

# **GREAT, GOOD AND GRUESOME COMPANIES**

## **London Value Investing Club**

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05-May-2016

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# IN 2007 ANNUAL LETTER

Charlie and I look for companies that have

- a) business we understand;
- b) favorable long-term economics;
- c) able and trustworthy management
- d) a sensible price tag.

Our criterion of “enduring” causes us to rule out companies in industries prone to rapid and continuous change. Though capitalism’s “creative destruction” is highly beneficial for society, it precludes investment certainty. A moat that must be continuously rebuilt will eventually be no moat at all.

Additionally, this criterion eliminates the business whose success *depends* on having a great manager. ...

But if a business *requires* a superstar to produce great results, the business itself cannot be deemed great. ...

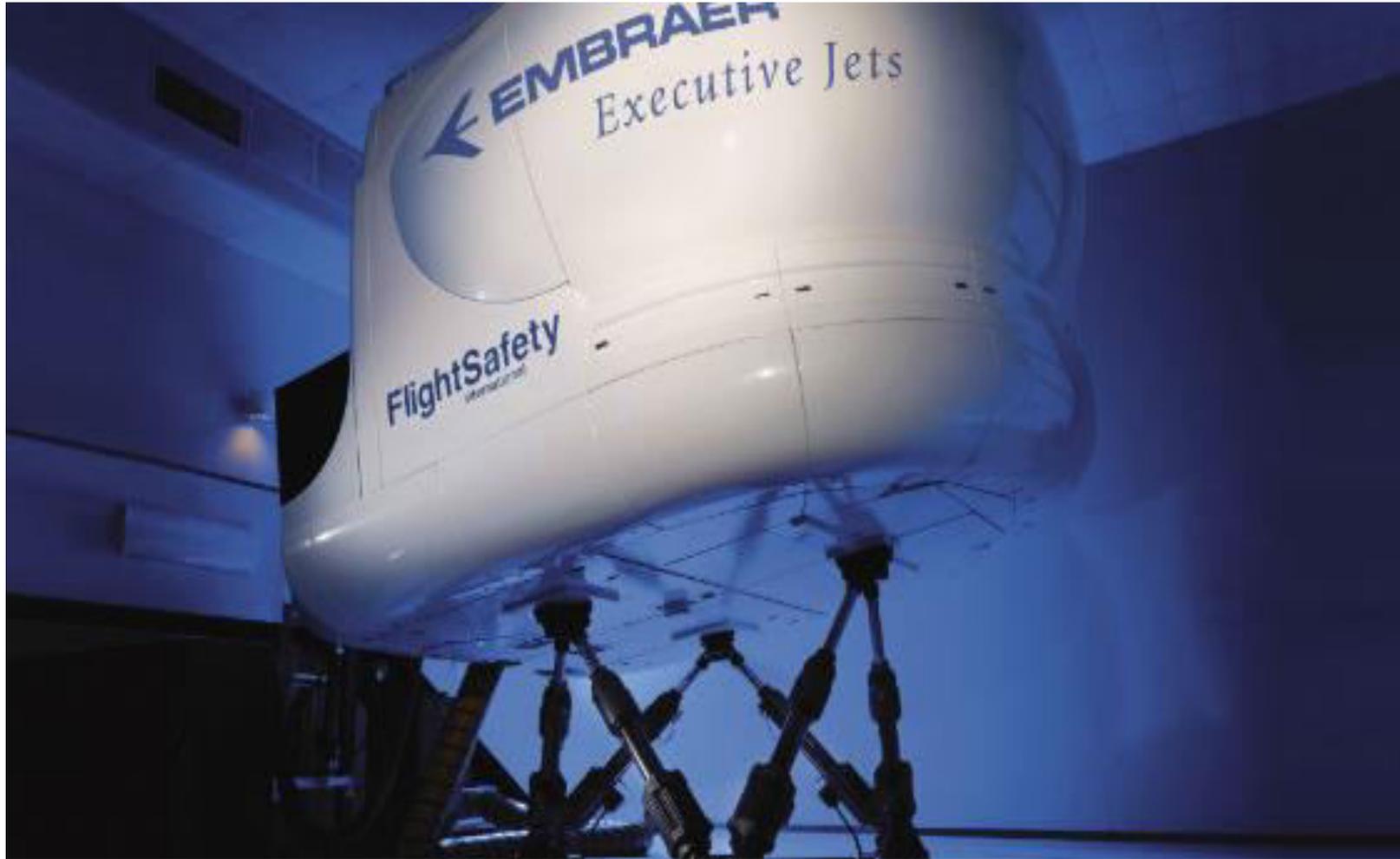
## **WARREN BUFFET: WHAT IS GOOD BUSINESS**



## GREAT BUSINESS: SEE'S CANDY

	1972	2007	CAGR (%)
Sales (\$million)	30	383	7.5
Pre Tax Profit (\$million)	5	82	8.3
Net Profit (33% tax) (\$million)	3.35	54.94	8.3
Capital Requirement (\$million) (Invested Capital)	8	40	4.7
Return on invested Capital	60%	200%	
Accumulated Pre Tax Profit (\$million)		1350	
Additional Investment between 1972-2007 (\$millions)		+32	
PE at buying time	7.5		
Earning Yield (%)	13.4		
Total Return (Earning Yield +PAT CAGR)(Approximately)	21.7		

## GOOD BUSINESS: FLIGHT SAFETY



## GOOD BUSINESS: FLIGHT SAFTEY

	1997	2007	Changes	CAGR (%)
Pre Tax Profit (\$million)	111	270	159	9.3
Net Capital Requirement (\$million) (Invested Capital)	570	1079	509	6.6
Return on invested Capital	19.5%	25%		
Return on Incremental Invested Capital			31.2%	

## **GRUESOME BUSINESS- AIRLINE**

**The worst sort of business is one that**

- **grows rapidly,**
- **requires significant capital to engender the growth,**
- **then earns little or no money. Think airlines.**

**Here a *durable* competitive advantage has proven elusive ever since the days of the Wright Brothers**

## GRUESOME BUSINESS- AIRLINE



# SOME CALCULATION



Worksheet

## **KEY TAKEAWAY**

- 1. Greatness is not dependent on growth.**
- 2. Great companies are invariably asset light – and not easy to find**
- 3. Great companies are fountains of dividends**
- 4. Good companies are fountains of earnings**
- 5. Gruesome companies are bottomless pits of capital consumption**

# REFERENCES

1. [Berkshire Hathway 2007 Annual letter to shareholder](#)
2. [Warren Buffet on Airline Industry](#)
3. [Warren Buffet on Good Business](#)
4. [Motilal Oswal 13<sup>th</sup> Wealth Creation Study](#)