

The Blockbuster Assignment

Initial Due Date: September 18th (but early submissions are welcomed & appreciated).

Target length: 2 pages.

Related to a topic we will discuss a bit more in September, for some companies, these are “balance sheet times” (e.g., banks). Going back to our August meeting, we looked at two balance sheets: Imperial Capital Bank and Blockbuster. These companies showed high-level similarities (e.g., low equity amounts), but we discussed why the accounting ‘story’ was a partial illusion (i.e., for IMPC, the situation is worse than reported, for BBI it is better).

As a bit of review, we then talked about income statements (not terribly important for IMPC’s current situation, very important for BBI). We noted that BBI’s presented income statement was confusing (at a basic level... “What, exactly, is your bottom line profit?”). Things that an “unsophisticated” investor likely wants to know are (1) How much income is derived from in-store rentals versus other income sources? and (2) Why are general and administrative costs so high (likely related to the “growth” strategy... which I noted during class, seems like a questionable strategy in my opinion).

Related to both the Fox book and financial accounting, this assignment indirectly investigates what a reasonable “unsophisticated investor” should be expected to do before purchasing shares of stock. Certainly, accounting information – as currently presented – is not as helpful as it could be (e.g. IMPC vs. BBI example)... even though both companies have almost certainly “followed all of the rules”.

The trick to being an informed “unsophisticated” investor begins with a time trade off: How much time should you spend investigating a company (say BBI) before making an investment decision? What is your framework for comparison? Potentially, the amount of time you spend researching car stereo options before making a purchasing decision would be a reasonable comparison. At least, it would be in my case, because I’d be willing to spend about 3 or 4 hours on each task.¹

Okay... so in a loosely fixed amount of time (about three or four hours), the assignment is to give your thoughts on BBI in about two pages (or less). You must (1) support *some* projections / statements with financial figures and (2) you can’t completely base your arguments on comparative analysis (e.g., If Netflix is worth X, then Blockbuster is worth Y) or “momentum” stories (i.e., trend lines of BBI’s stock performance). Loosely speaking, this is a fundamental analysis of Blockbuster... however you want to do it.

With such a wide open set of instructions, the “trick” to your analysis is having a system. Like college football, we can all use different systems... but the key is to stick with your system until you learn that something else works better. To illustrate, when looking at balance sheets, the “system” discussed during class was a focus on fundamentals: (1) what do I know about this company (i.e., start with business thoughts) then (2) what are the components of $A = L + E$ and what are the Revenue – Expense = Profit numbers? Do any of these numbers catch my attention? Do I suspect some numbers are “off” for some reason?

To clarify, NO TWO POTENTIAL INVESTORS will have the same exact thoughts about what will happen at BBI (or any other company). That said, all potential investors will (or should) have some sort of system

¹ Note the logical flaw in this analogy: with a car stereo, I will likely purchase *something*. In contrast, a stock purchase is often an “on / off” switch. Regardless, I’d still spend 3 or 4 hours (loosely defined) on each task.

for analyzing a company (or merger target or partner target, etc). If you have a system, it might work – roughly - like football progressions (e.g., I do step 1, then I do step 2, etc.). Note that progressions are not a cookbook because you can stop at any point (by analogy, “the primary receiver might be open... no further progressions are needed because you already threw the ball”).

An ideal stopping point is when (1) you have a story and (2) you have reasonable support for that story. Related to discussions from our first weekend, information and “your story” will likely interact (your story affects what you look at & what you look at affects your story).²

As a potential starting point, here are my current progressions regarding publicly traded companies (please feel free to innovate... my “system” is constantly being revised and all suggestions for improvement are welcomed).

1. Why would I want to look at this company? (In my case, I needed a generalizable class example & I had just rented a movie... in your case, I picked BBI for this assignment). Frequently, you can stop at this step by saying, “I don’t want to look at this company”.
2. What do I know about this business? (BBI is generalizable because almost everyone knows *something* about the company... which speaks to the value of the Blockbuster brand name.)
3. What does the BS & IS look like? (recall class discussion)
4. Check out Yahoo! Finance [BRIEFLY... you can spin your wheels / invest too much time with this resource very easily in my opinion]
5. GOOGLE news items [BRIEFLY] (here... you might want to check out BBI’s bid for Circuit City).
6. **Ask yourself: Do I have a story yet? What are my thoughts about this company?** If you have no story, repeat #2 through #4 (typically, you might want to revisit step 1... but this is a class assignment... so ‘skipping’ Blockbuster isn’t an option).
7. Ask yourself, is my story consistent with BBI’s management’s story? (Read / skim the MD&A discussion in BBI’s most recent annual report.)
8. Am I willing to do additional analysis? If not, remember you can quit the ‘progressions’ any time. If more analysis works for you, longitudinal analysis (BBI compared over time) and cross-sectional analysis (BBI vs. competitors) are both common. Reading footnotes to the annual report (i.e., further description of many numbers on the Income Statement and Balance Sheet) might also help.
9. Keep track of how much time you are spending... when the marginal benefit of additional investigation falls off, come to a tentative conclusion and tell your story.

² Be mindful of the well-documented psychological bias to ignore conflicting information... for example, don’t ignore information just because it’s not consistent with your story... modify your story instead.