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 $= \text{[Market Equity + Book Liabilities]} - \text{Cash and Cash Equivalents}$
  - 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.