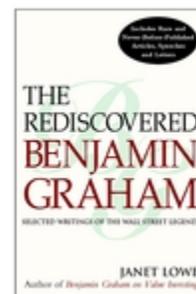


THE REDISCOVERED BENJAMIN GRAHAM *Lectures*

Lecture Number Nine

This is a transcript of a lecture from the series *Current Problems in Security Analysis* presented by **Benjamin Graham** at the **New York Institute of Finance** from **September 1946 to February 1947**. This content is found in abridged form in *The Rediscovered Benjamin Graham: Selected Writings of the Wall Street Legend* (Wiley, April 1999) by Janet Lowe. Alternatively, full html versions for all ten lectures are available on the [publisher's website](#).



Now, we turn to the New Amsterdam Casualty case, which is interesting for a completely different set of reasons, as I pointed out in the previous lecture. Here you have a very large discount in price from break-up value, but instead of having an unprofitable company, you have one which, over the years, has shown very good results indeed. Instead of having the stockholders suffering from what might be called a certain waste of assets -- in the sense of a business which is carried on for years on a relatively losing basis -- you have exactly the opposite: The stockholder is suffering from an undue desire by management to gather together and retain all the assets possible and to give out as little as they decently can to the stockholders. I think the contrast in the two cases is very extraordinary, and it deserves some careful thinking on your side. For it shows that the stockholders' interests are affected by developments and policies of a very diverse nature, and that a stockholder can suffer from failure to pay out earnings, when they are realized, nearly as much as he suffers from the failure to realize earnings.

Now, that will be vigorously denied by corporate managements, who insist that as long as the money is made and is retained in the treasury the stockholder does not possibly suffer and he can only gain. I think you gentlemen are better qualified than anyone else to be the judge of that very question. Is it true that the outside stockholder invariably benefits from the retention of earnings in the business, as distinct from the payment of a fair return on the value of his equity in the form of dividends? I believe that Wall Street experience shows clearly that the best treatment for stockholders is the payment to them of fair and reasonable dividends in relation to the company's earnings and in relation to the true value of the security, as measured by any ordinary tests based on earning power or assets.

In my view the New Amsterdam Casualty case is a very vivid example of how security holders can suffer through failure to pay adequate dividends. This company, as I remarked two weeks ago, has been paying a one dollar dividend, which is the same amount as paid by the other two companies. Its average earnings have been very much higher. For the five years 1941-45, the earnings are shown to have averaged \$4.33, after taxes, as against which their maximum dividend has been one dollar per annum.

You will recall that the North River Company during that period earned an average of \$1.12, one quarter as much, and paid the same dividend of one dollar. And the American Equitable, which earned an average of nine cents in those five years, also paid one dollar. If the New Amsterdam Company had been paying a dividend commensurate with its earnings and its assets, both, there is no doubt in my mind but that the stockholders would have benefitted in two major ways: First, they would have received an adequate return on their money, which is a thing of very great moment in the case of the average stockholder, and secondly they would have enjoyed a better market price for their stock.

It turns out that we have an extraordinarily pat comparative example here in the form of another casualty company, called the U.S. Fidelity and Guaranty. This pursues an almost identical line of business, and has almost identical earnings and almost identical assets, per share, as has New Amsterdam. But it happens to pay two dollars a share in dividends instead of one dollar a share, and so it has been selling recently at about 45; whereas New Amsterdam stock has been selling at somewhere around 26 to 28.

The difference in results to the stockholder between paying a reasonable and fair dividend and paying a niggardly dividend is made as manifest as it can be by these contrasting examples.

You may ask: What is the reason advanced by the management for failure to pay a more substantial dividend, when it appears that the price of the stock and the stockholders' dividend return both suffer so much from the present policy?

You will find, if you talk to the management on the subject, that they will give you three reasons for their dividend policy; and if you have done similar missionary work over a period of time, the arguments will sound strangely familiar to you.

The first reason they give you is conservatism -- that is, it is desirable, and in the interest of the stockholders, to be as conservative as possible. It is a good thing to be conservative, of course. The real question at issue is, can a company be too conservative? Would the stockholders be better off, for example, if they received no dividend at all, rather than one dollar -- which would be carrying the conservatism to its complete extreme? I believe that experience shows that conservatism of this kind can be carried to the point of seriously harming the stockholders' interest.

The second reason that you will get from the company -- and you will get it from every other company in the same position -- is that theirs is a very special business and it has special hazards; and it is necessary to be much more careful in conducting this business than in conducting the average business or any other one that you might mention. In this particular case they would point out also that the results for the year 1946 have been unsatisfactory, and that the current situation is by no means good.

Since every business is a special business, it seems to me that the argument more or less answers itself. You would have to conclude that there would be no principles by which the stockholders can determine suitable treatment for themselves, if it is to be assumed that each business is so different from every other that no general principles can be applied to it.

With regard to the statement that the 1946 results have been poor, it happens that if you analyze them in the usual fashion you would find that even in a bad year like 1946 the New Amsterdam Casualty Company appeared to earn on the order of two dollars and a half a share. Therefore it could well have afforded a larger dividend than one dollar, even if you took the one-year results alone, which it is by no means the proper standard to follow. Dividend policy should be based upon average earnings in the past and upon expected average earnings in the future.

It will be pointed out that some companies have been having difficulties in the insurance business in the last two years, and for that reason it is very desirable that conservatism be followed. We all know there have been some very unprofitable insurance concerns, and some have been profitable. To say that stockholders of profitable businesses cannot get

reasonable dividends because there are some unprofitable or some possibly shaky companies in the field, I would call rather irrelevant.

The third argument -- and this is especially interesting, I believe, because it comes down to the essence of stockholders' procedures and rights -- is that the stockholders do not understand the problems of the business as well as the management of a company. Therefore it is little short of impertinence for the stockholders to suggest that they know better than the management what is the proper policy to follow in their interest.

Of course, the trouble with that argument is that it proves too much. It would mean that regardless of what issue was raised, the stockholders should never express themselves, and should never dare to have an opinion contrary to the management's. I think you would all agree that the principle of stockholders' control over managements would be completely vitiated if you assume that managements always knew what was the best thing to do and always acted in the stockholders' interest on every point.

I want to say, with regard to the New Amsterdam Company -- since in this course we have been mentioning names right along, for the sake of vividness -- two things: First, I should have started by saying that my investment company has an interest in the New Amsterdam Casualty Company, and I have had a dispute with the management as to proper dividend policy. I want to say that, because you may believe that this presentation has been biased -- and you are perfectly free to form that conclusion if you wish. You should be warned of the possibility of bias. My belief, of course, is that the statements made fairly represent the issues in the case.

The second point I want to make very emphatically is that the New Amsterdam Casualty Company is extremely well managed by very capable people of the highest character, and that the issue that arises here is not one of self-interest on the part of the management, or lack of ability, but solely the question of dividend policy, and its impact on the stockholders' interest.

The solution of this problem of the stockholders' interest in the New Amsterdam case, and many others, is not easy to predict. As I see it, after a good deal of thought, analysis and argument on the subject, you need in these cases a long process of stockholders education, so that they will come to think for themselves and act for themselves.

Whether that will ever be realized I don't know; but I am very hopeful that people in Wall Street might play a part in giving stockholders sound and impartial guidance in regard to the holdings that they have, as well as to the securities which they might think of buying or selling.