



**BENJAMIN GRAHAM**  
**AND**  
**CIGAR BUTT INVESTING**

# Buffett's Approach

- Quality management (honest & competent)
- Good business
  - Easy to understand and predictable
  - Competitive advantage (brand, patent, economies of scale, network effect etc.)
  - Low debt
  - High return on equity
- Margin of Safety

# This is not how Buffett started

- Benjamin Graham was the guru of Warren Buffett (Book – “The Intelligent Investor”)
- He introduced concepts of
  - Investment vs. Speculation, Equity as business ownership, Mr. Market, Margin of Safety, Net-nets, work-outs
- Missing concepts
  - Management quality, business quality
- “Cigar butt” Investing

# Graham's approach

- There are no stock market “experts” who have knowledge of the future
- Focus on the past and present rather than the future
  - Hence focus on assets and liability and past earnings and not on future projections
  - Do not take any single year's earnings too seriously
- Implication of ignoring quality of management and business (or at least not putting any financial value on the same)

# Graham's Net-Net

- The stock price of a company is quoted below the net current assets (equivalent of cash) as a proxy for liquidation value
  - Either there is a serious error in the judgement of the stock market OR
  - In the policies of the company management OR
  - In the attitude of stockholders towards their property

# Cigar Butt investing – Buffett

"A cigar butt found on the street that has only one puff left in it may not offer much of a smoke, but the bargain purchase will make that puff all profit."

## Problems

- 1) The bargain price may not turn out to have been so cheap, since as soon as one problem is solved others will appear.
- 2) The benefits of buying cheap will be eroded by the poor returns of the business. This is particularly true if the business can't be quickly sold as it continues to deteriorate.

“Time is the friend of a wonderful business and enemy of the mediocre”

“It is far better to buy a wonderful company at a fair price than to buy a fair company at a wonderful price”

Warren Buffett

# Examples of some Cigar Butts

- Maharashtra Scooters (discussed earlier)
  - Underlying Bajaj Auto, Bajaj FinServ being quality businesses
- Piramal Healthcare
  - Today's stock to be discussed



# Piramal Healthcare

- Market Capitalisation Rs. 10,169 crores
- Borrowings Rs. 1,295 crores
- Total of Rs. 11, 464 crores
- Company has sold slightly more than half of its business for Rs. 17,000 crores, after allowing for taxes and staggered payment etc. Company would be left with cash of Rs. 11,854 crores.
- Remaining Business

FREE!

FREE!!

FREE!!!

# Remaining Business

- Contract Research and Manufacturing
- Anesthetics
- OTC drugs (Saridon, Lacto Calamine, Superactiv, i-pill)
- Total turnover of these businesses Rs. 1,464 crores
- Use of cash
  - Big one time dividend, organic growth, acquisitions
  - New businesses?

Thank you