2013 Annual Report

Harvard Financial Analysts Club

The Harvard Financial Analysts Club
2013 Executive Board

Operations

Jared Sleeper ’14
President of Operations

Albert Cui ’14
Chief Operating Officer

Gregory McDouglas ‘14
Chief Education Officer

Marshall Zhang ’16
Director of Comp

Jordan Feyko ‘14
Director of Alumni Relations

Ryo Ishizuka ’16
Director of Investor Relations

Chaodan Zheng ‘15
Director of Legal Relations

Logan Kerr ’15
Director of Corporate Relations

James Ho ‘16
Director of Recruitment

Joanne Cheng ’16
Social Chair

Yuning Zhang ‘16
Social Chair

Finance

Connor Haley ‘14
President of Finance

Eric Hendey ’14
Director of Investment Research

Justin Katiraei ‘15
Director of Investment Research

Kevin Sun ‘15
Director of Equity Research

Nathan Gupta ‘15
Director of Portfolio Management

Robert Kindman ’14
Director of Risk and Quant

Geoffrey Lee ‘14
Director of Risk and Quant

FELLOW MEMBERS AND ALUMNI:

2013 was a year of growth and change for HFAC.

Restructuring our Organization

It began with a comprehensive overhaul of the structure of HFAC's Asset Management program. Responding to feedback from compers that they didn't feel qualified to be members of investment research groups and seeking to improve the small-group dynamics that are the core of our club socially, we created an "Equity Research Associate" program in which newly graduated compers (and any interested HFAC members) could learn more about finance in a hands on way without the performance expectations of full-fledged Investment Research Analysts. At the same time, the creation of the program allowed us to dramatically reduce the size of our investment research groups, allowing them to become more cohesive and have higher levels of engagement in their members. We believe that the success of these new groups is already evident in HFAC's outstanding investment returns this year, and reviews of the Equity Research Associate program continues to be positive as the program evolves.

Supporting our Sponsors

On the corporate relations side, we continued to grow HFAC's impressive array of sponsors, adding market leaders such as Fidelity Investments and MIT Investment Management Co, as well as smaller firms such as Spark Investment Management, leading to record sponsorship income for the club. At the same time, we set out to ensure that HFAC utilized the tremendous financial resources available to it. Our board enjoyed social events ranging from mixers to paintball to an HFAC-Formal event in Boston, we instituted a well-used reimbursement program for small group bonding in often-innovative ways, and we introduced pizza (and chicken bites) as a staple at Asset Management meetings. We also sponsored a successful Wall St. Trip, visiting Goldman Sachs, Evercore and Blackstone and hosted site visits at leading buy-side firms in Boston.

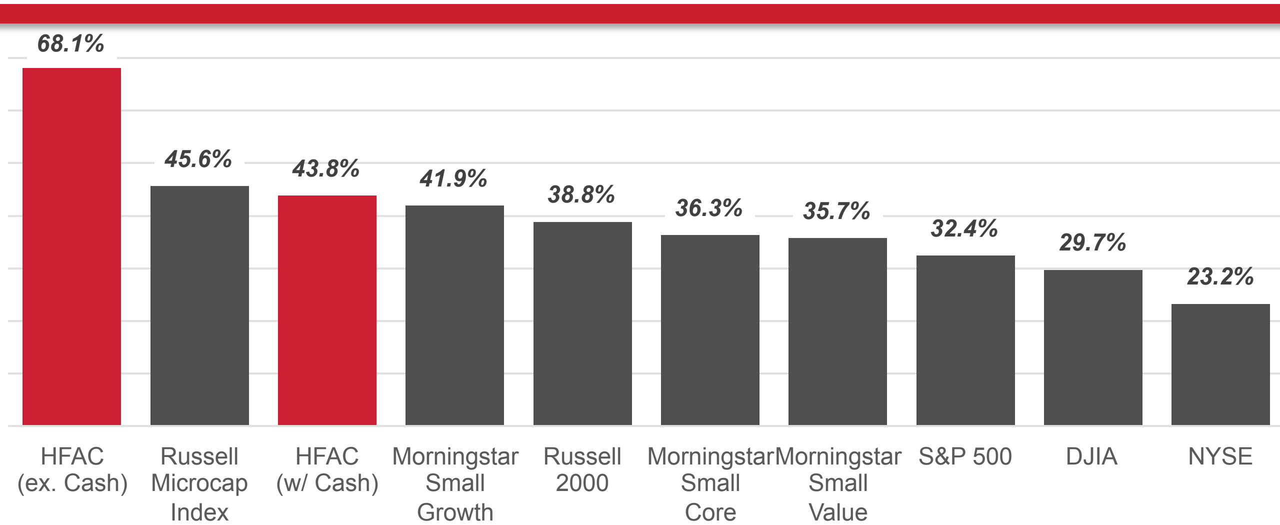
Graduating our Compers

Our comp continues to be a major source of strength for HFAC. We are set to graduate over 180 compers in 2013, including a record setting comp class of over 100 anticipated this fall. Our compers continue to get a rigorous introduction to accounting and valuation culminating in a final pitch competition, which now features a cash prize.

Conclusion

Overall, HFAC has never been stronger an organization at Harvard. We have had more social events, more active AM participation, more compers and better returns than ever before, and look forward to continuing to grow as an organization in 2014.

Portfolio Review



2013 has been an exciting and transformational year for the HFAC portfolio. The year began with a re-articulation of the fund's strategy, setting our focus on under-covered micro-cap stocks instead of the broader universe HFAC has historically pursued. Rather than the diversified portfolio that the fund has traditionally held, we concentrated in 6-8 high conviction positions and were unafraid to hold our best idea at more than 20% of the portfolio. After evaluating each of the fund's positions in accordance with this new strategy, we decided to conduct a thorough "spring cleaning" and liquidated more than 65% of the portfolio while resizing the remaining positions in accordance with our conviction. These initiatives positioned the fund to achieve outsized returns in 2013, and we hope that the positive effects of these changes will be felt for years to come.

Despite a challenging market environment for value investors, we have been diligent in pursuing our strategy and have reaped the rewards of our patience. Although our returns lagged the market's rapid ascent in the first half of the year, we have ultimately posted returns that are, to the best of our knowledge, the strongest in the history of HFAC or of any finance organization on Harvard's campus. To date, our returns stand at 68.1% on an ex-cash basis, which easily bests every mainstream market or fund index. Even after accounting for the cash drag associated with our "spring cleaning," our portfolio has still returned 43.8% with an average cash position of more than 37%.

Classification	Rank	Percentile
Small Value	1 of 386	99.7%
Small Blend	1 of 720	99.9%
Small Growth	2 of 720	99.7%
Mid-Cap Value	2 of 421	99.5%
Mid-Cap Blend	1 of 416	99.8%
Mid-Cap Growth	1 of 726	99.9%

BIGGEST WINNERS

Noble Roman's (NROM) – Up 162.2% YTD

When the fund first invested in Noble Roman's, we believed it had a number of characteristics of an attractive investment: a strong core business trading at 50% of peer multiples, a new Take-n'-Bake business that was ignored by the market, value that had been obscured by a lawsuit and forced selling, and a potential catalyst with the initiation of a dividend in 2014. While the market has clearly recognized some of the value in the business, our analysis shows that significant upside still remains. The company's Take-n'-Bake business continues to exceed even the most ambitious growth expectations (45 stores signed in 2013 vs. management guidance of 25), and although it will take time for the company to ramp up these locations, the business's operating leverage will allow for conversion of virtually 100% of incremental revenues to free cash flow. The thesis remains on-track, and our calculations value the stock at $2.50 to $3.35 if the company can reach a reasonable 100 Take-n'-Bake locations in the next 4 years.

Axia NetMedia (AXANF) – Up 78.2% YTD

We originally saw Axia as a company with a strong underlying business that was weighed down by major investments in new infrastructure projects that had yet to become profitable. Even without accounting for the growth potential in an industry with significant tailwinds and growing demand drivers, Axia traded at 3x pro-forma EBITDA.

The events of the last year have reaffirmed our initial thesis on the company while also causing the market to realize the value in the company. The company sold its new networks in Singapore and Spain for more than $40 million or 10x 2014E EBITDA, a significant premium to the market's implied valuation for the remainder of the assets even after accounting for growth. In addition, Axia extended the contract for the Alberta network until 2018, which we believe has substantially de-risked the company. We continue to believe that the company trades at 4x run rate EBITDA with a significant runway for growth.

BIGGEST WINNERS

Schuff International (SHFK) – Up 58.0% YTD

Our thesis on Schuff was relatively simple – it was a cyclical business trading at 4.5x normalized UFCF with a dominant position in a fragmented industry. Management's aggressive leveraged recapitalization, which allowed the company to retire 57.7% of shares at less than half of book value, further enhanced shareholder value. Additional research has reaffirmed the strength of Schuff's business, as its size confers a number of competitive and cost advantages. We believe that Schuff is a company that is still in the early innings of a recovery that will be driven by predictable macroeconomic tailwinds. As non-residential construction continues to recover, Schuff will be able to drive top line growth and margin expansion should allow it to return to its pre-crisis prosperity. While not an indication of our future expectations for the company, the fact that he company's enterprise value today ($107.4M) is nearly equivalent to its EBITDA in 2007 ($102.8M) highlights the extent to which the company is currently undervalued.

SCHUFF STEEL

BIGGEST LOSERS

Crimson Wine Group (CWGL) – Down 8.0%

We consider it relatively admirable that Crimson Wine Group, a stock that has declined 8% since we first purchased, represents our second biggest loser for this year. CWGL is a spin-off story that will likely play out gradually over the next several years. We saw the spin-off as a sign that Leucadia's management believed CWGL's assets were more valuable than the value Jeffries had assigned to them, and it is reassuring that Leucadia's billionaire founders chose to sit on the board of CWGL. While the company currently trades at just over book value, our research shows that CWGL's book value is actually understated by between $80 and $160M relative to its market cap of $200M. While there is no clear catalyst for this value to be recognized by the market, we believe this will by realized as the company continues to leverage its underutilized assets to increase production and drive revenue and earnings growth.

CRIMSON WINE GROUP

BIGGEST LOSERS

Sandstorm Metals and Energy (STTYF) – Down 71.2%

“Investing is a probabilistic business. For every commitment of capital we make, we compare our estimation of the likelihood of success with the probability of failure.”
~Harvard Alumnus Bill Ackman on Failure at J.C. Penney

Bill Ackman’s words can aptly be applied to our investment in Sandstorm as well. While we had seen a number of bullish indications for Sandstorm, we ultimately underrated the downside risks in the company. Although the company was hurt by the significant decline in commodity prices, a possibility that we had considered, it was the project-level risk that became the downfall of Sandstorm. Because the company gave late-stage financing to mines, we largely ignored the idiosyncratic risk of particular projects and viewed it as a near certainty that the projects Sandstorm invested in would ultimately produce income streams for the company. The events of the past year proved what a critical assumption this was, as each of the firm’s investments have experienced either total failure or crippling delays.

While Sandstorm was a significant decliner, it had a disproportionately low drag on overall returns due to its small position size. Nevertheless, this is a situation that we have studied carefully in an effort to avoid similar mistakes in the future, and although unfortunate, it has helped to shape the HFAC investing philosophy and allowed us to better position ourselves to outperform over the long term.

OTHER POSITIONS

INFUSystem Holdings (INFU) – Up 47.0%

InfuSystem has been a developing story for the fund and a thesis that has similarly evolved over time. We originally were interested in InfuSystem due to the work of an activist investor who also served as Chairman of the Board, Ryan Morris. We believed that Morris's aggressive cost cutting measures would allow the company to improve operating performance in the near term, but also saw the potential for Morris to make a bid to buy out the company. In July, Morris made what we considered to be a very fair offer to purchase the company for $1.85-2.00 per share, which was rejected by the Board. While we were disappointed in this decision, we were encouraged by the fact that the cost savings continued to materialize and believed that the buyout story had actually distracted from this core thesis on the company. In addition to the cost savings, the company's contract wins in 9 out of 9 CMS contracts it bid confirmed our original belief in the company's cost advantage relative to its competitors. The stock has now rebounded to the same level as after the Morris offer. Moving forward, operating improvements and cost savings should allow the company to continue to grow EBITDA. At 5.1x LTM EBITDA, we believe that the company's leading position and sustainable competitive advantages warrant a substantially higher multiple more in line with the five-year average of 7.3x EBITDA.

OTHER POSITIONS

Straight Path Communications (STRP) – Up 33.4%

Straight Path is the most recent addition to the HFAC portfolio and one that we are very confident will be a significant performer for us in the coming years. Straight Path is a complex micro-cap spin-off situation with a portfolio of assets that are extremely difficult to value. After over a month of research, we believe that there is significant value in both the company's patent portfolio and spectrum assets. The willingness of Kirkland and Ellis to litigate the company's patent portfolio on contingency indicates that those who are most knowledgeable about these patents believe there is significant value to be unlocked through more lawsuits, and the company's success in litigation in the past provides further evidence for this point. The company's spectrum holdings are poised to benefit from a secular shift toward small cell wireless backhaul driven by increased data usage. Straight Path's holdings represent the largest portfolio of FCC licenses for 39 GHz spectrum that would be used for this backhaul, which will allow the company to monetize this off-balance sheet asset in the next 3-5 years. We believe the company's assets are misunderstood by the market and significantly undervalued, creating a rare "heads I make 5x my money, tails I break even" situation.

WebMD Health (WBMD) – 4.2% return

WebMD was a brief holding for the fund that we pursued as an odd lot tender. We sold the shares for a 4.2% gain less than three weeks after we had purchased them for a quick incremental addition to the fund's annual return.

www.harvardfac.org