&D:** Are there particular investors that have helped form tenets of your investing philosophy, besides Ben Graham?

**AVDB:** There are lots of investors like Graham and Buffett and people of that nature, most of them you've heard of. There's one that I learned a great deal from, and pardon me for mentioning his name in a value-focused newsletter, but that was T. Rowe Price. He taught me three things that are really important. He was a growth stock investor, kind of like Phil Fisher. He was big on the qualitative aspects and he really made me stop and

(Continued on page 15)

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MANAGEMENT ASSOCIATION

## Arnold Van Den Berg & Jim Brilliant

(Continued from page 14)

think about the value of a business beyond the normal financial metrics. T. Rowe Price is an investor that is underappreciated in my opinion, and I think anybody who's interested in this field ought to study his life and his philosophy, because there are tremendous lessons to be learned.

***“Expertise in any field is largely driven by a mental database of experiences and patterns that are recognized by having lived through the different environments. To us, studying history is really important.”***

The second thing I learned from him is that he really regretted selling his business. His regret influenced me to make the decision that I would never sell Century Management, because when you sell, you lose control over the way the investment philosophy and business are managed, even though your name is

still associated with the business.

The third thing that I learned from him was the value of having incredible flexibility. He was a premier growth stock investor, and in 1969, he decided that his growth stocks were overvalued, as was the rest of the market. In addition, the government was printing money to provide the social programs that were established in the 1965 Great Society initiative, so he completely changed his point of view. He opened up the New Era Fund that consisted of the antithesis of the stocks he always followed. He bought gold and silver stocks, oil stocks, cyclical and basic materials stocks, and real estate, because he felt that inflation was coming. This proved to be a very good call, given the environment, and he provided a great return during difficult times. That was a very big lesson and that really helped me during the 1970s when I got started. In my early years we bought Swiss francs and claims on Swiss reserves. It was illegal to own gold at the time but you could buy collectibles (which I don't normally recommend), so we bought British sovereigns as they were selling at a small premium to gold bullion. This helped us a lot during the early '70s when inflation rose.

**G&D:** That leads to our next question. You founded Century in 1974 and have

seen multiple market cycles. Did that frame of reference help you in 2008 and 2009 and how does it frame your thinking now?

**AVDB:** I think the main lesson you get from being in different markets, and markets that go down quite a bit like the 1974 bear market and the 2008-9 bear market, is that when stocks go down 40% or 50%, some way or another, as a whole, stocks always come back. Everybody who starts out in this business knows that, but until you go through one of these markets and you see things fall apart and then come back, you don't have total faith when you're going through it that it will come back the next time around.

By going through these markets, it's given me complete faith in America and the American markets, because when you look at how low stocks get in these bear markets and you see how quickly they recover once things clear, you develop confidence that when you have something you believe is of value, you stick with it. You don't sell and if you have the cash, you buy more. That confidence helps you to navigate through these cycles and helps you sell stocks, like we've done this past year, and build up cash knowing that another cycle will come and you will be able to redeploy the cash when the bargains appear.

(Continued on page 16)

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## Arnold Van Den Berg & Jim Brilliant



Louisa Serene Schneider '06 addresses the audience at the 2014 CSIMA conference.

(Continued from page 15)

Right now, out of four hundred stocks, we only have ten, maybe twelve ideas that we could buy today. We know this is not a good time to be very aggressive and we're building cash.

**"We look for things like regulatory changes, policy changes, or demographic changes ... We find that often provides ripe areas for further investigation and a way to develop themes."**

That kind of anchors your philosophy about what is value. I think our 5:1 reward-to-risk ratio on the small cap stocks came out of going through these cycles and realizing that our buy point probably shouldn't be much more than 15-20% above our worst case. That has worked for us for many years. During our first 30 years we only had one down year, a loss of 9%, and averaged more than 15% during that time.

**G&D:** Did 2008-2009 influence the way you think about your worst case analysis? It was a market

that was so disruptive - did that change the way you think about worst case analysis or is it viewed as an aberration, a once in a lifetime type of market?

**AVDB:** No, I think that the 2009 market was very much like the 1974 market. It came a little quicker, but I think that the 1974 bear market was even worse because it lasted over six years. Just to give you an example, the 2007-09 bear market went from an 18x multiple to about a 10x multiple. The 1974 bear market went from an 18.9x multiple to an 8x multiple. The median P/E for the average stock in the Value Line® composite of 1,700 companies went to a 4x-6x multiple. I still consider the 1974 bear market the toughest one because it dragged out for six years. Not that a down market of a year and a half to two years is short; it is long when you're living through it, but it's not as long as six years.

**G&D:** How do you typically look for new ideas? You mentioned earlier that you keep a spreadsheet of the companies you are tracking and their reward-to-risk. Will you also use screens and other methods of sourcing ideas?

**JB:** We run a lot of screens. We subscribe to Value Line®, which covers several thousand companies over the course of a year. We find that to be a great

source of ideas. We certainly talk to other investors and share ideas that way. One of the areas that I find to be the most fruitful is identifying themes. That's because if you can identify a theme, you can leverage your research. Instead of one idea at a time, a theme allows you to pick up five to ten ideas.

We look for industries that are undergoing some dramatic improvements in their end markets that may not yet be realized in their price. To get to those, we look for things like regulatory changes, policy changes, or demographic changes. Probably the most prolific is technological change, and I don't mean the PC change, but changes in an industry due to different kinds of technology being used. We find that often provides ripe areas for further investigation and a way to develop themes. For example, in the energy industry, we've all heard about the well publicized fracking techniques utilized in onshore oil and gas drilling. While fracking has been around for decades, it is the combination of fracking and the relatively newer advanced drilling technologies such as long-lateral horizontal drilling, and directional drilling that has led to the tremendous increase in the amount of natural gas and oil produced in the United States.

**G&D:** With markets up

(Continued on page 17)

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## Arnold Van Den Berg & Jim Brilliant

*(Continued from page 16)*  
significantly in 2013, are there specific areas you think have become overheated or still find relatively attractive? And within that are there any specific investment ideas you would be willing to share?

**JB:** As Arnold has mentioned, it is hard to find value in the market today. And it's hard to find cheap stocks across an entire industry, so it's more of an individual stock-picking market at this point and it's tough to find good values. We obviously keep digging for them and we try to look for those themes that we think are mispriced. In particular, some of the areas where we think there's opportunity right now are in sectors of the energy market. Basic materials names have been beaten up, so we're finding some value there and also in some areas of insurance. I think we've all heard recently about the biotech industry and how that's gone crazy. We have no circle of confidence in biotech, so that doesn't affect us.

One theme we previously mentioned is natural gas. We believe the US is developing some very significant competitive advantages in different areas, and one is the energy market. That is evident with the increased production both in oil and natural gas.

On the natural gas side, that has a particularly positive

implication for the chemical industry, because in the US, we use natural gas to produce ethylene, which is the primary/basic component for most value-added chemicals. A few years back, we saw this when we observed natural gas prices declining rapidly. One of the things we look at are structural shifts, so when a new technology comes in, we look to see if it is going to impact an industry structurally. The production of natural gas became prolific and prices fell dramatically, so we were looking at those companies that stood to benefit from cheap natural gas and, of course, those that were going to get harmed. Some getting harmed were coal companies, because natural gas became very competitive from a cost standpoint. The chemical industry is one area in particular that would benefit because of lower input costs.

We recognized that and believed there would be significant share gains by US chemical companies, which would require capital spending. Well, it's coming to fruition, as there's about \$70-100 billion dollars that's going to be spent over the next five years. We bought a fair amount of these companies that we believe are going to benefit from this capital spending binge. One of my favorites in that industry is Jacobs Engineering (JEC). They're an engineering and

construction firm, and in my view one of the best run companies in the business. I'm not recommending that anybody buy it right now, but we see this being a five-to seven-year cycle. The stock is around \$63 now, and should it sell off into the mid-\$40s, we'd certainly be buying more of it.

Another company that is somewhat related is Orion Marine (ORN). They're a marine construction company that specializes in heavy construction projects that are around water. They're very big in the Gulf Coast, the Pacific Northwest, and the Caribbean. They do marine construction and dredging. It's a heavy construction business and coming out of 2008-9, the industry was peaking from the previous construction cycle. Their revenues, backlogs, and profits were declining and competition got very difficult. Bidding became very competitive, so their earnings collapsed. It showed up for us on a tangible book value screen that we run, but it also showed up in two other ways: one was our chemical theme, and the other was our Panama Canal expansion theme. It kind of gives you an idea how we try to triangulate different things based on cheapness and themes we're looking at.

They're widening the Panama Canal, which

*(Continued on page 18)*

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## Arnold Van Den Berg & Jim Brilliant

(Continued from page 17)

requires deeper and wider ports in the United States to be able to accept bigger ships. The project has been somewhat delayed by government budget issues, but it looks like the Army Corps of Engineers will start to release some projects pretty soon. Additionally, most of the chemical plants around the Gulf Coast will require marine construction. Orion Marine is in the very beginning stages of this and it's starting to have a positive impact on their backlog and revenues. The stock has run lately and is at roughly \$13, or about 40% above our buy point. I wouldn't buy here, but at lower prices, we'd certainly add to that position. Our target on that stock is about \$20.

**G&D:** Any others you would be willing to discuss?

**JB:** As you know, over the last couple of years, gold went from roughly \$700 to \$1,800 and then back down to \$1,200. Well, even more than the decline of gold prices, the gold miners went down dramatically. Gold went down roughly 34% and you had gold miners, depending on their market cap, down 50-85% from their recent peak. Back in December, we saw a lot of value in the gold miners so we bought a basket of miners that was diversified both geographically and by market capitalization. In our view, the gold miners at the end of the year were discounting roughly \$700 to

\$800 gold. We've done what we believe is a thorough analysis on gold and gold mining companies, which Arnold summarized in two articles he and the team wrote on this subject. We sent these write-ups to our clients back in February and March but they are still available on our website at [www.centman.com](http://www.centman.com) if you would like to read them.

We're not big buyers of gold miners right now and we're not buyers of gold itself. But we watch the companies individually because there are some that are nearing our buy points again.

**G&D:** Some of the ideas you mentioned play on themes that develop over multiple years. How long do you typically hold a position?

**JB:** Our average holding period is usually three years, but it depends on a couple of things. One is the overall market environment. Second is how quickly the theme is recognized in the stock price. As you know, stock prices discount the future, so while the theme may be a five to seven year theme, the stock may discount it three or four years out.

At the bottom of the cycle, a lot of these companies are very lumpy in terms of their business orders and backlog. Many investors want the rosy picture and the comfort of the crowd to

justify that they're right. It's really the down and dirty value guys that are buying some of these stocks at the bottom. What we often find is the longer the cycle, and the more that the earnings grow throughout the cycle, the more that multiples start expanding and you begin to attract growth investors. Typically, by the time those guys are in, we're out.

**G&D:** How do you think about position sizing? If you have a buy target and a sell target, is the position sizing a sliding scale between those two ends?

**JB:** We're an all-cap manager, so we'll buy across the market cap spectrum. The smaller the company is, the more cognizant we are about our ownership percentage relative to float and the amount of average daily trading volume. So we're very aware of that when we're taking our positions. A position typically ranges between 1% and 5% of the portfolio, depending on cap size, quantitative and qualitative factors, as well as valuation.

Let's say we want ABC Company to represent 3% of the portfolio. We may start out buying an initial position of 1% or 1.5% at our buy point with the idea this will leave us room to dollar cost average into the position if the price declines and gets closer to our worst case scenario.

(Continued on page 19)

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## Arnold Van Den Berg & Jim Brilliant

(Continued from page 18)

Sometimes it gets there, sometimes it doesn't, but this has an influence on our total position size. Then as the stock appreciates, we review every company at fair value for a potential sale or trim. The things that will influence whether we're going to sell or trim is the power of the thesis, how strong the company is in its industry, and if the company is performing within our stated theme and expectations.

It will vary by company and it will vary by market cap — the smaller the market cap, the more we have to sell in advance. There are many factors that go into it, but ideally we are able to get our maximum position and then somewhere between our designated fair value and sell point, we begin to exit so that by our final sell point we're at zero.

**G&D:** Are there certain valuation metrics that you pay the most attention to when you're evaluating your worst case scenario and fair value scenarios?

**JB:** We look at enterprise value-to-sales, price-to-cash flow, price-to-book, EBITDA, and P/E ratios. We look at the entire host of standard metrics. What we find is that depending on the company or the industry, different metrics are more important than others during different times of the cycle. For example, at the bottom of the cycle, the more cyclical, commodity-

linked and asset-driven businesses tend to be priced on asset values and so tangible book is our favorite valuation metric for these companies. However, at the top of the cycle, the same companies tend to trade based on earnings, EBITDA, and sales metrics. For less cyclical, steady cash flow generating companies, we focus on free cash flow and earnings based metrics, as book value doesn't tend to be as important.

**G&D:** There's no shortage of people who think the US is facing headwinds but you seem to have a pretty optimistic view. What drives your optimism and does it affect how you think about your investments?

**AVDB:** There are some big problems, no question about it. But, what people lose sight of is the fact that first of all, the US is a democracy. It has private ownership of assets and it has no currency restrictions. It has the highest level of technology; we're the leader in 3-D printing, hydraulic fracturing, robotics, and nanotechnology. We have the largest, most diversified and flexible capital markets in the world. You almost have to be a foreigner to appreciate what this country has over most other countries. You realize that what foreign investors are really looking for is the stability of the country and a sound political system. The political system is a bit of a

problem right now, but over the long run it has a tendency to straighten out because of the rules put in place by the founding fathers and because it's a democracy.

Just to give you an example, I checked the flow of funds from the Federal Reserve and found that foreign investors probably have more money invested in America right now than at almost any time in history. What that shows you is irrespective of the problems, if you compare the US to the rest of the world, there really aren't many other places you would go to invest. There may be better pricing, there may be better opportunities, but as far as a place to invest, and a place to live, and a place to do business, even with all its apparent shortcomings, I still believe the US is the best place. You know what they say in real estate: location, location, location. Well, America is probably the greatest location. In addition, and this is very important, we have one of the best militaries. When you apply some of the technological advances our military has incorporated, I personally believe it is the best. Just two years ago they landed a plane that was piloted by a robot on an aircraft carrier. This really gives you an appreciation for our tremendous military power and capabilities.

(Continued on page 20)



Second-place winner Akhil Subramanian '14 with Paul Orlin and John Friedland '97 at the 2014 Moon Lee Prize Competition.

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## Arnold Van Den Berg & Jim Brilliant

(Continued from page 19)

While most people in America don't consider that a big plus, if you lived anywhere else in the world, you certainly would, especially if you were living in Ukraine or Eastern Europe right now, or if you were in the Second World War like I was. My parents had their own business. They were successful and lived in the best part of town, and then, one day, Germany invaded Holland. Germany took over the country in five days and my parents ended up in a concentration camp.

When you put all of these things together, no matter what you think about the short term problems in America, or the short-term to maybe intermediate-term problems in the market, you still get back to the fact that America is one of the greatest places in the whole world. I personally don't think there will ever be another place like this.

**G&D:** A lot of value investors are strictly bottom-up but after 2008-09 macro analysis has become a bit more popular in the value camp. Can you give us an overview of how you think about it? How much weight do you give to the macro environment and are there particular indicators that you think are particularly telling?

**AVDB:** We wrote a piece in December 2004, and it's on our website if anybody's interested, when we started

seeing the imbalances developing in this country. We talked about the markets, we talked about the bubble in real estate, we talked about the increase in the federal debt, and not only in the federal debt but in the unfunded pension liability. Just to give you an example, at the time we wrote that piece, total government debt was \$7 trillion. Today it's \$17 trillion. The unfunded liabilities were \$40 trillion. Today they're \$90 trillion. When you have an environment like this, you obviously have to start thinking about what the end result will be.

We've always written that we believe the three most important things when it comes to investing in stocks are interest rates, inflation, and the fundamentals of the business. Understanding and applying these elements in our valuations are at the heart and soul of what we do. These are the things I pay the most attention to. When I started seeing things beginning to change in 2004, I began to realize that we might experience another period like the '70s, and, unless the Fed does the right thing soon, we could have a period of higher inflation. When you add to this the current P/E of about 18.5 or 19x (depending on which index you use), coupled with 1970s-like inflation, you could eventually end up with P/Es on large caps of 8x and on small caps of 4x to 6x. I'm

not predicting this will occur, but it is a potential outcome we have to consider. It's a long way down from here.

In addition to potential

***“Look for patterns because you're going to be building this mental database, a framework of your experience that you'll be able to rely upon to help impact your decision making.”***

inflation, over the next few years, I believe we could be facing, and again I'm not predicting this, a potential currency crisis. That's the other reason we were happy to pick up the gold stocks after they declined 50-80% from their 2011 peak, because gold is one of the investments that could hedge against a currency crisis or high inflation. As Jim mentioned earlier, we also have about 10-15% in oil-related companies. I think basic commodities, at the right price, are also a very good way to hedge against higher inflation or a

(Continued on page 21)

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## Arnold Van Den Berg & Jim Brilliant

(Continued from page 20)  
currency crisis.

**G&D:** Switching topics now, do you have any books you would recommend to aspiring or current investors that you found especially valuable? Or books outside investing as well?

**AVDB:** The book that is absolutely my favorite outside of normal investment books is one I personally reprinted because the publisher tells me they only sell about 25-50 copies a year. It's called, *From Poverty to Power* by James Allen. I am happy to send it out to anybody who will read it. If any of your readers would like a copy, we'll send them a copy at no charge. It does not deal directly with money, although it does in some aspects, but the philosophy is great. I've been reading it for 32 years now. Every time I go back to it, I find some new insight.

For books regarding investments and business I would recommend *Security Analysis* by Graham and Dodd; *The Intelligent Investor* by Ben Graham; *Common Stocks and Uncommon Profits, Paths to Wealth through Common Stocks*, *Conservative Investors Sleep Well*, and *Developing an Investment Philosophy*, all four by Philip Fisher. I'd also recommend *Margin of Safety* by Seth Klarman, *Value Investing Made Easy* by Janet Lowe, *Contrarian Investment Strategies* by David Dreman, *Be My Guest* by Conrad

Hilton (especially pages 21-25), and *When Genius Failed* by Roger Lowenstein. Other philosophical books I would recommend are *As a Man Thinketh* as well as *Eight Pillars of Prosperity*, both by James Allen, *Think and Grow Rich* by Napoleon Hill, and *The Richest Man in Babylon* by George Clason.

**G&D:** To wrap up, what advice would you give to current students interested in a career in investing? And do you have any advice on life in general that you would be willing to share?

**AVDB:** I would give you one quote by Dr. Karl Jung, the famous psychologist. Dr. Jung claimed that the subconscious mind contains not only all the knowledge that is gathered during the life of the individual but, in addition, it contains all the wisdom of past ages. That by drawing upon its wisdom and power, the individual may possess any good thing in life from health and happiness to riches and success. I think that's the best quote that I can give you on the subconscious mind. As far as advice to a young person starting off in the business, I can only say that it's one of the greatest businesses in the world. I think there are as many opportunities today as when I got started. I would encourage anybody who's interested in the field and who loves it to go into it. The only advice I can give is that you make a commitment that you will

stick it out no matter how long it takes, and that you have the belief that you're going to be successful, because everybody can be successful in this field if they make the commitment and develop the discipline.

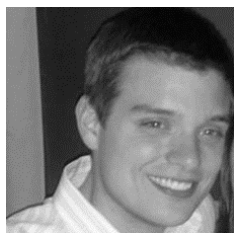
**JB:** I would just add that that learning is a lifetime endeavor. Upon graduation, you need to keep studying and keep reading. Look for patterns because you're going to be building this mental database, a framework of your experience that you'll be able to rely upon to help guide your decision making. While all the theory and education that you get in school is very valuable, the real world is where you're going to gain that practical knowledge. While both are important, it's been my observation that those that develop the greatest practical knowledge end up accumulating the most wealth, not just in terms of monetary rewards, but wealth in terms of friendships and non-monetary pursuits. I would encourage people to look at their university graduation as the beginning of a whole other life experience that can pay dividends.

**G&D:** That is a great note to end on. Thank you both for your time.

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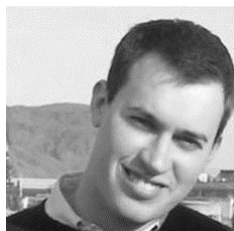
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## Allegion, Plc. (NYSE: ALLE) - Long 1st Place, 2014 Pershing Square Challenge



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Brian is a first-year MBA student at Columbia Business School. He is also Co-President of the Columbia Student Investment Management Association. Prior to CBS, Brian was an Associate at Millennium Technology Value Partners.



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**Øystein Kværner**

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### Recommendation

We recommend investors buy Allegion (ALLE) equity with a 12/31/16 base case price target of \$75. This represents ~50% upside from the current share price. Our investment thesis rests on four main points:

- 1) Allegion should see accelerating topline growth as nonresidential construction spending rebounds from cyclical lows in the US and Europe
- 2) The European business is significantly under-earning its peer group and own historical averages – this can normalize with self-help opportunities on the cost side
- 3) Irish domiciling and basic tax optimization strategies should reduce the company's effective tax rate below 25% (vs. 31% in 2014). This drives low-risk EPS growth independent of any cyclical recovery
- 4) Given the high FCF this business generates (over \$1 billion in the next 4 years vs. a \$5 billion market cap), effective capital allocation can drive meaningful upside (either via accretive M&A or buybacks)

### Business Description

Allegion is a leading global provider of mechanical and electronic security products that include key systems, exit devices, and other access control solutions. The business was part of Ingersoll Rand before being spun-off in late 2013. The company generated \$2.1 bn of revenue in 2013, with the majority of its exposure coming from US non-residential end-markets where it is the #2 player behind Assa Abloy.

We think Allegion is a high-quality business in an attractive industry with real barriers to entry related to required local building code expertise, SKU intensity, and channel complexities. With security being a high-value need but only representing a low percentage of total building costs, customer lock-in is high and the company has pricing power over time. This, combined with low capex requirements, leads to high FCF generation, and high returns on invested capital (21.4% over the last 3 years). We think Allegion can be a multi-year compounder with limited downside and the potential for significant upside.

### Investment Thesis

#### 1) Rebound in topline growth

Macroeconomic data suggests US and European non-residential construction spending remains well below long-term average levels, with Allegion's relevant end-markets down 40%+ peak-to-trough and only having seen a modest recovery off the lows. In Europe, we think the market has only recently bottomed, with the Southern countries where Allegion has the most exposure also down 40%+ from prior levels. All in, we don't think non-residential was ever as overbuilt as residential and current spending remains much closer to the bottom than mid-cycle levels. Allegion has benefitted from high-margin retrofit work during the down-cycle but we think growth will accelerate as the new build market finally rebounds.

Taken together, we think the current \$25 bn security access solutions market will grow at GDP-plus levels, with 1-2% pricing coming on top of any underlying growth in construction spending. We also see secular trends of increased budgets for building security and increased complexity/integration needs as driving additional growth.

#### 2) European margin opportunity

In Europe, we believe Allegion is significantly under-earning its peer group and its own historical averages and that this will mean-revert over time due to identifiable self-help drivers on the cost side. As context, this segment is breakeven today compared to historical average margins of 8-10%, historical peak margins of low/mid-teens, and current peer margins of up to 17% in Europe.

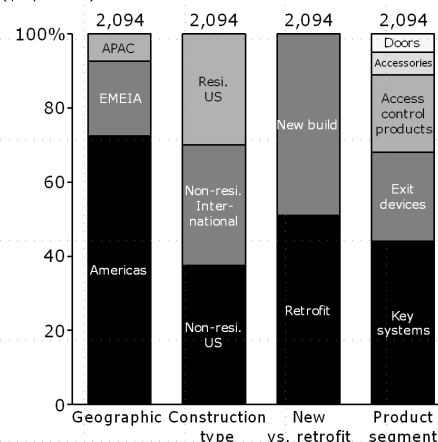
The key issue is that while the company's Southern European end-markets are down 40%+ from the peak, our diligence suggests the cost structure has basically not changed. This creates a large opportunity for overhead savings that current management is already executing on after being ignored as part of Ingersoll. In addition, the same LEAN team that improved US margins from the low-20s to the mid-/high-20s is just now getting started in

### Key statistics

• Share price (4/17/14):	\$50.15
• Share price at spin-off (12/2/13):	\$43.08
• Revenue 2013:	\$2,094M
• Adj. EBIT margin:	17.8%
• Market cap:	\$4,839M
• Enterprise value:	\$5,915M
• 3-month avg. daily volume:	1.1M
• FY'15 EPS (our estimate):	\$2.99
• FY'15 P/E	16.8x

### Revenue breakdown

Allegion revenue breakdown  
(\$M, 2013)



## Allegion, Plc. (Continued from previous page)

Europe. We think there should be a real efficiency opportunity here given Europe is 20% of sales yet represents ~55% of the business inventory.

### 3) Effective planning around Irish domiciled tax status

Allegion is guiding to a 31% effective tax rate this year but is an Irish domiciled company, a country with a corporate rate of 12.5%. History tells us that other Irish domiciled companies have been able to significantly reduce their effective tax rates over time. In addition, the fact that ALLE has high US profitability exposure should not mean it can't pay a much lower rate with effective planning (as an example, Ingersoll Rand pays an effective rate of 25% despite having a similar mix of US revenues). Between basic tax optimization strategies and a structural shift to more international profitability, we think ALLE can lower its effective tax rate to at least 25%, with a good chance of doing even better.

We would also note that Allegion can use its Irish domiciling as a strategic asset going forward. The key way we see that playing out is via M&A. The company's tax status gives it a structural advantage as a buyer and any assets they buy in lower tax jurisdictions should create a positive feedback loop that helps to further reduce its tax rate.

### 4) Capital allocation upside

Allegion is highly FCF generative – we think the business will generate over \$1 bn of FCF in the next four years vs. a market cap today of \$5 bn. Management has already laid out an initial framework to return at least 35% of annual FCF to shareholders via buybacks and dividends with a further 50% allocated toward strategic growth initiatives and/or M&A.

Over time, the M&A story here could be compelling. With a still-fragmented international market, we think Allegion can copy the Assa Abloy playbook for highly accretive M&A. ASSA has done over 100 deals in the last 9 years, generally buying tuck-in businesses at reasonable multiples (8-10x EBITDA) and then extracting synergies. If we assume ALLE can find deals at similar economics as Assa, we think accretive M&A could add \$10-\$20 of additional value, taking our \$75 base case closer to \$100.

Absent M&A, we think FCF can be used to aggressively buy back shares and drive EPS upside. At current prices, we estimate ALLE would be able to buy back 22% of its float with cumulative FCF by 2017.

### Key Risks

The investment is not without its risks but we think many of the key ones are nicely mitigated. A downturn in non-residential spending should be largely limited given already cyclically depressed numbers. While there is some risk that management won't execute on European margins, we take comfort that most of the low-hanging fruit has been identified and the company is using the same LEAN team that has already succeeded in the US. As for the risk of increased competition, we would note a largely stable, localized monopoly type industry structure in the developed world and the inability of Asian manufacturers to meaningfully gain traction in the US given the high barriers to entry.

Overall, we think the hardest risk to gauge today is management's ability to optimize capital deployment. Its first few deals will be critically important in our view.

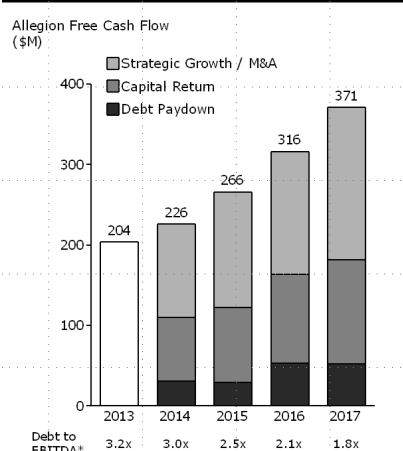
### Valuation

Our \$75 price target is based on a 16.5x forward multiple of 2017E EPS of \$4.53 (this assumes no M&A but a 13% reduction in average share count vs. today from buybacks). We think Allegion deserves a premium to a market multiple over the cycle for its business quality and earnings growth potential. In addition, we would note that if management more aggressively deployed FCF, we think it could buy back over 20% of its market cap (assuming current prices) and our \$75 target would then represent only 14.3x our adjusted 2017 EPS estimate under that scenario.

We also believe the investment has attractive skew, with a base case to downside case reward/risk of 2.6x. We view absolute downside from current levels as somewhat capped given Allegion is an interesting takeover candidate. Outside of the core security comps, we think building control solutions providers such as UTX and Honeywell could be interested in moving more into the security access solutions market. Allegion's Irish domiciled status adds to its potential attractiveness as a target for these companies (which also have lot of international cash on their balance sheets to deploy). If the share price were to dip much below \$40, we expect buyers would likely line up to bang on its door.

Financials:	2010	2011	2012	2013	2014E	2015E	2016E	2017E
Revenue	\$1,967.7	\$2,021.2	\$2,046.6	\$2,093.5	\$2,182.8	\$2,313.2	\$2,466.8	\$2,623.0
% Growth		2.7%	1.3%	2.3%	4.3%	6.0%	6.6%	6.3%
EBITDA	\$375.3	\$405.3	\$420.7	\$409.4	\$425.4	\$470.0	\$530.8	\$588.4
% Margin	19.1%	20.1%	20.6%	19.6%	19.5%	20.3%	21.5%	22.4%
FCF	\$186.0	\$240.0	\$249.6	\$203.7	\$226.2	\$265.5	\$315.6	\$371.4
EPS			\$2.38	\$2.13	\$2.36	\$2.91	\$3.64	\$4.53
Avg. Shares Outstanding				96.5	96.5	94.2	89.8	84.1

### Allegion Free Cash Flow



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### Joe Goldschmid

Joe is in his final year of the Joint JD/MBA Program at Columbia University. Prior to Columbia, he was an analyst in the Investment Banking Division of Morgan Stanley. He holds a BS from Massachusetts Institute of Technology.



### Allen Keel

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### Mahmud Riffat

Mahmud is a second-year MBA student in the Value Investing Program at Columbia Business School. Prior to CBS, Mahmud worked for five years in private equity and investment banking at Global Infrastructure Partners and Merrill Lynch. He holds a BSFS from Georgetown University.

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## Cablevision Systems Corporation (NYSE: CVC) - Short 2nd Place, 2014 Pershing Square Challenge

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### Recommendation

We recommend shorting Cablevision (CVC) with a potential return of +52%. There are three main points to our investment thesis:

- 1) *Real and Accelerating FiOS Threat*—Verizon FiOS is a superior fiber-to-the-home product, which once fully rolled-out, typically leads to 40-50% subscriber losses for incumbent cable operators.
- 2) *Continued Margin Erosion with an Over-leveraged Balance Sheet*—CVC has limited pricing power, and thus, limited ability to pass through soaring programming costs. This reduction in free cash flow prevents deleveraging and jeopardizes the dividend.
- 3) *Takeover Speculation has Artificially Driven Up Valuation*—CVC is not an attractive acquisition candidate, and current shareholders overestimate the likelihood of a takeover.

### Business Description

Cablevision is the fifth largest cable operator in the US, providing video, high-speed data, and voice services to 3.2 million subscribers in and around the New York Metropolitan area. The cable segment accounts for ~90% of the company's revenue (\$6.2 bn) and EBITDA (\$1.6 bn).

### Investment Thesis

#### 1) Real and Accelerating FiOS Threat

For many years, cable operators had de facto monopolies in their respective regional footprints with minimal overbuild from competitors. However, in 2004, Verizon announced the planned build-out of FiOS, a \$23 billion fiber-to-the-home network providing video, high-speed data, and voice services.

FiOS disrupts the monopoly model for incumbent cable operators for several reasons, namely the superior product offering (highest speed internet available), leading customer satisfaction (lowest industry churn rate), and Verizon's well-capitalized balance sheet, which allows for promotional offers sufficiently low to compensate new subscribers for their switching costs.

Given Cablevision's geographically concentrated footprint, the company is the most exposed to fiber out of any cable operator. Currently approximately 51% of CVC's footprint is exposed to FiOS, and this is estimated to increase to ~66% as Verizon complete its obligation to pass 100% of all New York City housing units by June 30, 2014, per the terms of the company's 2008 Franchise Agreement.

Currently only ~40% of homes in CVC's NYC footprint in the Bronx and Brooklyn (~23% of CVC's total customers) have access to FiOS. We expect this figure to approach 100% as Verizon completes its obligation under the NYC Franchise Agreement.

To analyze the likely impact of the FiOS rollout on CVC's customer base, we examined the effect of FiOS entry into other markets using data from the US Copyright Office. The losses after FiOS entered a market were devastating. For example, in the parts of Massachusetts that FiOS entered in 2006, Comcast (the incumbent cable operator) suffered cumulative subscriber declines of 55%. A similar phenomenon occurred in Staten Island after FiOS was introduced in 2006. Time Warner Cable lost ~45% of its subscribers to FiOS.

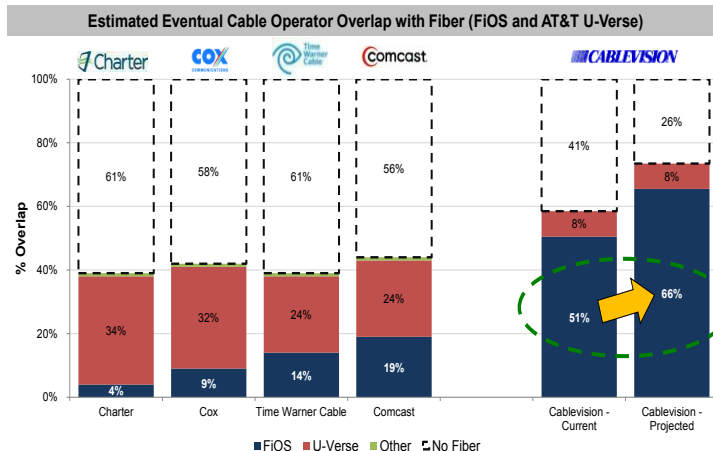
Our base case CVC subscriber projections use the Comcast Massachusetts decline curve applied to CVC's fiber-overlap footprint. Cablevision has lost 10% of its subscribers

As of April 7, 2014 (\$ mm, except per share data)

Current Capitalization	
Stock Price	\$16.12
Shares Outstanding	267.6
Market Capitalization	\$4,314
Debt	9,759
Collateralized Debt	(818)
Other Adjustments	18
Cash	(702)
Enterprise Value	\$12,572
Trading Statistics	
52 Week High / Low	\$20.16 / \$13.88
Avg. 3M Daily Volume (mm)	3.63
Borrow Cost	50 bps
Short Interest	16.4%

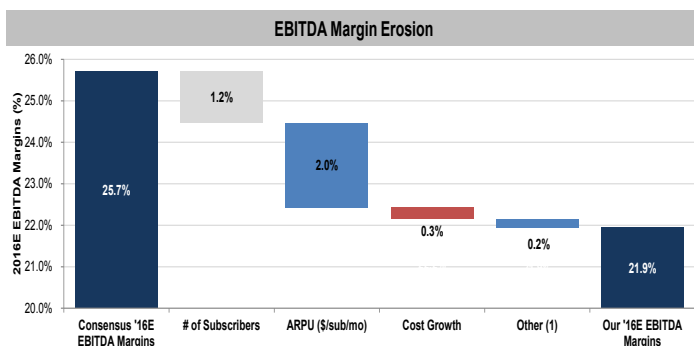
Valuation			
	2014E	2015E	2016E
EV / EBITDA	8.1x	8.9x	9.3x
EV / EBITDA - Capex	17.4x	21.2x	23.9x
P / E	51.8x	580.6x	n/a
Levered FCF Yield	3.5%	1.5%	(0.5%)
Net Debt / EBITDA	5.3x	5.8x	6.1x

Target Price / Return	
Target Price	\$7.06
Total Return	52.0%





## Cablevision Systems Corporation (Continued from previous page)



through 2013, and we project eventual cumulative losses of over 20%.

### 2) Continued Margin Erosion with an Over-leveraged Balance Sheet

As Verizon builds out FiOS, Cablevision faces a limited ability to raise prices, despite soaring programming costs. Studies have found that cable prices are 15-30% lower in areas with significant competition versus the norm of near-monopoly markets. The effect of the FiOS competition can already be observed in Cablevision's significant EBITDA margin

erosion since 2011. Other publicly traded cable operators better insulated from competition have cable-segment EBITDA margins near 35-40% versus the current 30% for Cablevision. We expect margins to erode further as the FiOS build-out accelerates.

Cablevision's profitability is not sustainable in an environment where programming costs have grown at 8 to 12% annually, but Cablevision's revenue per user has only grown 2-3% per year. The company's high leverage (5.3x Net Debt / 14E EBITDA) exacerbates this share price decline and puts the dividend at risk.

### 3) Takeover Speculation Artificially Driving Up Valuation

Cablevision's stock price has far outpaced fundamentals based on takeover speculation. The M&A rumors began in June 2013 after Charter made its initial offer for Time Warner Cable, and Cablevision's stock increased more than 25% over the next month.

Despite high estimated operating synergies in an acquisition, there are no likely strategic acquirers. All of the cable operators have observed or experienced the devastating results of FiOS competition in their own cable footprints, and will not want to acquire the operator with the highest FiOS overlap. Moreover, given Cablevision's bleak competitive outlook, the synergies from a strategic acquisition would only warrant a 10% takeover premium to current trading levels. This results in a compelling risk-reward ratio for our short recommendation.

### Valuation

We expect a severe reduction in EBITDA by 2016. This decrease is driven primarily by customer losses and margin erosion in Cablevision's FiOS overlap areas. Our target share price of \$7 amounts to a 52% total return when factoring in dividends and stock borrow costs.

### Near-term Catalysts

A) *Contractual*: Verizon has publicly stated that they will comply with their 2008 Franchise Agreement by passing 100% of New York City housing units by June 30, 2014.

B) *Political*: The Mayor de Blasio Administration seems determined to force Verizon's compliance with the 2008 Franchise Agreement by framing affordable broadband access as an economic-justice issue.

C) *Economic*: Verizon will aggressively market its FiOS product. Once Verizon has "passed" a building, the incremental investment to connect the building is well worth the expected return on capital. FiOS typically captures more than 40-50% market share.

### Key Investment Risks:

(1) An irrational strategic buyer acquires Cablevision, or the Dolan family attempts to take Cablevision private. (2) Cablevision improves operations and profitability by enhancing product offerings that maintain or increase the subscriber base. (3) The Verizon FiOS rollout does not materialize. Verizon fails to comply with its contractual commitment to build out its fiber network in New York City.

	Low	Base	High
2016E Subscribers (mm)	2.83	2.93	3.07
x: Monthly ARPU	\$156.77	\$156.25	\$165.14
<b>Cable Revenue (mm)</b>	<b>\$5,320.2</b>	<b>\$5,486.3</b>	<b>\$6,074.4</b>
Plus: Other Revenue	652.8	659.2	664.5
<b>Total Revenue</b>	<b>\$5,973.0</b>	<b>\$6,145.6</b>	<b>\$6,738.9</b>
Less: COGS & SG&A	(4,644.0)	(4,796.9)	(5,099.1)
<b>2016E EBITDA (mm)</b>	<b>\$1,328.9</b>	<b>\$1,348.7</b>	<b>\$1,639.8</b>
Multiple	7.0x	7.5x	8.0x
<b>TEV</b>	<b>\$9,302.6</b>	<b>\$10,115.2</b>	<b>\$13,118.7</b>
Less: Net Debt	(8,404.3)	(8,226.5)	(7,585.7)
<b>Target Equity Value</b>	<b>\$898.3</b>	<b>\$1,888.7</b>	<b>\$5,533.0</b>
Divided by: Shares O/S	267.6	267.6	267.6
<b>Target Price per Share</b>	<b>\$3.36</b>	<b>\$7.06</b>	<b>\$20.67</b>
<b>% Upside / (Downside) on Short Sale</b>	<b>79.2%</b>	<b>56.2%</b>	<b>(28.2%)</b>
<b>Plus: Dividends + Borrowing Costs @ 0.5%</b>			
Per Share	(\$0.68)	(\$0.68)	(\$0.68)
<b>% Upside / (Downside)</b>	<b>(4.2%)</b>	<b>(4.2%)</b>	<b>(4.2%)</b>
<b>Total Return:</b>			
Per Share	\$12.08	\$8.38	(\$5.23)
<b>Total % Upside / (Downside)</b>	<b>75.0%</b>	<b>52.0%</b>	<b>(32.5%)</b>
<b>Free Cash Flow Metrics:</b>			
2016E Unlevered FCF	488.8	540.2	722.0
Implied Unlevered FCF Yield	5.3%	5.3%	5.5%
2016E Levered FCF	(73.6)	(22.2)	169.2
Implied Levered FCF Yield	(8.2%)	(1.2%)	3.1%

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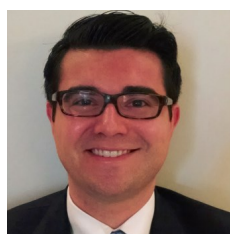
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## Carnival Corporation (NYSE: CCL) - Long 2014 Pershing Square Challenge

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### Recommendation

We recommend a long position in Carnival Corp. (NYSE: CCL) with a two-year Base Case target price of ~\$57 representing ~53% upside from 4/17/14 share price. As a result of one-time setbacks, CCL now trades at a significant discount to its intrinsic value. **(I) Reversion** to positive industry trends on ticket prices in a high fixed cost business will lead to substantial margin upside while **(II) operational improvements** driven by a new CEO provides additional opportunity.

### Business Description

CCL is the #1 player in the cruise industry with market share of ~48% servicing over 10 million passengers annually through a fleet of 101 cruise ships and a portfolio of 10 brands. CCL was incorporated in 1972 and is headquartered in Miami, Florida.

### Situation Overview

CCL has experienced two major incidents in two years. The Costa Concordia ran aground due to captain error causing 32 fatalities in January 2012, and the Carnival Triumph lost power stranding the ship for five days without working facilities in February 2013. These misfortunes have created severe dislocation in CCL's financial performance highlighted by its unprecedented divergence from industry pricing trends, best-in-class margins becoming worst-in-class and 40%+ underperformance to the S&P. This dislocation has created significant opportunity leaving behind an attractive stock trading below replacement cost.

### Investment Thesis

#### I. Reversion

- A) Adjusting for FY13 one-off issues: FY13 was a difficult year for CCL as the incidents drove up expenses and reduced pricing. Repair & maintenance, advertising and pricing were significantly impacted as they diverged from peer and historical trends. By normalizing these line items, we see a clear path to 500+ bps of EBIT margin improvement.
- B) Pricing rebound to industry norm: Over the long-term industry-wide pricing has enjoyed an upward trajectory even through cyclical interruptions. Additionally, competitor pricing has always trended together with historical correlations of over 95% until 2012. Subsequently, CCL displayed unprecedented divergence from positive pricing trends. The timing of the incidents were especially punitive as they interrupted CCL's rebound from the financial crisis. If CCL's rebound from the trough in 2009 had remained uninterrupted and continued at the same pace as peers, margins would have nearly doubled from current levels. Meanwhile, competitor margins and pricing have largely recovered; some have even reached peak levels.
- C) Timing of brand recovery: Before CCL can see price increases, its brand and reputation needs to be repaired. Our research has shown that while the Costa and Carnival brands were hurt by the incidents, they are **not** broken. In fact, the Costa brand has seen pricing and yield growth at the end of last year, and the Carnival brand's recovery is nearly complete. As we pass the second anniversary of the Costa Concordia incident, we approach the point of brand recovery and a reversion to positive industry pricing trends.
- D) Favorable industry dynamics support reversion: The global cruise sector has demonstrated yearly demand growth at 5% matching supply growth even during recessionary periods. The oligopolistic industry structure with consistent market shares highlights that competitors are relatively rational, while high barriers-to-entry preclude new entrants from taking share. Additionally, demographic tailwinds support volume and pricing growth as the youngest baby boomer is becoming a core cruise consumer at age 40. Lastly, the cruise product's value proposition is strong relative to other travel opportunities. We like these characteristics and believe they lay a solid foundation on which a reversion thesis can materialize.

(in millions, except per share figures)

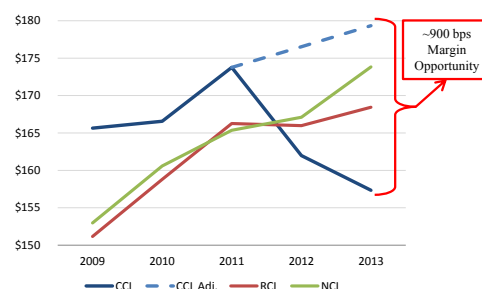
(All amounts, except per share figures)

Current Capitalization	
Share Price (4/17/14)	\$37.32
FDS	776
<b>Market Capitalization</b>	<b>\$28,975</b>
Plus: Debt	\$9,610
Less: Cash & Equiv.	(421)
<b>Enterprise Value</b>	<b>\$38,164</b>

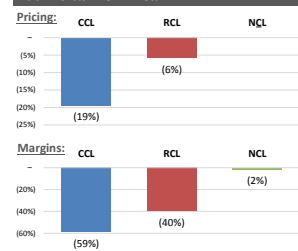
Trading Statistics	
52-wk Range	\$31.44 - \$41.89
Dividend Yield	2.68%
Avg 3M Dly Vlm (mm)	\$136

Valuation Summary		
	2015E	2016E
<u>Consensus:</u>		
TEV / EBIT	17.6x	14.5x
P / EPS	15.9x	12.6x
<u>Base Case:</u>		
TEV / EBIT	16.0x	12.3x
P / EPS	13.5x	9.8x
<u>Bull Case:</u>		
TEV / EBIT	12.6x	10.0x
P / EPS	10.2x	7.5x

Divergence in Avg. Ticket Pricing



% Delta from Peak



## Carnival Corp. (Continued from previous page)

### II. Operational Improvements

A) **Potential for other significant margin improvement:** Given CCL's scale advantage in a high fixed cost business, the company should enjoy higher operating margins relative to its smaller competitors (~48% market share vs. next largest RCL at ~23%). Since 2005, CCL's historically best-in-class margin profile has dissipated leaving it with the lowest EBIT margin of its peers in 2013. Our research suggests CCL previously did not manage costs effectively or take advantage of scale economies by integrating operations across its 10 brands. Given that CCL is a roll-up of acquisitions, integration synergies exist as CCL currently carries 6 headquarters, 10 yield management systems, 2 sales force offices and 3 reservation systems.

B) **New CEO better positioned to execute on margins:** Micky Arison, the previous CEO, was instrumental in the consolidation of the cruise industry (ending in 2003 with the Princess acquisition), but less operationally hands-on. He stepped down during CCL's run of disasters and announced in June 2013 that the new CEO would be Arnold W. Donald (a long-standing board member).

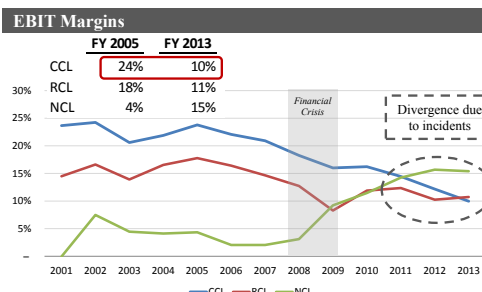
We believe the new CEO makes CCL more likely to undergo positive change. Donald is more focused on operational opportunities and has a good reputation among company insiders. He is also heavily incentivized with equity and stands to make up to \$24mm per year if Total Stock Returns reaches 17%. We think this fact pattern makes operational improvements within the company much more likely.

**Valuation:** Our 2-year target price in the Base Case is ~\$57 per share representing a 53% gross return from 4/17/14 share price of \$37.32. Our assumptions include:

- **Pricing:** Improves at a ~3% CAGR. CCL's pricing was growing at 4% in FY11 before the Costa incident interrupted its rebound from the financial crisis.
- **Volumes:** Grow in line with capacity expansion. Supply pipeline is highly visible as players announce shipbuilding plans 3-5 years in advance.
- **Margins:** Improve to ~17%. Given the high fixed cost nature of this business, price increases have a substantial impact on the bottom line.
- **Multiple:** Apply a 15x P/E multiple on our FY16 Base Case EPS estimate. CCL has historically traded at 16x P/E across cycles, and we believe CCL is not structurally different than it was historically.

In conclusion, our assumptions imply investing in CCL at less than 10x FY16 earnings in our Base Case and 7.5x in our Bull Case. We believe substantial capital impairment is unlikely as we are buying ~50% of the global cruise fleet at below replacement cost. Lastly, we believe CCL offers an attractive risk/reward profile with Base / Bear yielding 3.7x, and Bull / Bear yielding 7.3x.

**Key Risks:** (1) Overcapacity could weaken economics; (2) Pricing remain depressed or decline; (3) Mismanagement potential; (4) Another accident; (5) Consumers' shift away from cruising as a vacation alternative.



(\$ in millions, except per share figures)

#### Valuation and Upside/Downside Scenarios

	Base	Bear	Bull	Street	Variance to Base
<b>Key 2016E Estimates:</b>					
Revenue	\$18,512	\$17,170	\$19,441	\$18,302	1.1%
EBIT	\$3,093	\$2,027	\$3,831	\$2,629	17.6%
EBIT % Margin	16.7%	11.8%	19.7%	14.4%	2.3%
EPS	\$3.82	\$2.28	\$4.97	\$2.97	28.5%
<b>Valuation:</b>					
Target PE Multiple	15.0x	14.0x	15.5x		
2-Yr Target Price	\$57.26	\$31.90	\$77.02		
% Upside (excl. dividends)	53%	(15%)	106%		
% IRR (incl. dividends)	26%	(5%)	46%		

#### Implied Multiples on Current Valuation:

TEV / EBIT	12.3x	18.8x	10.0x
P / EPS	9.8x	16.4x	7.5x

#### Key Assumptions:

FY13-16 Pricing CAGR	3.3%	(0.0%)	5.5%
FY13-16 Volume CAGR	3.3%	3.3%	3.3%

(\$ in millions; except per ALBD and ticket pricing figures)

FYE November 30,	2007A	2008A	2009A	2010A	2011A	2012A	2013A	2014E	2015E	2016E
<b>Summary Income Statement</b>										
Volume (ALBD)	54	59	62	67	70	72	74	76	79	82
% Growth	8.4%	8.9%	5.4%	7.1%	5.1%	2.9%	2.9%	2.8%	3.2%	3.9%
Ticket Pricing	\$181	\$195	\$166	\$167	\$174	\$162	\$157	\$159	\$165	\$174
% Growth	1.5%	8.0%	(15.2%)	0.5%	4.3%	(6.8%)	(2.9%)	1.0%	4.0%	5.0%
Total Revenues	\$13,033	\$14,947	\$13,460	\$14,469	\$15,793	\$15,382	\$15,456	\$16,017	\$17,100	\$18,512
% Growth	10.1%	14.7%	(9.9%)	7.5%	9.2%	(2.6%)	0.5%	3.6%	6.8%	8.3%
EBIT	\$2,725	\$2,729	\$2,154	\$2,347	\$2,283	\$1,872	\$1,541	\$1,819	\$2,381	\$3,093
% Margin	20.9%	18.3%	16.0%	16.2%	14.5%	12.2%	10.0%	11.4%	13.9%	16.7%
EBIT / ALBD	\$50	\$46	\$35	\$35	\$33	\$26	\$21	\$24	\$30	\$38

Note: ALBD is a measure of capacity - # of beds available per year ("Available Lower Berth Days")

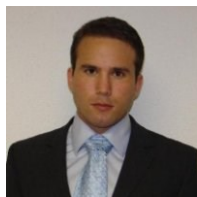
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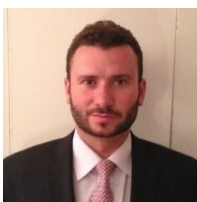
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## Clean Harbors, Inc. (NYSE: CLH) - Long 2014 Pershing Square Challenge

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Note: On April 24th (one day after the Pershing Square Challenge finals), Relational Investors filed a 13D disclosing a 9% stake in CLH.

### Recommendation

We recommend investors buy Clean Harbors, Inc. (CLH) stock with a 12-18-month target share price of \$85-95, representing ~50-70% upside. There are five main points to our investment thesis:

- 1) A fair valuation of the core hazardous waste management business more than covers the current share price with only 70% of the EBITDA. "The Core" has dominant market share, economies of scale, regulatory protection, excellent customer captivity and great ROICs
- 2) The shares are mispriced and out of favor due to transitory issues (weather and FX) and over-focus on the under-performance of a small segment (Re-refining)
- 3) Several non-core assets should be divested to generate cash for buybacks/acquisitions, and to re-focus management on the Core business
- 4) The industry changes that have hurt Re-refining have bottomed, and some structural industry shifts will convert Re-refining into a more stable "process business"
- 5) Management shifts will re-align attention on capital allocation and re-focus on the Core

### Key Trading Statistics and Financial Highlights

		(\$M)	Dec-12	Dec-13	Dec-14 E	Dec-15	Dec-16
Share Price	\$55.32						
Mkt. Cap	\$3,368	Revenue	\$2,188	\$3,522	\$3,604	\$3,777	\$4,034
+Net Debt	\$1,300	EBITDA	\$374	\$528	\$583	\$679	\$764
EV	\$4,667	FCF	\$130	\$138	\$180	\$223	\$241
52-Wk H/L	\$44.9/\$64.1	RR FCF	\$170	\$284	\$280	\$322	\$334
EV/15E EBITDA	6.9x	Adj. EPS	\$3.09	\$2.46	\$2.75	\$3.56	\$4.27
2015E Adj. P/E	15.5x	Rev Grth	10.3%	60.9%	2.3%	4.8%	6.8%
2015E RR FCF Yld	10.6%	EBITDA Grth	6.8%	41.3%	10.5%	16.4%	12.5%
2016E Adj. P/E	12.9x	EBITDA Mrg	17.1%	15.0%	16.2%	18.0%	18.9%

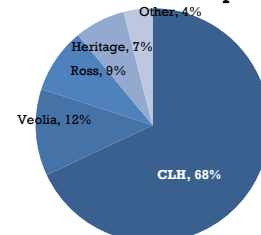
### Business Description

The Core (Technical Services-TS, Safety-Kleen Environmental-SKE, and Industrial & Field Services-IFS) is a vertically integrated hazardous waste disposal business; from cleaning, to collection, transportation, and disposal/recycling; carried out through 10K+ specialized vehicles, 8 incinerators (68% of N.A. capacity), and 11 landfills (24% of N.A. capacity). The other businesses include used oil re-refineries, housing lodges in Alberta, CA, and O&G Field Services (seismic, rentals, waste fluids). CLH has grown organically and through acquisitions and highly successful integration, compounding revenue and EBITDA at 23% and 26% since 2000.

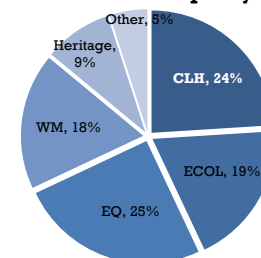
### Investment Thesis

- 1) The Core provides full margin of safety with competitive advantages
  - Economies of Scale - CLH is the largest player in every haz-waste end market and dominates national accounts. The incinerators and landfills are large fixed-cost assets that provide tremendous operating leverage (incinerators have 30-40% EBITDA margins and 90+% utilization; landfills have 20+ year remaining life), and a multi-year expansion comes online in 2016, increasing incineration capacity by 13% at double the revenue per unit. The rest of the company is focused on driving additional waste volumes into the disposal network. This allows CLH to be a full-service provider of related waste, cleaning and technical services and they have over 1,300 employees at customer sites, supplementing workforces.
  - Customer Captivity - US regulations mandate that waste generators keep the cradle-to-grave liability on their waste, so there are tremendous pre-qualifications for disposers. There is almost no customer turnover since CLH provides full tracking and paper-trail, so customers do not risk switching providers (customer captivity).
  - Irreplaceable Asset Value - Difficult permitting and regulatory barriers create huge moats, and there has not been a greenfield haz incinerator or landfill for 16 yrs+. High capital costs are generated by a large installed infrastructure base and complicated logistical network. CLH assets are essentially irreplaceable and permitting is a lengthy process, but these assets are insured for \$3-4B.
  - Regulatory barriers - Regulations protect almost every aspect of disposal operations. Customers are governed by RCRA regulations which mandate which wastes have to be burned or go to a designated hazardous landfill.

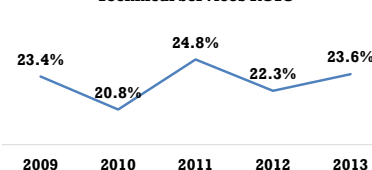
### NA Incinerator Capacity



### NA Landfill Capacity



### Technical Services ROIC





## Clean Harbors, Inc. (continued from previous page)

- TS and SKE (43% of EBITDA) are #1 in their markets for recurring waste from customers' ongoing operations, and provide most of the waste volume to the core disposal network. IFS (14% EBITDA) is the leader in event-driven mission-critical services; heavy-duty cleaning, planned plant turnovers, and natural disaster rapid response.

### 2) Out of favor on transitory issues and misses in re-refining

- The company was a market darling for years, but has now missed for 6 of the last 7 quarters.
  - Weather issues have hurt CLH for 5 of the past 8 quarters; \$30M+ EBITDA effect in 2013 and another \$15-20M so far in 2014. The street is now extrapolating these margins. CAD FX hit for another \$20M.
  - In late 2012, CLH acquired Safety Kleen (SK) for \$1.3B to drive more volume into its disposal assets, picking up a large collections network with 200,000 customers. The SK Environmental piece of SK has been a tremendous success, with annual cost saving of \$100M+. The Re-refining piece meanwhile suffered as the industry's price and cost indices diverged the first time in years and 2013 EBITDA came in \$80mm below original guidance. The knife has already fallen and the industry is correcting.
- The multiple misses on transitory weather and Re-refining have overshadowed the SK Enviro success, turned sentiment negative, and now the Street is unwilling to reflect their own documented expectations for volume growth and pricing power in their financial projections. The Street is just dead wrong.

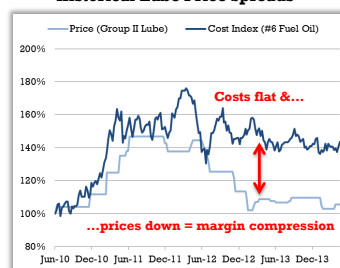
### 3) Sell non-core Lodging and Seismic assets to re-deploy capital and focus attention on the Core

- Lodging is a \$65mm EBITDA business, buried within CLH at the street's 8x valuation. Meanwhile the industry is trading assets at 11.0-12.5x, the planned OIS spin-off showing low-teen valuation, and another major acquirer is seeking to deploy capital. This can generate \$700M+ of proceeds with another \$100M+ from selling Seismic.
- These proceeds can be directed towards a buy-back (10% accretive in '16) or to acquire one of the two large competitors of the Core that are currently for sale.
- These sales will re-direct management and investors' attention to the Core, proper capital allocation, and ROIC, which has been dragged down by non-core businesses.

### 4) Re-refining is not a falling knife and the industry is correcting. Was most of EBITDA miss, but only small portion of our base case upside.

- Historically, the primary product from the waste oil collections industry has been low-value-add recycled fuel oil. As a result, price paid for collected waste oil, the primary input cost, by industry standard was also indexed to the price of this fuel oil. Prices for base lube, currently representing 1/3 of output, have also tracked the fuel oil indices for years, but recently, base lube and used oil costs diverged, pressuring re-refining margins. But, new recycling technology and cheap nat gas is increasingly driving volume into high-value-add base lube production – and CLH is the #1 lube re-refiner with 51% of N.A. capacity.

Historical Lube Price Spreads



- Primary diligence confirms that the industry is starting to re-index the prices paid for waste oil to base lube. This will explicitly match revs and costs of lube re-refiners to the same index, eliminate commodity risk from the COGS stack, and turn Re-refining into a fixed-margin process business, lifting valuation.

### 5) Leadership changes can fix some capital allocation mis-steps and redirect attention to Core and ROIC

- Board and management are indicative of CLH's (successful) roll-up history. Board enhancements and a permanent CFO would bring in the experience to guide a \$5B, diverse environmental firm and bring focus onto capital deployment and returns.

## Valuation

2015 SOTP and Value Walk show margin of safety from the Core, with the other segments acting as "free options." But 2016 represents CLH's true earnings power, as CLH bring on the new incinerator, benefits from \$200M of growth capex at 20% ROICs, and Re-refining eliminates some valuation discount. This points to the high end of our range.

	2015 Metrics (base)			2016 Metrics (base)		
	EBITDA	Multiple	EV	EBITDA	Multiple	EV
CORE (a)	\$606	8.5x	\$5,149	\$681	8.0x	\$5,445
O&G Field (a)	43	6.5x	277	54	6.0x	324
Re-refining	77	7.0x	537	80	7.0x	561
Lodging	84	10.0x	840	88	9.5x	838
Seismic	21	6.5x	137	22	6.0x	132
Corp. OH	(151)	7.0x	(1,057)	(161)	6.5x	(1,049)
<b>Total EV</b>	<b>\$679</b>	<b>8.7x</b>	<b>\$5,882</b>	<b>\$764</b>	<b>8.2x</b>	<b>\$6,251</b>
less: Net Debt			\$1,015			\$758
Equity Value			\$4,867			\$5,494
<b>Implied Share Price</b>			<b>\$82.44</b>			<b>\$93.05</b>
<b>Upside to Current</b>			<b>49%</b>			<b>68%</b>

(a) Core excludes Lodging and O&G Field excludes Seismic; non-core units to be sold  
(b) Net debt allocated 80% to Core, 10% to O&G Field, and 10% to Re-refining

Value Walk	EBITDA less Corp. OH		Implied Share Value		Cumulative	Upside
2015 Core Business (a)(b)	\$500	\$60.93	\$60.93	\$60.93	10%	
2015 O&G Field Services (a)(b)	27	\$1.17	\$62.11	\$62.11	12%	
2015 Oil Re-refining (a)(b)	62	\$5.59	\$67.70	\$67.70	22%	
Sell Lodging & Seismic	90	\$14.75	\$82.44	\$82.44	49%	
<b>Base Target</b>	<b>\$679</b>	<b>\$82.44</b>				
New Incinerator	32	\$4.59	\$87.03	\$87.03	57%	
Core Improvement (1% margin)	27	\$3.24	\$90.27	\$90.27	63%	
Lube \$ Reversal (~half of '13 declines)	40	\$4.74	\$95.01	\$95.01	72%	
CAD FX Rate	15	\$2.20	\$97.21	\$97.21		
<b>Near-term Value Potential</b>	<b>\$793</b>	<b>\$97.21</b>			<b>76%</b>	
<b>2016 Base Case</b>	<b>\$764</b>	<b>\$93.05</b>			<b>68%</b>	
<b>2016 Bull Case</b>	<b>\$862</b>	<b>\$106.40</b>			<b>92%</b>	

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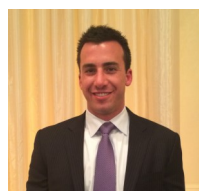
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Carter is a first year MBA student at Columbia Business School. Prior to CBS, Carter worked in private equity at Veritas Capital after spending two years in Bank of America Merrill Lynch's Global Leveraged Finance Group.

**George Taras**

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**Luke Tashie**

Luke is a first year MBA student at Columbia Business School. Prior to CBS, Luke acquired and operated two small businesses after working as an analyst for four years at Noonday Asset Management (Farallon Capital).



## Naspers (JSE:NPN) - Long 2014 Pershing Square Challenge

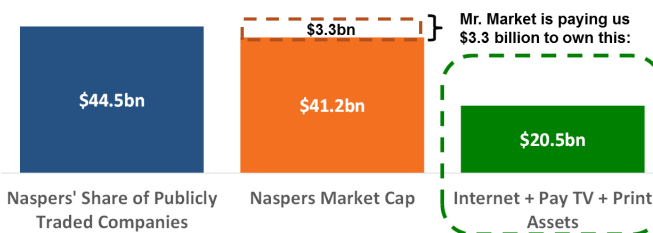
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### Naspers is the world's best company you've never heard of — and Mr. Market is paying us to own its core assets

Naspers is a South African internet and media company with a \$41 billion market capitalization and a phenomenal collection of compounding assets with sustainable long-term upside. The company's ownership in publicly traded internet assets is worth \$45 billion dollars, which is greater than Naspers' total market capitalization. Additionally, Naspers owns over 120+ other internet assets, including leading online classifieds, marketplace and e-tail sites, in winner-takes-all markets at the cusp of monetization in the fastest growing regions of the world. Naspers also owns a 30%+ margin quasi-monopoly PayTV business currently expanding throughout Sub-Saharan Africa, where the subscriber base is expected to more than double by 2020.



**We recommend buying Naspers and shorting the publicly traded assets to exploit this opportunity**

### Business Description

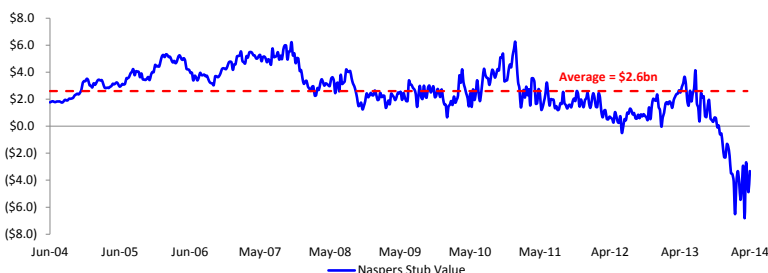
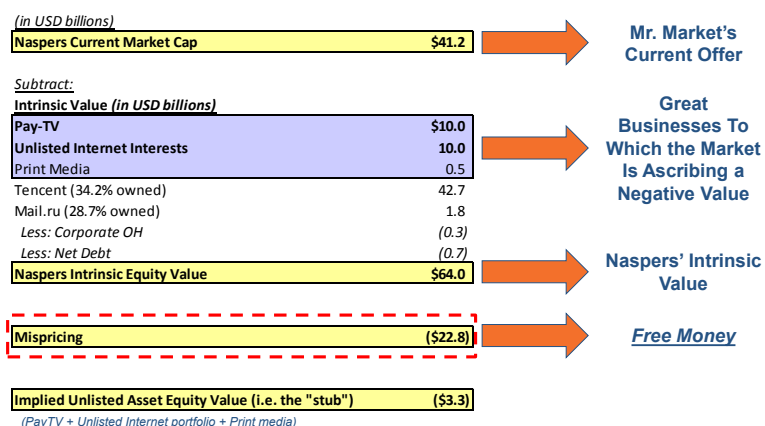
Naspers operates in three segments: PayTV, Internet, and a legacy print business upon which it was founded. PayTV generates over \$1bn in EBITDA annually, has >90% market share in its core markets and we conservatively project y/y topline and EBITDA growth of 12% and 15%, respectively, for the next three years. The internet segment is comprised of Naspers' 34% interest in Tencent, its 29% interest in Mail.ru and its partial and full ownership of over 120+ additional internet businesses in emerging markets, mostly focused in online classifieds, e-commerce and marketplace business models. The legacy Print media business is profitable, but not a substantial portion of the business today.

### Investment Thesis

**The market is currently valuing Naspers' interest in its listed assets (Tencent and Mail.ru) at greater than 100% of the entire value of Naspers**

The Naspers "stub" represents the compounding and high growth business to which the market is currently ascribing a negative \$3.3 billion valuation. Conservatively, we think the Naspers "stub" is worth >\$20 billion resulting in total mispricing of \$23 billion.





The "stub" has historically traded at a positive value and has only recently traded down as a result of significant increase in market value of Naspers' listed internet assets. This is in spite of the fact that the value of the assets comprising the stub has compounded over time and is expected to compound >25% well into the future.



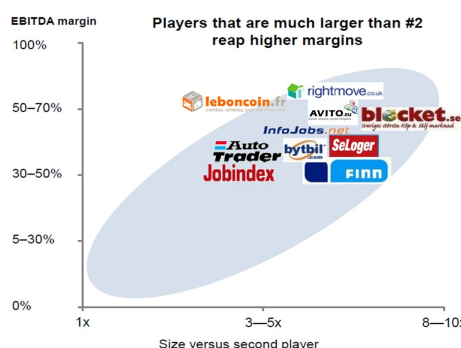
## Naspers (Continued from previous page)

**Naspers' unlisted assets ("the stub") is comprised of attractive global businesses that are compounding >25% annually and we estimate should be valued at \$20bn+**

Naspers' PayTV is a wonderful asset that is a quasi-monopoly business with 30%+ EBITDA margins, 90%+ market share in South Africa, exclusive sports and entertainment content and produces \$1bn+ in EBITDA annually that has been growing by mid-double digits. Naspers has invested heavily to grow PayTV in Sub-Saharan Africa, where the number of subscribers is expected to more than double by 2020. We believe PayTV is worth \$10bn today based on comparable multiples of other cable/tv companies and will continue to be a core growth driver of the business going forward.

Key Assets	Description	Value to Naspers Today	Upside Value in 5 Years
	Craigslist of Russia	\$500m	\$4-7bn
	Amazon of India	\$1.8bn	\$7-10bn
	eBay, Amazon and Craigslist of Eastern Europe	\$3.2bn	\$7-10bn
	Craigslist of India and Brazil (and others)	\$650m	\$3-4bn
		\$6.2bn (~60% of \$10bn online valuation)	\$21-31bn

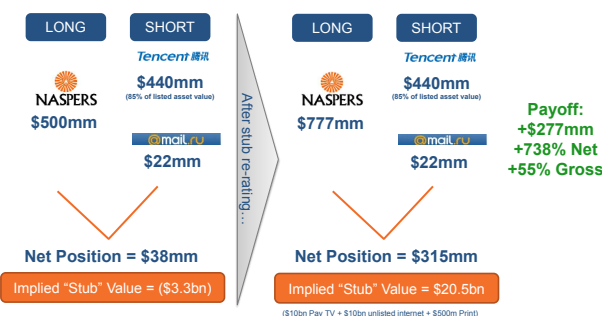
Naspers' unlisted internet asset portfolio is comprised of well positioned, market leading online classified, ecommerce, marketplace and other online businesses. The company has historically provided little to no information on these assets, but through our primary research, we believe this portfolio is conservatively worth \$10bn today and should compound in value at a rate of 25-50% over the next five years. In the exhibit above, we have highlighted just a few of Naspers' well-known internet assets that are leading internet companies in their respective markets. The value of these four internet assets accounts for 60% of the \$10bn we have included in the intrinsic value of the "stub." Further, we estimate there to be 4-5x upside potential on these four assets alone. Naspers' also has a whole portfolio of 120+ additional internet assets which we also believe are very attractive. For example, online classifieds are inherently winner-takes-all businesses, and Naspers has 20+ such businesses which are on the cusp on monetization and on the path of achieving EBITDA margins of 50-70%+. The chart to the right highlights the massive monetization potential that Naspers is currently on track for in online classifieds.



Naspers' secrecy in its ownership interests is not new. For example, Naspers purchased 46% of Tencent in 2001 for \$32m and did not disclose its stake until Tencent went public in 2004, when their post-money ownership in the newly listed company was >\$1bn. Although it is unclear if Naspers owns the next Tencent in its portfolio, the 120+ internet assets combined with a growing PayTV business clearly are substantially mispriced at the negative \$3.3bn valuation the market is currently ascribing to them.

**The market is currently attributing a value of negative \$3.3bn to the stub, creating a wonderful opportunity to effectively get paid to own Naspers' world class PayTV business and interests in 120+ well-positioned internet businesses in the fastest growing markets in the world**

In order to exploit this massive market inefficiency, we have outlined an illustrative transaction based on gross exposure of \$500m (net \$38m). Through a simple re-rating of the stable and growing PayTV and unlisted Internet Assets to our conservative valuations, investors can generate a net return of 738% (55% gross). Over time, we only expect the stub to become more valuable as its underlying assets compound rapidly, thus allowing the patient investor to generate returns in excess of these conservative assumptions.



### Risks/Mitigants

Should the South African Rand (ZAR) further dislocate from the USD/HKD, the stub could widen further. The cost to fully hedge against this risk is inexpensive (~1% annually today) which would only minimally impact returns.

The Company takes no actions to help narrow the gap.

Ideally for holders of the stub, the company would pursue accretive actions such as selling a portion of its interest in Tencent and simultaneously buying back shares in Naspers. Additionally, some internet assets are likely to IPO in the next few years. Lastly, increased disclosure would allow the market to better understand Naspers' unlisted holdings.

Investors may argue that a holding company discount applies in this case.

We believe that a substantial holding company discount is not warranted due to i) lack of tax friction associate with sale of stake, ii) we are shorting highly liquid assets with low cost of borrow, iii) highly competent management team with great capital allocation track records, and iv) ability to hedge out any currency risk.

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Eric Rosenfeld

## Eric Rosenfeld

(Continued from page 1)

**Graham & Doddsville (G&D):** How did you become involved in activist investing?

**Eric Rosenfeld (ER):** While I was at Harvard Business School, I worked for a summer at Bear Stearns in their risk arbitrage, options, and interest rate futures groups. A senior person there told me those would be the three great growth areas over the next five years. That person sure was right.

I went back to Bear's arbitrage department when I graduated and started working on takeovers – not just plain vanilla types of situations but bidding wars, unsolicited offers, and the more interesting types of situations. I was recruited to run the arbitrage department at Oppenheimer three years later and managed both firm capital and outside capital.

At Oppenheimer, we focused on the more interesting types of situations – competitive situations and aggressive 13Ds. There were corporate raiders involved and we would often become active in situations. We influenced which company would end up buying another and helped to coordinate bidding wars. We also were activist investors.

Fourteen years later, CIBC bought Oppenheimer. I had to stay for a year as part of

that acquisition but the day after the year was up, I left and started Crescendo to focus on the most interesting and profitable parts of what we had done at Oppenheimer, specifically deep value investing and activist investing.

**G&D:** Can you describe your investment process?

**ER:** We are really company-specific and look into particular industries or markets. The first requirement is to find undervalued stocks, opportunities where there is a value gap and a difference between where the stock is trading and where we think it can trade.

One of the ways that we come up with ideas is by running screens. The most important metric we look at is probably enterprise value (“EV”) to free cash flow. We also look at EV to EBITDA, EV to operating income, EPS multiples, and, on the downside, we look at liquidation value.

We also get ideas from other board members. We've been on over 20 boards and as a result we personally know about 200 directors. Many of the directors serve on other boards and may suggest ideas to us. They see the value we are able to create and they'll try to get us to help with other companies with which they are involved.

We receive ideas from analysts. Analysts may or may not be good at finding undervalued stocks, but they know when the institutional shareholders are unhappy. Having disgruntled shareholders, shareholders that want and would support change, is a requirement for us, and so analysts bring us ideas.

Other value investors are a source of ideas, specifically value investors that buy a stock and enter the “Wait, Hope, and Pray” mode. When things don't go their way and they get frustrated, they may call an activist like us.

Finally, we get ideas from employees – either former employees who have lost their jobs and think that they can get their jobs back by bringing us into the company or current employees who aren't happy with the direction of the company or the leadership of the company and feel that their careers will benefit from having the company on surer footing.

**G&D:** How do you get your name out to those employees or make them aware that you're out there?

**ER:** Our name typically isn't out there to companies we haven't already identified. However, sometimes people have heard about us in the news or they know somebody who was at a company where we were

(Continued on page 33)

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MANAGEMENT ASSOCIATION



## Eric Rosenfeld

(Continued from page 32)  
involved.

**G&D:** Besides disgruntled shareholders, what are other things you look for in an investment?

**ER:** We're looking for a company that's significantly undervalued. We're typically looking for an upside of at least 50% and maybe significantly in excess of that depending on how long we think it's going to take to draw out that value. Our average holding period is slightly in excess of three years, and so, in most cases, it's not an immediate value creation.

Stocks may immediately increase after we surface. That frequently happens but usually we get on the board and work over a period of years to bring out value. Occasionally, we'll call for the sale of a company – we did that a while back with Aeropostale.

Aeropostale is primarily a teen retailer and it also has a division which caters to 4- to 12-year-olds. The company has been having difficulty recently, as has the whole sector, and we think that the turnaround that they're attempting to engineer would be better accomplished in a private setting – either under a financial sponsor or as a smaller part of a much larger company – where they're clear of the public microscope and not judged on a quarterly basis.

In that particular case, we sent a public letter to the company calling for the immediate hiring of investment bankers to start a sales process. And while the company has not sold itself, they did hire bankers and recently announced a financing deal with Sycamore Partners.

**“The laws are different in Canada than in the United States and they're more favorable to shareholder democracy in several respects. The most important difference is that if you own 5% of a Canadian company, you can requisition a shareholder meeting.”**

**G&D:** How do you think about normalizing EBITDA, especially for a retail turnaround?

**ER:** Well, their average

EBITDA margins used to be about 14%, and we're actually only assuming that they get back to 9% or so in our valuation. We're not saying that things are going to be as rosy as they were a long time ago, just that they're going to be much better than the trough earnings that you have right now.

**G&D:** A lot of your activism has been focused on Canada. Can you tell our readers why you've done a lot of work there?

**ER:** The laws are different in Canada than in the United States and they're more favorable to shareholder democracy in several respects. The most important difference is that if you own 5% of a Canadian company, you can requisition a shareholder meeting. You can send in a letter to the board and, three or four months later, the whole board is up for election. There are no staggered boards, so the whole board can be replaced.

That is a tremendously powerful tool for the activist shareholder and it helps us in negotiating with companies. When we're asking for substantial representation on the board, the company knows that unless we reach an agreement, we may very well replace the whole board or virtually the whole board. I think it helps us get

(Continued on page 34)

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## Eric Rosenfeld



Students discuss the pitches at the 2014 Moon Lee Prize Competition.

(Continued from page 33)

to a negotiated solution, which we greatly prefer over a proxy battle, but when we need to have a proxy battle we will.

Without shareholder support, we can't negotiate our way onto the boards, nor can we win a proxy battle, and that's another important difference between Canada and the US. In the US, you generally can't call a special meeting, and when you do, you may need to own 50% or 25% of the company. In very rare cases you can do so with 10%, and virtually never can you call a special meeting with just 5% of the stock.

In most cases, you just have to wait for the company's annual meeting, and so if your timing is wrong, you might have to wait 10 or 11 months until you have that vote and can have a board level change. On top of that, if the board is staggered, you can only get a maximum of a third of the board in one year and you have to wait another year to get the other third needed to gain effective control.

Another difference between Canada and the US is that a shareholder doesn't have to publicly surface until they own 10% of the company in Canada. This may change; there was a proposal floated in 2013 by the CSA in Canada to move to a 5% threshold. If they do change the threshold to 5%, it may inhibit activist campaigns because the activist might

feel they can't get a large enough stake to make a change. This would damage shareholder democracy amongst some smaller companies and lower the value of some Canadian stocks that may just be left to languish in their undervalued state.

Another difference is the poison pill or the shareholder's rights plan. When poison pills were first introduced in the United States in 1984, the initial idea was that they would give the board some more time to look for alternatives when faced with an unsolicited offer.

This has morphed over the last 30 years to a point where boards in Delaware can just say no to an offer that they don't like. You can have 95% of the shareholders supporting an offer, but if the board chooses not to accept it, they can hide behind the poison pill. The bidder would need two successful proxy fights over two years to get control of the board and remove the pill.

It's better in Canada than it ever was here. The view there is that, since the shareholders own the company, they should have the ultimate power in deciding whether a company is sold. If you have an unsolicited offer in Canada and the shareholders want to accept the offer, the board will have several months to look for

alternatives. At the end of this period, the regulators or the courts will issue a cease trade order which will eliminate the poison pill and allow the offer to go through. A company that is put into play in Canada is much more likely to transact than a company that is put into play in the United States.

Another important difference is that you are more likely to have concentrated institutional shareholders. In certain companies, we'll be able to go out and speak to five or six institutions and understand what 35% to 45% of the shareholders are thinking and whether they are willing to support us. In contrast, in the US, we might have to speak to a lot more shareholders to find out what an equivalent percentage of the shareholder base is thinking.

**G&D:** Have you looked for opportunities in other countries that share similar characteristics as Canada?

**ER:** No. Our view is that since there are so many opportunities in the United States and Canada – and we're in the same time zone, we know the laws, we know the people – that there's no need to go further afield. For example, why go to Japan, where you have a different culture and a different language and a different time zone? It just doesn't make sense to make

(Continued on page 35)

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## Eric Rosenfeld

*(Continued from page 34)*  
it more difficult. We try to make it easier on ourselves, not harder.

***Our view is that since there are so many opportunities in the United States and Canada – and we're in the same time zone, we know the laws, we know the people – that there's no need to go further afield...It just doesn't make sense to make it more difficult. We try to make it easier on ourselves, not harder.***

**G&D:** Can you talk about any of your other current investments or favorite past investments?

**ER:** Cott Corporation is an interesting story. Cott is the largest manufacturer of private label beverages in the world, and for most of the major retailers in the United States and Canada and Great Britain, Cott has

manufactured their private label carbonated soft drinks, CSDs.

The company was started about 60 years ago in Montreal and its headquarters were later moved to Toronto. It was a very trusted supplier and partner with its customers, and CSDs were a very important category to those customers. Retailers discounted Coke and Pepsi to bring people into their stores but they did not make any significant profit selling them.

Retailers could sell their private label soda at a lower price point but a much higher margin – it was a very important category to them – and so they would work with Cott implementing their strategy.

The CEO and founder of Cott passed away about 16 years ago. He was replaced by two successive CEOs, each lasting a few years. Then about eight years ago, the board hired a CEO who didn't get the board to drink the soda, he got the board to drink the Kool-Aid. He convinced the board that Cott could double its profit margins from 18% to 35% if it moved a lot more into brands rather than private label. He thought the customers would have to listen to Cott and that Cott wouldn't have to listen to its customers.

He moved the headquarters from Toronto to Tampa, he

hired a lot of high-priced branding people, and he put a sign up on the wall that said, "We're not here to make money, we're here to make history." He ultimately succeeded at both – he didn't make any money and now he's history.

He proceeded to alienate and compete with Cott's customers. One of the products they introduced was called FortiFido. It was fortified dog water – dog water with vitamins and minerals added – that sold for \$1.99 a quart, and came in four flavors. Rather than going to Walmart, which sells more dog products than any company in the world, Cott did this on its own, and tried to create a new category and a new product.

Customers were unhappy, sales and profits started declining, and the stock went from \$16 to under \$3. The bonds were yielding over 30% at the time, and that's when we started getting involved. We bought 8% of the company, I met with the chairman, asked for board representation, and within a few weeks, we negotiated for four board seats out of eleven.

I went on the board along with Greg Monahan from Crescendo. We also brought on a gentleman who had been in senior management at Cott five years before and knew how the strategy worked when it

*(Continued on page 36)*

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MANAGEMENT ASSOCIATION

## Eric Rosenfeld

(Continued from page 35)

was the right strategy. Our fourth board member had just retired as CEO of Walmart Canada and thought it would be a great challenge to help turn around the company. He came from Cott's largest customer, in one of their largest countries, and brought a retailer's perspective, a customer's perspective, to the board.

While we were in negotiations, the existing board fired the CEO, and when we came on the board we were immediately tasked with finding a new CEO. We ended up promoting someone from within the company who was great at execution and hadn't been responsible for setting that wrong strategy, and he's been a great CEO.

After that, our job was to get the customers to love and trust Cott again. It was simpler since we didn't have to figure out a new strategy – we just had to go back to the old strategy, stop competing against our customers, cut the overhead that had been built up, get rid of FortiFido, and take the sign off the wall.

We did all that and within about one and a half years, the stock rallied to \$9. The company has instituted a dividend and a stock buy-back program, it has refinanced its debt, which is now trading around 6%, and it has also made a large acquisition and bought the

largest private label manufacturer of juices.

Cott is a good example of how we do what we do. We don't get involved in the micro-management of the company – my previous experience with soda was drinking soda. What we do is make sure that the right management team is in place (the CFO and the general counsel were also replaced at Cott), make sure that the right strategy is in place, and make sure that the right capital structure is in place.

***“We don't get involved in the micro-management of the company....What we do is make sure that the right management team is in place.”***

**G&D:** You mentioned Cott's bonds were yielding 30% which sounds like a distressed situation. Do you ever get concerned about something like that or consider buying debt?

**ER:** Their debt was our biggest concern. There was

a potential that this company could go bankrupt, and I have no doubt in my mind that had there not been a change, they would have gone into bankruptcy. However, we thought that the fix was so simple that it could be executed quickly enough to save the company.

**G&D:** You mentioned that you don't try to be operators but instead try to find good management. What do you look for in a good manager and how do you think about matching a manager to a particular situation?

**ER:** In general, I've found that a good manager is someone who is a good delegator – once a company gets large, it's pretty difficult to really micromanage. A good manager has confidence in his or her opinions but is also willing to take constructive criticism. A good CEO works well with the board and has the trust of the board and the respect of the people at the company.

Knowledge of the industry is important, but there are good CEOs who have moved from one industry to another and done very, very well.

**G&D:** Thank you very much for your time.

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## CBS at the Center of Women in Investing



**Columbia Business School students talk to panelists at the Heilbrunn Center's Women and Value Investing Lunch on March 6, 2014.**



**Current Columbia Business School students at the Cornell Women in Investing Conference in November 2013.**



**Columbia Business School students Suhasini Bhargava '15 and Kathy He '15.**



**The CBS team presents their stock pitch at the Cornell Women in Value Investing Conference in November 2013.**

For more information, please visit the Heilbrunn Center's page on Women and Value Investing:  
[http://www8.gsb.columbia.edu/valueinvesting/resources/Women\\_andValueInvesting](http://www8.gsb.columbia.edu/valueinvesting/resources/Women_andValueInvesting)



H. Kevin Byun

## H. Kevin Byun

(Continued from page 1)

### Graham & Doddsville

**(G&D):** How did you become interested in investing?

**H. Kevin Byun (HKB):** I had always been interested in finance and investing but it became very clear what I needed to do when I read Joel Greenblatt's first book, *You Can Be a Stock Market Genius*, which is about special situations investing. I had found a logical way to find opportunities in the markets. It's a framework and philosophy grounded in fundamental analysis and value investing.

The other equally important influence was Warren Buffett's original partnership letters, which discussed many of his special situations investments in the 1950s. Buffett was an activist investor as well, and people forget how aggressive of an investor he was. What I saw was that there was substantial overlap between Greenblatt and Buffett's processes. While they were effective across different decades, I could see the overlap in their fundamentals. I was shocked that most people did not manage their money this way, but it's a big world and there's no one right way. My view was that special situations investing would be my way to find great ideas and produce outsized returns. The great part about it was that they provided me with a clear template on how to do it. It's been working great so far.

**G&D:** How has special situations investing, and your style, evolved since you launched your fund?

**HKB:** Coach John Wooden used to start every basketball season by showing his players how to put on their socks. The fundamentals haven't really changed at all. The framework and philosophy has always been that of opportunistic investing. The types of investments depends on what opportunities have presented themselves, be it liquidations, Dutch tenders, spin-offs, split-offs, bankruptcies, transformative M&A, et cetera. There are many different special situations that can arise in any sector or industry. You just have to be ready for them.

I can speak about my evolving approach to special situations though. When I started out, I leaned more heavily on quantitative analyses. I could hang my hat on the quantitative analysis and still do well with that alone, without needing the more qualitative feel for context and situational dynamics. However, now I see you develop a sense and become more efficient and effective in terms figuring out the factors that will drive a particular investment. Many times it may simply be an understanding of management or board incentives, which can be very powerful, while the numbers may hide what is really there.

I'll add that there is a huge secular wave of special situations that is getting bigger. New spin-offs are announced every week it seems. Pressure is building for increased M&A activity. There are many interesting opportunities for special situations investors. It's a very busy time.

**G&D:** Can you talk about your perspective on portfolio and risk management?

**HKB:** I've learned that finding great ideas and portfolio management are very different skills. Both are critical. Since the start, my main focus was on fundamental analysis and finding great ideas. My conviction on the value of fundamental analysis has only gotten stronger. But from experience, my view on portfolio management has changed. You can learn from my experience.

Since the start of the fund, I had been running 50% cash from 2008-10. We made solid returns every year. Even in 2008 we made over 30% with no shorts, all special situations. In 2011 there was a concentrated window in which many incredibly interesting ideas had catalysts in the back half of the year. I utilized more complex options positions to express these ideas, something I had never done before or since. That was July 2011. What happened in August the next month? The European financial crisis hit, and the market tanked.

(Continued on page 39)

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## H. Kevin Byun

(Continued from page 38)

It was painful at the time but it was the best experience in my career. I learned a very good lesson. I really questioned everything at that time. I questioned the research process, I questioned the portfolio management, and I was determined not to learn the wrong lessons. When I was reflecting on the investments, I actually gained more conviction in those ideas, and those stocks ended up accelerating and hitting their target prices faster than the market. My ideas ultimately played out the way I expected, but it was a challenge to navigate through an unexpected crisis.

That's what portfolio management and hedging are about. You have to be prepared for those unexpected events and be in a position where you can manage those risks. I've grown to have a much greater appreciation for getting that part right. Right now we have about a quarter cash and in this environment it's a good balance. That balance is actually what allowed us to return 67% in 2013 while maintaining 30% cash. 2014 has been a good year so far as well.

**G&D:** You started Denali Investors in 2007 shortly after graduating from Columbia Business School. Can you describe the process and challenges in starting your fund?

**HKB:** I'll start by saying I

attended Columbia Business School and entered the Value Investing Program specifically because I found out Joel Greenblatt taught a class there and I wanted to take it. In business school, I couldn't shake the feeling that starting my own fund was what I had to do. During that time, if you were walking on the streets of New York City and sneezed, somebody would hand you \$100 million. It was that kind of weird environment that I did not think was sustainable. I thought it was more sustainable to be independent for many reasons.

***"That's what portfolio management and hedging are about. You have to be prepared for those unexpected events and be in a position where you can manage those risks."***

I wanted my fund to focus on compounding returns and keeping my investors' interests as the top priority. The very structure of some funds turns this upside

down. I wanted other risks removed, be it business risk, career risk, the politics, and so on. I wanted to build a truly independent firm that was structured in the right way. I wanted to take concentrated positions, which to me means holding five to ten positions at between 5% to 15% each. This approach made much more sense to me than what I was seeing out there.

It took some time after graduation to get through the mechanics of launching the fund and selecting service providers. I wanted to ensure I set up the fund the right way so that it was operationally efficient. Once the basic blocking and tackling was taken care of, I'd be able to focus on generating returns for my investors.

What's more important is how to structure the partnership the right way. For this, I basically tore a page out of the original Buffett partnership structure in terms of the compensation and fee structure because it seemed more aligned to me, which is a 6% hurdle and above that 25% performance. I like the hurdle.

It was really just taking a bunch of simple concepts and setting them up in the right way. I was basically taking the addition by subtraction approach so that when I started I had improved my chances. Also, a year after I started came the greatest gift that an investor

(Continued on page 40)

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## H. Kevin Byun

(Continued from page 39)

could have asked for, the 2008 financial crisis. It was a very exceptional time to be investing. The fund did very well.

One of the early challenges for me at Columbia was that I knew I wanted to launch a fund, but I also knew I needed more context and better investing situational awareness. What I had learned up to that point was just the tip of the iceberg. There were skills I needed to develop. I remember thinking – how do I get the most out of my time here, learn the most? One of those crazy projects I took upon myself to do while at Columbia was to read every Value Investors Club write-up. I didn't know what I was getting myself into.

**G&D:** I hope there were a lot fewer write ups then than there are now.

**HKB:** There's more than twice the number of write ups now because Value Investors Club started in 2000, but the one thing that I hadn't factored in was the Q&A section. The volume of content there is impressive, some of it very high quality. In many ways the Q&A is much more valuable than the write-ups themselves. You have the write-up, which is basically advertising, and then you have the Q&A critique, which helps keep things honest. My goal then was to read all these ideas and keep learning whereas a lot of people stop because it gets frustrat-

ing. You start with basic questions, which leads to more questions and it multiplies. But that is the only way to get to the other side where you earn the right to simplify appropriately. You have to go through that difficult, frustrating stage first. I remember there was this forgotten room behind the IT department with no windows and an industrial printer and I would print out reams of filings, write-ups, everything, and just sit and read through them all.

I kept a detailed record of my questions to ensure I was diligent about getting up the learning curve and reaching those inflection points. There really wasn't anything magical about the process when you're looking in from the outside. As I went through all of these materials I absorbed more and more investing reference points, more case studies in terms of the research, the analysis, and the thought process. It was something that made a lot of sense for me personally and greatly accelerated my understanding.

**G&D:** Contrasting 2008 to now, what are your thoughts on the market as it currently stands?

**HKB:** At the beginning of 2014, I sized up the position level and market hedges significantly. I believed 2014 would be a year of heightened volatility. We saw some of it at the end of January and early February,

when the market dropped sharply but rebounded quickly. This past week in early April, the same pattern occurred and it is very volatile beneath the surface. Funds are struggling. They are reducing their gross and net exposures significantly. You can feel that pressure downwards on a lot of trendy names. That said, it is creating opportunity for investors with cash. There are more interesting special situation names to look at now than there were last year despite the markets being higher. My focus remains on building the portfolio one solid idea at a time, but I am diligent about the position level and market hedges to help get us through a more volatile environment.

**G&D:** How would you describe your current pipeline, particularly in the context of your 30% cash position?

**HKB:** There are roughly 400 ideas that are on our watch list. 40 of those 400 are in the pipeline, which are more interesting ideas. Among those 40, I'm looking for one to be good enough to replace an existing position, of which there are ten. If the market pressure results in another large selloff, it may create another window to be able to act decisively. I've always viewed our cash position as very beneficial and a key strategic asset.

(Continued on page 41)

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## H. Kevin Byun

(Continued from page 40)

**G&D:** How do you source and narrow down your opportunity set?

**HKB:** There are many special situation opportunities these days. Sourcing is mostly following the news flow and paying attention. Having been at this game a little while, it's a bit simpler to identify the particular drivers for each idea and to decide which ideas to allocate more time to. A new idea may be one that reminds you of a previous idea or it could be an unexpected opportunity. I will say it is definitely much more work to get to fewer names. But it's worth it.

**G&D:** You've talked about using options to structure interesting risk/reward scenarios around special situations. Can you talk a bit more about this?

**HKB:** The options market is actually quite elegant and beautiful. For the ideas we are investing in where we see that the stock is mispriced, by definition the option is being priced off of the stock so the option is also inherently mispriced, but much more so. Some investors may not appreciate the options market. They also might not appreciate special situations. I've found that the combination of those different areas can actually create some very powerful ways to express a thesis or an investment idea. It takes a while to get a feel for each of those areas. What's great about special

situations is that, from point A to point B, you have a clearer line of sight, in the way that a sports event or a sports game has a start and an end. This is similar in that we expect that a certain event will occur over a certain period of time. It may be a spin-off, a merger, a liquidation, or a tender, et cetera.

***"[Idea] sourcing is mostly following the news flow and paying attention. Having been at this game a little while, it's a bit simpler to identify the particular drivers for each idea and to decide which ideas to allocate more time to."***

There are some events that you know are approaching and where you see a disconnect between the current stock price and the appropriate value.

The market is forced to revalue that security upon

the occurrence of this upcoming event. But options are generally priced off models that look backward, not what's about to happen. That's inherently very interesting. It's very different from what I think is the more common narrative that you'll buy something and you don't care where it trades because you're looking three to five years out. Those investments can make sense and we've made them. But I believe definitive catalysts create a much higher-probability way to extract value over time.

Whether you create that through straight equity or whether you incorporate options as a way to magnify the return in a cost-effective manner or to skew the risk reward by creating certain hedges, there are a lot of potential ways to construct the trade depending on the pricing and availability. But when you can put these multiple pieces together it's much more powerful than just being purely a straight equity investor or being purely an options investor.

**G&D:** Can you walk us through a particularly successful hedging strategy?

**HKB:** In Q4 2011, we identified Genworth as severely mispriced. At the time, it was a \$5 stock. We accumulated a decent position that comprised 10% of our holdings. As the stock doubled, I became concerned this position may start to

(Continued on page 42)



Professor Bruce Greenwald and Alex Porter at the 2014 Moon Lee Prize Competition.

We at Columbia Business School and the whole Value Investing Community were deeply saddened to hear of the recent loss of our dear friend and thought-leader Alex Porter.

Between 1976 and 1993, Porter's fund, which he called "Amici," generated a net compound annual return on the order of 20 percent. Amici Capital today manages \$2.2 billion. Alex will not only be remembered for his great success on Wall Street, but also for his tremendously kind and considerate nature.

The Heilbrunn Center will be proud to continue Alex's generous legacy of giving back and supporting student ideas through the Moon Lee Prize Competition, which we co-produce with Amici Capital each January. We feel incredibly grateful to have known Alex and he will be greatly missed by all.

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## H. Kevin Byun



Joe Goldschmid '14, Allen Keel '14 and Mahmud Riffat '14 present their thesis on Cablevision (CVC) at the 2014 Pershing Square Challenge.

(Continued from page 41)

overwhelm the book. I wanted to manage the increasing size. One way was to use a stock replacement strategy, in which you can take 90% or 95% of the gains off the table and then replace that with 5% or 10% via calls. That way you're still getting similar exposure to a longer term thesis, but you're managing the risk in terms of holding very large position, and the volatility of that position over the short term. Now Genworth is at \$18 so we've used that tactic a number of times.

Another example is SunEdison from 2012. A series of catalysts occurred with respect to SunEdison that resulted in a tripling of its share price. I took about 40% of that position and placed a collar on it, keeping it tighter on the downside and more room on the upside. I didn't want to have my investors dealing with short term capital gains when it wasn't necessary. I believed there was still significant upside through carve-outs of certain entities that I expected would drive further value. But given the volatility in the stock, we appropriately incorporated hedges to manage through the catalysts.

**G&D:** Let's discuss ideas. Could you share one you are involved in currently?

**HKB:** One company I've been following for quite some time and initiated a position in last quarter is Dover Industries (DOV)

and its spin-off, Knowles (KN).

Dover is a \$15 billion market cap company and Knowles is roughly \$2.5 billion. Dover was trading close to \$100 per share, but dropped 10% before the spin-off when the management lowered guidance on its earnings call. Then all of a sudden you had the market selloff in February, and it was down another 10%.

At the time, New Dover (ex-Knowles) was valued in the mid to high \$60s, and I believed the fair value to be between \$80 and \$90. I thought the Knowles spin-off was worth at least \$15 to \$20 per pre-split share. After the sudden selloff, Dover became incredibly interesting and became a core position. All of this occurred when the market lost its mind, and the management created this cover by taking down guidance. Even better, the catalyst was right around the corner, less than one month away.

New Dover increased 25%, reaching our mid-term target price very quickly by March. We exited New Dover and rolled the proceeds into the spin-off, Knowles, which had not moved. Knowles appears to be a classic case of an orphaned spin-off – it is much smaller than its parent company, has a different focus, and started with no analyst coverage. But Knowles' business is simple: it provides the acoustic systems

that go into all of our phones, tablets, laptops, and hearing aids. Knowles owns that space. If you think about the number of units of smartphones, tablets, laptops, etc., the runway is simple to understand. The ASP for a current system is roughly \$2 to \$3, which will increase to \$4 to \$6 as mobile devices become more sophisticated. On the cost side, Knowles will reduce its 18 facilities down to 11, which should save it \$40 to \$50 million a year. Comparables trade at much higher valuations than Knowles. I believe fundamentals and margins will improve significantly.

**G&D:** What gave you the sense that Knowles' projections were potentially understated?

**HKB:** I thought it was interesting that Knowles grew through the implosion of Nokia and Blackberry sales because there were large customers. This is because Knowles is in every other OEM such as Samsung and Apple. Since the NOK and BBRY headwind is now over, fundamentals could ramp sharply.

More generally, management teams are catching on to the benefits of spin-offs in terms of their personal incentives and compensation; the lower the price of the spin-off entity, the better off economically the management team will be as their compensation packages get

(Continued on page 43)

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## H. Kevin Byun

(Continued from page 42)

struck at lower prices. Incentives are powerful and may compel management teams to lean conservatively on their numbers ahead of a spin. This could be prudent, opportunistic, in their self-interest, or all of the above.

**G&D:** Could you share another special situation idea?

**HKB:** Another one that I've been following since last year is Rayonier's (RYN) upcoming spin-off of its specialty chemical business, Rayonier Advanced Materials (RYAM) which is two-thirds of Rayonier's business. Most of the cellulose specialties business is in cellulose acetate, which turns wood into the plastic fiber that is used in cigarette filters. It is a very high-margin and attractive business. I believe it warrants a much higher multiple.

Rayonier is a timber REIT, and the timber REIT investor base is generally seeking dividend yield. There are already several pure plays in the timber space that trade at 3.5% to 4% dividend yields. Rayonier is currently wide of that, despite my belief that its 2.6 million acres of land is of higher quality relative to its peers. But let's say I'm not a lumberjack and that's wrong and it is similar quality. Then it should trade in-line with its peers. Well, right now the stock is at roughly \$45 and the dividend per share is about \$2.

The RYAM spin-off should be valued at roughly \$25 to \$35 per share post-spin based on my valuation. Based on management comments during a conference call, the dividend yield for RYAM is expected to be 1.5%, which translates very roughly to \$0.50 per share on a share price of \$25 to \$35. Management also stated that the total expected dividend distribution for both entities should be in line with the current dividend of \$2 per share. This leaves \$1.50 for the parent company to distribute. At a 4% yield, that already puts you in the high \$30s. So what does that mean? If the current stock is at \$45 and you have the spin-off that I believe is worth at the midpoint \$30. That creates a stub of \$15 for New Rayonier which should by itself be worth at least \$30 to \$40. That's interesting.

Depending on how the different pieces initially trade we're talking about two entities together that are incredibly mispriced. The reason is because the existing dividend yield seeking investor base sees this current Rayonier as worst-in-class because of its chemicals business, while the specialty chemicals investors are avoiding it because it's inside a timber REIT business.

Another interesting wrinkle is that roughly three-fourths of the debt will be moved to the RYAM spin-off. That signals a few things. I believe

this was deliberately structured because Rayonier Advanced Materials is a high cash flow business, and will have the ability to de-lever quickly. The initial equity valuation for Rayonier Advanced Materials will be lower due to the initial leverage. Interestingly, the Chairman & CEO is going with the spin-off. Lastly, New Rayonier will have the lowest leverage by far among comparables, which will be interesting for strategics. Events will beget events.

**G&D:** Is there another idea you can share?

**HKB:** Well, no special situations conversation would be complete without mentioning John Malone. This is one of the most interesting windows in the Malone era because we have three Liberty spin-offs that are occurring this year: Liberty Media (LMCA), Liberty Interactive (LINTA), and Liberty Ventures (LVNTA). These are seemingly disparate businesses whose value will be unlocked in similar ways.

With Liberty Media, they're going to create a tracking stock for Liberty Broadband (LBRDA). With respect to Liberty Interactive, two new entities will be created: Liberty Digital (LDCA) and QVC (QVCA). QVC is a very underappreciated business. Liberty Ventures is essentially a publicly traded hedge fund run by John

(Continued on page 44)

**"Incentives are powerful, and may compel management teams to lean conservatively on their numbers ahead of a spin. This could be prudent, opportunistic, in their self-interest, or all of the above."**

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## H. Kevin Byun

(Continued from page 43)

Malone and Greg Maffei. Liberty Ventures will spin-off Liberty TripAdvisor Holdings (LTRPA) which will hold the 22% economic stake and 57% voting stake in TripAdvisor (TRIP) along with the BuySeasons entity and some debt.

Now what looked like three complicated companies in very short order will look very different and simplify into six less complicated entities. There is really no analysis across all these entities particularly because each seemingly operates in a different industry. But the way I think about it is, if you do the work and identify the key drivers for each business, then you can identify the opportunities with the most upside.

I should mention that Liberty Ventures itself is a separation from Liberty Interactive. When Liberty Ventures came out, it was panned pretty heavily because it was perceived as an opaque entity and began trading at \$40 per share. As the discount has narrowed and the NAV has increased, the stock has tripled. Liberty Ventures also came out with a seemingly complex rights offering in the way that the separation was structured.

The previous spin-off of Starz (STRZA) from Liberty Media was another interesting idea. John Malone was literally giving his plan away ahead of time. You can question how someone as well-known and respected

as John Malone was able to spin off Starz at a bargain. Yet Starz came out and was incredibly cheap and was trading at a very steep discount to all of its peers. We bought Starz post-spin. In just over a year and a half Starz more than doubled.

Liberty Broadband is doing a similar structure with a rights offering. What's great about it is that, if you've done the background work, you can get a sense of the context of the events that are coming around the corner. I believe that even today these entities are trading at substantial discounts to their value with the catalysts getting closer. So it's worth paying attention.

**G&D:** That's a lot of tickers, John Malone certainly likes his tax-free spin-offs. On another track, since you are an avid reader, do you have any book recommendations?

**HKB:** I found it very helpful to read books about successful entrepreneurs, investors, and financial history. You can pick up a lot of good ideas. Ray Kroc's book, *Grinding It Out: The Making of McDonald's*. Another one is *How to Be Rich* by J. Paul Getty. One more is *Alchemy of Finance* by George Soros. Don't let the bad titles fool you.

Last year, I began reading everything I could about Masayoshi Son. He is one of the greatest entrepreneurs that ever lived. Yet there

were no books in English about him. I complained to him that everyone here wants to know more about you. By everyone I meant me. I said it's crazy nothing has been translated yet. I said it's hilarious when your first company sold a multi-language pocket translator! He was deep into the Sprint acquisition. But a few months later the first book ever in English shows up on Amazon. I recommend *Aiming High*. I think the Sprint T-Mobile deal happens, by the way. It would be great for consumers.

**G&D:** Those sound great. One last question, do you have any advice for current students looking to enter the investment management industry?

**HKB:** I've always believed investing is meritocratic. Your work, discipline, and purpose will determine whether you make it. There is no birthright to insight and that's a great thing. Get very focused and earn your place at the table.

**G&D:** Thank you for taking the time to speak with us, Mr. Byun.

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## 2014 Moon Lee Prize Competition

On January 31, 2014, Amici Capital hosted the 5th annual Moon Lee Prize Competition. The prize is given in memoriam of Moon Lee, a dedicated value investor with Amici Capital from 2003 to 2008, who demonstrated a tireless ability to identify and analyze deep-value opportunities that few could see. In his honor, his friends at Amici Capital initiated this competition. Finalists – who were selected based on pitches submitted by students taking a course in Applied Value Investing – included Stephen Lieu (XPO Logistics), Patrick Stadelhofer (World Acceptance Corp.), Akhil Subramanian (Pandora), and Jackson Thies (Post Holdings). Patrick Stadelhofer won the \$15,000 first-place prize while Akhil Subramanian took home \$5,000 for his second-place finish.



Jon Friedland '97 opens the event.



Patrick Stadelhofer '14 (first place winner) presents his thesis.



Professor Bruce Greenwald asks questions.



The four finalists pose after the competition.



Louisa Serene Schneider '06 talks with alumni.



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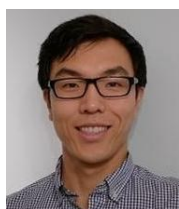
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