
Stock Valuation – The Buffett Way

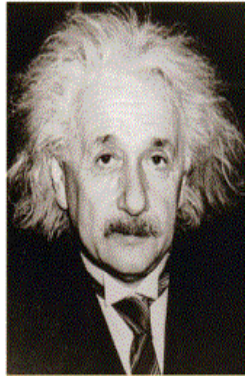
Week 2: Investing from Business Perspective

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Agenda

- The power of compounding
- How to value a business
 - Read financial statement
 - Owner earnings
- How to value intrinsic value of stocks
 - The discounted value
 - The discounted cash flow method
- How to search for investment opportunities
 - Three categories of value stock
 - Online screeners
 - Checklist for stock selection
- No-brainer investment opportunities

The power of compounding



“The most powerful force in the universe is **compound interest.”**

Albert Einstein



Annual Investment **\$4,000.00**
Annual Percent Return **10%**

Estimated Annual Return	Balance	Interest	New Balance
January 1, 2009	\$4,000.00	\$400.00	\$4,400.00
January 1, 2010	\$8,400.00	\$840.00	\$9,240.00
January 1, 2011	\$13,240.00	\$1,324.00	\$14,564.00
January 1, 2012	\$18,564.00	\$1,856.40	\$20,420.40
January 1, 2013	\$24,420.40	\$2,442.04	\$26,862.44
January 1, 2014	\$30,862.44	\$3,086.24	\$33,948.68
January 1, 2015	\$37,948.68	\$3,794.87	\$41,743.55
January 1, 2016	\$45,743.55	\$4,574.36	\$50,317.91
January 1, 2017	\$54,317.91	\$5,431.79	\$59,749.70
January 1, 2018	\$63,749.70	\$6,374.97	\$70,124.67
January 1, 2019	\$74,124.67	\$7,412.47	\$81,537.14
January 1, 2020	\$85,537.14	\$8,553.71	\$94,090.85
January 1, 2021	\$98,090.85	\$9,809.08	\$107,899.93
January 1, 2022	\$111,899.93	\$11,189.99	\$123,089.93
January 1, 2023	\$127,089.93	\$12,708.99	\$139,798.92
January 1, 2024	\$143,798.92	\$14,379.89	\$158,178.81
January 1, 2025	\$162,178.81	\$16,217.88	\$178,396.69
January 1, 2026	\$182,396.69	\$18,239.67	\$200,636.36
January 1, 2027	\$204,636.36	\$20,463.64	\$225,100.00
January 1, 2028	\$229,100.00	\$22,910.00	\$252,010.00
January 1, 2029	\$256,010.00	\$25,601.00	\$281,611.00
January 1, 2030	\$285,611.00	\$28,561.10	\$314,172.10
January 1, 2031	\$318,172.10	\$31,817.21	\$349,989.31
January 1, 2032	\$353,989.31	\$35,398.93	\$389,388.24
January 1, 2033	\$393,388.24	\$39,338.82	\$432,727.06
January 1, 2034	\$436,727.06	\$43,672.71	\$480,399.77
January 1, 2035	\$484,399.77	\$48,439.98	\$532,839.74
January 1, 2036	\$536,839.74	\$53,683.97	\$590,523.72
January 1, 2037	\$594,523.72	\$59,452.37	\$653,976.09
January 1, 2038	\$657,976.09	\$65,797.61	\$723,773.70
January 1, 2039	\$727,773.70	\$72,777.37	\$800,551.07
January 1, 2040	\$804,551.07	\$80,455.11	\$885,006.18
January 1, 2041	\$889,006.18	\$88,900.62	\$977,906.79
January 1, 2042	\$981,906.79	\$98,190.68	\$1,080,097.47
January 1, 2043	\$1,084,097.47	\$108,409.75	\$1,192,507.22
Retirement/Nest Egg Total			\$1,192,507.22

The power of compounding – cont.

Alice's age	Mike's Age	Year	Taxable Account (bank+investment)		Roth IRA		401K		Inflation Rate		
			Return Rate	2.00%	Return Rate	8.00%	Return Rate	8.00%		3.50%	
			Annual Saving	\$ 25,000	Annual Contrib	\$ 10,000	Annual Contrib	\$ 31,000		Depreciated with Inflation Rate	
			Saving	Balance	Saving	Balance	Saving	Balance	Total Saving	Rate	years
25	27	2010	\$ 10,000	\$ 10,200	\$ 20,000	\$ 21,600	\$ 60,000	\$ 64,800	\$ 96,600	\$ 96,600	
26	28	2011	\$ 25,000	\$ 35,904	\$ 10,000	\$ 34,128	\$ 31,000	\$ 66,960	\$ 136,992	\$ 132,197	1
27	29	2012	\$ 25,000	\$ 62,122	\$ 10,000	\$ 47,658	\$ 31,000	\$ 105,797	\$ 215,577	\$ 200,751	2
28	30	2013	\$ 25,000	\$ 88,865	\$ 10,000	\$ 62,271	\$ 31,000	\$ 147,741	\$ 298,876	\$ 268,580	3
29	31	2014	\$ 25,000	\$ 116,142	\$ 10,000	\$ 78,053	\$ 31,000	\$ 193,040	\$ 387,234	\$ 335,802	4
30	32	2015	\$ 25,000	\$ 143,965	\$ 10,000	\$ 95,097	\$ 31,000	\$ 241,963	\$ 481,024	\$ 402,535	5
31	33	2016	\$ 25,000	\$ 172,344	\$ 10,000	\$ 113,505	\$ 31,000	\$ 294,800	\$ 580,648	\$ 468,897	6
32	34	2017	\$ 25,000	\$ 201,291	\$ 10,000	\$ 133,385	\$ 31,000	\$ 351,864	\$ 686,540	\$ 535,004	7
33	35	2018	\$ 25,000	\$ 230,817	\$ 10,000	\$ 154,856	\$ 31,000	\$ 413,493	\$ 799,165	\$ 600,973	8
34	36	2019	\$ 25,000	\$ 260,933	\$ 10,000	\$ 178,044	\$ 31,000	\$ 480,053	\$ 919,030	\$ 666,922	9
35	37	2020	\$ 25,000	\$ 291,652	\$ 10,000	\$ 203,088	\$ 31,000	\$ 551,937	\$ 1,046,676	\$ 732,969	10
36	38	2021	\$ 25,000	\$ 322,985	\$ 10,000	\$ 230,135	\$ 31,000	\$ 629,572	\$ 1,182,691	\$ 799,230	11
37	39	2022	\$ 25,000	\$ 354,944	\$ 10,000	\$ 259,345	\$ 31,000	\$ 713,417	\$ 1,327,707	\$ 865,825	12
38	40	2023	\$ 25,000	\$ 387,543	\$ 10,000	\$ 290,893	\$ 31,000	\$ 803,971	\$ 1,482,407	\$ 932,873	13
39	41	2024	\$ 25,000	\$ 420,794	\$ 10,000	\$ 324,965	\$ 31,000	\$ 901,769	\$ 1,647,527	\$ 1,000,495	14
40	42	2025	\$ 25,000	\$ 454,710	\$ 10,000	\$ 361,762	\$ 31,000	\$ 1,007,390	\$ 1,823,862	\$ 1,068,813	15
41	43	2026	\$ 25,000	\$ 489,304	\$ 10,000	\$ 401,503	\$ 31,000	\$ 1,121,461	\$ 2,012,268	\$ 1,137,949	16
42	44	2027	\$ 25,000	\$ 524,590	\$ 10,000	\$ 444,423	\$ 31,000	\$ 1,244,658	\$ 2,213,671	\$ 1,208,029	17
43	45	2028	\$ 25,000	\$ 560,582	\$ 10,000	\$ 490,777	\$ 31,000	\$ 1,377,711	\$ 2,429,069	\$ 1,279,180	18
44	46	2029	\$ 25,000	\$ 597,294	\$ 10,000	\$ 540,839	\$ 31,000	\$ 1,521,408	\$ 2,659,540	\$ 1,351,529	19
45	47	2030	\$ 25,000	\$ 634,740	\$ 10,000	\$ 594,906	\$ 31,000	\$ 1,676,600	\$ 2,906,246	\$ 1,425,209	20
46	48	2031	\$ 25,000	\$ 672,934	\$ 10,000	\$ 653,298	\$ 31,000	\$ 1,844,208	\$ 3,170,441	\$ 1,500,352	21
47	49	2032	\$ 25,000	\$ 711,893	\$ 10,000	\$ 716,362	\$ 31,000	\$ 2,025,225	\$ 3,453,480	\$ 1,577,095	22
48	50	2033	\$ 25,000	\$ 751,631	\$ 10,000	\$ 784,471	\$ 31,000	\$ 2,220,723	\$ 3,756,825	\$ 1,655,576	23
49	51	2034	\$ 25,000	\$ 792,164	\$ 10,000	\$ 858,029	\$ 31,000	\$ 2,431,861	\$ 4,082,053	\$ 1,735,938	24
50	52	2035	\$ 25,000	\$ 833,507	\$ 10,000	\$ 937,471	\$ 31,000	\$ 2,659,890	\$ 4,430,868	\$ 1,818,325	25
51	53	2036	\$ 25,000	\$ 875,677	\$ 10,000	\$ 1,023,269	\$ 31,000	\$ 2,906,161	\$ 4,805,107	\$ 1,902,888	26
52	54	2037	\$ 25,000	\$ 918,690	\$ 10,000	\$ 1,115,930	\$ 31,000	\$ 3,172,134	\$ 5,206,755	\$ 1,989,778	27
53	55	2038	\$ 25,000	\$ 962,564	\$ 10,000	\$ 1,216,005	\$ 31,000	\$ 3,459,384	\$ 5,637,953	\$ 2,079,152	28

How to Value a Business - Read Financial Statement

- **Revenue:** also called “sales”. The amount of money a company generated from its sales activities during a certain period.
- **Depreciation:** when a company buys a asset (like a machinery), it can depreciate or expense that asset over the course of many years.
- **Amortization:** when a company buys an intangible asset, it can amortize or expense that asset over time.
- **Net income:** also called earning. A company’s after-tax income as stated on its tax return.

XYZ Company Income Statement

Description	Amount
Revenues	\$10,000.00
Cost of Good Sold	\$5,000.00
Depreciation	\$500.00
Net Income	\$4,500.00

How to Value a Business - Read Financial Statement (cont.)

XYZ Company Balance Sheet

	Before Transaction	After Transaction
Assets		
current assets		
cash & cash equivalents	\$10,000.00	\$0.00
Inventory	\$5,000.00	\$0.00
account receivable	\$0.00	\$10,000.00
total current assets	\$15,000.00	\$10,000.00
plant, property & equipment	\$0.00	\$9,500.00
Total Assets	\$15,000.00	\$19,500.00
Liabilities		
Total Liabilities	\$0.00	\$0.00
Shareholder Equity		
Additional Paid-in Capital	\$15,000.00	\$15,000.00
Retained Earnings	\$0.00	\$4,500.00
Total Shareholder Equity	\$15,000.00	\$19,500.00

How to Value a Business - Read Financial Statement (cont.)

XYZ Company Cash Flow Statement

	After
Cash Flows from Operating Activities	
Net Income	\$4,500.00
Depreciation	\$500.00
Changes in Operating Assets and Liabilities	
(Increase) decrease in accounts Receivable	(\$10,000.00)
Net Cash Provided by (used in) operating activities	\$0.00
Cash flows from investing activities	
Capital Expenditures	(\$10,000.00)
Net Cash Provided by (used in) investing activities	(\$10,000.00)
Change in Cash, Net	(\$10,000.00)

How much does owner really earned?

How to Value a Business – Owner Earnings

Warren Buffett's 1986 Letter to Shareholders

"... If we think through these questions, we can gain some insights about what may be called "owner earnings." These represent (a) reported earnings plus (b) depreciation, depletion, amortization, and certain other non-cash charges such as Company N's items (1) and (4) less (c) the average annual amount of capitalized expenditures for plant and equipment, etc. that the business requires to fully maintain its long-term competitive position and its unit volume. (If the business requires additional working capital to maintain its competitive position and unit volume, the increment also should be included in (c). However, businesses following the LIFO inventory method usually do not require additional working capital if unit volume does not change.)"

*Owner Earnings = Net Income +
Depreciation and Amortization + Non-Cash
Charges - Average Capital Expenditures*

How to Value a Business – Owner Earnings (cont.)

	2010	2009	2008
Operating activities			
Net Income	208,336	198,425	183,698
Depreciation	19,791	16,693	14,648
Amortization	5,710	6,983	12,214
Share-based compensation	7,757	750	—
Excess tax benefits from share-based compensation	(685)	—	—
Deferred income taxes	124	3,860	840
Changes in assets and liabilities net of acquired			
Increase in receivables	(12,246)	(24,112)	(31,365)
Increase in inventory	(3,817)	(26,539)	(22,033)
Increase in accounts payable	7,739	4,562	18,600
Increase (decrease) in accrued liabilities	2,633	(560)	28,170
Increase in long-term receivables	(2,742)	(15,704)	(7,733)
Other changes from operating activities, net	8,838	(3,164)	8,720
Net cash provided by operating activities	241,438	161,194	205,759
Investing activities			
Additions to property and equipment, net of acquisitions	(19,507)	(49,153)	(31,533)
Proceeds from disposals of property and equipment	9,163	—	—
Distribution agreement	—	(100,000)	—
Sale of investments	—	35,062	16,777
Purchase of investments	—	(21,680)	(22,141)
Acquisitions, net of cash	(12,665)	(39,228)	(72,855)
Net cash provided by investing activities	(23,009)	(174,999)	(109,752)
Financing activities			
Payments of long-term debt	(120,017)	(20,031)	(176,269)
Cash payments received on notes receivable from ESOP	1,202	1,101	775
Loan to ESOP	(105,000)	—	—
Common stock issued, net	19,205	20,354	20,223
Excess tax benefits from share-based compensation	658	—	—
Net cash (used in) provided by financing activities	(203,952)	1,424	(155,271)
Effect of exchange rate changes on cash	855	1,460	3,107
Net increase (decrease) in cash and cash equivalents	17,399	(8,157)	(54,611)
Cash and cash equivalents at beginning of period	224,392	232,549	287,160
Cash and cash equivalents at end of period	241,791	224,392	232,549

Patterson
Dental,
Statement
of Cash
Flows, in \$
thousands

How to Value a Business – Owner Earnings (cont.)

Patterson Dental, Owner Earnings and Free Cash Flow, in \$ thousands

	2010	2009	2008
Owner Earnings			
Net Income	\$208,336	\$198,425	\$183,698
Depreciation	\$19,791	\$16,693	\$14,648
Amortization	\$5,710	\$6,983	\$12,214
Changes in assets and liabilities net of acquired			
Increase in receivables	(\$12,246)	(\$24,112)	(\$31,365)
Increase in inventory	(\$3,817)	(\$26,539)	(\$22,033)
Increase in account payable	\$7,739	\$4,562	\$18,600
Increase (decrease) in accrued liabilities	\$2,633	(\$560)	\$28,170
Increase in long-term receivables	(\$2,742)	(\$15,704)	(\$7,733)
Other changes from operating activities, net	\$8,838	(\$3,164)	\$8,720
Additions to property and equipment, net of acquisitions	(\$19,507)	(\$49,153)	(\$31,533)
Owner Earnings	\$214,735	\$107,431	\$173,386
Alternatively			
Additions to property and equipment, net of acquisitions (average)	(\$33,398)	(\$33,398)	(\$33,398)
Owner Earnings	\$200,844	\$123,186	\$171,521
Free Cash Flow			
Net cash provide by operating activities	\$241,438	\$161,194	\$205,759
Average Capital Expenditures	(\$33,398)	(\$33,398)	(\$33,398)
Free Cash Flow	\$208,040	\$127,796	\$172,361

How to Value a Business – Owner Earnings (cont.)

Enron's Owner Earnings from 1997 to 2000, in \$ mil

	1997	1998	1999	2000
Description				
Net Income	\$105.00	\$703.00	\$893.00	\$979.00
Depreciation & Amortization	\$600.00	\$827.00	\$870.00	\$855.00
Non-cash Charges	(\$65.00)	(\$233.00)	(\$1,000.00)	\$1,769.00
Capital Expenditures	(\$2,000.00)	(\$2,000.00)	(\$2,000.00)	(\$2,000.00)
Owner Earnings	(\$1,360.00)	(\$703.00)	(\$1,237.00)	\$1,603.00

Enron's stock price

STUNNING COLLAPSE



Data: Bloomberg Financial Markets

How to Value a Business – Owner Earnings (cont.)

Making sense of “Owner Earnings”

- Net Income
- Depreciation and Amortization
- Non-cash Charges
- Capital Expenditures
- What Owner Earning Tells us
 - It tells us a very simple and unnerving fact about the business which may be poised to grow or may be headed for trouble
 - It tells us if the business can stand on its own two feet, and whether or not it has the funding it needs to grow
- Difference between Owner Earnings and Free Cash Flow
 - FCF usually includes certain items that may otherwise not be included in an owner earnings calculation. E.g. FCF negates the cost of not include “stock based compensation” since it does not require an actual cash outlay. Owner earning excludes this item.
 - They are very close for large companies; might be quite differ for small companies.

How to value intrinsic value of stocks

Warren Buffett said

Intrinsic value is “an important concept that offers the only logical approach to evaluating the relative attractiveness of investments and businesses... It is the discounted value of the cash that can be taken out of a business during its remaining life.”

What is discounted rate – a simple example

How much do I need to invest today in order to earn 20 percent of a one-year, \$1000 bond paying 5% interest, (i.e. I know I can cash out in one year for \$1050)?

$$PV(20\%, 1, 0, -\$1050) = \$875$$

How to value intrinsic value of stocks (cont.)

The Discounted Cash Flow (DCF) Valuation – the Buffett way

Value of stock = PV of FCF (or OE) + PV of terminal price

Year	Growth Rate	Future Cash	Present Value	# of year
2011	9.00%	\$15.40	\$14.13	1
2012	8.55%	\$16.72	\$14.07	2
2013	8.12%	\$18.08	\$13.96	3
2014	7.72%	\$19.47	\$13.79	4
2015	7.33%	\$20.90	\$13.58	5
2016	6.96%	\$22.35	\$13.33	6
2017	6.62%	\$23.83	\$13.04	7
2018	6.29%	\$25.33	\$12.71	8
2019	5.97%	\$26.84	\$12.36	9
2020	5.67%	\$28.37	\$11.98	10
2021	3.00%	\$29.22	\$11.32	11
2022	3.00%	\$30.09	\$10.70	12
2023	3.00%	\$31.00	\$10.11	13
2024	3.00%	\$31.93	\$9.55	14
2025	3.00%	\$32.88	\$9.03	15
2026	3.00%	\$33.87	\$8.53	16
2027	3.00%	\$34.89	\$8.06	17
2028	3.00%	\$35.93	\$7.62	18
2029	3.00%	\$37.01	\$7.20	19
Sum			\$215.08	billion



The net worth of JNJ is \$50.85 bil, therefore the true value of JNJ stocks is $\$215.08 + \$50.85 = \$265.93$ bil.

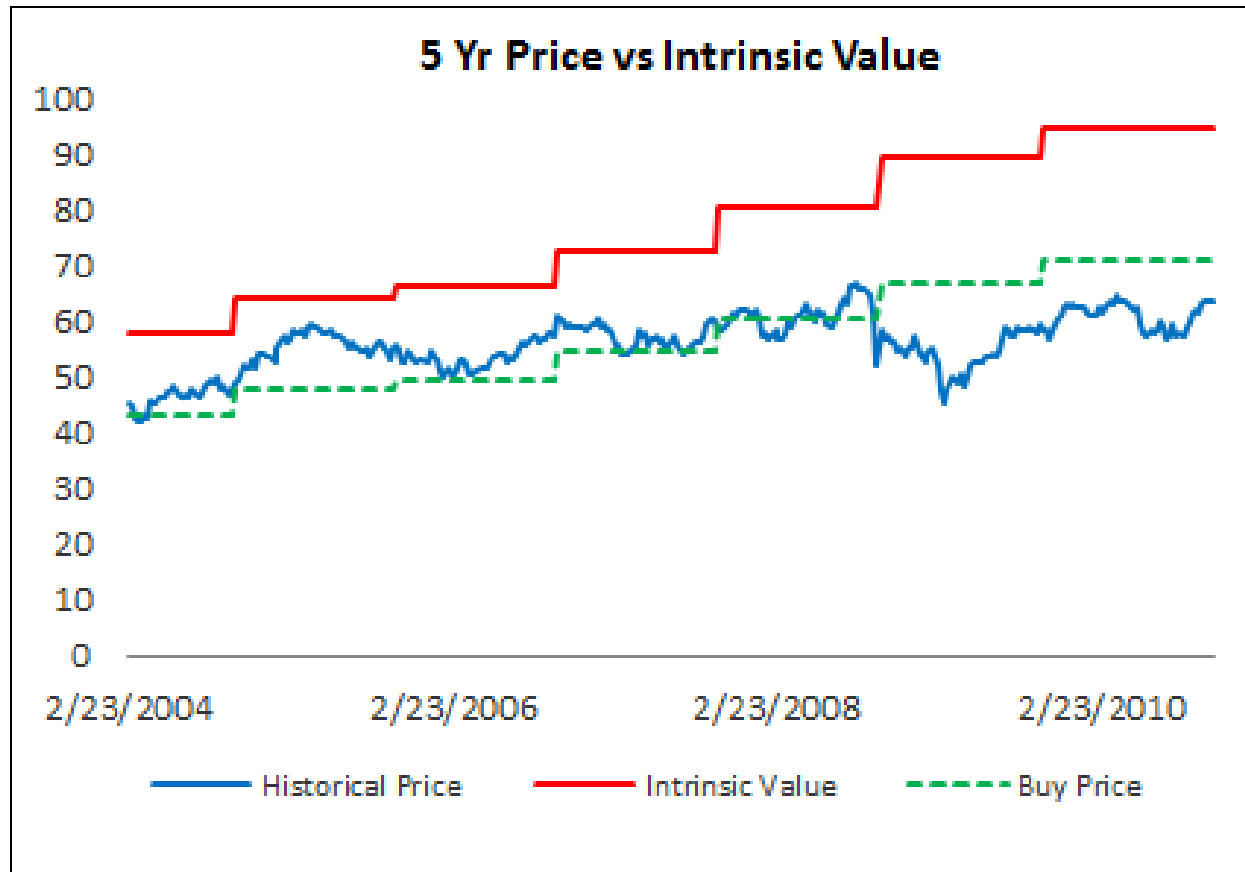
The total outstanding shares of JNJ is 2.75 bil.

The intrinsic value of JNJ is \$96.70.

Compared with the current stock price of JNJ \$63.69. It is underpriced.

How to value intrinsic value of stocks (cont.)

The Discounted Cash Flow (DCF) Valuation – the Buffett way



How to search for investment opportunities

Three categories of value stock

- Undervalue stocks: stock price is less than 1/3 of the intrinsic value
- Net-net stocks:
 - Stock price is less than 66% of the NCAV,
NCAV = Current Assets – Total Liabilities
 - Stock price is less than NNWC,
NNWC = Cash & Equivalents + (Accounts Receivables x 0.75) +
(Inventory x 0.5) – Total Liabilities
- Special condition (“workout”) stocks: - “These are the securities with a timetable. They arise from corporate activity - sell-outs, mergers, reorganizations, spin-offs, etc. In this category we are not talking about rumors or “inside information” pertaining to such developments, but to publicly announced activities of this sort.” – Buffett 1964 letter

How to search for investment opportunities (cont.)

Review of free online screeners:

MSN money

<http://moneycentral.msn.com/investor/finder/customstocks.asp>

Yahoo Finance

<http://screen.finance.yahoo.com/fscr/us/launch.html>

CNBC

<http://www.cnbc.com/id/15839076/site/14081545/>

Google Finance

www.google.com/finance/stockscreeener

Robotdough – the best screener

<https://robotdough.com/>



Almost unlimited screening criteria, which allows you much greater flexibility in querying the stock market

How to search for investment opportunities (cont.)

Hi shucmu [My Account](#) | [Invite Friends](#) | [Logout](#)

Dashboard Screens Watchlist Portfolio **Screeener**

Search Results

x Price > 1 +

x PE Ratio < 10

x Market Cap > 50M

x ROA (Q) > 5%

Key Financials	Market Cap	Cash	ROA (Q)	Piotroski Score	Clear
Valuation Ratios	Enterprise Value	Total Assets	ROA (TTM)	Tax Rate	Submit
Leverage Ratios	Total Revenue (Q)	Total Equity	ROE(Q)	Free Cash Flow (Q)	Save
Efficiency Ratios	Operating Income (Q)	Earnings Yield	ROE (TTM)	Free Cash Flow (TTM)	
Dividends	Operating Income w/ Depreciation (Q)	Dividend Yield	Altman Z-Score		
Per Share Data	Net Income (Loss) (Q)	Earnings/Share	Altman Z-Score (Modified)		
Market Data					
Balance Sheet					
Cash Flow (Q)					
Cash Flow (TTM)					
Income Statement (Q)					
Income Statement (TTM)					

How to search for investment opportunities (cont.)

Other tailored online screeners and free spreadsheet:

Free valuation spreadsheets
(tons and tons of spreadsheets)

<http://pages.stern.nyu.edu/~adamodar/>

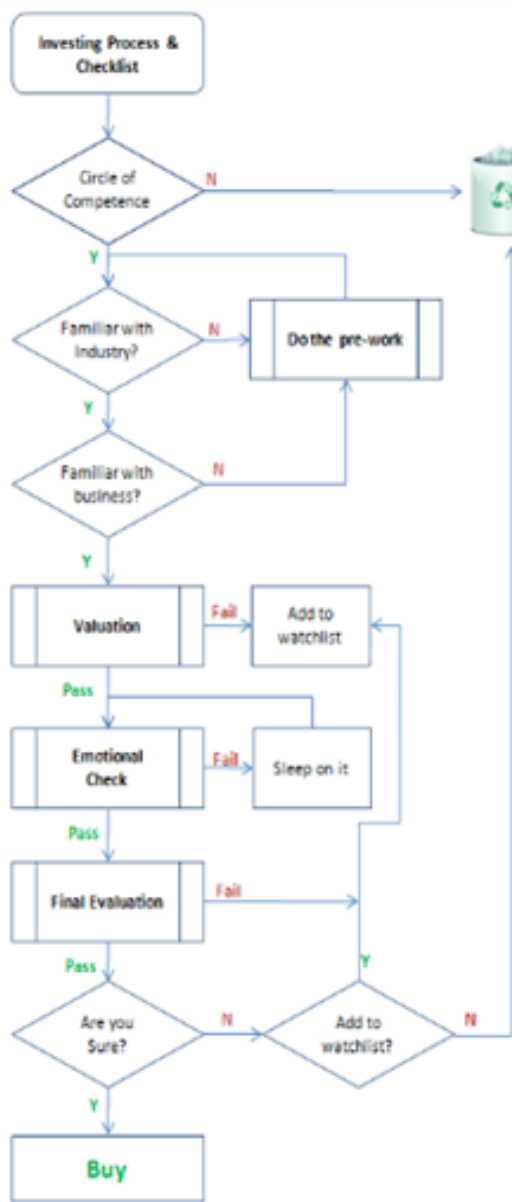
Damodaran from NYU

How to download the online information?
Httrack

www.httrack.com/



How to search for investment opportunities (cont.)



Pre Work
 Preliminary Background Reading

- Read articles on Blogs, Sites, Forums, Alerts to get familiar with idea
- Read news headlines

Valuation
 Financial Statement Analysis

- Analyse line items
 - [Income statement](#) + [competitive advantage](#) analysis
 - [Balance sheet](#) + [competitive advantage](#) analysis
 - [Cash Flow statement](#) + [competitive advantage](#) analysis
 - [Quality of Earnings](#) ([Inventory](#), [tax](#), [EPS](#))
- Competitor comparison
- Verify [15 value investing metrics and ratios](#)
- [Discounted Cash Flow](#) / [Graham's Value](#) / [Earnings Power Value](#) / Multiples / Sum of Parts

Dirty Work

- 2 annual reports
- 3 quarterly reports
 - specific attention to footnotes at the end of the report
 - managers discussion - consistency, candidness
- 2 letter to shareholders
 - compare words, numbers to annual report numbers
- Latest proxy
 - CEO compensation (% of sales)
 - Greed factor (bonuses, reimbursements, planes, boats, family donations)
 - Insider ownership
- Search CEO history, track record, personality

Checklist for undervalue stock selection

Emotional Check

- Write down how you are feeling
- Beware of
 - wanting to just buy and study later
 - hindsight bias
 - overconfidence
 - obligation to buy due to amount of research
 - reluctance to accept differing opinions
 - social proof bias
- If required, take a break and clear your mind. Get away from the excitement and noise.

Final Evaluation

- What can go wrong?
- What are the risks? How likely are the risks?
- How can you lose money?
- How would you categorise this investment?
- How attractive is this idea compared to the other holdings? (There can only be ONE best idea. Not 2 or 3.)
- What is the expected holding time frame?
- What should be the portfolio sizing?
- What price will you sell?

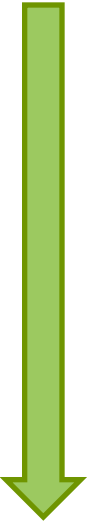
How to search for investment opportunities (cont.)

Checklist for Net-net Stock selection

1. General improvement in the industry
2. Favorable change in the company's operating policies, with or w/o a change in management. These changes include more efficient methods, new products, abandonment of unprofitable lines
3. A sale or merger
4. Complete or partial liquidation
 - 4.1 complete liquidation - liquidating dividends
 - 4.2 partial liquidation - distribute \$xx special dividend or/and \$xx per share to its shareholders
5. Have other attractive statistical features, such as
 - 5.1 satisfactory current earnings and dividends
 - 5.2 high earning power in the past
6. Avoid issues which have been losing cash assets and quick assets at a rapid rate and show no definite signs of ceasing.
7. Exit plan - two years; or 100% return; or a material change in the business that would no longer make its then market price attractive

How to search for investment opportunities (cont.)

Checklist for Special Condition Stock selection

- 
1. Due diligence by both parties
 2. Agree on a price, terms, and contingencies (financing, regulator approval)
 3. Get preliminary shareholder sentiment (or controlling shareholder approval)
 4. Secure financing arrangements (if needed)
 5. Obtain regulator (SEC, FCC, any and all) approval
 6. Get final shareholder approval at a meeting called for that purpose
 7. Complete the deal

Once you have past Step 5, there are a few minute details to be worked out and a little work on our part to analyze the deal.

No-brainer investment opportunities

Stay in your sphere of confidence

When it comes to researching investment opportunities, nothing is more important than your sphere of competence and confidence – the world in which you are comfortable investing. How do you know what companies are in your sphere of confidence? Answer these questions:

- What does the company do?
- How does it do it?
- What is the market like for the company's products or services?
- Who is the company's competition?
- How well guarded is it from a competitor?
- Five and ten years from now, will this company be making more money than it is making today? Why?
- What is the intrinsic value of this company?



No-brainer investment opportunities (cont.)

What are no-brainer investment opportunities?

1. Stick with sphere of confidence and competence;
2. stick with intelligent investing;
3. demand the margin of safety

- For example:

I am selling you \$10000 envelop, deliver to you in three years
The value of the offer = $PV(9\%, 3, 0, -10000) = \7721.83

If you pay me \$7,721.83 today

If you pay me \$4,500.00 today

No-brainer investment opportunities (cont.)

How to look for no-brainer investment opportunities?

- Look for Strong business – Moat
 - A strong business is one that can generate excess cash and then can easily do so in the future. This business does not have to be big to be strong; a big business is not always strong.
 - e.g Coca-cola, Walmart
- Look for growing business- CROIC \geq 10%
 - CROIC – the cash return on invested capital
- Demand a margin of safety

The key to making money in the stock market is not in finding the most rapidly growing companies; rather, it is in finding the strong companies that are growing (at virtually all rates) and buying them with a significant discount to the business's intrinsic value.

Q & A



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