

*Columbia University*  
*Graduate School of Business*  
*B7313*  
*Security Analysis*  
Syllabus  
September 10, 2004

Fall 2004, EMBA – Elective C  
Professor Paul Johnson  
Office Hours: By appointment and by telephone.

209 Warren Hall  
pauljohnsonyc@yahoo.com  
Office Phone: (212) 293-3402

### **Introduction**

The purpose of this course is to provide students with a real world view of the role and activities of an equity security analyst. In the course, we will build a construct of how capital markets function, teach the tools as well as the “thought process” involved with security analysis, and, expose the students to the mental limitations we all bring to the activity. The course will focus on three aspects of securities analysis: (1) understanding the process of analyzing companies; (2) understanding the valuation process; and (3) understanding the challenges of achieving success in a highly competitive capital market.

There is no formal structure to security analysis and the subject cannot be taught through books and readings alone. Although certain books and articles do provide analytical tools, security analysis must be learned through practice. Consequently, the course is split into two sections. The first eight lectures will focus on the various tools of the security analyst to help in the investment process. In the last two lectures, students will practice what they have learned by presenting an original company analysis and stock recommendation to the class. We will wrap-up the course during the final examination period, although the course does not have a final exam.

The course prerequisites are courses in Accounting and Finance. In addition, Advanced Financial Accounting is recommended.

## Grades

Grades in the course will be based on:

- (1) Basic reports of company analysis, due at the last class (group project). (30% of grade)
- (2) Presentation of company analysis. Each group member will participate in the presentation (group project). (30% of grade)
- (3) Three one-page essays assigned during the course, handed in and discussed in class (individual). (30% of grade)
- (4) Class participation (individual). (10% of grade)

### Breakout:

Group projects:	60% of grade
Individual activities:	40% of grade

### Group Projects:

Students will work in groups to analyze a company; both for an in-class presentation and a final basic report. Each group will analyze a different company (selected from a list of potential companies) as to its investment merit. Students will present (as a group) a recommendation on the company's stock in class and write up their analysis in a report due at the end of the course.

**Basic Reports:** In the basic report, the groups will analyze the company, its financial prospects and present a recommendation on the company's stock. The basic report is a written version of the in-class presentation.

**Presentation of Basic Report:** Groups will present their stock recommendations and company analysis to the rest of the class. Groups will present either a BUY recommendation or a SELL recommendation and are expected to try to convince the rest of the class to follow the recommendation. The class presentations will be graded partially by how well you persuade the class to follow your recommendation and how well you know the key issues to the recommendation.

We will discuss both of these assignments in more detail in class and there will be a separate handout explaining the requirements.

### Individual Activities:

Although 60% of each student's grade will be derived from the group projects, individual activities have an important impact on final grades.

**Essays:** Each student will hand-in three single-page essays to questions assigned during the course. Although students are welcomed to discuss these topics with fellow students, each student will be required to submit their own response to the question.

In light of the fact that we are in the midst of the information revolution, all assignments need to conform to the following: laser or ink jet printer, on 8 ½ x 11 white paper, 1” inch margins (all four sides), with 10-12 point font (Arial or Times Roman are preferred), and doubled spaced.

**Class Participation:** Students will be graded on how well they contribute to the class discussions; points will be given for quality over quantity. The first section of the course is primarily lecture based and there will be plenty of time for class participation. Class participation in the second part of the course will be limited to the Q&A periods of the presentations. Students are encouraged to challenge, disagree and pose alternative views; but obnoxious behavior will not be tolerated.

Additional individual and group projects will be assigned during the course.

**A general comment:** Security analysis is a very competitive business (a little like business school). Therefore, bonus points are given for creative thinking and insightful analysis. Just applying bulk effort is not the best solution to doing well in this class.

## **Course Material**

**Readings:** There following four books are required for the course:

Robert Hagstrom, Investing: The Last Liberal Art, Texere LLC, New York, NY, 2000  
Janet Lowe, Damn Right! Charlie Munger, John Wiley & Sons, New York, NY, 2000  
Alfred Rappaport and Michael Mauboussin, Expectations Investing, Harvard Business School Press, Boston, MA, 2001  
Bruce Greenwald et al, Value Investing, John Wiley & Sons, New York, NY, 2001

Additional readings will also be handed out weekly or posted on the Internet.

**Internet:** In addition to BOLD, the following two sites will be used for class material:

[www.CapAtColumbia.com](http://www.CapAtColumbia.com) – my website for class.

[www.ExpectationsInvesting.com](http://www.ExpectationsInvesting.com) – in conjunction with Michael Mauboussin’s book.

**Case Book:** I will hand out additional articles during the course. Unfortunately there has been a tremendous amount written about the stock market and some of it actually is good! I have tried to put together a list of articles that will help you in the class and, more importantly, help you in the real world. I will attempt to select the best articles from my collection and point them out in class. Think of the articles as the gift that keeps on giving!

**Newspapers:** The stock market is the life blood of a capitalist economy. Therefore, the market gets a tremendous amount of press coverage. The Wall Street Journal and Investors' Business Daily are the best day-to-day sources of information on the stock market and Barrons does an excellent weekly summary; although all of the popular business press cover the market as well. We will discuss in class major developments related to the stock market and to specific companies assigned to groups in this class. Please read the financial press and be prepared to discuss these articles.

**For the Seriously Ambitious:** There are a tremendous number of books on the stock market, many of them are actually informative and provide important insights into security analysis. Picking a reading list is difficult, but the following 13 books are the most interesting as far as I am concerned. Although they are not required reading, I recommend them highly.

Suggested Texts:

Nassim Nicholas Taleb, Foiled by Randomness, Texere, New York, NY, 2001  
Michael Lewis, Moneyball, W.W. Norton & Co., Inc., New York, NY, 2003  
Ben Mezrich, Bringing Down the House, Free Press, New York, NY, 2002  
Benjamin Graham, The Intelligent Investor, 4<sup>th</sup> edition., Harper & Row, New York, 1973  
Roger Lowenstein, Buffett: The Making of an American Capitalist, Random House, New York, 1995  
James Surowiecki, The Wisdom of Crowds, Doubleday, New York, NY, 2004  
Peter Bernstein, Capital Ideas, Free Press, New York, NY, 1992  
Burton Malkiel, A Random Walk Down Wall Street, Eighth Edition, W.W. Norton & Co., Inc., New York, NY, 2004  
Tom Copeland, et al, Valuation, Third Edition, John Wiley & Sons, New York, NY, 2000  
Phil Fisher, Common Stocks and Uncommon Values, John Wiley & Sons, New York, NY, 1996  
Robert Cialdini, Influence, Perennial Currents, New York, NY, 1998  
Georges Charpak, debunked!, Johns Hopkins University Press, Baltimore, MD, 2004  
Geoff Moore, Paul Johnson and Tom Kippola, The Gorilla Game, Picking Winners in High Technology, HarperBusiness, New York, NY, 1999

### **Final Exam Class:**

There will not be a final exam in this class. However, we will attempt to meet on the final exam time to recap the course, review the "Realities of Wall Street" or "How to Get a Job There," and hand out class awards. The last day is usually the best (and most fun), so please try to attend. The written report is due on the final exam day.

## Class Schedule

### 1. September 10 - Introduction and Overview

Syllabus and Grades  
Class Expectations and Goals

Overconfident and wrong  
Luck vs skill  
Predictions and the value of forecasting

History of class

### 2. September 11 - Capital Market Theory

Fooled by randomness

Making a market: GM/IBM  
Market Efficiency

Complex Adaptive Systems (CAS)  
Wisdom of the Crowd  
Academy Awards

Introduction to mechanics

Selection of groups

**Homework:** mechanics 1  
Stock performance  
Essay: Is the market short-term oriented?

### 3. September 24 - Expectations Theory

Why Buy Stocks?  
Importance of expectations  
Is the market short-term oriented?  
Bid for Cisco

**Homework:** mechanics 2

### 4. October 8 - Competitive Advantage

Definition of a good business  
Greenwaldian analysis  
Franchise value and sustainability

Value creation  
Growth  
Self-financing growth

**Homework:** mechanics 3  
Essay: Valuing the Met

5. October 22 - Forecasting/Scenario Planning/Management

Forecasting exercise  
Scenario planning and robustness  
Management  
    Incentives  
    Governance  
    Capital allocation

Selection of companies for final report

**Homework:** mechanics 4  
Valuation assignment

6. November 5 - Introduction to Valuation

Theory of valuation  
Liquidation/Replacement  
Introduction to risk

Guest Lecture – Artie Williams, Summit Street Capital  
EMBA, CBS 2002

**Homework:** mechanics 5  
Essay: Value vs Growth?

7. November 6 – Valuation II

Value vs growth

Earnings Power  
Valuing an asset - DCF  
Value drivers  
Value of franchise  
Value of growth  
Quantification of expectations

8. November 20 – The Tools

Forensic analysis  
Shenanigans/Cash flow shenanigans  
Introduction to short-selling  
Research techniques

Rational Decision Making – controlling your emotions  
Technical Analysis  
Presentation skills

Case Study (similar to the student reports)  
Handout in class

Final wrap-up  
Questions  
Open discussion

9. December 3 – Student Presentations

10. December 11 – Student Presentations

11. December (Final Exam Period) - Optional

Final recap of the course (What you can take to the real world)  
Survival on Wall Street - How to find a job  
Award Ceremony  
Final party

**Basic Reports Due**