B.G. found that trends did not continue for any great length of time.
When sales go up there is a tendency for the profit margin to rise at least immediately.
Kroger the other way around.
Companies always seem to adjust themselves to a larger amount of business ultimately
in such a way that they don't make any more profit per dollar on the larger business than they
used to make on the smaller.

Next question is the multiplier we would apply to expected future earnings of $1.70 on
this company(Barker). Suggestion that shares of smaller companies occupying a secondary
position and with records that are not satisfactory when you study them over a period of years —
those companies should be valued on a fairly modest basis and I would be inclines to think
that a multiplier of 12 would be as high as you would be k likely to give and on that basis
you would get a valuation of this company between 20 and 21 without any allowance for the
asset component or consideration. Selling at moment above this value (1/17/47).

Valuation of this company is on conservative side- when we valued k Dow Jones average
we tended to get a value higher than the market price. This shows that secondary companies
do not show up as well in this method of analysis.

Then compared Barker Bros to mandel Bros. Mandel $18\frac{1}{2}$ million sales on an average before
the war (profit margin very low). 27 million during war. 30 million post war. Feels profit
margin should be better. Compares current earnings.

Word or two on asset component on earning power valuation. Don't want to stress it too
much as it is not customarily used and we have no particular reason for believing we are right
how
For the record B.G. indicates how he feels). If the earning power value exceeds the asset value
some reduction should be made for that fact. We suggest 1/4 of the difference be taken off.
r
Arbitary figure. If difference is great adjustment more important.

Where the assets exceed the earning power we do not value the company upward because
we are not very much impressed by assets that do not have earning power.

There is one rather important difference there and that relates to working capital. When
the working capital exceeds the earning power value, we are impressed by experience to
believe that there is some significance in that fact and in summary fashion we are inclined
to add 1/2 of the difference to the earning power value to allow for the excess working capital
which in some way or other tends to make itself felt over the years. Sometimes you get it in
a distribution; sometimes you get it in sale of the property; sometimes you get it because the
company changes its policy and is able to use its working capital more effectively than
otherwise. He is not inclined to stress that technique of analysis too much. (nowtakes stock
in what we are trying to do in these lectures).

We discussed first→ The market market behavior in general in the years 1941-45 in relation to economic changes that affected security values. We considered new factors that were involved in the correct statement of the results that an individual company may have achieved during the war and post-war periods. And then we have just recently finished our discussion of the techniqu of valuing companies, based upon the capitalization of earning power and with a minor adjustmer for the asset picture.

Scope of the analysis activities in the securities markets and his approach to his function of analyzing securities and drawing conclusions from his analysis.

Two fundamentally different approaches that the analyst may take to securities as a whole

1. The conventional one-- that is based primarily on quality and on prospects.

2. The penetrating one and that is based on value.

The conventional one isdivided into 3 separate ways of dealing with securities.

A. Identification of good stocks ie; Strong stocks, strong companies, well-entrenched compan-ies or high quality companies and those companies presumably can safely be bought at reasonabl prices. This seems like a simple enough activity.

B The selection of companies which have better than average long-term prospects of growth and earnings. They are generally called growth stocks.

C. An intermediate activity which involves the selection of companies which are expected to do better business in the near term than the average company. All 3 of these activities I call conventional.

The second approach should be divided into 2 sub-classifications of action.

A. The purchases of securities generally when the market is at a low level as the market is considered by analysts.

B. The purchase of special or individual securities at almost any time when the price appears to be well below the appraised or analyzed value.

XB AN APPRAISAL OF THE APPRAISERS THEMSELVES (B.G)

A is the most useful of the conventional approaches as long as a conscientious effort is made to see that a good stock is not selling above the range of conservative value.

Investors do not make mistakes or bad mistakes in buying good stocks at fair prices.

To see that good companies and their prices are on the whole reasonable is their job and also t

of established investment counsel and it accounts for their ability to survive in spite of the

fact that they are not in a very easy kind of business.

Getting into type B is more interesting and difficult ground. For a long while selection of

growth stocks was the best regarded type of activity of analysts.

It is questionable whether you can establish a technique and transmit it to someone else.

B.G. thinks at bottom success of identification of growth stocks comes from being smart

or shrewd and doesn't consider it a standard quality of a good security analysis to be smart

or shrewd. Doesn't seem to him to fit into the general pattern or canon of security analysis

to require these rare qualities.

Security Analysts should be required to be wise in the sense that his is technically competen

that he is experience and that he is prudent. Doesn't think this type of wisdom is adapted for

selection of growth stocks

Third activity of conventional sort. This is done most day by day in Wall St. operations. The

trade investigation which leads one to believe that this industry or company is going to

have an unusually good year in the next 12 months and therefor should be bought. He is most

skeptical of this Wall St. activity probably because it is the most popular form of passing the

time of the Security analyst. Regards it as NAIVE in the extreme.

To carry conventional lines of activity and analysis it is necessary that you

impose some fairly obvious but nonetheless rigorous conditions on your own writing and

recommending. If you select good stocks, determine and specify that the price is within a

range of fair value. If you select growth stock determine and specify the round amount which

the buyer at the current price is already paying for the growth factor as compared with its

reasonable price if the growth prospects were only average. Then determine and state whether

in the analysts judgment the growth prospects are such as to warrant the payment of current

price by a prudent investor.

See statements of that kind made in the security analysis and in circulars. In recommending

a stock for its near-term prospects determine and state whether in the analysts judgment

the market price and its fairly recent market action has reflected the expectations of the

analyst.

Near term valuation one or two years.

Unconventional or penetrating type of analysis which emphasizes value.

First division represents buying into the market as a whole at low levels-- that is

copy book procedure.

Formula.   Industrial Production times Consumers purchasing power equals Income Payments

B.G.s formula for measuring chance of sucess of special situations. Judgment a factor.

    G equals Gain in points if successful
    L equals loss in points if unsuccessful
    C equals Chance of success in %
    Y equals Time of holding in years
    P equals Current Price

Metropolitan West Sides at 25.

Indicated Annual Return equals $\dfrac{GC - L(100-C)}{YP}$ $\dfrac{9 \times 75 - 6 \times 25}{1 \times 26}$ equals $\dfrac{525}{26}$ equals 20.2%

Some more publications that I have not read

Unorthodox Investment G(erald) M Loeb Barrons Book Dept
Realistic Speculation   "   "   " "
Common Speculation by the Trader(Harry Nelson) Barrons
Investment for Appreciation L.L.B.Angas Somerset Publishing Co
The Dow Theory by Robert Rhea
Stock Market Theory & Practice by Shabacker By Forbes Publishing
Security Analysis Graham & Dodd McGraw Hill
Interpretation of Financial Statements Graham & Meredith
10 Lectures Current Problems in Security Analysis.

Railroad calculations

The most conservative way to determine earnings protection for a railroad bond where net after taxes(railway operating income) is greater than amount available for fixed charges(gross income) is:
    (a) Divide the amount available for fixed charges by the amount available for fixed charges minus net income
    (b) Divide net after taxes by the net after taxes minus net income   Question ?

If net after taxes(Rway Oper Income) exceeds Gross income (net after rents plus other income)
    use this figure in calculating fixed charges called the net deductions method.
    Subtract net income from net after taxes to get fixed charges.
    Subtract net income from gross income to get fixed charges.   See Security Analysis.

Low market in relation to the past pattern of the market and by simple valuation methods such as the type we have been discussing. A good analyst doesn't change his concept of what the earnings of the next 5 years are going to be because the market changes. His views of averag future earnings would change only because he is convinced that there has been some change in underlying factors of a very significant sort.

An example is the Yale University method.

Good to buy undervalued securities. One proviso don't buy them when the general marke seems very hg high.

A cheap stock tends to decrease along with the popularity of others when the stock market falls. Lower prices stocks lose more percentagewise than the high prices ones. Field of undervalued securities is popular at all times.