UNIVERSITY OF AUCKLAND INVESTMENT CLUB

INVESTMENT BULLETIN

STUDENT WRITERS - STUDENT OPINIONS

AUGUST 16TH 2021 ISSUE NO.24

Sandfly Beach

The University of Auckland Investment Club
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Prices as at Friday 13th August 2021
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An update from the club

A RUNDOWN OF THIS WEEKS PITCHES WRITTEN BY OUR INVESTMENT COMMITTEE ANALYSTS

Tattooed Chef

Tattooed Chef

Tattooed Chef (NASDAQ: TTCF) is a plant-based frozen food manufacturer, selling its goods in the United States in over 4,000 retail stores and its e-commerce channel. They are in a growth phase, with revenues increasing by 63% between FY19 to FY20. Tattooed Chef has a private label and their 'Tattooed Chef' label, which sells products such as; Cauliflower Mac & Cheese Bowls, Organic Acai Bowls, and Cauliflower Crust Cheese Pizza. Tattooed Chef label products are innovative, nutritious and tasty. They produce and source most of their vegetables from Italy and create most of their value-added products in the United States. In part due to COVID-19, the frozen food industry has an estimated 4.2% CAGR for 2021-2026. This is also driven by more health-conscious eating, more middle-class households who are time-poor and people looking for foods with longer shelf lives. As the Tattooed Chef label is relatively new (started in 2017), the company is now focusing their efforts on marketing and customer acquisition. As they also currently only sell their products in the US, there is a large opportunity to expand globally in the future. The Investment Committee passed TTCF to the valuation stage by a vote of 9/15. Sandy Guo and Michael Smith will run the valuation.

"The Tattooed Chef is strategically positioned to provide quality and tasty meals to health-conscious consumers living increasingly busy lives"

New age Disney

WRITTEN BY SARAH JEONG

FAVOURITE DISNEY PRINCESS? VILLAIN? “A WHOLE NEW WORLD” OR “REFLECTION” AT KARAOKE? FOR MANY OF US, A SECOND IS ALL YOU NEED TO ANSWER THOSE QUESTIONS.

Disney has been a household name since its gorgeous classics, and iconic Mickey Mouse films became family favourites. Disneyland, dubbed “the happiest place on earth”, finds its way onto bucket lists and popular travel destinations. More interestingly, since the COVID-19 pandemic began in late 2019, it seems as though the world has slowed down while Disney put its operations at full speed.

To give context, Disney advanced market encompassing business moves before COVID-19. In 2006 they made their biggest acquisition, acquiring Pixar Animation Studios for USD 7.4 billion. Marvel Studios was acquired for USD 4 billion in 2009 as a subsidiary, integrating entirely in 2015. The purchase of Lucasfilm in 2012 gave Disney the rights to “Star Wars” and “Indiana Jones”. Studio acquisitions aren’t all Disney has been up to though. Parallel to diversifying its film franchises, the company has also been steadily repackaging its classic animated films into live-action movies. In doing so, they successfully garnered interest from young adult audiences who grew up with the classics: a difficult feat for traditionally children’s movies. Walt Disney Pictures studios have been consistently releasing live-action or photorealistic adaptations to existing animated films, releasing at least one every year since 2014, and four in 2019: *Dumbo, Aladdin, The Lion King,* and *Maleficent*: *Mistress of Evil*.

At the other end of the studio, the Marvel Cinematic Universe keeps fans well-fed with TV shows like *The Falcon and the Winter Soldier, WandaVision, Loki* and blockbuster *Black Widow*. Actors famously sign into six or nine movies when contracting with Marvel. Star Wars is similarly a developing cinematic universe as Disney introduces its new characters and sends off cult favourites to their ends. Recent Pixar animated releases *Soul, Onward*, and *Luca* also received positive critical attention, though they failed to reach the audience levels that previous animations did. Disney has few box office failures to account to its name. Still, with Soul streaming mostly exclusively on Disney+ due to the pandemic and Luca being exclusive to the streaming service, the Pixar originals aren’t counterparts to *Toy Story* or *Nemo*. Onward suffered significantly from the pandemic, with American cinemas going into lockdown just three weeks after its theatrical release. It made $141.9 million in cinemas, failing to meet its own budget. Despite all three of these animations moving onto Disney+, they were available under a regular subscription instead of an additional $30 premium that Disney’s most recent princess *Raya and the Last Dragon* and *Black Widow* came with.

The world in its entirety hasn't been all smooth sailing since. By all means, the company should have suffered a massive setback during the pandemic, which shut down all of its global Disneyland and Disneyworld locations and vacation cruises.

As cinemas closed down for months on end, release days of would-be blockbusters were pushed back entire years. On the other hand, the entertainment industry experienced a huge positive demand shock from the implications of lockdown and having the population stay at home. People unable to watch new releases on the big screen watched them from the comfort of their homes. The average level of media interaction for the average person has skyrocketed, social media platforms such as Tiktok also coming to life at the height of the pandemic. Disney+ launched in November 2019, and it took just 16 months to reach 100 million subscribers. For Netflix, it took 16 years.

Rather than a testament to the effectiveness of Disney+ business strategy or lack thereof of Netflix, these figures are reflective of how much our interaction with entertainment media has changed in the past few years. The company reported a profit of $29 million in 2020, down 67% from what it recorded for 2019. However, in that same period, Disney's share price increased 58%. Disney shares closed at an all-time high of USD 183.65 in March this year, more than doubling its share price of USD 86 in March 2020. After its biggest slump in March 2019, shares have seen experienced 36.9% growth in the past year, 86% growth in the past five years, appearing to stabilise at a much higher value than ever before.

Disney's movement from household favourite to entertainment "too big to fail" giant is an interesting narrative to follow. The pandemic has completely changed the future of theatre and home entertainment. The way entertainment leaders like Disney develop their releases and strategies in response continues to shape that future. Not everyone is ecstatic about Disney+, with titular *Black Widow* actress Scarlett Johansson suing the company over the movie's release on Disney+ concurrently with its theatre release, as she is not contracted to its profits. Hollywood reporter Matthew Melloni recently tweeted about the demoralising effect on Pixar employees of their studio originals becoming immediately available on Disney+ without premiums and without ever running brilliant box office runs. And despite being popular, Disney remakes and live-action attract claims that the studio no longer cares about creating magical stories but more about making money with nostalgic audiences.

On the one hand, Disney has flexibly adapted to the state of the market, creating a library of streamable content to last months on end. On the other hand, this might be the reason why it loses its most loyal following and magic-like quality.

The Enron catastrophe, 20 years on

WRITTEN BY ROHAN BHATT

IN DECEMBER 2001 – A FEW WEEKS AFTER MICROSOFT GAVE BIRTH TO THE XBOX AND WARNER BROS UNVEILED HARRY POTTER AND THE PHILOSOPHER'S STONE – ENRON CORPORATION FILED FOR BANKRUPTCY. WITH USD 63.4 BILLION IN ASSETS, ENRON'S BANKRUPTCY, AT THE TIME, WAS THE LARGEST IN THE HISTORY OF CORPORATE AMERICA. TWO DECADES LATER, IT IS THE SEVENTH-LARGEST EVER. A SYMBOL OF FINANCIAL FRAUD AND MISCONDUCT, ENRON'S FASCINATING STORY IS THAT OF A WALL STREET DIAMOND, CRUSHED BY THOSE WHO CREATED IT. ITS LEGACY REMAINS RELEVANT 20 YEARS LATER.

Who was Enron?

Enron Corporation was an energy company formed in 1985, following a merger between Houston Natural Gas Co and InterNorth Incorporation. CEO of the latter, Kenneth Lay, retained the same position for Enron and consolidated the gas pipeline operations of its predecessors into the Enron Gas Pipeline Operating Company. Additionally, Lay drove Enron into the business of electrical energy by establishing cogeneration units and power plants. Gas would prove the key to Enron's ascension - enter Jeffrey Skilling.

In the early 1980s, the US market for natural gas underwent a process of deregulation, resulting in an open, spot market for gas. Skilling, a former McKinsey & Co. consultant, provided Lay with a solution to eliminating the debt Enron had incurred in its merger. In 1989, Skilling established the "gas bank"; an entity run by Enron, which intermediates gas producers and consumers. Not only would Enron guarantee gas supply, but it would also allow parties to hedge price and other risks amidst transactions.

Skilling's genius essentially transformed Enron into a market-maker for energy derivatives, controlling the trading of gas futures and contracts through swaps and options. Leaving the financial jargon aside, Enron managed the supply of gas alongside bets regarding gas prices. Within a year, immense exposure led to the gas bank becoming Enron Gas Services, and the Enron Finance Corporation was established to maintain the market on gas derivatives, with the architect Skilling leading them both.

The journey upward

The 1990s saw Enron step foot into various ventures, the first being

international power projects. From 1991 onwards, Enron began building overseas power plants, spanning locations including England, India, Brazil and the Philippines. A quarter of the company's earnings were tied to such projects by 1996, distinct from domestic retail electricity sales.

Additionally, Enron launched an internet-based commodities trading website in 1999 – EnronOnline. This platform leveraged Skilling's experience and was, in essence, an extension of the gas bank, with real-time prices and information. Alongside gas, however, EnronOnline facilitated trading unique commodities such as weather and telecommunication bandwidth capacities. At the peak of the dot-com bubble, such a proposition was akin to a brand-new, five-bedroom house in Epsom entering Auckland's housing market. Investors leapt on it. Consequently, Enron stock rose 55% in 1999, before being split 2:1.
Before the turn of the 21st century, Lay's vision and Skilling's innovation portrayed Enron as a fresh, fearless company, with footholds in multiple sectors and strong core competency as a gas and electricity wholesaler. The question, then, begs itself –

What went wrong?

Every aspect of Enron's operations mentioned above sounded spectacular and trustworthy. Alas, that's as far as the story goes. In reality, Enron had invested billions of dollars in multiple ventures, returns on which were not only absent, but in the negative. The most controversial of these investments included an electricity plant project in India, multiple Brazilian utilities and local fibre optic networks. Thanks to an uncompromising balance sheet, however, investors were kept in the dark, and how.

Enron's loophole went by the name of mark-to-market (MTM) accounting. Via MTM, assets and liabilities subject to changes in value should be reported at their fair or current value to produce timely and realistic financials. This allowed Enron to revalue its energy-related holdings after each financial period and classify estimated, unrealised profits as income.

An example of such is Enron's partnership with Blockbuster Video in July 2000, through which Enron sought entry into the video-on-demand industry. Related partnership assets were then valued according to expected industry growth. Enron used MTM to list projected future revenues of USD 53 million as earnings, which were nowhere to be found in reality.

Furthermore, the company leveraged the common industry practice of transferring debt to special purpose entities (SPEs) – external legal entities that exist off-the-books but aren't real companies. Although extremely complex, Enron used SPEs to offload any loss-making assets and billions of dollars of debt in exchange for company shares. Transactions with these SPEs went as far as to involve leading American investment banks, all of

whom surreptitiously pocketed cash without any complaints. The bottom line was kept analogous with Enron's reputation, and no questions were asked.

By late August 2000, following a split the year before, Enron stock was trading at a peak of USD 90.75, making it the seventh-largest publicly traded company in the US. In the process, however, many executives, including Lay and Skilling, had begun selling their own shares of Enron, knowing well the reality of the company's financial health. In February 2001, Lay stepped down as CEO, naming Skilling as his successor. Six months later, Skilling himself resigned, due to personal reasons.

In October 2001, Enron disclosed a quarterly loss of USD 618 million, the first of many dominoes to fall. Extensive criminal and legal investigations led to the company admitting to the fabrication of its financial information since 1997. Infamously, Enron's accounting firm, Arthur Anderson (AA), ordered the eradication of all of the company's detailed financial files in late 2001. Failing to recognise Enron's malpractice, AA was convicted for obstruction of justice and revoked from auditing public companies, leading to dissolution. Ironically, AA's consulting arm benefited more from their relationship with Enron than its auditors, both of whom were guilty of encouraging Enron's behaviour in the name of downright fees. Prior to filing for bankruptcy in December 2001, Enron stock had fallen to USD 0.26.

What can we learn?

Enron's fall left numerous lessons in its wake surrounding the importance of accounting and regulation. Finance and investing are avenues that are fundamentally underpinned by numbers. However, these very numbers are often naively perceived as objective sources of truth. Enron's story is a precedent to the fact that numbers, in the same way as words, can be manipulated, highlighting the value of regulation and compliance.

Ultimately, the processes of any business come down to a chain of events, with clear material and financial links. Things should make sense. Unfortunately, amidst Enron's innovation, common sense went missing. All those involved with Enron were told what they wanted to hear, and they believed it. Hence, perhaps the biggest lesson here lies in human nature. When things are going well, no one bats an eye. But once the tide turns, everyone is to blame, apart from oneself.

Pricing Pollution - an insight into carbon credits in New Zealand

WRITTEN BY ZAC BALLANTYNE

IN A WORLD WITH AN EXTENSIVE RANGE OF FINANCIAL INSTRUMENTS AND DERIVATIVES AVAILABLE TO INVESTORS, CARBON CREDITS COULD EASILY BE CONFUSED FOR SOMETHING THEY ARE NOT. ARE THEY A FORM OF CRYPTO CURRENCY, OR SOME SORT OF TANGIBLE ASSET? CLIMATE CHANGE AND GREENHOUSE GASES ARE AN IMPORTANT TOPIC OF CONVERSATION, AND PLACING A QUANTITATIVE MEASURE ON THE COST OF THIS POLLUTION SEEMS LIKE A COMPLICATED TASK WITH BOTH UPSIDES AND LIMITATIONS. CARBON CREDITS AIM TO FILL THIS GAP, ALIGNING BOTH THE COUNTRY'S ECONOMIC AND ENVIRONMENTAL GOALS.

The recently updated Emissions Trading Scheme (ETS) aims to combat climate change by assigning a price to pollution through carbon credits – known as New Zealand Units (NZUs). The price of NZUs has increased steadily over the last 12 months, which suggests evidence of an investment case for both retail and institutional investors. However, the question remains – how is pollution valued? And will NZUs create a big enough deterrent to reduce climate change, or will they create a significant burden on New Zealand businesses?

Carbon credits, or NZUs, represent a unit of greenhouse gases. Each NZU corresponds to 1 tonne of carbon dioxide or equivalent greenhouse gas. Depending on the industry, businesses are either allocated NZUs, or are required to pay them. To earn credits, the business must be actively involved in extracting and storing greenhouse gases or prove their activities actively play a positive role in reducing emissions.

Companies that emit greenhouse gases from industries outlined in the ETS are required to purchase the units to offset their emissions.

These polluters can purchase units directly from the government or, alternatively, from the secondary market, most commonly peer-to-peer. The government holds quarterly auctions with an effective price floor and ceiling to help regulate the price and avoid market manipulation. Anyone has the right to buy these credits. The easiest way for retail investors in New Zealand to access the market is probably through Salt Funds Management Carbon Fund (NZE.CO2), which broadly tracks the price of carbon credits.

The overarching long-term plan of the ETS is to limit the amount of NZUs available for purchase at auctions over the coming years. It is planned that by 2025, there will be approximately 18% fewer units available for purchase than today.

Basic supply and demand laws tell us that the inherent price of NZUs should increase over this period as the resource becomes more scarce. This, of course, has the potential to create a valuable commodity. Although this would be nice for investors, there are

several other contributing factors to the price of these units.

The availability of units is intended to correlate closely and supplement the emissions budgets proposed by the Climate Change Commission. The Commission suggested NZUs would need to increase to a price of $140 by 2030 and $250 by 2050 to see considerable reductions in emissions (this was modelled, not forecasted!). This would pose significant financial burdens on businesses but also highlights potential investment opportunities. Clearly, political interference will be influential to carbon credits, as inevitable alterations to the scheme could positively and negatively impact pricing.

Another key driver of price is the European carbon market. Although this is not directly linked to the New Zealand market, it can be loosely viewed as a general indication of the larger market and pricing direction.

The viability of carbon credits remains in question, and whether or not they will actively play a part in reducing climate change. Perhaps the biggest flaw is the allocation of free units to specific industries. The recipients of these free credits include some of our largest polluters, including Tiwai Point, Glenbrook Steel Mill, and Fletcher Building. The government has promised to reduce this free allocation, but only at a rate of 1% per annum for the next ten years. Considering the ETS is only applicable to less than half of our current emitters, this free allocation is lessening the scheme's efficiency.

Furthermore, the economic impact on our smaller operators, such as local farmers, could be of significant detriment to our economy. Agriculture is currently not included in the scheme, so farmers are not required to purchase carbon credits. If this changes, further issues undoubtedly will arise from the induced economic burden on these individuals and small businesses.

Global cooperation is also a necessity for the ETS to be a success. An unintended consequence may be that businesses move their operations offshore from New Zealand to countries with less rigid pollution and climate controls. North America and Australia notably currently do not have any requirements regarding carbon credits – only voluntary markets. With only a number of weeks until the United Nations Climate Change Conference (COP26), this issue will be at the forefront of government minds, as countries will soon need to make pledges and targets to fall in line with the Paris Agreement.

Overall, there are many upsides to the ETS. A future where carbon credits are an intrinsic component of business models is foreseeable.

The intention is there, and it is now a question of the correct implementation and global cooperation. There is no doubt the ETS will have a positive effect on the climate change struggle, but it is by no means the be-all and end-all. Although there is evidence of a compelling investment case, investors should still be cautious of the pricing vulnerability to political interference and the nature of the isolated domestic market. We should be encouraged by the progress made so far in reducing our nation's climate footprint. It is definitely worth keeping an eye on this positive and proactive approach to placing a price on pollution.

Looking back at the Archegos debacle: Bill Hwang's blunder

WRITTEN BY MATT ATTWOOD

FROM METEORIC RISE TO FINANCIAL IMPLOSION. BILL HWANG USED BORROWED MONEY TO PROP UP HIS PERSONAL FORTUNE FOR IT ALL TO BE LOST WITHIN TWO DAYS.

Who is Bill Hwang? What is Archegos?

Bill Hwang is an anomaly, a man who was not on Wall Street's radar, and one of the wealthiest people in the world by March 2021. Having grown up in South Korea, Hwang moved to the United States with his parents at around 18 years of age. Hwang is a devoted Christian and was a figurehead in the Korean Christian community. He began his career in finance with Hyundai Securities after graduating from UCLA with a degree in economics and an MBA from Carnegie Mellon University. After leaving Hyundai Securities, Hwang met and began to work for his mentor Julian Robertson, founder of Tiger Management, a renowned American investment firm. Robertson would later seed $25m into Hwang's own hedge fund called Tiger Asia Management.

Tiger Asia Management did exceedingly well as Hwang escalated his wealth to more than $200m. However, in 2012 Hwang pleaded guilty to insider trading and had to pay a settlement of $44m to the SEC and subsequently closed the firm. This led to the creation of his family office firm called Archegos Capital Management. A family office is a private wealth management firm that caters to ultra-high-net-worth (UHNW) investors. Family offices are typically established for families or investors with over $100m in investable assets.

What happened to Archegos?

In 2013, Bill Hwang used his wealth in excess of $200m and invested in Archegos Capital Management. Initially, he was very successful due to two key investment strategies;

1. Investment in Tech Stocks: Hwang rode the boom of the 2010's with heavy investment in companies such as Amazon, LinkedIn, Facebook, Netflix, and Google.

2. Used borrowed money (leverage): This exacerbated his gains and allowed him to double down on the same investments.

Within seven years of operation, Hwang accumulated a highly liquid $20b net worth through essentially borrowing and betting on the same investments over and over. Not only was Hwang amassing a fortune, but he was essentially anonymous the

whole time. This is because Archegos, as a family office, was not subject to the same disclosure requirements as other hedge funds. Archegos was never mentioned in the regulatory filings that disclose major shareholders in public stocks. This was achieved through Hwang's use of swaps, which are a type of derivative security that exchanges two parties' cash flows or liabilities from different financial instruments. Put simply; the swaps gave Hwang the exposure to the investment gains or losses of the underlying asset (stock) without him directly owning it. The stocks he was earning from were under the names of the banks he was borrowing from, such as Credit Suisse and Nomura Japan.

On March 22, ViacomCBS announced a stock and convertible bond sale with the intention of raising $3b capital. Hwang has heavily invested in ViacomCBS and had an oversized position in it. Before the stock and bond sale, Hwang had continued to invest as share prices climbed, however, the sale drastically hurt share price as it fell 9% the following day and another 23% the day after. This forced a margin call, which is when the value of an investor's margin account falls below the broker's required amount. The banks of Wall Street demanded that Hwang presented collateral in the form of cash and urged him to sell his stock so that he could save his wealth. Hwang refused to sell.

Hwang's faith

Hwang justified his investment strategies through his devotion to God. He was not only dismissive of hedging opportunities but also continued to borrow and speculate on the same stocks. He claimed he was not afraid of either death or money because he was following God's word. Hwang lived an extremely modest lifestyle; he drove a Hyundai SUV and occupied a suburban house in New Jersey. His investment strategies essentially equated to that of a Wall Street Bets or RobinHood punter with no second thought or self-doubt.

Outcome & lessons from the fiasco

He lost it all. The $20b net worth he accumulated so quickly disappeared in two days. One of the largest single losses of an individual in modern finance. Not only did Hwang lose his personal fortune, he also cost the banks around $10b total, of which the biggest losers were Credit Suisse at $5.5b and Nomura Japan at $2.5b. Over a week in March, as banks dumped his holdings and share prices plummeted, Hwang essentially wiped $30b. Hwang is known as an invisible whale, someone who wields outsized influence in financial markets whilst remaining anonymous. If there's anything we can learn from Hwang's insane blunder, it's to diversify, hedge, and don't overleverage.

MYOB column

How to flex: Enabling flexible working arrangements

Flexible working arrangements have become the norm for professional services firms. But are they working for your organisation?

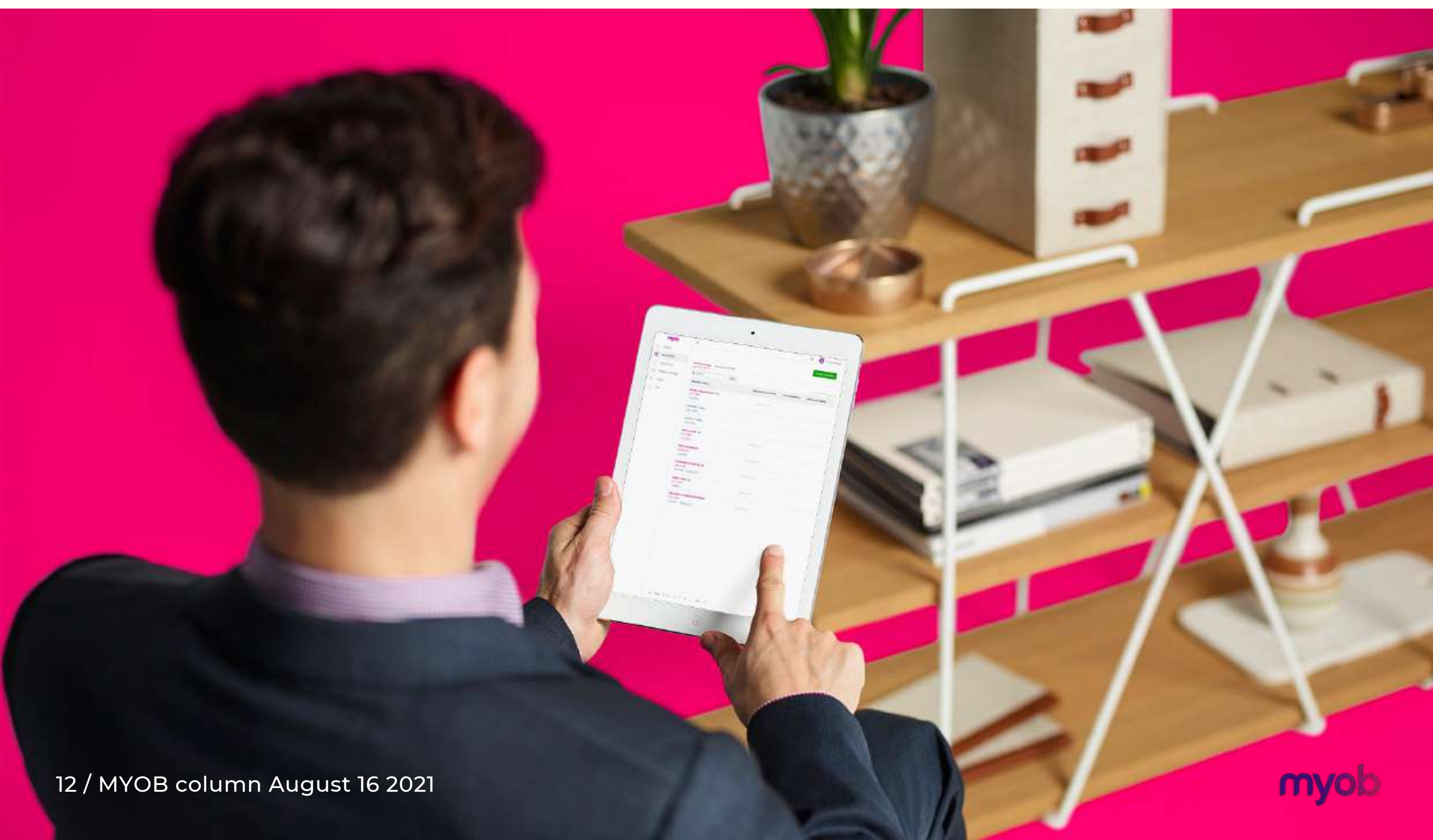
Many businesses have been worried about giving employees too much control over where and when they work. Without oversight, how can you tell that your people are actually working while they're at home?

For business owners, productivity is an ongoing concern, but it's no longer so clearly tied to the presence of the workforce in a central time and place.

The pandemic, with its strict working-from-home requirements and disrupted childcare arrangements, created the ultimate test – and by and large, many organisations have seen that working from home and flexible work hours are possible.

Increasingly workers are choosing their employment based on the availability of flexible working conditions, and there are direct benefits for businesses that are quick to adjust their systems and processes to accommodate it.

Read the full article here to find out how to create a more flexible workplace and make flexible working business as usual:



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