It cannot be denied that the Great Depression of 1929 and the Wall Street crash that followed was perhaps the most humbling experience for investors at the time. Life was tough and there was no hope to clutch on to. After crushing losses, most stocks were available at ridiculously cheap prices over the next decade as the markets remained trapped in a bear grip.

But as any stock expert will tell you today, behind every market disaster lurks opportunity – if you just look hard enough. It was the same for Benjamin Graham, who, despite suffering heavy financial losses himself, began a conscious campaign of snapping up stocks that suddenly became available at bargain prices.

Graham’s strategy was simple: buy companies that he likened to cigar butts – typically abandoned but still good for a puff or two. And you could pick them up for virtually nothing. Stocks quoting below their liquidation values after keeping a ‘margin of safety’, allowing for any contraction in prices, were his key bets.

His strategy soon started being talked about in the investing community. One man, in particular, was highly influenced by Graham’s strategy, and in tribute to his ‘idol’, bought shares in about a hundred such cheap companies. His faith soon paid off: in five years, John Templeton – whose name today is synonymous with value investing – had multiplied his original investment several times, despite around 15 of those companies going bankrupt.

The value investing philosophy propounded by Graham and practised vigorously by Sir John Templeton was eventually perfected into an investing technique that called on investors to buy stocks cheap – so cheap that there was very little chance of the stock falling any further (thus avoiding any loss of capital).

After Graham articulated his thoughts on the subject in the book Security Analysis in 1934, value investing grabbed the attention of several professional investors, many of who have added their own perspectives over the following decades. Nevertheless, the basic essence of value investing has remained the same: buy cheap.

It was a philosophy that was born in desperate times (the Depression years), and underwent a baptism by fire as it was tested time and again over the next few years.

So it wouldn’t be wrong to wonder just a little bit whether those principles still work in today’s times, given that the past few years have been exceptionally exuberant for the world’s major stock markets.

Cut to January 2008. In sharp contrast to the crisis engulfing the stock markets when Graham started out, the world’s economies – India’s included – were exuding confidence like never before. Many experts claimed that Indian financial markets were experiencing a secular bull run, not a cyclical upswing that would die down anytime soon.

Times have changed since Benjamin Graham wrote the Security Analysis but his principles can hold investors in good stead even now.

N Mahalakshmi & Mohammed Ekramul Haque

13 June 2008 Outlook PROFIT
HOW WE DID THE BACK-TESTING

The universe
Earnings yield portfolio: A portfolio of 30 stocks with the highest earnings yields, the minimum cut-off being double the bond rate for the respective year, from the BSE-500 universe, excluding financials, with a debt-equity of less than 1. For years that threw up less than 30 stocks, we went with the available stocks.
Net-net & cash bargains: All listed companies with a trading history of more than 90 per cent excluding financials was taken as the universe. We calculated net-net by deducting debt and current liabilities from current assets. The 30 or available stocks for the respective years with market cap less than net currents were considered for the portfolio each year. Companies with cash and marketable securities less than 5 per cent of total assets and companies with cash and cash equivalents less than the market-cap constituted the cash bargain portfolio for the respective years.

Dogs of the Nifty: Top 10 stocks based on dividend yield at the end of every year.

The returns
We computed total returns (price appreciation plus dividend income) for the portfolio constituted every year and with a holding period of 1-10 years for the respective years with market-cap less than net currents were considered for the respective years. All data has been sourced from CMIE Prowess.

CASH BARGAINS PORTFOLIO

<table>
<thead>
<tr>
<th>Year</th>
<th>1 yr</th>
<th>2 yr</th>
<th>3 yr</th>
<th>4 yr</th>
<th>5 yr</th>
<th>6 yr</th>
<th>7 yr</th>
<th>8 yr</th>
<th>9 yr</th>
<th>10 yr</th>
<th>Latest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sensex 1998</td>
<td>56.30</td>
<td>54.19</td>
<td>53.95</td>
<td>53.75</td>
<td>53.54</td>
<td>53.34</td>
<td>53.17</td>
<td>52.96</td>
<td>52.77</td>
<td>52.59</td>
<td>52.68</td>
</tr>
<tr>
<td>Sensex 1999</td>
<td>53.64</td>
<td>53.59</td>
<td>53.58</td>
<td>53.57</td>
<td>53.56</td>
<td>53.55</td>
<td>53.54</td>
<td>53.53</td>
<td>53.52</td>
<td>53.51</td>
<td>53.50</td>
</tr>
<tr>
<td>Sensex 2000</td>
<td>53.07</td>
<td>52.98</td>
<td>52.90</td>
<td>52.82</td>
<td>52.74</td>
<td>52.66</td>
<td>52.59</td>
<td>52.52</td>
<td>52.45</td>
<td>52.38</td>
<td>52.37</td>
</tr>
<tr>
<td>Sensex 2001</td>
<td>52.59</td>
<td>52.51</td>
<td>52.44</td>
<td>52.37</td>
<td>52.30</td>
<td>52.23</td>
<td>52.16</td>
<td>52.09</td>
<td>52.02</td>
<td>51.95</td>
<td>51.94</td>
</tr>
<tr>
<td>Sensex 2002</td>
<td>51.99</td>
<td>51.91</td>
<td>51.84</td>
<td>51.78</td>
<td>51.71</td>
<td>51.65</td>
<td>51.59</td>
<td>51.52</td>
<td>51.45</td>
<td>51.38</td>
<td>51.37</td>
</tr>
<tr>
<td>Sensex 2003</td>
<td>50.88</td>
<td>50.81</td>
<td>50.74</td>
<td>50.67</td>
<td>50.60</td>
<td>50.53</td>
<td>50.47</td>
<td>50.40</td>
<td>50.33</td>
<td>50.26</td>
<td>50.25</td>
</tr>
<tr>
<td>Sensex 2004</td>
<td>50.47</td>
<td>50.40</td>
<td>50.33</td>
<td>50.26</td>
<td>50.19</td>
<td>50.12</td>
<td>50.06</td>
<td>50.00</td>
<td>49.93</td>
<td>49.86</td>
<td>49.85</td>
</tr>
<tr>
<td>Sensex 2005</td>
<td>49.93</td>
<td>49.86</td>
<td>49.85</td>
<td>49.78</td>
<td>49.72</td>
<td>49.65</td>
<td>49.59</td>
<td>49.52</td>
<td>49.46</td>
<td>49.39</td>
<td>49.38</td>
</tr>
<tr>
<td>Sensex 2006</td>
<td>49.46</td>
<td>49.39</td>
<td>49.38</td>
<td>49.31</td>
<td>49.24</td>
<td>49.18</td>
<td>49.11</td>
<td>49.05</td>
<td>48.98</td>
<td>48.91</td>
<td>48.89</td>
</tr>
<tr>
<td>Sensex 2008</td>
<td>48.49</td>
<td>48.42</td>
<td>48.41</td>
<td>48.34</td>
<td>48.27</td>
<td>48.21</td>
<td>48.14</td>
<td>48.08</td>
<td>48.01</td>
<td>47.94</td>
<td>47.93</td>
</tr>
</tbody>
</table>

The world has changed in many ways. And the way business is done has changed appreciably. In the past century, while industrialisation was still underway, manufacturing was the mainstream of business and companies were largely asset-heavy.

Today’s businesses are more service-led and asset-light. Even the landscapes for accounting practices, securities regulations and shareholding patterns are dramatically different. Graham’s success was also in part because he had the luxury of buying businesses that were truly ‘cigar butts’ because of the state of the economy at the time.

Greenwald’s philosophy still stays relevant in the changed times, (one of optimism, although recent data does point to a slowdown) compared with the gloom that the Father of Financial Analysis was witness to. Outlook Profit sought answers for this by relying on two factors: data, because data does not lie; and people who have been un-adulterated value investors.

Before we do the results (please wait patiently – being patient is the first rule in value investing!), we present a quick look at Graham’s various strategies.

THE PHILOSOPHY

Graham’s investment radar mainly flashed stocks that could be classified as bargains based on earnings potential or asset values.

The key earnings-based strategy that most lay investors can easily adopt involves buying stocks that offer a substantial earnings yield, typically, twice the prevailing bond rate.

The earnings yield is the reverse of the price-earnings multiple. The logic is simple: if you view stocks as bonds that offer no growth but yield fixed returns (consider profits as a proxy for interest earned) then the asset should be valued like a bond. If the earnings yield is twice the bond yield, it means that the asset actually promises to double the returns you could get from holding the bond. Given that the business is profitable and will continue to be so, returns could be impressive as the yield in excess of the bond rate would provide an adequate margin of safety in the event of any capital erosion. Another earnings-based strategy is to buy stocks that offer substantial dividend yield.

Asset-based strategies of Graham revolve around buying stocks that are quoting either below their liquidation value (especially for businesses that do not have a future) or at a substantial discount to the company’s asset set value (for businesses that boast good future prospects).

Another set of bargains includes stocks of companies quoting below the value of marketable securities and cash on their books after deducting outstanding debt. The logic here is that the company can use its cash and securities to pay off its debt and other liabilities and still the shareholders would have something in their hand.

At the heart of Graham’s philosophy lies the ability to favour what is out of favour. Embrace the ugly, not the beautiful. Lift the disgraced and disregard ed. And it works!

Sanjay Bakshi, CEO, Tacita Capital is a deep-value investor.
The world has changed in many ways. And the way business is done has changed appreciably. In the past century, while industrialisation was still underway, manufacturing was the mainstay of business and companies were largely asset-heavy.

Today’s businesses are more service-led and asset-light. Even the landscapes for accounting practices, securities regulations and shareholding patterns are dramatically different. Graham’s success was also in part because he had the luxury of buying businesses that were truly ‘cigar butts’ because of the state of the economy at the time.

In Graham’s philosophy still stay relevant in the changed times, (one of optimism, although recent data does point to a slowdown) compared with the gloom that the Father of Financial Analysis was witness to! Outlook Profit sought answers for this by relying on two factors: data, because data does not lie; and people who have been unadulterated value investors. Before we disclose the results (please wait patiently – being patient is the first rule in value investing!), we present a quick look at Graham’s various strategies.

**THE PHILOSOPHY**

Graham’s investment radar mainly flashed stocks that could be classified as ‘bargains’ based on earnings potential or asset values. The key earnings-based strategy that most lay investors can easily adopt involves buying stocks that offer a substantial earnings yield, typically, twice the prevailing bond rate. The earnings yield is the reverse of the price–earnings multiple. The logic is simple: if you view stocks as bonds that offer no growth but yield fixed returns (consider profits as a proxy for interest earned) then the asset should be valued like a bond. If the earnings yield is twice the bond yield, it means that the asset actually promises to double the returns you could get from holding, given that the business is profitable and will continue to be so, returns could be impressive as the yield in excess of the bond rate would provide an adequate margin of safety in the event of any capital erosion. Another earnings-based strategy is to buy stocks that offer substantial dividend yields.

Asset-based strategy of Graham revolves around buying stocks that are quoting either below their liquidation value (especially for businesses that do not have a future) or at a substantial discount to the company’s asset set value (for businesses that boast good future prospects).

Another set of bargains includes stocks of companies quoting below the value of marketable securities and cash on their books after deducting outstanding debt. The logic here is that the company can use its cash and securities to pay off its debt and other liabilities and still the shareholders would have something in their hand. At the heart of Graham’s philosophy lies the ability to favour what is out of favour. Embracing the ugly, not the beautiful. Lift the disgraced and disregarded. And it works!

Sanjay Bakshi, CEO, Tactica Capital is a deep-value investor.
The strategy of picking up stocks that were trading below their liquidation values (current assets minus current liabilities and debt) by contrast, when the markets plunged to their nadir in 2000, 135 stocks met these criteria.

Nevertheless, some of the most successful value investors in the country believe that some changes to Graham’s strategies may be required to make it more effective (although given that the back testing showed such good results, we wonder why?)

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>8.83</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>9.60</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>11.33</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>13.33</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>15.74</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>18.70</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>20.00</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>22.00</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>24.00</td>
<td></td>
</tr>
</tbody>
</table>

Chetan Parikh, MD, Heeey investments has been a committed value investor who has earned yields that are twice as high as the bond yield proved to be spot-on for investors. Returns on such a portfolio beat the Sensex every time! Cash bargains and net-nets have worked with 70 per cent accuracy. (See table: Cash Bargains Portfolio)

Graham’s way of gauging the market temperature works beautifully as well. The proof of the pudding is in the eating. Stocks that were ultra-cheap in the past decade. Out of the 5,000 odd traded stocks at the peak of the IT bull run in 1998-99, 22 stocks were trading below their liquidation values (current assets minus current liabilities and debt). By contrast, when the markets plunged to their nadir in 2000, 135 stocks met these criteria.

Nevertheless, some of the most successful value investors in the country believe that some changes to Graham’s strategies may be required to make it more effective (although given that the back testing showed such good results, we wonder why?)

MISSING OUT ON GROWTH?

Focusing on the cheap stocks often means missing out on other opportunities. Why? Because the market is usually instantly enamoured by anything new that turns up in business until they find reason to think otherwise. Remember the dot-com boom? Companies were awarded sky-high valuations before it dawned on investors that many business models were simply unsustainable.

However, the notion that you could be left behind if you don’t pay the price for growth is not entirely baseless. “If you buy stocks based strictly on traditional value investment principles, you will only play the arbitrage opportunity (the difference between the fair price and the market price) but the bigger opportunity in a country like ours lies in the future as the business grows,” says K N Siva Subramanian, vice president at Franklin Templeton Mutual Fund. He considered one of the best fund managers of the past decade or so.

Sure enough, a Graham approach would have encouraged investors to pass over new, emerging businesses that have given outstanding returns on the horizons: Infosys Technologies, HDFC Bank, Pantaloon Retail, and Suzlon Energy to name just a few. None of these stocks would have qualified as value stocks in the Graham sense ever.

But you would have built an equally stellar portfolio of stocks consisting of Bharat Televentures and State Bank of India (at one time available significantly below book value), public-sector companies such as Bharat Earth Movers and BHEL and private-sector companies such as Areeva T&D, Peninsula land, Gujrat NRE Coke, Mercator Lines, Alan Oshfrse and even Jai Corp. All of them have rewarded investors with handsome dividends and capital appreciation.

Most of these names were ignored a few years ago either because business conditions were bad or the market simply didn’t change. Three were alternative opportunities that were more alluring.

“The market periodically gets into a phase of madness when there is a fascination for certain sectors and the others are completely forgotten,” says E A Sundaram, a former fund manager with HDFC Mutual Fund who now manages funds for the BirlaHouse. And it’s true: during the dot-com boom, remember how the old economy was forgotten? A year ago, software service companies had joined the ranks of fallen angels. A true Graham follower would, however, buy stocks precisely when there are no takers for them.

And what about growth? Graham never believed in relying on the future, so he would not pay a penny for growth. The difference between Graham followers and the growth seekers is primarily that the former are risk averse (you can even call them miserly) and don’t seek to pay a price for growth.

“Value investors want growth for free,” says Sanjay Bakshi, professor at Gargison’s Mangal Development Institute. ‘And by doing so, they could well make errors of omission but not of commission.” He also runs an investment firm called Tactica Capital, which specialises in deep-value plays.

Other experts echo the sentiment. Managing director of Motilal Oswal Securities Chetan Parikh says an attractive purchase price is key to making money. “The moment you pay a price for growth, where there is no certainty in the outcome, he asks. “You are not dealing with the company here, you are dealing with the price of the stock. People do not understand what role the price plays.”

The sceptics argue the other side. “The Graham model is geared to finding cheap cigar butts, but many such companies may have issues with, their character itself,” says Bharat Shah of ARI Raymond James who started out as a value investor but later changed track. “Cheapness can be an illusion. Just being cheap is not good enough for me, it has to be supported by capital efficiency and confidence about growth. While I like the cheapness that Graham would have liked, I would also like quality of business that Fisher would have liked.”

If wishes were horses, that would have been true! In today’s circumstances, it is not easy to find stock that offer growth prospects with the margin of safety embedded the way Graham liked it. Most experts, however, believe trying to combine a growth style and the rather contrarian value-style technique don’t mix very well.

Still, the perception of value lies in the eyes of the investor. “The biggest contribution of Graham to the world of finance was three words – margin of safety – and if you keep that in mind while investing you will seldom go awry, wrong,” says fund manager Banda ram.

THE CHALLENGES

Nevertheless, some strategies were largely a product of circumstances that prevailed during Graham’s time are becoming less effective and riskier proportions. It’s easy to see the con-

EARNINGS YIELD PORTFOLIO

<table>
<thead>
<tr>
<th>Year</th>
<th>Portfolio</th>
<th>Sensex</th>
<th>Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>7.79</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2001</td>
<td>7.89</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2002</td>
<td>7.98</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2003</td>
<td>8.08</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2004</td>
<td>8.18</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2005</td>
<td>8.28</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2006</td>
<td>8.38</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2007</td>
<td>8.48</td>
<td>10.00</td>
<td>12.57</td>
</tr>
<tr>
<td>2008</td>
<td>8.58</td>
<td>10.00</td>
<td>12.57</td>
</tr>
</tbody>
</table>
The strategy of picking up stocks
Back-testing key Graham strategy reveals a stunning performance. The strategy of picking up stocks that are twice as high as the bond yield proved to be spot-on for investors. Returns on such a portfolio beat the Sensex every time! Cash bargains and net-nets have worked with 70 per cent accuracy. (See table: Cash Bargains Portfolio)

Graham’s way of gauging the market temperature works beautifully as well. The proof of the pudding is in our cupboard that were ultra-cheap in the past decade. Out of the 5,000 odd traded stocks at the peak of the IT bull run in 1999, 22 stocks were trading below their liquidation values (current assets minus current liabilities and debt). By contrast, when the markets plunged to their nadir in 2000, 135 stocks met those criteria.

Nevertheless, some of the most successful value investors in the country believe that some changes to Graham’s strategies may be required to make it more effective (although given that the back testing showed such good results, we wonder why?)

MISSING OUT ON GROWTH?
Picking on the cheap stocks often means missing out on other opportunities. Why? Because the market is usually instantly enamoured by anything new that turns up in business until they find reason to think otherwise. Remember the dot-com boom? Companies were awarded sky-high valuations before it dawned on investors that many business models were simply unsustainable. However, the notion that you could be left behind if you don’t pay the price for growth is not entirely baseless. “If you buy stocks based strictly on traditional value investment principles, you will only play the arbitrage opportunity (the difference between the fair price and the market price) but the bigger opportunity in a country like ours lies in the future as the business grow,” says K N Siva Subramanian, vice president at Franklin Templeton Mutual Fund. He is considered one of the best fund managers of the past decade or so.

For sure, adopting a Graham approach would have encouraged investors to pass over new, emerging businesses that have given outstanding returns on the bourses: Infosys Technologies, HDFC Bank, Pantaloon Retail, and Suzlon Energy to name just a few. None of these stocks would have qualified as value stocks in the Graham sense ever. But you would have built an equally stellar portfolio of stocks consisting of Bharti Teleservices and State Bank of India (at one time available significantly below book value), public-sector companies such as Bharat Earth Movers and BHEL and private-sector companies such as Aarena T&D, Peninsula Indl, Gujarat NRIL Coke, Mercator Lines, Alain Offshore and even Jai Corp. All of them have rewarded investors with handsome dividends and capital appreciation.

Most of these names were ignored a few years ago either because business conditions were bad or the market simply ignored them. Three were alternative opportunities that were more alluring.

“The market periodically gets into a phase of madness when there is a fascination for certain sectors and the others are completely forgotten,” says E A Sundaram, a former fund manager with HDFC Mutual Fund who now manages funds for the Birlashas. And it’s true: during the dot-com boom, remember how the old economy was forgotten? A year ago, software service companies had joined the ranks of fallen angels. A true Graham follower would, however, buy stocks precisely when there are no takers for them.

And what about growth? Graham never believed in relying on the future, so he would not pay a penny for growth. The difference between Graham followers and the growth seeker is primarily that the former are risk averse (you can even call them miserly) and don’t seek to pay a price for growth.

“Value investors want growth for free,” says Sanjay Bakshi, professor at Gurgaon’s Manat Development Institute. ‘And by doing so, they could well make errors of omission but not of commission.” He also runs an investment firm called Tactica Capital, which specialises in deep-value arbitrage.

Other experts echo the sentiment. Managing director of Motilal Oswal Securities Limited says an attractive purchase price is key to making money.

“The moment you pay a price for growth, where is the outperformance?” he asks. “You are not dealing with the company here, you are dealing with the price of the stock. People do not understand what role the price plays.”

The sceptics argue the other side. “The Graham model is geared to finding cheap cigar butts, but many such companies may have issues with their character itself.” says Bharat Shah of ARK Raymond James who started out as a value investor but later changed track. “Cheapness can be an illusion. Just being cheap is not good enough for me, it has to be supported by capital efficiency and confidence about growth. While I like the cheapness that Graham would have liked, I would also like quality of businesses that Fisher would have liked.”

If wishes were horses, that would have been true! In today’s circumstances, it is not easy to find stock that offer great growth prospects with the margin of safety embedded the way Graham liked it. Most experts, however, believe trying to combine a growth style and the rather contrarian value-style technique don’t mix very well.

Still, the perception of value lies in the eyes of the investor. “The biggest contribution of Graham to the world of finance was three words—margin of safety—and if you keep that in mind while investing you will seldom go awfully wrong,” says fund manager Bandraam.

THE CHALLENGES
Nevertheless, some strategies that were largely a product of circumstances that prevailed during the past Graham’s time are becoming less effective and riskier propositions. It’s easy to see the con-

EARNINGS YIELD PORTFOLIO
Portfolios with earnings yield more than double the bond rate with a maximum of 30 stocks

<table>
<thead>
<tr>
<th>Year</th>
<th>1 yr</th>
<th>2 yr</th>
<th>3 yr</th>
<th>4 yr</th>
<th>5 yr</th>
<th>6 yr</th>
<th>7 yr</th>
<th>8 yr</th>
<th>9 yr</th>
<th>10 yr</th>
<th>Latest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>80.16</td>
<td>82.77</td>
<td>14.34</td>
<td>19.78</td>
<td>9.57</td>
<td>27.44</td>
<td>36.53</td>
<td>48.24</td>
<td>42.40</td>
<td>42.47</td>
<td>43.82</td>
</tr>
<tr>
<td>1999</td>
<td>40.05</td>
<td>41.56</td>
<td>14.52</td>
<td>28.85</td>
<td>66.97</td>
<td>79.74</td>
<td>85.49</td>
<td>64.39</td>
<td>78.46</td>
<td>59.64</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>39.06</td>
<td>40.99</td>
<td>36.37</td>
<td>70.69</td>
<td>82.05</td>
<td>91.31</td>
<td>79.16</td>
<td>75.19</td>
<td>78.79</td>
<td>103.1</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>24.41</td>
<td>25.71</td>
<td>14.52</td>
<td>47.13</td>
<td>53.35</td>
<td>119.25</td>
<td>85.99</td>
<td>95.32</td>
<td>100.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>1.1</td>
<td>2.82</td>
<td>17.13</td>
<td>15.00</td>
<td>27.90</td>
<td>25.69</td>
<td>25.33</td>
<td>23.83</td>
<td>7</td>
<td>109.9</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>11.33</td>
<td>11.05</td>
<td>37.92</td>
<td>32.98</td>
<td>31.52</td>
<td>89.67</td>
<td>84.08</td>
<td>32.80</td>
<td>35.96</td>
<td>110.9</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>264.56</td>
<td>217.49</td>
<td>134.53</td>
<td>118.07</td>
<td>112.65</td>
<td>127.18</td>
<td>137.33</td>
<td>110.09</td>
<td>122.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>91.06</td>
<td>42.90</td>
<td>56.94</td>
<td>47.14</td>
<td>42.33</td>
<td>39.09</td>
<td>39.09</td>
<td>39.09</td>
<td>39.09</td>
<td>39.09</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>289.12</td>
<td>220.77</td>
<td>134.53</td>
<td>118.07</td>
<td>122.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>434.92</td>
<td>342.67</td>
<td>32.23</td>
<td>28.10</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>434.92</td>
<td>172.23</td>
<td>110.90</td>
<td>110.90</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>95.67</td>
<td>50.13</td>
<td>41.10</td>
<td>35.96</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>119.92</td>
<td>79.41</td>
<td>95.08</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>33.56</td>
<td>33.56</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>14.69</td>
<td>14.69</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The concept of book value and whether it reflects the true worth of a company have undergone fundamental changes over time. Book value was one of the prime parameters Graham preferred judging what was on the balance-sheet to looking at unquantifiable parameters. In his time, companies were asset-heavy and it made sense to look at asset values. Not anymore. Today, the real value of several business lines not in the plant and machinery they own, but in more unquantifiable factors. Take software services, for instance. In this industry, the real assets are the technically skilled people who walk in and out of the company gate every day; they’re not mentioned in the balance-sheet at all.

Similarly, the real value of consumer companies lies in their brands and distribution network, again not quantified in the statement of accounts. The balance-sheet does not capture the value of intangibles like brands, but they also have cash flows attached to them,” points out Sundaram.

Similarly, Graham’s idea of looking at net working capital requires rethinking as well. The whole idea of net-net was to buy a company below its working capital because if the market did not give the company the valuation it deserved, the promoter could easily liquidate the company by realising the receivables and cash, pay off payables and debt – and still take home some cash (by the way, we’re not even accounting for fixed assets here)! Obviously, Graham was looking at what was truly dirt cheap (cash butts)!

He would have rejected companies with low net current assets outright. But, in today’s world, high working capital is taken as a sign of a deteriorating competitive position. Higher receivables being built up, large discounts to customers, larger collection periods – all these are actually signs of worsening business conditions. Indeed, some of the best-run companies in the world have a negative working capital – consumer companies like Hindustan Unilever, Procter & Gamble and several others actually have been operated with negative working capital for quite some time now.

Some Graham strategies like cash bargains work well in mature markets like the US because the shareholding pattern is diffused, so a financial investor could identify situations and act in a fashion that compels management to unlock value. But in India, since promoters usually hold fairly large stakes and corporate raiders are not that common, the probability of liquidation is rather slim and dilutes the case for unlocking value in such stocks.

Besides, another risk with Graham’s cheap stocks is that while you can buy a business at a lower price than what it’s worth, you can never tell whether it will add or subtract value. Templeton’s Subramanian quotes a classic example: when Warren Buffet bought Berkshire Hathaway, it was still a textiles company. And instead of continuing like that, Buffett used the cash to build a business that offered growth.

While buying cash bargains may be a rewarding proposition for an activist investor who can take the reins of management and steer course differently, it may not be the same for regular stock investors, who may not be in any position to influence management.

Anchet on stock comes from the mid-cap segment of pharmaceutical stocks. Take the Indian subsidiary of Merck. Despite the fact that it has the equivalent of 30-40 per cent of its market capitalisation in cash, the stock price has shrivelled. In hindsight, it’s easy to figure out why the stock has underperformed: revenues haven’t grown as much and the balance-sheet has shrunk. So even as the company continues to add to its cash pile every year, the stock remains trapped in the doldrums.

Again, finding the right margin of safety itself is a difficult proposition for strategies like cash bargains. Since these could involve long waiting periods, unless there is a trigger in sight, the opportunity cost of capital, the potential casualties in the portfolio (because Graham believed in diversification with less due diligence as opposed to the strategy of concentration with utmost due diligence that Buffet follows) and the fact that Graham never looked beyond fair-value situations (not letting ‘profits run’), the margin of safety has to be considerably high. Finding such stocks in current circumstances poses a serious challenge.

While Graham’s strategy is great in terms of capital protection, it focuses only on the arbitrage value between the margin of safety and the fair value of the stock (in fact, Graham would invariably sell the stock even before the fair value was achieved). By doing so, some present-day value investors say you would lose out on the bigger value that is usually built into the growth of the company. Templeton’s Subramanian says that it makes a lot of sense to look at metrics such as dividend yields because growth opportunities in some segments may have exhausted but the situation may be entirely different for India, where growth in those segments may be just picking up.

The ideal environment for the Graham framework to work is a purely capitalistic society with little controls. But some companies that are going cheap in the Indian markets today namely those in the oil, fertilisers and sugar business are those that have been hit because of government controls. These stocks look cheap, but it’s unlikely the situation will correct itself unless the government steps in.

Again, one of the gripes against...
The concept of book value and whether it reflects the true worth of a company has undergone fundamental changes over time. Book value was one of the prime parameters Graham looked at. But he preferred judging what was on the balance-sheet to looking at unquantifiable parameters. In his time, companies were asset-heavy and it made sense to look at asset values. Not anymore. Today, the real value of several business lines not in the plant and machinery they own, but in more unquantifiable factors. Take software services, for instance. In this industry, the real assets are the technically skilled people who walk in and out of the company gate every day; they’re not mentioned in the balance-sheet though.

Similarly, the real value of consumer companies lies in their brands and distribution network, again not quantified in the statement of accounts. “The balance-sheet does not capture the value of intangibles like brands, but they also have cash flows attached to them,” points out Sundaram.

Similarly, Graham’s idea of looking at net working capital requires rethinking as well. The whole idea of net-net was to buy a company below its working capital because if the market did not give the company the valuation it deserved, the promoter could easily liquidate the company by realising the receivables and cash, pay off payables and debt – and still take home some cash (by the way, we’re not even accounting for fixed assets here). Obviously, Graham was looking at what was truly dirt cheap (cigar butts).

He would have rejected companies with low net current assets outright. But, in today’s world, high working capital is taken as a sign of a deteriorating competitive position. Higher receivables being built up, large discounts to customers, longer collection periods – all these are actually signs of worsening business conditions. Indeed, some of the best-run companies in the world have a negative working capital – consumer companies like Hindustan Unilever, Procter & Gamble and several others actually have been operated with negative working capital for quite some time now.

Some Graham strategies like cash bargains work well in mature markets like the US because the shareholding pattern is diffuse, so a financial investor could identify situations and act in a fashion that compels management to unlock value. But in India, since promoters usually hold fairly large stakes and corporate raiders are not that common, the probability of liquidation is rather slim and dilutes the case for unlocking value in such stocks.

Besides, another risk with Graham’s cheap stocks is that while you can buy a business at a lower price than what it’s worth, you can never tell whether it will add or subtract value. Templeton’s Subramanian quotes a classic example: when Warren Buffett bought Berkshire Hathaway, it was still a textiles company. And instead of continuing like that, Buffett used the cash to build a business that offered growth.

While buying cash bargains may have a rewarding proposition for an activist investor who can take the reins of management and steer course differently, it may not be the same for regular stock investors. The main reason may not be in any position to influence managements. An example of this is from the mid-cap segment of pharmaceutical stocks. Take the Indian subsidiary of Merck. Despite the fact that it has the equivalent of 30-40 per cent of its market capitalisation in cash, the stock price has shrivelled in hindsight. It’s easy to figure out why the stock has underperformed: revenues haven’t grown as much as the balance-sheet has shrunk. So even as the company continues to add to its cash pile every year, the stock remains trapped in the doldrums.

Again, finding the right margin of safety itself is a difficult proposition for strategies like cash bargains. Since these could involve long waiting periods, unless there is a trigger in sight, the opportunity cost of capital, the potential casualties in the portfolio (because Graham believed in diversification with less due diligence as opposed to the strategy of concentration with utmost due diligence that Buffett follows) and the fact that Graham never looked beyond fair-value situations (not letting ‘profits run’), the margin of safety’s has to be considerably high. Finding such stock is the ideal environment for the Graham framework to work. It is a purely capitalist society with little controls. But some companies that are going cheap in the Indian markets today namely those in the oil, fertilizers and sugar business are those that have been hit because of government controls. These stocks look cheap, but it’s unlikely the situation will correct itself unless the government steps in.

The ideal environment for the Graham framework to work is a purely capitalist society with little controls. But some companies that are going cheap in the Indian markets today namely those in the oil, fertilizers and sugar business are those that have been hit because of government controls. These stocks look cheap, but it’s unlikely the situation will correct itself unless the government steps in.

Again, one of the gripes against

**Cover Story**
Outlook PROFIT

Cover Story

VP, Franklin Templeton Mutual Fund, has an enviable long-term track record. Following the rule always is never chance of being duped, quite high. Earnings are thus suspect and the obscure stocks on which there is lit-igious success, an anti-thesis to Gra-ham’s solutions. If the stock trades at a multiple of four times or so, and earnings are still growing, your total returns could be very attractive since you can pocket a dividend yield, a price appreciation equal to the earnings growth and see a potential re-rating of the stock as well. In addition, a poten-tial buy-back by a proactive manage-ment, special dividends, or open offers arising from potential take-over bids act as catalysts as well. Despite the deep value some hold-ing companies have, not many take a look in for such stocks simply because there are no obvious triggers in such companies. A best way to spot them is by looking at divergences in cash flows and earnings in recent years (not just the annual ones) as cash bargains, he says.

“The problem with looking at future cash flows, as Graham also explained, is that it requires a judge-ment of the future and those projections can differ from person to person. Nevertheless, since stocks are now more available at high discounts as in Graham’s time, “we can’t ignore the value of future cash flows while looking at valuations,” says Bakshi.

While Graham’s solution is so diffi-cult is because it may feel more simistic, so most investors will be re-acted. The problem with looking at accounts statements for just a year or two is that the aggregate picture for fi ve years, which will offer clearer to the true picture,” says Bakshi.

Another fact that Graham followers need to accept is that they will rarely make extraordinary returns. On the other hand, they will rarely lose mon-eys, they could be viewed into a treasure-chest of cash, they could be viewed as cash bargains, he says.

“Unless you know that the inter-ests of the promoters are aligned with the vested interests of promoters can sometimes erode value in such stocks. In Graham’s time, the perceived value of the holding company im-plies that you would be left in the dark county to intrinsic worth. The perceived value in the company improves as the value in the underlying subsidiary. Usually, term returns ratios. With companies operating in cyclical industries, stocks should be picked up when the industry is down in the dumps.

Another reason why most investors get bludgeoned with their stock picks is that they don’t al-ways focus as much on ab-solutely necessary. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose mon-eys. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose mon-eys. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose mon-eys. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

Graham’s strategy is that frequently the list of worthy buys is made up of obscure stocks on which there is lit-tle public information. The reported earnings are thus suspect and the chance of being duped, quite high. So following the rule always is never chance of being duped, quite high.

And finally, there is an echo to Gra-ham’s philosophy: it’s pretty much like the fact that some companies are always cheap – and they deserve to be so – there are others that deserve superior valuations. So says Subramanian, is Infosys Technologies. Earlier on we made this argument, this time we stress that it is quite high. So following the rule always is never chance of being duped, quite high. Earnings are thus suspect and the obscure stocks on which there is litigious success, an anti-thesis to Graham’s solutions. If the stock trades at a multiple of four times or so, and earnings are still growing, your total returns could be very attractive since you can pocket a dividend yield, a price appreciation equal to the earnings growth and see a potential re-rating of the stock as well. In addition, a potential buy-back by a proactive management, special dividends, or open offers arising from potential take-over bids act as catalysts as well. Despite the deep value some holding companies have, not many take a look in for such stocks simply because there are no obvious triggers in such companies. A best way to spot them is by looking at diversions in cash flows and earnings in recent years (not just the annual ones) as cash bargains, he says.

“The problem with looking at future cash flows, as Graham also explained, is that it requires a judgement of the future and those projections can differ from person to person. Nevertheless, since stocks are now more available at high discounts as in Graham’s time, “we can’t ignore the value of future cash flows while looking at valuations,” says Bakshi.

While Graham’s solution is so difficult is because it may feel more simplistic, so most investors will be reacted. The problem with looking at accounts statements for just a year or two is that the aggregate picture for five years, which will offer clearer to the true picture,” says Bakshi.

Another fact that Graham followers need to accept is that they will rarely make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

True, there are those who have been actuated with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

Inelligent Investing

It cannot be denied that Graham’s philosophy generated enormous psychological strength and will-power. That’s because building a Graham-style port-folio requires going after little-known or desired stocks. We all know what kinds of stocks are thrown up on those screens, but it requires nerves of steel and guts to buy these stocks. Why? For one thing, you may not have heard about most of them. For another, most of these stocks will be drenched in pes-simism, so most investors will be re-hesitant to invest in them.

Indeed, the reason value investing is so difficult is because it may feel completely foolish for a while. But true value investors are not worried about looking foolish as long as they are certain they haven’t acted foolishly,” remarks Bakshi.

Yet impressions mat-ter to a large swathe of investors. So even if backing turns up with sparkling re-sults, it’s still difficult for many to go ahead and take the plunge. The reason value in-vesting is not popular is because people do not have the patience to go through these dull and laborious processes, says Mo-silal’s Agarwal.

Another reason why most investors get bludgeoned with their stock picks is that they don’t always focus as much on absolutely necessary. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

True, there are those who have been actuated with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

Inelligent Investing

It cannot be denied that Graham’s philosophy generated enormous psychological strength and will-power. That’s because building a Graham-style port-folio requires going after little-known or desired stocks. We all know what kinds of stocks are thrown up on those screens, but it requires nerves of steel and guts to buy these stocks. Why? For one thing, you may not have heard about most of them. For another, most of these stocks will be drenched in pes-simism, so most investors will be re-hesitant to invest in them.

Indeed, the reason value investing is so difficult is because it may feel completely foolish for a while. But true value investors are not worried about looking foolish as long as they are certain they haven’t acted foolishly,” remarks Bakshi.

Yet impressions mat-ter to a large swathe of investors. So even if backing turns up with sparkling re-sults, it’s still difficult for many to go ahead and take the plunge. The reason value in-vesting is not popular is because people do not have the patience to go through these dull and laborious processes, says Mo-silal’s Agarwal.

Another reason why most investors get bludgeoned with their stock picks is that they don’t always focus as much on absolutely necessary. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

True, there are those who have been actuated with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

Inelligent Investing

It cannot be denied that Graham’s philosophy generated enormous psychological strength and will-power. That’s because building a Graham-style port-folio requires going after little-known or desired stocks. We all know what kinds of stocks are thrown up on those screens, but it requires nerves of steel and guts to buy these stocks. Why? For one thing, you may not have heard about most of them. For another, most of these stocks will be drenched in pes-simism, so most investors will be re-hesitant to invest in them.

Indeed, the reason value investing is so difficult is because it may feel completely foolish for a while. But true value investors are not worried about looking foolish as long as they are certain they haven’t acted foolishly,” remarks Bakshi.

Yet impressions mat-ter to a large swathe of investors. So even if backing turns up with sparkling re-sults, it’s still difficult for many to go ahead and take the plunge. The reason value in-vesting is not popular is because people do not have the patience to go through these dull and laborious processes, says Mo-silal’s Agarwal.

Another reason why most investors get bludgeoned with their stock picks is that they don’t always focus as much on absolutely necessary. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.

True, there are those who have been actuated with the fact that sometimes, they will make extraordinary returns. On the other hand, they will rarely lose money. It’s important to be comfortable with the fact that sometimes, they will make extraordinary returns.
**PICKING WINNERS**

Finding the catalyst: Buying cheap is a great idea but the biggest challenge in Graham-style investing is figuring out the trigger that will unlock value in the stock. While a margin of safety is important, it is essential to look at the probability of getting that translated into returns. Sometimes, the catalysts could be growth itself, says professor Bakshi. If the stock trades at a multiple of four times or so, and earnings are still growing, your total returns could be very attractive since you can pocket a dividend yield, a price appreciation equal to the earnings growth and see a potential re-rating of the stock as well. In addition, a potential buy-back by a proactive management, special dividends, or open offers arising from potential take-over bids set as catalysts as well.

Despite the deep value some holding companies harbour, there are few takers for such stocks simply because there are no obvious triggers in such situations. Admittedly, it is difficult to find a way to play these stocks. The catalyst, be it a change in form of business or an underlying subsidiary, usually, when business turns, the perceived value of the holding company improves. By then, it is too late to address the intrinsic worth. The perceived value in the company improves as a consequence.

A case in point is Nalwa Sons. The stock was trading at a 75% per cent discount to its intrinsic value when Agarwal backed it. Today (Nalwa holds 45 lakh shares) got re-rated for the better, the discount contracted to 16% of its intrinsic value.

Experts say the way to view such companies is by taking a call on how the operating business of the subsidiary will fare in long haul. For instance, if cement is expected to do well for the next two years, it would make a lot of sense to put money in holding companies of cement enter-

Graham’s strategy is to sit back and look at the operating business of the subsidiary to judge whether the trigger is real and earn money on the profits. Graham found the market was not comfortable with the idea of value investing, yet Graham himself was able to make extraordinary returns. On the other hand, there is a perception that value investing is for the patient or the amateur. That may not be correct. Graham himself was a very aggressive catalyst and very early on regretted he had not bought stocks on which he weighed on and judged correctly.

The relentless pressure of keeping up with the Joneses and the need to boast about the latest stock pick is one reason why investors need to overcome is that they rarely make extraordinary returns. On the other hand, they may rarely make extraordinary returns. On the other hand, they may rarely see the stock price go up to par and then go on to make a fortune. Graham identified the trigger and bought the stock. He was the one who benefited. Graham’s answer was to buy the stock and take the plunge.

Another reason why most investors get disillusioned with their stock picks is that they don’t always produce outcomes. The problem with looking at diversification in cash flows and earnings in recent years (not just quarters) can also be effective in spotting the warning signs. Instead of looking at accounts statements for just a year, one should look at the aggregate picture for five years, which will offer clues to the true picture, says Bakshi.

One of the useful tools in Graham’s system is to identify companies whose earnings are not impacted by cyclical risks. The profit will be consistent and earnings decline if the cycle turns for the worse. One way to assess these companies may be to look at average earnings for the past five years or more to remove the effect of cyclicity.

Professor Bakshi says one has to look at cash bargains to identify companies with fairly certain cash flows and not focus as much on absolute cash levels. Since companies with regular cash flows will soon turn into a treasure chest of cash, they could be viewed as cash bargains, he says. The problem with looking at future cash flows, as Graham also explained, is that it requires a judgement of the future and those projections can differ from person to person. Nevertheless, since stocks are now no longer available at high discounts as in Graham’s time, “we can’t ignore the value of future cash flows while looking at valuations,” says Bakshi.

While Graham’s solution to minimising the risk of bankruptcy and frauds was diversification, looking for low beta stocks, and earnings and intrinsic value in recent years (not just quarters) can also be effective in spotting the warning signs. Instead of looking at accounts statements for just a year, one should look at the aggregate picture for five years, which will offer clues to the true picture, says Bakshi.

As Motilal’s Agarwal puts it: “Value investing is not popular because people do not have the patience to go through these dull and mundane details.”

**INTELLIGENT INVESTING**

It cannot be denied that Graham’s style of investing demands enormous psychological strength and will-power. That’s because building a Graham-style portfolio requires going after little-known or desired stocks. We all know what a stock’s intrinsic value is but how many of us have the patience to go through these dull and mundane details. The relentless pressure of keeping up with the Joneses and the need to boast about the latest stock pick at a party is what investors need to overcome to become really successful investors.