

# Value Investing Seminar #3

## Accounting for Value Investing

November 16<sup>th</sup>, 2023

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Judson Lindley

*President*

Matthew Gaines

*Vice President of Portfolio Management*



CULVERHOUSE  
INVESTMENT MANAGEMENT GROUP

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# Introductions

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# Introductions

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## Judson Lindley, President

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J.P.Morgan



**Year:** Senior

**Hometown:** Maryville, Tennessee

**Major:** Finance

**Semesters in CIMG:** 7

**Full-Time:** Equity Research Analyst – *J.P. Morgan Chase*

**Internship Experience:**

2023 – Summer Equity Research Analyst – *J.P. Morgan Chase*

2022 – Summer Equity Research Analyst – *Barclays*

# Introductions

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## Matthew Gaines, VP of Portfolio Management

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**Year:** Senior

**Hometown:** Milton, GA

**Majors:** Accounting, Economics

**Semesters in CIMG:** 7

**Full Time:** Academy Associate – Point72 Asset Management

**Internship Experience:**

2023 – Academy Summer Analyst – *Point72 Asset Management*

2022 – Research Intern – *Saguaro Capital Management*

# Value Investing Seminars

## Schedule of VIS

Date	Topic
Nov. 1 <sup>st</sup>	Intro to Value Investing- <i>Overview, Value Investing Opportunities, Strategy, Sources of Value Ideas</i>
Nov. 8 <sup>th</sup>	Intro to Investment Research
Nov. 16 <sup>th</sup>	Accounting- <i>Financial statements, cash vs. accrual, profit, margins, growth</i>
Nov. 30 <sup>th</sup>	Intro to Valuation- <i>Relative &amp; Intrinsic Valuation</i>

## Overview

- Designed to provide a comprehensive overview on:
  - Value Investing strategy
  - Opportunities at UA
  - Research
  - Company & Industry analysis
  - Financial statement analysis
  - Practical valuation concepts

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## **Value Investing Opportunities at UA**

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# Culverhouse Investment Management Group Overview

## *The University of Alabama's Premier Student Managed Investment Fund*



CULVERHOUSE  
INVESTMENT MANAGEMENT GROUP

**64 Members**

**8 Sector-Focused  
Committees**

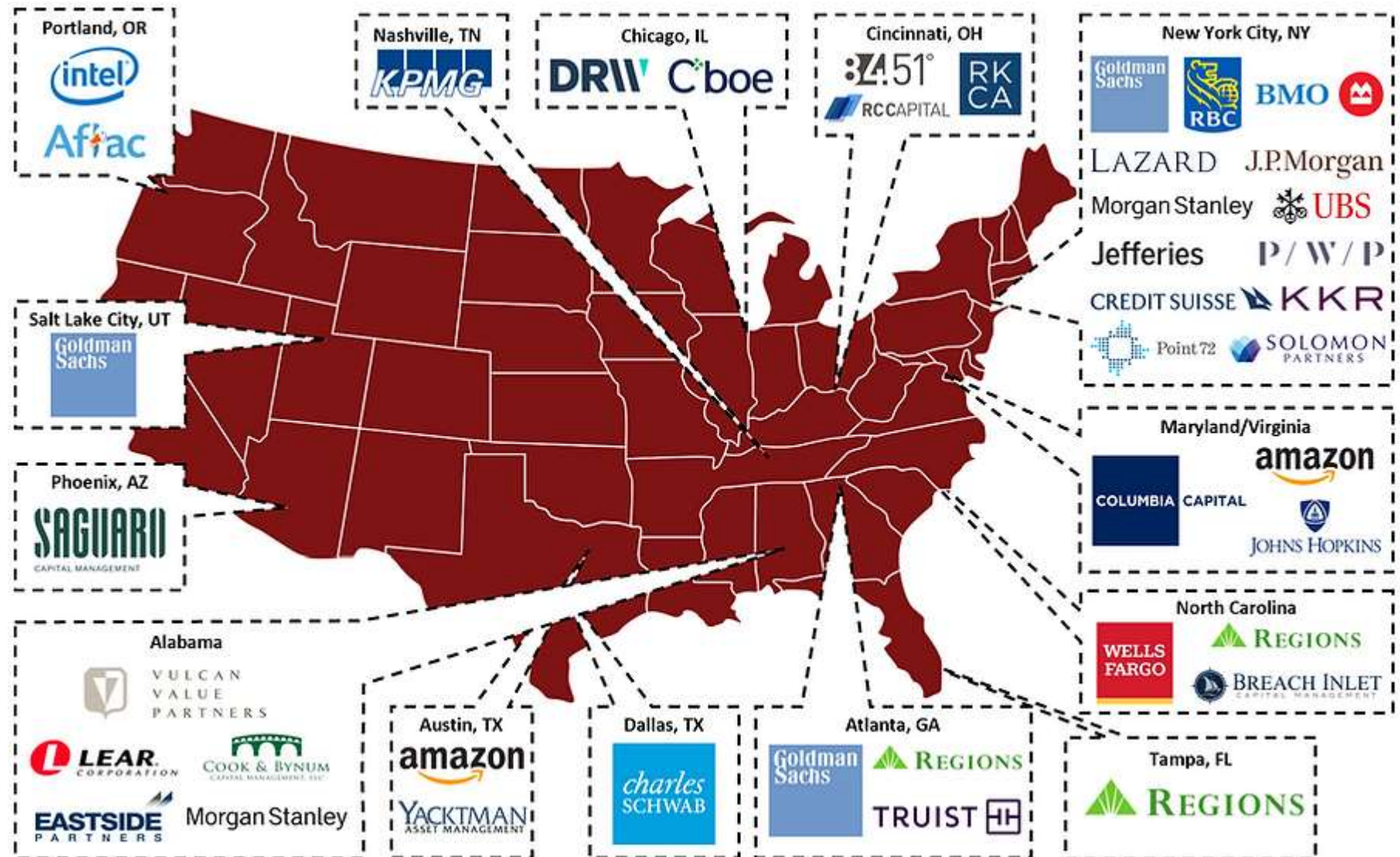
**236 Fall 2023  
Applicants**

**10 Fall 2023 CIMG  
New Members**

- **Student-run investment fund managed by students at The University of Alabama**
  - ▶ Initial capital of \$315,000 was donated by Culverhouse alumni in 2009
- **Uses a value-based, equity-only investing philosophy to actively manage a \$1,800,000 portfolio**
  - ▶ Concentrated portfolio with twenty names across a variety of industries
  - ▶ New members undergo an 8-week intensive course that enables them to be an effective equity research analyst
- **Members have access to the Vulcan Value Partners Research Library and Trading Room**
  - ▶ A collaboration room in Bidgood Hall was created in 2016 after a donation from C.T. and Kelly Fitzpatrick
  - ▶ An additional donation from the Fitzpatricks in 2020 added \$500,000 to the portfolio and created the Fitzpatrick Center for Value Investing
- **Students receive guidance and mentorship from professional investors**
  - ▶ Twice a year, an Advisory Board comprised of 14 investors visits Tuscaloosa to hear updates from the group and provides feedback on pitches
  - ▶ John Heins and Mark Meulenberg, the Director and Associate Director of the Fitzpatrick Center for Value Investing, serve as advisors for the Culverhouse Investment Management Group



# 2022-2023 Internship and Full-Time Placement



# Culverhouse Investment Management Group Structure

## *The University of Alabama's Premier Student Managed Investment Fund*

The group prepares students for careers in a variety of competitive fields both in and out of the finance industry by giving them the experience of managing a professional fund.

### Research Process and Committee Breakdown

Aerospace,  
Defense, and  
Transportation

Consumer  
Discretionary

Consumer  
Staples

Financials

Healthcare

Industrials  
and Energy

Technology

Telecom,  
Media, and  
Entertainment

#### Committee Research Process

A committee agrees on an investment idea they wish to pursue

They then develop an investment thesis and model for the idea

#### Weekly General CIMG Meeting

Committee members present their recommendation to the group at a general meeting and answer questions about their idea

#### Continual Research Process

Committees are responsible for monitoring and updating their positions quarterly and to determine if new news would change an investment thesis

### Portfolio Holdings

amazon

Charter  
COMMUNICATIONS

CHENIERE

Constellation  
Brands

Disney

DOLLAR TREE

FEMSA

fiserv.

F1

HANES  
Brands Inc

JANUS  
INTERNATIONAL GROUP

MAXAR

MaxCyte

NAVIENT

NIKE

tapestry

TJ-maxx

United  
Healthcare

VERTEX

# John Heins – Director Fitzpatrick Center for Value Investing



## **Education:**

B.S., University of Pennsylvania, M.B.A., Stanford University

## **Current Roles:**

President & Editor-in-Chief, Value Investor Media, Inc.

## **Previous Roles:**

President & CEO, Gruner + Jahr USA Publishing

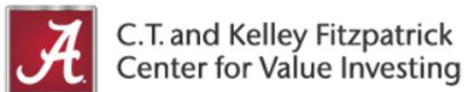
Senior Vice President, Personal Finance, AOL

Reporter, Forbes Magazine



C.T. and Kelley Fitzpatrick  
Center for Value Investing

# Mark Meulenberg – Associate Director Fitzpatrick Center for Value Investing



## **Education:**

B.S., Cornell University, Chartered Financial Analyst

## **Current Roles:**

Chief Investment Officer & Managing Partner of Masonry Capital  
Management

## **Previous Roles:**

Chief Investment Officer, VNB Wealth Management

Brown Brothers Harriman & Co., Portfolio Manager

U.S. Trust Company, Portfolio Manager

Sanford Bernstein & Co. Inc., Associate Portfolio Manager

# Value Investing Opportunities at UA

## *Value Investing Minor*

The Value Investing minor provides students with a strong foundation for examining the critical aspects of investing decisions, including generating good ideas, conducting fundamental business and industry research, analyzing financial statements, and credibly estimating what businesses and companies are worth. The focus is on practical applications. Students will be prepared for a broad range of business careers, including investment management, investment banking, private equity, management consulting, corporate business development, corporate finance and entrepreneurship. The Value Investing minor is restricted to Finance majors only.

Value Investing Minor		Hours
FI 317	Introduction to Value Investing	3
FI 422	Value Investing: Principles and Practices	3
FI 423	Advanced Value Investing	3
AND...	Two Approved Electives	6
Total Hours		15



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# Introduction to Accounting

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# What is Accounting?

***Accounting is the language of business.***

- **Accounting is a standard set of rules for measuring a firm's financial performance. Assessing a company's financial performance is important for many groups, including:**
  1. The firm's officers (managers and employees)
  2. Investors (current and potential shareholders)
  3. Lenders (banks)
  4. General public
- **Standard financial statements serve as a “yardstick” of communicating financial performance to the general public.**

For example, quarterly financial statements released by Apple provide both its managers and the general public with an opportunity to assess the company's financial performance.

Why does this matter? Investors, managers, and bankers need to make informed decisions about the health of the firm, growth prospects, and how to allocate capital.

# Income Statement

***The income statement lists a company's revenue, expenses, and taxes, with its after-tax profit at the very bottom, over a period of time.***

- To appear on the income statement, each item must meet the following criteria:
  1. *Must correspond to the period shown on the income statement*
  2. *Must affect the company's taxes. For example, interest paid on debt is tax-deductible, so it appears on the income statement, but repaying debt principal is not tax-deductible, so it does not appear on the income statement*

## 4 Main Sections of the Income Statement

### Revenue and Cost of Good Sold

- Revenue is the value of the products/services that a company sells in the period
- COGS represents the expenses that are directly linked to the sale of those products and services

### Other Income and Expenses

- Goes between operating income and pre-tax income. Interest shows up here
- Other examples include write-downs and anything else that is not part of the company's core business operations

### Operating Expenses

- Items that are not directly linked to product sales
- Includes employee salaries, rent, marketing R&D, rent, market, depreciation, and amortization

### Taxes and Net Income

- Net income represents the company's "bottom line"



# Income Statement Example

## Apple's 2023 Income Statement

	Years ended		
	September 30, 2023	September 24, 2022	September 25, 2021
Net sales:			
Products	\$ 298,085	\$ 316,199	\$ 297,392
Services	85,200	78,129	68,425
Total net sales	383,285	394,328	365,817
Cost of sales:			
Products	189,282	201,471	192,266
Services	24,855	22,075	20,715
Total cost of sales	214,137	223,546	212,981
Gross margin	169,148	170,782	152,836
Operating expenses:			
Research and development	29,915	26,251	21,914
Selling, general and administrative	24,932	25,094	21,973
Total operating expenses	54,847	51,345	43,887
Operating income	114,301	119,437	108,949
Other income/(expense), net	(565)	(334)	258
Income before provision for income taxes	113,736	119,103	109,207
Provision for income taxes	16,741	19,300	14,527
Net income	\$ 96,995	\$ 99,803	\$ 94,680
Earnings per share:			
Basic	\$ 6.16	\$ 6.15	\$ 5.67
Diluted	\$ 6.13	\$ 6.11	\$ 5.61
Shares used in computing earnings per share:			
Basic	15,744,231	16,215,963	16,701,272
Diluted	15,812,547	16,325,819	16,864,919

# Key Income Statement and Operating Ratios

## 1 **Y/Y Revenue Growth (%) = $Y2 \text{ Sales} / Y1 \text{ Sales} - 1 = X\% \text{ Growth}$**

- Tells us how fast a company's sales are growing over time, the success of new product launches, where your company is at in a potential industry or product cycle, etc.

## 2 **Gross Margin (%) = $(\text{Revenue} - \text{COGS}) / \text{Revenue}$**

- Measures a company's margin after accounting for the cost to produce/procure its goods/services. GP primarily deducts "variable" costs (i.e. For every additional product I sell you, I must spend x dollars to produce/procure it)

## 3 **Operating Margin (%) = $(\text{Gross Profit} - \text{Operating Expenses}) / \text{Revenue}$**

- Operating margin measures a company's margin from its core business operations after deducting fixed costs such as employee salary, marketing expenses, and research and development. Measures the health of a business removing extraneous factors like one-time charges, interest, or changes in taxation

## 4 **EBITDA Margin (%) = $(\text{EBIT} + \text{D\&A}) / \text{Revenue}$**

- EBITDA and EBITDA Margin adds the "non-cash" expenses of depreciation and amortization back to EBIT. It is a proxy for cash flow. EBITDA is generally the most widely used metric for comparing and valuing companies. A drawback of EBITDA is it masks the cost of a company's assets, which show up in operating expenses through D&A

## 5 **Net Income Margin (%) = $\text{Net Income} / \text{Revenue}$**

- Net Income or Net Income Margin measures a company's total income after deducting interest and taxes from Operating Income. Flows to the top of the Cash Flow Statement and into retained earnings on the Balance Sheet

# Balance Sheet

*The balance sheet shows the company's sources – its assets – and how it acquired those resources – its liabilities and equity – at a specific point in time.*



Assets are the resources the company owns & has access to, with the “right” side of the balance sheet representing how it funded the procurement of the assets

# Balance Sheet Example

## Apple's 2023 Balance Sheet

1

	September 30, 2023	September 24, 2022
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents	\$ 29,965	\$ 23,646
Marketable securities	31,590	24,658
Accounts receivable, net	29,508	28,184
Vendor non-trade receivables	31,477	32,748
Inventories	6,331	4,946
Other current assets	14,695	21,223
Total current assets	143,566	135,405
Non-current assets:		
Marketable securities	100,544	120,805
Property, plant and equipment, net	43,715	42,117
Other non-current assets	64,758	54,428
Total non-current assets	209,017	217,350
Total assets	\$ 352,583	\$ 352,755

2

<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Current liabilities:		
Accounts payable	\$ 62,611	\$ 64,115
Other current liabilities	58,829	60,845
Deferred revenue	8,061	7,912
Commercial paper	5,985	9,982
Term debt	9,822	11,128
Total current liabilities	145,308	153,982
Non-current liabilities:		
Term debt	95,281	98,959
Other non-current liabilities	49,848	49,142
Total non-current liabilities	145,129	148,101
Total liabilities	290,437	302,083

3

Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, \$0.00001 par value: 50,400,000 shares authorized; 15,550,061 and 15,943,425 shares issued and outstanding, respectively	73,812	64,849
Accumulated deficit	(214)	(3,068)
Accumulated other comprehensive loss	(11,452)	(11,109)
Total shareholders' equity	62,146	50,672
Total liabilities and shareholders' equity	\$ 352,583	\$ 352,755

# Key Balance Sheet, Leverage, and Liquidity Ratios

## 1 **Current Ratio** = Current Assets/Current Liabilities

- Measures how likely a company is to be able to pay off short term liabilities with existing assets. Is a primary measure of a firm's liquidity. Generally, a current ratio above 1 is safe.

## 2 **Debt/Equity** = Total Liabilities/Shareholders Equity

- Measures the degree to which a company's assets are financed by debt (liabilities) or equity. A lower ratio is generally desirable, but can be indicative of an inefficient capital structure.

## 3 **Net Debt/EBITDA** = (ST Debt + LT Debt – Cash)/Last Year EBITDA

- Measures how “levered” a company is against the “cash flow” (EBITDA) they produce from business operations and shows the number of years it would take to pay back debt. Sustainable leverage depends on the industry and should be viewed in the context of a company's peers.

## 4 **Interest Coverage** = EBIT/Interest

- Divides a company's operating income by interest paid in the period to determine how easily a company can pay interest on outstanding debt. Measures the risk of a company's current debt load.

# Cash Flow Statement

***This is used to adjust non-cash revenue or expenses on the income statement. The cash flow statement shows how a company's cash balance actually changes.***

- ***Since the income statement requires significant management judgement, it is often misleading about a company's liquidity and can be prone to manipulation.***
- ***A company may show high profitability but is running out of cash because significant revenues recognized were noncash.***
- ***A company may show low or negative profitability but is generating a ton of cash during the period because the major expenses was non-cash depreciation & amortization.***

## Cash From Operations

- ***How much cash did the company generate from operations during the period?***
- ***Uses net income as a starting point and converts accrual-based net income into cash flow from operations via a series of adjustments***

## Cash From Investing

- ***Deals primarily with capital expenditures***
- ***Also shows asset sales and purchases***

## Cash From Financing

- ***Where the majority of line items related to capital allocation shows up.***
- ***Net borrowing, pay-down of debt, new issuance of stock, and share repurchases.***
- ***Also has issuance of dividends.***

# Cash Flow Statement Example

## Apple's 2023 Cash Flow Statement

1

	Years ended		
	September 30, 2023	September 24, 2022	September 25, 2021
Cash, cash equivalents and restricted cash, beginning balances	\$ 24,977	\$ 35,929	\$ 39,789
Operating activities:			
Net income	96,995	99,803	94,680
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation and amortization	11,519	11,104	11,284
Share-based compensation expense	10,833	9,038	7,906
Other	(2,227)	1,006	(4,921)
Changes in operating assets and liabilities:			
Accounts receivable, net	(1,688)	(1,823)	(10,125)
Vendor non-trade receivables	1,271	(7,520)	(3,903)
Inventories	(1,618)	1,484	(2,642)
Other current and non-current assets	(5,684)	(6,499)	(8,042)
Accounts payable	(1,889)	9,448	12,326
Other current and non-current liabilities	3,031	6,110	7,475
Cash generated by operating activities	110,543	122,151	104,038

2

Investing activities:			
Purchases of marketable securities	(29,513)	(76,923)	(109,558)
Proceeds from maturities of marketable securities	39,686	29,917	59,023
Proceeds from sales of marketable securities	5,828	37,446	47,460
Payments for acquisition of property, plant and equipment	(10,959)	(10,708)	(11,085)
Other	(1,337)	(2,086)	(385)
Cash generated by/(used in) investing activities	3,705	(22,354)	(14,545)

3

Financing activities:			
Payments for taxes related to net share settlement of equity awards	(5,431)	(6,223)	(6,556)
Payments for dividends and dividend equivalents	(15,025)	(14,841)	(14,467)
Repurchases of common stock	(77,550)	(89,402)	(85,971)
Proceeds from issuance of term debt, net	5,228	5,465	20,393
Repayments of term debt	(11,151)	(9,543)	(8,750)
Proceeds from/(Repayments of) commercial paper, net	(3,978)	3,955	1,022
Other	(581)	(160)	976
Cash used in financing activities	(108,488)	(110,749)	(93,353)

4

Increase/(Decrease) in cash, cash equivalents and restricted cash	5,760	(10,952)	(3,860)
Cash, cash equivalents and restricted cash, ending balances	\$ 30,737	\$ 24,977	\$ 35,929

# Key Cash Flow Statement Items

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## 1 Cash Flow From Operations

- Cash flows and outflows that directly relate to the company's main business activities. Companies should generate sufficient cash from operations to grow, and if not, will need to finance growth.

## 2 Capital Expenditures

- Money spent by a company to acquire, upgrade, or maintain long-term physical assets such as plants, property, buildings, technology, or equipment. Can indicate how much a company reinvests in the growth of its business vs. its peers or the general "capital intensity" of an industry

## 3 Cash Flow From Investing

- Measures the use or source of cash from investing activities such as the purchase of physical assets, investments in securities, or the sale of securities or assets.

## 4 Cash Flow From Financing

- Measures the flow of cash used to fund the company. Can involve debt, equity, and dividends. Common line items include raising and paying down debt, paying dividends, and repurchasing shares.



# Putting it All Together

*Follow Cash First – Double Entry Accounting Importance – How did you pay for something*

Income Statement		
	2018	2019
in €m	Act	Act
Revenue	100	110
Costs of Goods Sold	(60)	(65)
Gross Profit	40	45
Operating Expenses	(23)	(20)
EBITDA	17	25
D&A	(2)	(2)
EBIT	15	23
Financial Result	(5)	(6)
Tax	(3)	(5)
Net Income	7	12

Balance Sheet		
	2018	2019
in €m	Act	Act
Cash	10	13
Accounts Receivables	15	19
Inventory	15	19
PP&E	20	19
<b>Total Assets</b>	<b>60</b>	<b>70</b>
Accounts Payable	10	12
Debt	20	16
<b>Total Liabilities</b>	<b>30</b>	<b>28</b>
Share Capital	23	23
Retained Earnings	7	19
<b>Shareholders' Equity</b>	<b>30</b>	<b>42</b>
<b>Total Liabilities &amp; Equity</b>	<b>60</b>	<b>70</b>

Cash Flow Statement		
	2018	2019
in €m	Act	Act
Net Income		12
D&A		2
Δ Accounts Receivables		(4)
Δ Inventory		(4)
Δ Accounts Payable		2
<b>Operating Cash Flow</b>		<b>8</b>
Investments in PP&E		(1)
<b>Investing Cash Flow</b>		<b>(1)</b>
Debt Repayment		(4)
<b>Financing Cash Flow</b>		<b>(4)</b>
<b>Total Change of Cash</b>		<b>3</b>

# Value Investing Seminars

## Culverhouse Investment Management Group

### Schedule of VIS

Date	Topic
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### Contact Information



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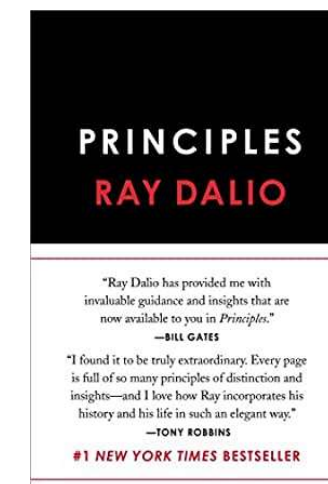
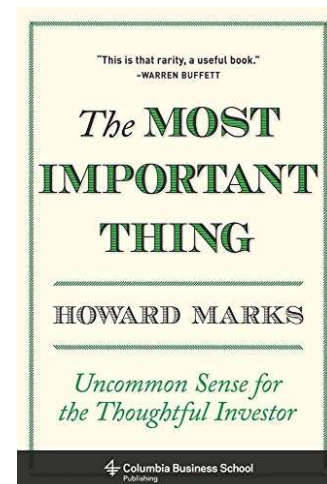
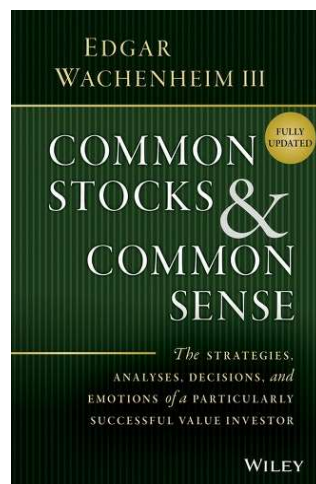
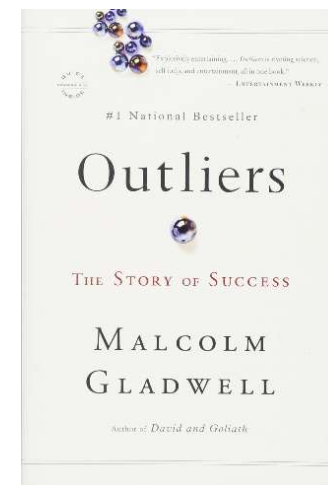
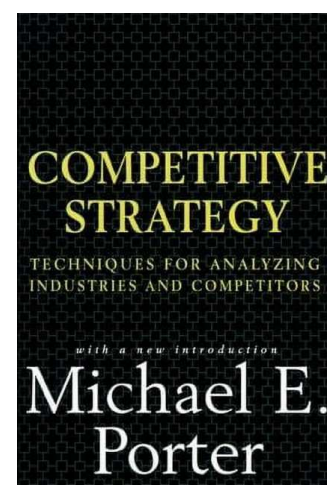
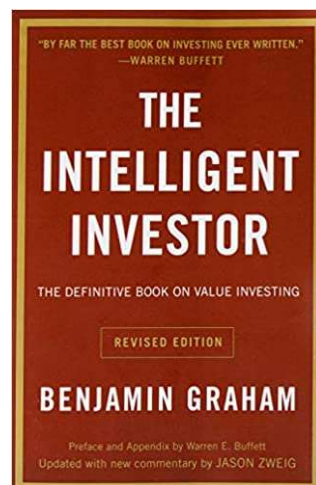
**Matthew Gaines**

*VP of Portfolio Management*

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# Areas for Further Research / Book Recs

- [Warren Buffett Archive](#)
- [Howard Marks Letters](#)
- [Vulcan Value Partners Letters](#)
- [Horizon Kinetics letters](#)
- [Nomad Letters](#)
- [Wall Street Journal](#)
- [Investopedia](#)
- [Stratechery](#)



# Thanks for Coming!

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