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AIA NEWSLETTER

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LAURENCE AND LORI
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FOR FINANCE & INVESTMENTS

2

Interview with Stephen A. Greene ('85),
Adjunct Professor and Founding
Member, Fink Center for Finance &
Investments Advisory Board,
UCLA Anderson

5

Fink Center Stock Pitch
Competition 2017

8

Student Stock Pitch –
SINA Corporation (SINA)

10

Interview with Antonio Bernardo,
UCLA Anderson Distinguished
Professor of Finance, California Chair
in Real Estate and Land Economics

14

Inaugural Fink Center
Credit Pitch Competition

15

Meet the Editors

STUDENT EDITORS

Sam Kendrick ('17)

Paige Kolesar ('17)

Lukas Langermann ('18)



INTERVIEW WITH STEPHEN A. GREENE ('85)

Adjunct Professor and Founding Member, Fink Center for Finance &
Investments Advisory Board, UCLA Anderson

AIA: Your academic background is in history. What drew you to finance?

Stephen Greene: I started off thinking I was going to be an academic and not an historian, in part because I came from a family where being an academic was highly prized. I was in a Ph.D. program at Stanford and, as I say to some of my students, I got my first lesson in economics looking at supply and demand in the academic job market. There was a lot of supply and no demand for history professors.

To be honest, once I'd decided to leave academics, the decision to do the MBA was more about eliminating things I didn't want to do than any particular conviction about business. In fact, I would have been challenged at that time to explain what finance was and how it differed from economics. It was only when I started the program that I started to appreciate the career opportunities that finance offered. It also helped that the early- and mid-1980's were great growth periods for financial services and for investment banking in particular. Like lots of things in life, it turned out to be "right place, right time."

In all seriousness, though, one of the reasons I feel so strongly about Anderson — and why I'm excited to be part of the faculty — is because doing my MBA here was such an inflection point in my life. I was in a career that wasn't going in the right direction, and Anderson gave me a chance, at an extremely low cost at the time, to turn that around and have a successful career doing something else.

AIA: After business school, you spent many years at large firms like Houlihan Lokey Howard & Zukin and Arthur Andersen. What led you to start your own firms (Eureka Capital Partners, Crevice Capital Partners) later in your career?

SG: When I started at Houlihan, it was a pretty small, entrepreneurial place — I think I was about employee number 30. Arthur Andersen, of course, was a very large, global, professional services firm but, on the inside, it actually felt much smaller; you didn't have lots of people sitting around telling you what you couldn't do. Now, in retrospect, maybe that was a bad thing because when a

“little” problem like Enron came along, there was nobody telling the audit team in Houston what they couldn’t do.

Although I never had anything to do with any audits (much less the Enron one), I realized pretty quickly that the Enron situation was a huge problem for the firm as a whole. At the time, I was heading up Andersen’s corporate finance and restructuring activities in the healthcare industry and I wanted to keep the core of my team together. In addition, I figured that if I wasn’t ready to be an entrepreneur at that point in my life, I never would be. So I reached out to a few people whom I’d come to know and respect over the years (including one who had a small, existing broker-dealer in Orange County) and we set up a boutique investment bank called Eureka Capital Partners with two offices — one in New York and the other in Newport Beach — to do some of the same things that we did at Andersen. We had a very good run there, and I remained a senior managing director and member of our executive committee until 2010.

The primary reason I left Eureka was that, over time, I tired of being in the advisory business. You spend a lot of time in investment banking trying to come up with good ideas and trying to help clients get things done, but then clients have a way of screwing things up on you. At some point in your career, you reach a point where you want clients to get out of the way and let you drive. This is where I was by the end of those Eureka years — I wanted to do more principal investing while my partners really wanted to stay focused on advisory work.

After leaving Eureka, I joined a couple of different private equity platforms but really didn’t find one that meshed well with my investment philosophy. Hence, in 2013, I set up my own family office called Crevice Capital Partners which I use as a vehicle for private equity investing. The platform is significantly (although not exclusively) focused on healthcare services and has a “deep value” orientation. That orientation is mostly due to my restructuring background. When most people see a messy situation, they want to run away from it. Me, I want to take a closer look since one person’s distress could well be another’s opportunity.

The healthcare industry focus is what led me to Nashville, TN. Nashville is arguably the preeminent healthcare services center in the country. There are more public companies in the healthcare services space based in Nashville than any other metro area, mostly because of Vanderbilt and HCA. These big firms have spawned a bunch of entrepreneurial activity, and my thesis was that at least a few of these businesses may have run off the rails but still be investible. So far, that has proven out. I now split my time between Nashville and Los Angeles.

AIA: What was it like starting these two firms? What advice would you give people who are looking to start their own firms?

SG: I guess a couple of things come to mind. First, as important as the business strategy is when starting a firm, the people and how they deal with the risks of entrepreneurship are equally important. I think we were somewhat thoughtful at Eureka about the people we brought together, but we were also fortunate to have success quickly. Any business has its ups and downs, but these tend to be amplified in an entrepreneurial setting. It’s important to find people who are mentally tough enough to get through the difficulties.

Second, I think the thing that was most shocking to me in the early days at Eureka was how much regulation you need to deal with in getting a firm going. I used to come home and say to my wife, “I wonder how people who are less smart or less well informed manage to keep out of jail,” because it seemed that every week or so some regulator would pop up saying, “You need to deal with me.”

While I don’t sympathize with many of Donald Trump’s positions, I will say that he is on to one issue regarding the relationship between capital formation and entrepreneurship, on one hand, and regulation on the other. It’s not just about the number of regulations, though – it’s about the number of regulators and the way in which they pile on regulations that often conflict with each other. My words of wisdom on this are not to underestimate the time and effort that you, as an entrepreneur, will have to take away from your focus on the business to deal with these issues.

AIA: Speaking of politics, there has been much political speculation about the future of the healthcare (e.g., debate around the Affordable Care Act). How much has politics played into how you think about investment opportunities?

SG: In the healthcare services industry, you always have some degree of uncertainty because there’s “stroke of the pen” risk. Even if you’re not operating in segments like skilled nursing or home healthcare, which are heavily dependent on government reimbursement via Medicare and Medicaid, you’re still somewhat at risk on what happens to government reimbursement because insurers tend to follow suit.

As an investor, I think the politics around the ACA are not so much creating uncertainty as much as they are increasing the noise level. Despite the hype, it’s worth keeping in mind that people who are covered under the exchanges are less than 10% of the U.S. population. The vast majority of people still get their insurance through their employers. Even though politicians on one side or the other may

argue that the ACA has had implications for the broader population, the impact really hasn't been that major. Most of the issues with the exchanges — like the increase in premiums, high deductibles and narrowing of networks — are real issues but only for a small minority of people.

For this reason, I don't see the current debate about repealing and replacing the ACA having that much impact on investment activity in the sector. The exception to this rule is with respect to Medicaid where large questions do exist. Will Medicaid eligibility/rates be cut if Medicaid is now block-granted to the states? What will happen with Medicaid expansion? Several additional "red states" are now looking at it but from the perspective of potentially expanded flexibility through so-called 1115 waivers. Until a direction on these issues is clear, it's hard to invest in any payer or provider with significant Medicaid exposure.

From a broader perspective, I continue to be hopeful — though not confident — that the discussion on healthcare reform will ultimately move in the direction of addressing the "affordability" issue for all Americans. It is unsustainable for us to be spending nearly 20% of our GDP — at least 40% more than other developed economies — on a system that provides middling outcomes at best. This implies a rethink on healthcare from top to bottom, but it is very difficult politically.

AIA: What are your thoughts about the active versus passive debate?

SG: When we talk about active versus passive, we tend to forget that a lot of ETF usage is done by active managers who are simply using low-cost ETFs for making sector allocations. So, I'd rather characterize the debate as one between "stock-pickers" and "sector-pickers."

As everyone points out, the flow of funds out of stock-picking has been primarily a function of cost. It's expensive to maintain comprehensive research on individual companies and the results over the past 10 years have not justified the investment. I believe that a large part of the problem for stock-pickers has been that the markets we've been in the past few years have been driven by monetary policy. Virtually all asset classes have moved up and down together. It has been hard for stock-pickers to differentiate themselves in a world where differences in the performance of individual companies are small relative to the influence of central banks.

Having said this, I think we may be closer than people think to hitting something of an equilibrium in the flow of funds into indexes, if for no other reason than that the pricing of index stocks is creating arbitrage opportunities relative to stocks in the same industry that are not in an

index. Furthermore, whether ultimately successful or not, it's clear President Trump will attempt to go forward with something big in the areas of infrastructure, tax cuts and deregulation. What all of these have in common is that they're inflationary and the consequent increase in interest rates — and cost of capital — may well return us to a stock-pickers market. We've already seen much more differentiation between winners and losers in the Trump administration's first 100 days than we did in the prior eight years under Obama.

AIA: What opportunities do you see for your firm now? What does an attractive investment opportunity look like?

SG: My investment approach is highly focused on managing downside risk. All investors talk about that, but when you're in the public market you have a fail-safe called selling, which gives you an opportunity to limit the damage when you make a mistake. When you're in private equity, you're all in. Your liquidity options over the short term tend to be low. You need to find a way to make it work. I'm a big believer in trying to find something that's hedged on the downside. On the flip side, as just stated, valuations of all asset classes have gotten inflated as a result of our monetary policy. It's very hard to find investment opportunities today where you have appropriate downside protection but you have some upside that's worth shooting for. I'm pretty finicky when it comes to this sort of stuff.

I just made an investment in a healthcare business down in Nashville. This was a company that was premised on a roll-out strategy for a specialized type of medical clinic. The company's first clinic was very successful and seemed to prove the model so the founders were able to raise about \$30 million from venture capital investors to expand. Unfortunately, the next several clinics never were able to perform at the level of the first one. The only good thing was that, along the way, the founders decided to acquire a semi-related business in an adjoining healthcare sector. The strategic rationale for the acquisition never played out, but the business itself did grow substantially on a top-line basis even though profitability remained weak primarily due to back-office problems.

A new management team came in a couple years ago and started fixing things, but there still remained a capital need until the entire company could get solidly in the black. This need occurred at just the time when the VCs were coming to the end of their fund. When VC or PE investors come to the end of their fund, they really are in a difficult place because they have very strong fiduciary responsibilities not to invest across funds because there are different investors. You can't be perceived as using money from Fund 2 to bail out investors in Fund 1. The requirement to find new investors, along with the

company's checkered past, led the board to offer up a discounted "down round." I was turned on to the situation by some friends in town and decided to take a look.

I liked what I saw. The valuation was a massive reduction from where it had been funded previously. More importantly, the sale value of this second business — in reality, the core business — was at least two and a half to three times what the pre-money value of the entire business was going to be in this down round. This new preferred round in which I would be investing was going to be at the top of the capital stack — all prior issuances of preferred stock and convertible debt were being flattened into the common. There was, thus, substantial downside protection both structurally and from a valuation point of view. Plus, there was upside: The second business was in an area that I knew and understood. I had a close business relationship with an executive who spent 30-plus years of his career in this space. I was able to bring him in as a consultant to the board to help us improve the margins and grow the business.

There are several elements of this story that capture what I'm looking for in an investment. The valuation needs to be right — conservative relative to reasonable expectations. There need to be structural protections on the downside. Then, I want to have an opportunity to put my thumb on the scale in favor of a positive result. It's not as though I'm going to come in there and improve the operations myself, but the fact that I knew someone in the space who could come in and do that was a big deal.

AIA: What advice would you give to students and alumni looking to get into private equity? What are the pros and cons of various career paths?

SG: The biggest problem with private equity today is that it has become a very mature business; depending on how you define the industry, there's more than \$1 trillion of capital — "dry powder" — sitting on the sidelines waiting to be invested. This means that many sponsors are struggling to raise new funds and those that do are often raising smaller funds, not larger ones. It is this absence of growth that is making the industry so difficult to penetrate for today's MBAs. Even those students who have backgrounds in private equity are not guaranteed a seat if they step out to go to business school.

If I were bound and determined to get into the private equity business, I would try to approach it from the buy side rather than the sell side. While having two or three years of investment banking experience is helpful, particularly if it's focused on M&A, sponsors like people who think like investors and you don't get that experience in the banking business.

In choosing where to look in the private equity world, I would encourage students to think about firms with structures different from the typical "2 and 20" fund. Firms with longer investment horizons like permanent capital funds and family offices have potential advantages in that they can consider investment opportunities that traditional PE funds cannot. This may give them staying power in a very competitive investment market, making for more career opportunities.

ABOUT STEPHEN

Stephen Greene joined the UCLA Anderson faculty after nearly a 30-year career in private equity and investment banking. A specialist in mergers and acquisitions and financial restructuring, his transaction experience includes public and private M&As, sell-side and buy-side representations, hostile takeovers, Chapter 11 and out-of-court restructurings, capital raisings of both debt and equity, fairness opinions and cross-border deals. He has closed more than 100 large cap and middle market transactions across a wide range of industry verticals, including consumer products, financial services, healthcare, industrials, retail and technology.

Greene currently focuses on value-oriented private equity investments through his family office, Crevice Capital Partners. Prior to forming Crevice Capital in 2013, he held partner-level positions in investment

banking, merchant banking and private equity, including as a global equity partner at Arthur Andersen, where he was responsible for various components of its U.S. corporate finance and restructuring businesses. He began his investment banking career at Houlihan Lokey Howard & Zukin, and later became managing director in charge of Houlihan's San Francisco office.

Greene is a founding board member of the Fink Center for Finance & Investments at UCLA Anderson. A member of the Phi Beta Kappa and Beta Gamma Sigma honor societies, he was the recipient of a Fulbright/Hays Fellowship for study in the United Kingdom.

Greene holds an MBA in finance from UCLA Anderson School of Management, and an M.A. and a B.A. in history from Stanford University.



FINK CENTER STOCK PITCH COMPETITION 2017

By Danwei Chen

On Friday, February 10, 2017, UCLA Anderson and the Laurence and Lori Fink Center for Finance & Investments hosted the 7th annual Fink Center Stock Pitch Competition. The Fink Center, working alongside the Stock Pitch Directors, invited and hosted teams from 12 business schools across the United States and Canada, including:

- Columbia Business School
- Cornell University Johnson Graduate School of Management
- Western University Ivey Business School
- NYU Stern School of Business
- Northwestern University Kellogg School of Management
- Stanford Graduate School of Business
- Carnegie Mellon University Tepper School of Business
- Dartmouth College Tuck School of Business
- UCLA Anderson School of Management
- University of Chicago Booth School of Business
- USC Marshall School of Business
- UVA Darden School of Business

Serving as judges of the competition were the following distinguished investment management professionals:

- Casey Borman ('03), Founder, Borman Capital
- Iman Brivanlou ('06), Ph.D., Managing Director and Head of Income Equities, Trust Company of the West (TCW)
- Jerry Klein ('94), Managing Director of Wealth Management, Merrill Lynch
- Melvin Lindsey ('99), Founder and Managing Partner, Nile Capital Group
- Todd Lowenstein ('99), Managing Director, Director of Research, Senior Portfolio Manager, HighMark Capital Management

- Rod Rehnborg ('96), Partner, Marshall Wace
- Brian Sterz ('14), Senior Client Advisor, Miracle Mile Advisors
- George Tharakan ('97), Portfolio Manager, Alamar Capital Management
- Chris Wright ('09), Portfolio Manager, Kayne Anderson Rudnick

Prior to the competition, the 12 teams prepared their pitches from a preselected list of large-cap stocks created by the Stock Pitch Directors. The stocks spanned a wide range of sectors and included Netflix, Walmart, Twitter and Tesla. In the first round of the competition, all teams presented pitches of their stock of choice to a panel of three judges. Each team gave their recommendations for a one-year investment horizon based on original analysis, taking into consideration factors such as recent performance of the stock and the perceived effects of the new presidential administration. Pitches were followed by a question-and-answer session from the judges, testing the thoroughness of each team's knowledge. Throughout the day, judges operated on the basis of objectivity and were unaware of each team's business school affiliation.

After the first round, participants and guests listened to a keynote speech by Ray Kennedy ('88), portfolio manager and equity owner at Hotchkis & Wiley Capital Management. Kennedy spoke about his 31 years of industry experience and his current role at H&W, including his extensive



Ray Kennedy ('88)

knowledge of the high-yield bond market. Kennedy also indulged questions from the audience, many of which came from students seeking career advice and insight into the current investing landscape. Following the keynote, the much-awaited announcement of the three finalists was made. UCLA Anderson (J² Capital), UVA Darden (Team Crunch) and Stanford GSOM (Stock Stalkers) celebrated their advancement in the competition and quickly began preparing for the final round of pitches.

With the final round open to audiences, the finalists were required to present pitches on United States Steel Corporation (NYSE: X). All three teams gave a recommendation to sell or short the stock, which has faced much uncertainty in recent years, including a near bout with bankruptcy, but rebounded following the 2016 election. After extensive deliberation and consideration by judges, a winner emerged.

“From working at a hedge fund for the past few years, I can attest that the Fink Stock Pitch Competition closely simulates pitching to a portfolio manager at a real-world investment firm.”

— Justin Phillips ('18)

Third place, along with a prize of \$2,500, was awarded to Stanford GSOM, and 2nd place, with a prize of \$4,000, was awarded to UVA Darden. The winning announcement was saved for last: UCLA Anderson emerged as the winner of the Fink Center Stock Pitch Competition, the first victory for the home team since 2013. The champions were Justin Phillips ('18) and Jarrid Johnston ('19), both first-year Anderson students.

“From working at a hedge fund for the past few years, I can attest that the Fink Stock Pitch Competition closely simulates pitching to a portfolio manager at a real-world investment firm. The judges asked insightful, tough questions regarding potential vulnerabilities in our thesis,” said Phillips, who intends on staying in the equity hedge fund or mutual fund space upon graduation. Johnston, who is also working toward a career in active investment management, adds, “Justin and I were able to leverage backgrounds in finance to clearly and confidently defend our pitch during the Q&A portion. I encourage all students interested in investment management to participate in this competition.”



First-year Anderson students. Justin Phillips ('18) and Jarrid Johnston ('19) win first place



“It’s pretty high caliber. You need a certain level of preparation, talent, and dedication to make the cut and that shows up in the presentations.”

— Todd Lowenstein ('99),
Highmark Capital
Stock Pitch judge

STOCK PITCH DIRECTORS

- John Bay ('17)
- Gloria Fan ('17)
- Paige Kolesar ('17)
- Alexander Kua ('18)
- Samuel Silverson ('17)
- Timothy Van Harmelen ('18)
- Janelle Zhu ('18)

STUDENT STOCK PITCH: SINA CORPORATION (SINA)

By Phil Meng ('17)

SINA Corporation (Nasdaq: SINA)

Date of Report	3/29/17	Market Capitalization (M)	\$5,210
Current Price	\$73.56	Shares Outstanding (M)	70.88
52-Week Range	\$44.57-85.24	Institutional Holdings	56.4%
Avg. Daily Volume (M)	.738	Fiscal Year End	12/31/2016
FY 2016 EPS (actual)	\$1.41	Beta	0.98
FY 2017 EPS (expected)	\$2.40	FY 2016 Revenue (M)	\$1020.5
FY 2016 P/E	52.17	FY 2016 Net Income (adj.) (M)	\$109
FY 2017 P/E (forward P/E)	30.65	Book Value/share (mrq) (M)	\$37.02
Dividend (n/a)	n/a	Price/Book Value (mrq)	1.97x
Dividend Yield (n/a)	n/a	Industry	Internet Software and Security
Index Membership	n/a	Debt/Capitalization Ratio	25.2%

BUSINESS DESCRIPTION

SINA Corporation, through its subsidiaries, operates as an online media company in China. It operates SINA.com, an online brand advertising portal that provides region-focused format and content, including multimedia news; business news coverage and personal finance columns; sporting events news; automobile-related news; entertainment news and events; technology updates; interactive video products, such as news, sports, entertainment and education; and education, digital, fashion, luxury, health, collectibles, travel and other interest-based channels. The company also offers SINA mobile, a mobile portal, which provides news and entertainment content from SINA.com in a mobile browser and application format. In addition, it operates Weibo.com, which offers self-expression products to enable users to express themselves on the Weibo platform; social products to promote social interaction between users on the Weibo platform; discovery products to help users discover content; notifications, games, VIP membership and mobile apps; advertising and marketing solutions; and tools and application programming interfaces. Furthermore, the company offers MVAS, which allow users to receive news and information; mobile games and pictures; and participate in dating and friendship communities. Additionally, it operates a game portal that provides users with downloads and gateway access to online games; information and updates on online and PC games; and value-added application tools. The company also provides eReading, a one-stop shop for book reviews; and free email, VIP mail, and corporate email services for enterprise users; as well as a website for bloggers to publish and read original writing. SINA Corporation was founded in 1997 and is headquartered in Shanghai, China.

INVESTMENT THESIS

Weibo's (WB) strong earnings and user growth are driving SINA's value: SINA's ~51% ownership of Weibo is, in my opinion, SINA's most valuable asset as Weibo has demonstrated scalability and execution capability in the past two years. SINA's growth largely relies on Weibo's Twitter-like social media platform. Compared with Tencent's social networking platforms, Weixin and QQ, Weibo is similar to an online media platform embedded with social networking functions where users can easily follow or find their favorite celebrities, groups or topics and interact with them. Weibo's user base has continued to grow after the company's accelerated monetization via advertising. Last quarter, Weibo's monthly active users (MAUs) rose 34% annually to 297 million, and 89% of those users accessed the service from mobile devices. Its daily active users (DAUs) rose 32% to 132 million. By comparison, Twitter's MAUs only rose 3% to 317 million last quarter, and its DAUs grew just 7%.

At this rate, Weibo will easily eclipse Twitter in the near future. Weibo still has plenty of room to grow — China has an Internet penetration rate of just 52%, compared to a penetration rate of 89% in the U.S. Furthermore, the ongoing Chinese ban on Twitter, Facebook and other foreign social networking platforms will help Weibo remain one of the country's top social networking platforms for the foreseeable future.

SINA's ownership in Weibo is undervalued: SINA's Weibo ownership (~51%), valued at WB's current stock price (~\$52.50), is greater than SINA's entire market cap. That means SINA's other businesses, its net cash and investments, are valued at less than zero. Moreover, SINA is the controlling majority shareholder and the actual operator of Weibo,

so I find no basis for the market to undervalue SINA's Weibo stake. Either Weibo's valuation has to come down or SINA's market cap has to go up (potential SINA/WB arbitrage opportunity).

Core business stabilization: Clearly, the ex-Weibo segment is in decline. However, as SINA focuses its efforts on growing Weibo, it is very likely that the portal and others did not receive as much attention as they did in the past and, as a result, performance suffered. Yahoo's core business acquisition shows that despite the loss in popularity and revenue, portal sites still hold some importance to strategic buyers even in today's "everything going mobile" environment. Furthermore, Sohu.com (SINA's portal site competitor) was able to keep its portal business revenue basically flat from 2015, indicating SINA's portal business might have room for improvement.

Management maintains strategy of focusing on shareholder returns: The company distributed \$376 million in Weibo stock to SINA shareholders, repurchased \$800 million in convertible bonds and has a \$500 million stock buy-back in place through mid-2017. Furthermore, management has further options, including special dividends, with \$1.2 billion of net cash (excluding that of Weibo).

Valuation: Using a sum-of-the-parts valuation, SINA seems to be significantly undervalued. I believe Weibo will continue to thrive as a public social media platform, and user growth and rising engagement will lead to higher monetization. I also expect Weibo margins to expand rapidly over the next few years, driven by rising scale. Although SINA's portal traffic and revenue are declining, revenues should stabilize and possibly return to growth in 2017, driven by mobile ads.

Using a conservative price target for WB of \$55/share (~\$12B market cap) produces SINA ~\$83.50/share; ~\$17/share of net cash; ~\$4/share of portal business (based on 1x FY17E portal ad revenue); ~\$16/share of other investments (at book value); generates a valuation for SINA of \$120/share.

Based on this valuation, I consider SINA to be undervalued given the rising value from its subsidiary Weibo (who is positioning itself as a key video distribution platform), the improving performance of its portal and cash investment portfolio. There could potentially be significant additional upside if the company is able to perform and/or exceed any of the expectations detailed here, producing a price target in the \$115-\$120/share range, and making SINA an attractive BUY opportunity at the current price of \$73.56.

PRINCIPAL INVESTMENT RISKS

Potential slowdown of Weibo usage: Mobile portal app monetization may not accelerate as expected. Additionally, Weibo's long-term strategy to target advertising versus maintain/enhance user experience could pose a challenge to the company.

Continued slowdown of brand advertising on SINA portal: The risk of worse-than-expected declines in the portal, as well as weaker monetization and lower margins, pose a risk to SINA. It is difficult to see a turnaround in the portal business due to both traffic and advertising dollars shifting to social networking services and new media formats. However, it is unlikely that the portal business will be priced at negative value in this case.

Relatively weak execution ability and product innovation compared to peers: Failure of Weibo to generate interesting content could produce intensifying competition from other mobile and social players. Weibo is facing competition from Tencent's Weixin and other mobile media apps, which can dilute its active user base and advertising budget.

Regulatory risk on online advertising.

Economic growth slowdown: A decrease in economic activity could lead to weaker overall advertising sentiments.

RECOMMENDATION AND PRICE TARGET

- **Target price:** \$115-\$120/share. Current share price = \$73.56, implying ~55% upside.
- **Recommendation:** SINA is a **BUY** for the SIF portfolio at or below \$80.

Phil Meng ('17) is pursuing an MBA with concentrations in entrepreneurship and finance at UCLA Anderson School of Management's Executive MBA Program. Meng began his career as a derivatives trader on the American Stock Exchange and has held positions as a trader and portfolio manager for hedge funds and proprietary trading firms focused on volatility in New York. He is exploring a career shift away from the trading environment. Meng graduated from the University of Pennsylvania in 2001 with dual degrees from The Wharton School (B.S., finance and decision processes) and The College of Arts and Sciences (B.A., psychology), and was awarded the CFA charter in 2016.





INTERVIEW WITH ANTONIO BERNARDO

UCLA Anderson Distinguished Professor of Finance,
California Chair in Real Estate and Land Economics

AIA: To start off, could you tell us about your career and how you came to Anderson?

Antonio Bernardo: I got my Ph.D. at Stanford in economics. When I started my Ph.D., I was originally interested in macro, but I found it confusing. I got interested in finance when I was a graduate student. It made more sense to me. The theories were cleaner and it felt more applicable to the real world. After graduating, I came to UCLA. I was incredibly lucky to come to UCLA at the time. The faculty included Richard Roll, Michael Brennan, who since retired, Fred Weston, who since passed away, and Eduardo Schwartz. They were the leaders of the group, and at the time, it was one of the two or three best finance groups in the world. I would pinch myself every day that these are the people I got to go to work with. I've loved being here since the day I arrived, and this will be my 23rd year.

AIA: How is Anderson's finance department different from those at other top business schools?

AB: One thing that is a hallmark at UCLA, and this is somewhat unusual, is that from a research perspective people here tend to be very broad. For example, Richard Roll published mainly on asset pricing but also made really fundamental contributions to corporate finance. Michael Brennan and Eduardo Schwartz were the same and also made contributions to multiple areas. For me, it was great because I like to work in many different areas.

The other thing that is unusual about Anderson is that many of the top finance schools that people think about are really not great research environments. For example, many of the senior people at

those schools spend a lot of their time doing outside consulting, which I think is very valuable in the right proportion, but they stop being active. Our senior people have a foot in the door, in terms of the private world, but they are firmly focused on research. Our group has always struck a really good balance. A good example of this is Francis Longstaff, who is the top researcher on credit markets and has also been a consultant at PIMCO and BlackRock. You can see how that work in the private sector has informed his research.

AIA: As you think about your own research over time, are there any broad themes that emerge?

AB: Like I mentioned, I have moved around a lot, but there is one theme that comes to mind and it was inspired by a consulting project I was involved with. The basic problem was quite simple: A biotech company was wondering how to make decisions about which projects to fund. They have many projects in the pipeline, and invariably the person making the decision has to rely on people who are better informed. They go and gather information from scientists and researchers involved in all of these projects and then try and make a decision, but the information they are getting is always really optimistic. The scientists have a private incentive to say the project is going great because their funding is at stake. This was the problem I was given. How can they provide incentives so that they get truthful information? Based on that, I wrote a series of papers on how capital budgeting decisions and incentives should be jointly determined. What it led me to think about is how, in finance, we teach students how to make a decision given certain information. Take projects with a positive NPV. We take the information as given: "Here are the cash flow estimates and then do the rest mechanically." But in real organizations, the hard part is getting accurate information.

I've written numerous papers over the years on this theme while working on other ideas as well, but recently this theme has led me to think about how we do contracting in healthcare markets. A very common problem that people talk about in healthcare is that you have doctors who have better information about the health of the patient, but they might have incentives to over-treat, especially in a fee-for-service world. On the other hand, the other solution people argue for is capitation, where you give the doctor a fixed amount of money per patient and let them decide what is best. But then you have an incentive to undertreat because what the doctor doesn't use ends up in his or her pocket. So insurers are wondering, "How do we get better information out of doctors?" They want to figure out what is important and what they should pay for. My research turned out to be very useful in this new field. It was interesting how that whole research stream started from a very simple question that was posed to me in a consulting project, and then I started to see how the theme was present in many economic relationships.

AIA: Recently, you have been researching optimal capital structure. Could you tell us a little about that?

AB: I have been thinking about how capital structure choices are influenced by other firms in the industry. It is work I've been doing with Ivo Welch and Alex Fabisiak, a Ph.D. student. For the most part, previous research on the subject has focused on the characteristics of the firm in question. The mechanism we have identified and explored is that many firms in an industry have a relatively common set of assets. If you think about a company that makes a debt decision, one consideration is what value assets have if they have to be liquidated in a distressed situation. The price they will get for those assets depends on how many other similar assets are being liquidated at the same time. But that then depends on the debt decisions that other firms in the industry have made.

To use airlines as an example: If all industry participants are highly levered, and the airline business is cyclical, then there is a chance that many companies will want to sell similar assets at a similar time and the price will be very low. Now, as a firm I am thinking, "The costs of financial distress are larger when other firms have more debt." So we argued that the cost of debt is dependent on what other firms are doing. And it isn't just in corporate finance.

Take a hedge fund. Say a hedge fund is following a momentum strategy, as are a lot of other funds. It is a crowded trade. And say the other hedge funds have decided to take on a lot of leverage. If momentum does poorly, then investors might want to redeem money. The assets that the funds will sell to pay investors are momentum assets. The fact it is a crowded trade depresses momentum stocks even further. So now the risk associated with the position is associated with how many others are crowding the trade. Hedge funds worry about this all the time, but there is an analogue in corporate finance.

One implication of this is that a company might want to be contrarian. You might want to be selling when others are buying and then buying at fire-sale prices with very little competition. And you see people who adopt these types of strategies. Warren Buffett is known for buying out-of-favor companies. There are firms in the shipping business that keep conservative debt policies in order to have capital to buy ships when other firms go bust and must liquidate at low prices. It's not that no one has thought about these things, it's more that when we think about and teach capital structure, we tend to think about the characteristics of the individual firm and not so much about what the peers are doing, even though that can be an important part of an optimal capital structure choice.

AIA: In general, are there any aspects of your research that you think investors should pay more attention to when making decisions?

AB: There's a branch of corporate finance that says that insiders have more information and use that information to make decisions. So then market participants should use these decisions as indicators. That's a pretty well thought through area of finance called "signaling." A good example of this is a share buyback. The problem is that if markets are relatively responsive then this information gets incorporated quickly and it is hard for it to be a trading strategy, because for a trading strategy, you need to be ahead of the game.

It's not that I believe that markets are efficient at any moment in time. I tend to have a view that, over medium to longer periods of time, market prices reflect fundamental values. In the short run, I think there is pretty good evidence that prices do not reflect fundamental values. If you just look at how much prices move in the short run relative to how much information comes out, it suggests that markets are moving a lot for other reasons. But I think what we have also learned is that it is really hard to come up with a trading strategy that is profitable without private information. So when I think about what corporate finance can contribute to investing, I'm stuck with the idea that I think corporate financing decisions do convey information to the market, but they are public signals that get incorporated relatively quickly.

AIA: Active versus passive is a big debate right now in the investment world. Do you think the conversation is overlooking anything?

AB: One interesting issue that exists, which is hard to disentangle, is that we look at data from relatively large investors when evaluating if professionals can outperform the market. Almost any investor will tell you how much harder it is to invest large amounts of money. You need to find more opportunities and, on top of that, your trades move the market against you. It could very well be that there are things that can be taken advantage of by smaller investors, but funds with a lot of

INTERVIEW WITH ANTONIO BERNARDO **CONTINUED**

money need to either find a lot of different strategies, which isn't easy, or a strategy that could be exploited at scale, which isn't easy.

AIA: How do you think potential changes in taxes and regulation could affect corporate finance and financial markets?

AB: If you look at some of the proposals that are being discussed, such as the Trump administration's idea of lowering the corporate tax rate, there are some things that we can expect. For starters, we can expect corporate valuations to go higher because after-tax cash flows will be higher. But there could be variation in the effect. Perhaps companies that have lower corporate tax rates today would see less of a benefit. Relatively large companies, for example, often have lower tax rates because much of their profits come from foreign subsidiaries where they have been able to avoid taxes by not repatriating. Thus, smaller, more domestic-based firms might be bigger beneficiaries. Another area that this could matter in, from a capital structure perspective, comes from one of the big benefits of debt financing being its tax shield benefit. If the tax rate goes from 35% to 15%, then the tax benefits get reduced dramatically, and we could see a pivot from debt financing to equity financing. Does that mean that we are going to see the supply of corporate bonds shrink? If that is the case, then what is the effect on yield spreads?

Another set of issues has to do with regulations. The regulations that the administration wants to get rid of, do they primarily affect incumbent firms at the expense of new entrants? How will the valuations of incumbent firms change? How will new business

formation and growth be affected? There are a huge number of finance implications tied to the tax rules, from foreign profits and corporate tax rates, and when that is combined with potential changes in regulation, there could be a fundamental rethinking of what the equilibrium looks like in these markets. I think it makes a lot of sense for people to think through the implications. I don't think these changes will affect all firms equally, and a smart investor should be looking into where potential disproportionate effects might occur. I don't think the play here is to buy the market, which means that I think this is an exciting time for investors. This is a time when you can dust off all you know about economics, finance and strategy and really think through who the winners and losers might be.

AIA: You are beloved by students and have received several teaching awards. What do you think makes a great professor?

AB: I've done well in the classroom, and a lot of faculty have asked me to come visit their classes and make suggestions on how to improve the teaching. My first observation is that, overall, the general level of teaching is really, really high. I think back to my days as a student, and I think that the level of teaching at Anderson is just so much better now. My second observation is that it really is a bad idea to give advice on teaching based on how you yourself teach. These things are very individual. For example, some people are very good at cold calling and do it in a way that brings out interesting discussion, but some people are really bad at it.

I think that one thing that is hard about teaching in an MBA program



Bahman Mirzaee ('18), AIA president, makes the opening remarks at the 2017 Fink Investing Conference



Conference Co-Director Nick Bender ('17) and second-year MBA student Gloria Fang ('17) learn about the panelists and speakers

is dealing with the different backgrounds students have when they come to the class. When you are teaching finance, there are some people who have backgrounds in economics and finance and they find this way of thinking to be straightforward. But what people sometimes forget is that some students aren't just coming in without a background in finance, but they are also coming in without a background in any of the fields. And as a consequence, you have to keep in mind how difficult it is from that perspective to learn statistics, finance and economics, all at the same time.

In general, we should have more empathy for how difficult that is. One of the things I have tried to do over the years is to try and make sure everyone gets value out of the class. If you are new to finance, what you might get out of the class is a new way to think about problems. But at the same time, I want to teach people who already know that way of thinking. Overall, the quality of teaching at Anderson is incredibly high, and who wins teaching awards at this point is a matter of splitting hairs.

AIA: Do you have any advice for students graduating and starting careers in finance?

AB: I've given the same advice for two decades: You learn in strategy that in any market you need some competitive advantage. That means that you have a set of skills that is somewhat unique. I've always thought that the real advantage of coming to a place like UCLA, which is really on the cutting edge, in terms of research, is that you get exposed to the people who are changing the way we think about

important areas in management. Students should figure out who those people are and take classes from them and get an edge. There are people on the faculty who know and understand things that few people understand. So figure out who those people are in your field and try and create a competitive advantage. That's a big part of the value of being at a top university with a research focus like UCLA. There are people around here who are really in the thick of it. Line up at 2 a.m. to get into their classes and learn from them — that's what I would be doing.

ABOUT ANTONIO

Antonio Bernardo is a professor of finance at the UCLA Anderson School of Management where he has held an appointment since 1994. He also served as department chair and senior associate dean for academic affairs from 2006-2009. Bernardo's research interests include corporate finance, asset pricing, information economics and organization theory. Professor Bernardo received his Ph.D. in economics in 1994 from Stanford University and his B.A. in economics from the University of Western Ontario in 1989.

Bernardo has published articles in leading journals of economics and finance, including the *Journal of Political Economy*, *The Quarterly Journal of Economics*, *The Journal of Finance* and *The Journal of Financial Economics*. He is also a winner of several teaching awards, including the Neidorf "Decade" Teaching Award, which recognizes a faculty member's exemplary teaching contributions.



Hans Hufschmid ('85), managing partner, AltB Partners LP



Andrea Eisfeldt, professor, Laurence D. and Lori W. Fink Endowed Chair in Finance and Neel Kashkari, president and CEO, Federal Reserve Bank of Minneapolis



Tad Rivelle, group managing director, chief investment officer-fixed income, co-director fixed income, TCW

INAUGURAL FINK CENTER CREDIT PITCH COMPETITION

On May 31, 2017, the Fink Center for Finance & Investments held the Inaugural Fink Center Credit Pitch Competition. The idea originated in the fall of 2016, and was conceived by John Bay ('17). After months of development with the Fink Center and co-founders Paige Kolesar ('17), Charles McMahon ('17), and co-director Joseph Chiu ('18), the first MBA-level credit pitch competition was launched.

Students invited nine top MBA schools from across the nation to participate in a 12-week portfolio competition capped off with a bond pitch competition at UCLA. With a three-month timeline and \$100,000 of "paper money" to invest, teams submitted an original portfolio of up to 10 bonds and were permitted to make 20 trades over the course of the competition. Each team was anonymous, but identifiable by a Greek letter team name.

Every week, each team's returns were made public so competitors and onlookers could track their progress. The best 12-week portfolio performance would win the top prize, but the competition also rewarded those who excelled in other ways. At the end of the 12-week period, the teams would travel to Los Angeles to make bond pitches to a panel of judges comprised of industry professionals, who would choose the best bond pitch and most improved portfolio prizes.

The panel of judges included Ray Kennedy ('88), a portfolio manager with Hotchkis & Wiley; Brian Gelfand ('14), fixed income trader for TCW; Kevin Bekas ('15), an analyst with DoubleLine; and Julie Greenman ('07), principal - investor relations for Ares Management.

The following schools competed:

- Columbia Business School
- Duke Fuqua School of Business
- Berkeley Haas School of Business
- Northwestern Kellogg School of Management
- MIT Sloan School of Management
- NYU Stern School of Business
- Michigan Ross School of Business
- Carnegie Mellon Tepper School of Business
- UCLA Anderson School of Management

On Wednesday, May 31, competing teams travelled to Los Angeles to make their bond pitches at the UCLA Meyer and Renee Luskin Conference center. Each team was given 15 minutes to present and

GIVING BACK

If you are interested in hiring full-time UCLA Anderson MBA students for internships or full-time positions, please contact Regina Regazzi, assistant dean and director of the Parker Career Management Center, at regina.regazzi@anderson.ucla.edu or at (310) 825-2902.

If you would like to post employment opportunities or participate in on-campus recruiting, please navigate to Anderson's online recruiting system at ow.ly/XapKp.



15 minutes to answer questions from the judges. The judges also delivered a panel on fixed income, and shared their experiences in attending UCLA Anderson.

The judges also addressed how they would've approached competing in the bond portfolio component, and agreed that a three-month horizon was challenging to work with. "Within that shortened time frame, it's tough to do distressed - it's just tough to do event-driven," said Brian Gelfand of TCW. "The fact of the matter is that it's a paper portfolio, and you wouldn't be moving the market, obviously, by transacting," added Kevin Bekas of DoubleLine.

The judges then deliberated on the team's presentations. With high-caliber pitches from all schools, they faced tough decisions. The winner of Best 12-Week Portfolio Performance was determined ahead of the bond pitches, and was awarded to Team Iota (Duke Fuqua), who won a prize of \$3,000. The judges awarded Most Improved Portfolio, with a prize of \$2,000, to Team Delta (UCLA Anderson), and Judges' Choice of Best Bond Pitch went to Team Zeta (Northwestern Kellogg), who won a prize of \$2,000. The teams and judges then celebrated the completion of a groundbreaking competition with a reception.



Credit Pitch Competition MBA student directors John Bay ('17), Paige Kolesar ('17) and Joseph Chiu ('18)



Winners of the Most Improved Portfolio at the Credit Pitch Competition, UCLA Anderson team members Phil Meng ('18) and Nick Heard ('18)

MEET THE EDITORS



Sam Kendrick ('17) is pursuing an MBA with a concentration in finance and investment management at the UCLA Anderson School of Management. Prior to attending Anderson, Kendrick worked in the entertainment industry as an associate producer at Tinder Hill Productions, where he developed and wrote TV pilots for CBS, Amazon and TV Land with writer-producer Michael Borkow. Kendrick's passion for value investing is what led him to Anderson, and last summer he worked in equity research at Thornburg Investment Management. Kendrick graduated from Yale University in 2006. He can be contacted at sam.kendrick.2017@anderson.ucla.edu.



Paige Kolesar ('17) is pursuing an MBA with an emphasis in finance at UCLA Anderson. Kolesar interned at Dimensional Fund Advisors in its Financial Advisor Services group in Austin, Texas, last summer. She will be returning to Dimensional Fund Advisors in Santa Monica after graduation. Prior to attending Anderson, Kolesar was a project manager at Northern Trust in Chicago, where she managed several software development projects as part of a company-wide initiative to improve profitability. Kolesar graduated from the University of Michigan in 2012 with a B.A. in economics. She can be contacted at paige.kolesar.2017@anderson.ucla.edu.



Lukas Langermann ('18) is pursuing an MBA with a concentration in finance and consulting at the UCLA Anderson School of Management. Prior to attending Anderson, Langermann was an associate investment director at Cambridge Associates, a consulting firm focused on helping nonprofits, pensions, governments and private wealth clients achieve their investment goals. He graduated from Northeastern University with a dual degree in international business and a concentration in finance. This summer he will be working on M&A and growth strategy at KPMG Strategy in Silicon Valley. He can be contacted at lukas.langermann.2018@anderson.ucla.edu.



UPCOMING EVENTS

Fall:

- Fellowship Selections: Kayne Investment Management, Brown Private Equity and Investment Banking Fellows
- Women in Finance

Winter:

- Stock Pitch Competition
- Private Equity Roundtable

Dates and speakers for next year's events are still being determined. Please check the Fink Center website for updates: www.anderson.ucla.edu/centers/fink-center-for-finance-and-investments/events.

The Laurence and Lori Fink Center for Finance & Investments has many opportunities for alumni support. If you are interested in being a mentor, event speaker or Fink Center group member, please contact the Fink Center's assistant director, Alexandra Gomez, at alexandra.gomez@anderson.ucla.edu.

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