Martin Shkreli Finance Lessons: Notes & Takeaways

Lesson 1

Source

- Most people (99%) become successful by managing Other People's Money
    - e.g. pension funds, banks, hedge funds (Sculptor Capital fka. Och-Ziff Capital, Citadel), Carlyle, Fortress, Berkshire (only half owned by Buffett)
- Tiny percentage (1%) of people become successful by managing their own money (Family Office)
    - e.g. George Soros, Carl Icahn, Michael Bloomberg, Michael Dell, Steve Cohen, Bill Gates (Cascade Investment LLC), Joe Lewis (currency trader)
- **Better route is to gain some skill that someone will pay you a lot for.**
    - Someone should be willing to pay you for your advice if you are actually "good" at this.
    - Fee income may be better than income based on own capital (higher risk)…
- If you can make 20% per annum with Other People's Money, generally that is sus.
    - Buffett's LT return p.a. is only 15%
- Better to listen/take advice from "Legends" who have made $100M to $1B vs. people who have made $1M on accident.
    - Rather wait for the right mentor since its hard to shake bad habits.
- Myth: Unable to access really rich people
    - **Build your network:** You can't access Buffett, but you **can** know friend of Buffett, or friend of friends
    - Examples: Einstein in-person meeting with famous physicist, Palmer (founder of Oculus) – be brilliant at one thing)
- Will not be successful if you only focus on 1 asset class

Teach Yourself by Learning from the Best

- **Top Priority:** Read everything by Warren Buffett & Charlie Munger, books, annual letters, old hedge fund letters from Buffett
- Read everything you can from the famous investors (e.g. Carl Icahn)
- **"Corporate Finance Textbook – Brealey & Myers"**
    - Shkreli got this textbook for 14th bday
    - Not technical, much more philisophical
    - Whole Major in 1 PV formula
- **"Phil Fisher – Common Stocks and Uncommon Profits"**
    - Practical book
    - "Scuttlebutt" originates from here. Means talks, rumors about the company.

    - A manual on due diligence – e.g. channel checking
- **"Seth Klarman – Margin of S**
    - Practical book
- Thinks the two books above replaces the Graham-Dodd books; does **not** recommend Graham-Dodd books

Basics

- Price = The price of one share. Does not mean much. Just the last price.
    - Has no correlation to total value of company
- Mkt Cap = Total pie. =Total outstanding shares * Last price.
- Cash = Cash + ST investments + Marketable Securities + Equity Method Investments + Other investments
    - Cut it off at accounts receivable (takes 45-60 days) and inventory
- Debt = ST debt + Loans and notes payable + Current maturities of LT debt + LT debt

---

Lesson 2: Financial Statements, Apple Model

Source

- 8K: Any material/disposable event
- 13G/D: Ownership statement ("big ballers")
- Spend a lot of time on IS/BS, then graduate to CF statement.
- **Important metric to look at: Net Cash / Market Cap**
    - Eg. Apple had $150B in net cash (excl. debt), and with a $500B market cap, 30% of the market cap is in cash.

Balance Sheet

Assets

- Goes in the order of most liquid to illiquid
    - Cash
    - Marketable securities (bonds, equities)
        - Martin adds in **Long Term marketable securities (likely 2050 US govt bonds)** to cash
    - Acc Receivables
        - Usually paid in 30-60 days
        - Figure is inclusive (net) of bad debt
    - Inventory
        - Includes raw materials, work in progress (WIP aka half finished products), and finished products
    - PP&E
        - Hard asset (buildings) with a useful life of 1+ year (required!)
    - Goodwill & Intangible Assets
    - Other Current Assets (Prepaid expenses)
        - Eg. Money earned by MSFT when you pay on Jan 1 for a subscription

- Look up unfamiliar line items in the financial statements such as:
    - “Vendor non trade receivables” in Apple’s BS

Liabilities

- Accounts Payable: Expenses that you have to pay on a paycheck-to-paycheck basis (more ST oriented)
    - e.g. you have to pay $2K to an employee in the upcoming 2 weeks in exchange for work
- Accrued Expenses: Total expenses that you have to pay sometime in the future (more LT oriented)
    - e.g. you have to pay a senior partner $10M bonus for targets achieved by the end of the year
- Deferred Revenue (aka Unearned Revenue): Received $ for undelivered product.
    - e.g. Tesla Cybertruck, gift cards
- Commercial Paper: Loans from banks

Shareholders Equity (SE)

- **Shareholders Equity (SE) = Book Value**
- Shareholders Equity (SE) = A – L
- Tangible Book Value = SE excluding intangibles/goodwill

Income Statement

- Revenue
    - Definition: When the **title** of the product is passed to the customer
    - “**Revenue Recognition**” rules are the most important thing to look at.
    - Remove inter-company revenue
    - Rules for returns
- Example: I get paid $10M cash to promote product over 4 years
    - IS: Each quarter revenue: $625K
    - BS: Cash: +10M, Deferred Revenue +9.375M
- COGS vs. SG&A
    - COGS: Costs to make the product.
        - Labor to create iPhone and factory managers’ pay are included in COGS per Martin
    - SG&A: Costs to run the company.
        - Tim Cook’s salary, rent for office buildings, legal expenses, marketing
- Tax Rate = Taxes paid / **Pretax** income
    - Denominator is not revenue

Time Value of Money

- **Discount rate (r) = risk free rate (aka interest rate and usually equal to inflation rate) + risk premium (aka risk of default)**
    - Risk free rate: The % return you expect to earn on CF now vs. CF later.
        - Can earn 1.5% from US risk free bonds.
    - Risk premium: The riskiness of the cash flows.
        - US govt is risk free so rp = 0%, Brazil is risky af so rp = 6%.
    - High interest rate (7.5%)
        - –Martin’s perpetuity is worth **less** cuz u can reinvest for high interest rate now vs.

later.
    - Low interest rate (1.5%)
        - ++Martin's perpetuity is worth **more** cuz you don't earn much more by reinvesting now.
- $1 today > $1 tomorrow
- Opportunity cost = risk
- Most fortunes are made because someone correctly predicts that a black swan event happens or doesn't happen.
- PV Perpetuity = 1/r
- Dividend Discount Model = 1/(r-g)
- Excel =NPV(r, Series of CFs)

Lesson 3: Guide to Fundamental Research

Source

- **Summary of How to Value a Company**: "A company is worth the discounted sum of its cash flows from today until eternity."
- **Guide for how to do Fundamental Research**
    - Use Common Stocks and Uncommon Profits as a guide
    - Reach out to IR team for any questions, its their job to talk to you
    - 1. Read 10-K to learn about (in detail) what each Business Segment does
        - Each business segment has its own tab in the Model
        - In each revenue segment: who are Clients/Customers? who are Competitors?
    - 2. Listen to the earnings conference calls on the website, while reading the earnings decks
        - Tip: Go to Press Releases instead of 10-K for quarterly earnings data, and 10-Q's for the rest
    - 3. **Read a minimum of 1 year of press releases and take notes/update model with them.**
    - 4. Grill management
        - Trust determines how high (bad) or low (good) the discount rate is – do you trust the CEO to be able to generate sustained/grow CF for the next x amount of years?
        - Red Flag if CEO cant be bothered to join earnings conference call
    - 5. Rinse and Repeat on peers, customers, suppliers in order to understand the entire supply chain.
- **Who to Ignore:**
    - Other investors, Wall St. Research, TV/CNBC
- Bonds
    - Debt where lender gives borrower funds and expects to be paid back with interest.
    - Senior to equity
- For NPV: Equity discount rate must be **higher** than debt's discount rate since debt is senior to equity.
- Discount the cash flows (NI)
- Don't forget to get Terminal Value as well, discounted to today

---

Lesson 4: IBM Model (Value Co)

Source

- 1. Project out rev/NI
- 2. Terminal Value = Apply a -3% NI decline for the rest of infinity
- 3. =NPV(discount rate, the NI stream in step 2)
- 4. Project out Net Cash + NI for the rest of infinity
    - ROIC = The rate of return IBM can earn on their Net Cash balance. Martin used =Interest Income (in "Other income" in IS) / Net Cash balance
- Example: if 12x P/E or EV/Earnings multiple: it will take 12 years to get your money back.
- Flipped around is the Earnings Yield (E/P or Earnings/EV)
    - Compare this % yield to what a 10-year bond yields.
- Remember to adjust for **currency swings:**
    - Look up USD/EUR historical prices over quarters. If USD/EUR has **dropped**, this means the Euro has dropped significantly.
- No arbitrage concept: Stock prices and news have nothing to do with each other
    - Everyone knows good news is coming, so there is no upside left.
    - Has to be a surprise vs. expectations to generate alpha.
- Red Flag: When companies say that this 1 segment of their business is doing very well, that means the rest of their business is falling apart.
- On average, 8 out 10 stocks will be fairly valued, 1 will be cheap, and 1 will be overvalued

Lesson 5: Alarm.com (ALRM) Model (Growth Co) and AT&T Model

Source

- Narrow your universe to the area you want to focus on, are most interested in, and you think can generate the most alpha.
    - This is your Main Database page that you come to and will link off towards external models
- Number of employees is important
- **This concept I still don't really get:** Apparently a lower P/E is **bad** since the earnings yield is higher.
    - E.g. AAPL 8x EV/E vs. IBM 13x EV/E
    - 12% AAPL E/EV vs. 8% IBM E/EV, so investors are assigning a higher discount rate (riskier) to AAPL vs. IBM…
- D&A
    - Do **not** include D&A in EBIT/NI for SaaS Co's since it is a non cash expense
    - Include D&A in highly asset intensive industries such as telecom, energy
- **Operating Leverage** definition: NI Y/Y growth should grow faster than Revenue Y/Y growth since your costs will only grow equal or less than revenue growth
    - If rev +10% Y/Y, costs should only grow equal or less than 10%, so resulting NI Y/Y growth

should be >10% Y/Y
- Depreciation (to expense tangibles) and Amortization (to expense intangibles)
    - Depreciation Expense for any PPE (useful life >1 year) is **not included** in IS
    - Capex expenses for PPE is expensed as Depreciation expense/n years of life

Cash Flow Statement

- CFO
    - Swung by Acc Receivables and payables. Not as stable as NI per Martin.
    - Add back D&A, usually the biggest swing factor
- CFI
    - Capex will show up here, any purchase of PP&E

Lesson 6

Source

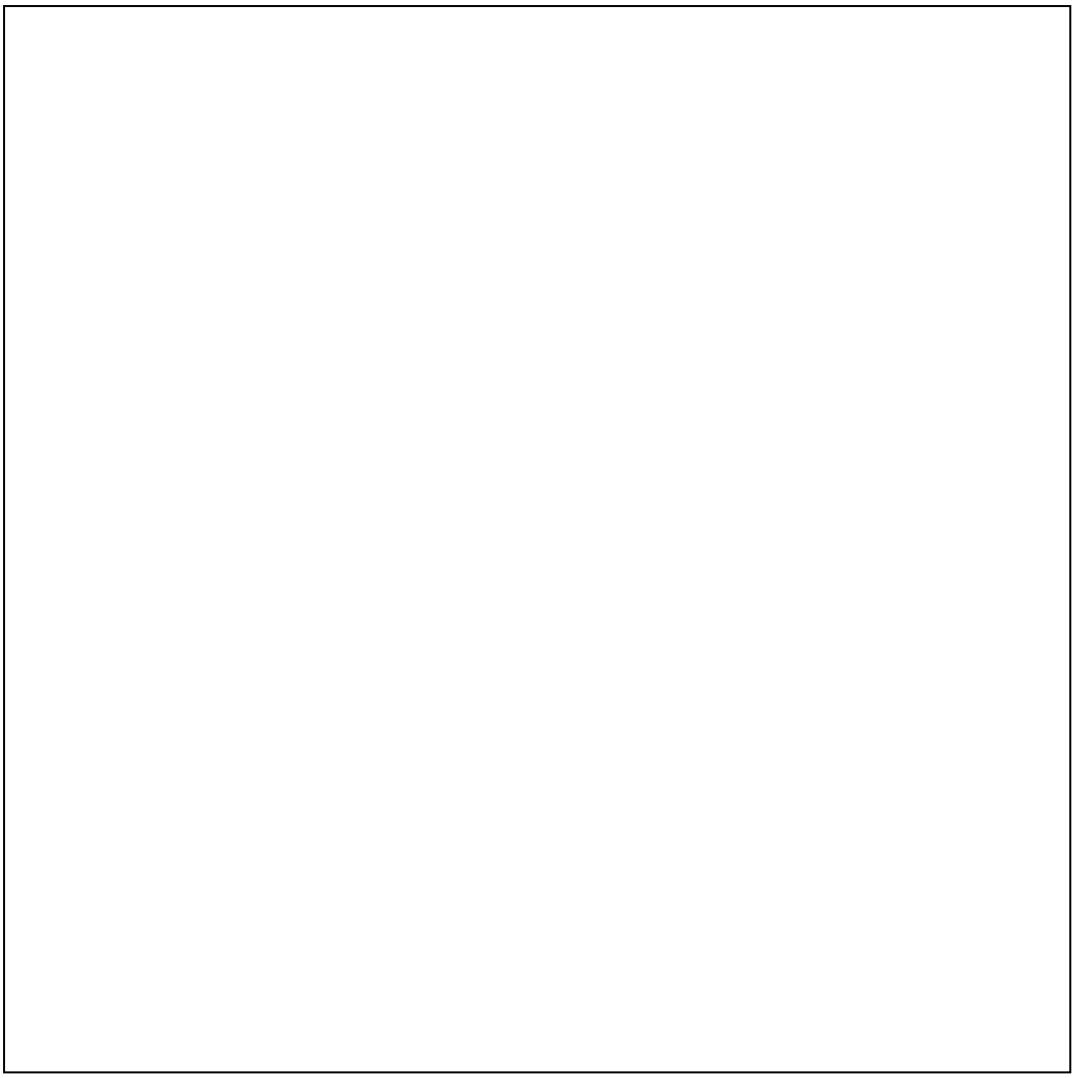
- Almost all corporate activity on planet is done in aim of creating equity value through increased stock value or dividends.
- For every seller there is a buyer.
- What is the ideal number of stocks in your portfolio?
    - The more the better, but both have winners
    - Diversified: **Renaissance and Steinhardt** (2 famous outperforming hedge funds with 100-1000 stocks in port)
    - Concentrated: **Buffett's early portfolios, Sequoia**
- Excel IRR formula: =RATE(5 years, 0, -10, 20)
- "Securities Lending Payable": Means the company is short stocks
- NI is a smoothed out CF statement. CF is more granular & volatile – shows how a business moves it about on a quarterly basis.
- **To Value Growth Stocks Like FB:**
    - **Use ARPU*DAU as a better estimate from straight-line revenue growth**
    - Check Y/Y growth rate of users (volume growth)
    - Check Y/Y growth rate of ARPU (price increases)
    - ...and compare against Y/Y revenue growth rate
    - Comp prices against peers per month, and if you would pay that amount per month

---

Lesson 7

Source

- Read **No Bull by Michael Steinhardt**
- Watch out for tail risk (5 sigma moves)
- Prefer steady upward trend with minimal drawdowns

- Martin likes 10-20% of stop loss as max
- Position sizing: no position greater than 10% of port
- Comparables in main database can tell you alot of interesting things:
  - 
- Google competitor analysis:
  - Total TAM ($600B ad spend) – what is its growth and Google's market share?
  - Google's market share vs. Facebook, WPP, Omnicom (traditional media, radio, TV)?
- 1) Growth of the CFs vs. 2) Risk to the CFs
  - Look at both to calculate value
- Common Shares: Shares that are not subject to an event
- Diluted Shares: Includes shares that are convertible upon certain events (employee stock options)

Lesson 8

Source

- Short: Borrowing shares
- Buy side (investors): mutual funds, hedge funds, pensions, individuals,
- Sell side (investment banks): Service the investors. securities research, securities trading, ibanking (lending – if IBM wants to issue debt, you have to go to a bank and they will coordinate with the buy

side folks, M&A advice, underwriting)
- Stock recs
    - Ignore everyone else's opinions
    - Time is better spent researching your own independent opinion
- Level 1 ADR: Sponsored by the company, company makes US filings
- Level 3 ADR: Not sponsored by the company, company does not file in the US (e.g. TCEHY)
- Make sure 1 ADR = 1 Overseas share, could be different
    - 1 ADYEY share = 0.02 ordinary
- **Hard to find** Asian and European companies' total shares outstanding on their materials
- Excel: =TRIMMEAN(A1:A10,80%)
    - Only data points that are within 80% of the median are included
- Intel Model
    - No revenue growth stocks trade at similar multiples. Expected.
    - Revenue Segments:
        -

Left off at: 1:10:00

Lesson 12: Netflix Analysis

Source

-

← Previous Post

Next Post →

This site uses Akismet to reduce spam. Learn how your comment data is processed.

0 COMMENTS