FLETCHER KING:

A Classic Benjamin Graham Net Current Asset Value Share?

Do we have a company here that is trading below its net current asset value, NCAV, while also meeting Benjamin Graham's criteria of:

1. Good management
2. Good prospects for the business
3. Stability?
(see *The Financial Times Guide to Value Investing* for summary of criteria)

Any light you can shed will be welcomed. What have I missed?

Market capitalisation is £2.7m. Current assets are £4m (which includes £2.6m of cash). If we deduct all the liabilities we arrive at a NCAV of £3.1m, significantly greater than Mr Market currently values the company. A further adjustment might be to reduce the receivables as recommended by Graham. Let's remove 20% of receivables which amounts to £0.29m bringing NCAV to only slightly above market capitalisation. However, an argument can be made for adding to the NCAV the £0.5m classified as non-current 'available-for-sale investments' (actually stakes in three property investment syndicates run by FK).
A further consideration is that the NCAVs shown on recent balance sheets have consistently been above £3m for at least three years.

What about the indicators of a well-run stable company?

1. Good management.
There are 18 members of staff. The three leaders have been with the company for a minimum of 14 years. They each have decades of experience in commercial property management. They have seen recessions come and go. David Fletcher, founding director and chairman, has 40 years of experience. He also owns 14.6% of the shares. The managers have formed good relationships with clients, some over decades. Seemingly honest and realistic appraisal of the business prospects through the recession years: using words/phrases such as 'challenging', 'keep a steady eye on overhead costs' 'it will take all our ingenuity and resource to maintain turnover'

2. Good prospects
Profits before tax for the last three years have not fallen below £0.29m pa and dividends have consistently been 1.5p. With a share price of 31p the dividend yield is just under 5%. This performance has been achieved at a low point in the property cycle. At the last high point (2007) dividends amounted to 4.75p pa. Given the company's balance sheet strength there is every reason to believe that what remains of the current recession will be survived. Could dividends then go back to 4.75p? If they do then the Mr Market might push up the share price.
Of the reasons Benjamin Graham gives for a turnaround in the prospects of a NCAV company perhaps the most compelling for this case is that the earning power will be lifted to the point where it is commensurate with the company's asset level. This will not come about

through either the benefit of competitor exit from the industry or from the replacement of the senior managers, but by an improvement in the property market combined with tight management practices (honed in the recession). FK has high operational gearing: with high fixed costs, small percentage increases in revenues should feed through to large percentage increases in eps. Another possibility is a merger, as another firm may value the brand name and the long-standing relationships with property fund managers, but this is unlikely given the sense of continuity of the existing managerial team. The final alternative of liquidation would be wasteful given the profitability and the reputational competitive advantage enjoyed by this firm.

3. Stability
Positive profits have been achieved year-in-year-out through a difficult period (satisfying Graham's high average past earnings power requirement) and the balance sheet has remained robust. Much of the income comes from collecting rents on buildings for client quarter-after-quarter, providing a solid source of revenue. I cannot detect manipulation of earning numbers and sense that such a conservatively run firm is unlikely to play accounting tricks.

Some negatives

1. Much of the value created is taken by staff.
Of the £3m of so of annual revenue more than half is taken in employee benefits. Two directors each take about 10% of annual turnover in remuneration. While experienced and capable executives in the City can expect high rewards a Board that takes 25% of revenue and 250% of the profit before tax can legitimately be asked: Are you really operating this business for the benefit of all shareholders?

2. Are they too small?
Will the larger property investors consider using a firm with so few surveyors?

3. Illiquidity of shares.
Might shareholders be trapped?
It is important in investments of this type to buy on a portfolio basis – see Testing Benjamin Graham's Net Current Asset Investing in London by Glen Arnold and Xiao Ying published in the Journal of Investing, obtainable at www.glen-arnold-investments.co.uk