

Greenwald, Bruce C. N.; Kahn, Judd; Sorkin, Paul D. & van Biema, Michael. Value Investing:

From Graham to Buffet and Beyond, John Wiley & Sons, 2001, [Equity Investing] Grade



Ben Graham taught value investing with David Dodd at Columbia, starting in 1928. Since then, Columbia has been the academic center for value investing. Graham and his disciples have been extremely successful, mainly because they used Graham's investment concepts. But as competition improved, Graham's rules for valuation of stocks needed updating as well. After some years in the shadow of Modern Portfolio Theory, Professor Greenwald brought back value investing teaching to Columbia in 1993. The logic is the same, but the operationalization is adapted to current standards of pricing of assets. His acknowledged course is the starting point of this book.

We all know how to value stocks in theory – it's all about the net present value of cash flows. We need to do a lot of input - for many years. But few of us excel in forecasting. Slight changes in input variables change the value of the stock significantly. Is there a better way?

I believe Professor Greenwald's approach is the way to go. It's based on basic capitalism, supply and demand and barriers to entry. Most companies don't have a sustainable competitive advantage and should be valued to reproduction cost. Usually reproduction cost is equivalent to earnings power value. Sometimes, with a truly good management team, earnings power value slightly exceeds reproduction cost value. Only for companies with a true competitive advantage – usually economies of scale with either patents or some consumer captivity – are calculations of profitable growth value needed.

These three building blocks – 1) reproduction cost value (replacement cost of net assets), 2)

earnings power value (the value of a company's current earnings, properly adjusted) and 3) profitable growth value (the uncertain contribution of growth to intrinsic value) - are the core of Professor Greenwald's valuation approach. It is far easier to forecast long-term value drivers for these building blocks than to do a common DCF analysis; moreover, the outcome is easier to understand. How much do I pay for estimated growth? What is an informed industrial buyer prepared to pay for the assets?

The authors will walk you thru all the needed adjustments to calculate the different parts of a company's intrinsic value. It's a joyful ride and there are several interesting case studies that help you understand the valuation approach better. You will never return to doing DCFs as your primary valuation approach.

Part three of the book is about value investing in practice, with profiles of eight value gurus such as Seth Klarman, Walter and Edwin Schloss, Mario Gabelli, Glenn Greenberg etc. These pages are interesting as well, but not – surprisingly enough – up to par with Professor Greenwald's writing about valuation.

I have read many books about security analysis and valuation. Some have been very good but none has helped me as much with practical valuation as Value Investing. The margin of safety to buy this book is enormous. This easy-to-read book is for everyone including very experienced analysts, except for those that focus on earnings surprises.

I have read this book several times, and I believe you will too if you belong to the value investing tribe.

Michael Persson, January 6, 2012