# Ben Graham Then and Now

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In mid-1932, almost precisely at the bottom of the Great Crash, Benjamin Graham turned up as a freelance writer in the pages of FORBES. He was later to be known as the father of value investing and as a mentor to Warren Buffett. But at the time he was the manager of a fairly obscure hedge fund.

That fund, which combined long and short positions but was mostly long, was hurting. It had tumbled 70% from its 1929 high. (The Dow was down 87%.) Stocks had got too cheap, Graham pleaded. The fact that profits were vanishing almost didn't matter. You could buy companies for less than their net liquidating value. You got the goodwill and the factories for nothing.

Graham defined liquidating value in a very conservative way. Take working capital (current assets like cash, inventories and receivables, less current liabilities), then subtract any debt not already included among the current liabilities. A third of the industrial companies on the New York Stock Exchange were trading for less than their liquidating value, he said.

Are we in that kind of a crash now? Not quite. In the big crash stocks sank to one-ninth of their highs. This time around the S&P is still (as of the Oct. 17 close) not even down by half from its high. The S&P industrials are collectively trading at 2.2 times book value, and that book value includes a fair amount of fluff in the form of goodwill.

Martin Sosnoff noted in a recent Forbes.com column that the S&P 500 index is going for 12 times its plausible 2009 earnings. That's cheap, but not screamingly cheap. The dividend yield on the index is 2.9%, three-quarters of what it has averaged since 1926. Longstanding bear Andrew Smithers turned bullish recently. But economist Gary Shilling, who accurately foretold the housing bust and the exhaustion of the consumer, says the stock market could test its 2002 low.

We went hunting for Grahamesque bargains in Wall Street's wasteland. A table of companies trading at a discount to net working capital appears below. It's an intriguing list, but it doesn't include mainstream names as did Graham's list 76 years ago. A parallel assortment of Japanese bargains appears in Overflowing Coffers.

Graham died in 1976. He might have remained mostly unknown to the investing masses if not for the fact that his disciple became the richest man in the world. In an op-ed essay in the *New York Times* on Oct. 17, Buffett declared that stocks were a buy. He did not spark a rally.

**June 1, 1932**

There are literally dozens of companies that have a quoted value less than their cash in the bank. More significant still is the fact that an amazingly large percentage of all industrial companies are selling for less than their quick assets alone--leaving out their plants and other fixed assets entirely.

This means that a great number of American businesses are quoted in the market for much less than their liquidating value; that in the best judgment of Wall Street, these *businesses are worth more dead than alive*.

What is the meaning of this situation? The experienced financier is likely to answer that stocks always sell at unduly low prices after a boom collapses. As the president of the New York Stock Exchange testified, "In times like these, frightened people give the United States of ours away." Or, stated differently, it happens because those with enterprise haven't the money, and those with money haven't the enterprise to buy stocks when they are cheap.

We must recognize that the situation existing today is *not* typical of all bear markets. Broadly speaking, it is new and unprecedented. It is a strange, ironical aftermath of the "new era" madness of 1928--29. It reflects the extraordinary results of profound but little understood changes in the financial attitude of the country.

Two plausible and seemingly innocent ideas--the first, that good stocks are good investments; the second, that values depend on earning power--were distorted and exploited into a frenzied gospel that ended by converting all our investors into speculators. This situation made our corporations rich and their stockholders poor, by reversing the relative importance of commercial loans and Wall Street loans, by producing topsy-turvy accounting policies and wholly irrational standards of value--and in no small measure was responsible for the paradoxical depression in which we find ourselves submerged.

**June 15, 1932**

Instead of lending directly to big business, the banks have been forced to lend to their stockholders against pledges of their shares, or to purchase securities on their own account.

The whole development has proved most disastrous to stock holders and most embarrassing to the banks. The best form of borrowing has been replaced by the worst. The safety of the loans, and to some extent, the solvency of the banks making them, has been placed at the mercy of stock market fluctuations, instead of resting on the financial strength of our large corporations.

Let corporations return to their stockholders the surplus cash holdings not needed for the normal conduct of their business.

**July 1, 1932**

The unprecedented spectacle confronts us of more than one industrial company in three selling for less than its net current assets, with a large number quoted at less than their unencumbered cash.

As far as the stockholders are concerned, their interest in the corporation's cash account is just as theoretical as their interest in the plant account. *If* the business were wound up, the stockholders would get the cash; *if* the enterprise were profitable, the plants would be worth their book value. "*If* we had some ham, etc. etc."

This criticism has force, but there is an answer to it. The stockholders do not have it in their power to liquidate it. At bottom it is not a theoretical question at all; the issue is both very practical and very pressing.

We have not yet found any way to prevent depression from throttling us in the midst of our superabundance. But unquestionably there are ways to relieve the plight of the stockholders who today own so much and can realize so little. A fresh viewpoint on these matters might work wonders for the sadly demoralized army of American stockholders.

# Bargain Basement

**Companies now trading at a discount to net working capital.**

| Company \| Industry | Latest Closing Price | Net Liquid Asets/ Share* | Premium to Market Value** | Market Value ($mil) |
|---|---|---|---|---|
| Audiovox \| telecommunications equip | $5.05 | $11.20 | 122% | $115 |
| Smart Modular Technologies \| electronic components | 1.85 | 3.09 | 67 | 113 |
| Crocs \| footwear | 2.19 | 3.60 | 65 | 181 |
| Tech Data \| electronics distributors | 21.96 | 33.77 | 54 | 1,109 |
| Novatel Wireless \| computer communications | 4.56 | 6.39 | 40 | 149 |
| West Marine \| specialty stores | 5.17 | 6.95 | 35 | 114 |
| Horsehead Holding \| zinc, minerals | 3.48 | 4.67 | 34 | 122 |
| Adaptec \| computer communications | 2.77 | 3.53 | 27 | 334 |
| Benchmark Electronics \| electronic components | 9.86 | 12.03 | 22 | 660 |