

Discussion of
"From Falling Angels to Shooting Stars: Was the NASDAQ
Collapse an Overreaction?"

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Main Findings: Summary

- Low enterprise value firms earn high returns
 - Enterprise Value = [Market Equity + Book Liabilities] – Cash and Cash Equivalents
 - CAPM adjusted return is **2.3%** and **4.5%** per month for the EW and VW portfolios of a sample of ***negative*** enterprise value firms
 - Inclusion of additional technical factors – B/M, Size, and Momentum – does not attenuate these returns

Comments #1:

Where does low valuation come from?

- Three potential explanations for the low valuation
 1. Agency issues
 2. Information asymmetry
 3. Investor overreaction: the preferred explanation
- To establish the overreaction argument, we need to identify the trigger for such overreaction
 - NASDAQ “bubble” may be responsible for a subset of the low enterprise value firms (129 observations)
 - But how about the rest 352 (=481 – 129) firms?
 - NASDAQ “bubble” do not seem to be the direct trigger

Comments #2: the Role of Arbitrageurs

- The mispricing seems to be large and rather persistent
- Two types of arbitrageurs may attempt to take actions
- Type I: Passive investors
 - They do not seek to actively participate in the daily routine management of the firm
 - They could implement a simple buy-and-holding (BH) strategy: the BH strategy does not seem to be particularly risky

Comments #2: the Role of Arbitrageurs, cont'd

- Type II: Active investors
 - They are so-called “catalysts” in the language of Graham-Dodd type of “value investing”
 - see, Value Investing: From Graham to Buffett and Beyond, 2004, by Greenwald, Kahn, Sonlin and van Biema.
 - They seek to unlock the value of the firm - these negative enterprise value firms are good takeover candidates
 - Indeed, a substantial fraction (about 51%) of these negative enterprise firms got acquired (see Table 3)

Comments #2: the Role of Arbitrageurs, cont'd

- There are several puzzles
 - The first puzzle is why it takes so long for Type II investors to step in and create values.
 - Sector wide financial constraint? Capital immobility?
 - The second puzzle is why Type I investors do not seem to take into account future actions of Type II investor in the ex ante valuation.
 - The third puzzle is what the management / insiders do during those scenarios when low enterprise values occur.

Final Remarks

- It is very interesting to study the price and organizational evolutions of these low and negative enterprise value firms.
- It remains to pin down exactly what causes the swing to low/negative valuation at the first place.
- Studying the behaviors of Type I, Type II investors and Insiders could yield additional insights on how these investors create values.