Chapter 13

A Comparison of Four Listed Companies

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Three manufacturing companies, one Air Freight company

TABLE 13-1 A Comparison of Four Listed Companies

	ELTRA	*Emerson Electric*	*Emery Air Freight*	*Emhart Corp.*
A. Capitalization				
Price of common, Dec. 31, 1970	27	66	57¾	32¾
Number of shares of common	7,714,000	24,884,000[a]	3,807,000	4,932,000
Market value of common	$208,300,000	$1,640,000,000	$220,000,000	$160,000,000
Bonds and preferred stock	8,000,000	42,000,000		9,200,000
Total capitalization	216,300,000	1,682,000,000	220,000,000	169,200,000
B. Income Items				
Sales, 1970	$454,000,000	$657,000,000	$108,000,000	$227,000,000
Net income, 1970	20,773,000	54,600,000	5,679,000	13,551,000
Earned per share, 1970	$2.70	$2.30	$1.49	$2.75[b]
Earned per share, ave., 1968–1970	2.78	2.10	1.28	2.81
Earned per share, ave., 1963–1965	1.54	1.06	.54	2.46
Earned per share, ave., 1958–1960	.54	.57	.17	1.21
Current dividend	1.20	1.16	1.00	1.20
C. Balance-sheet Items, 1970				
Current assets	$205,000,000	$307,000,000	$20,400,000	$121,000,000
Current liabilities	71,000,000	72,000,000	11,800,000	34,800,000
Net assets for common stock	207,000,000	257,000,000	15,200,000	133,000,000
Book value per share	$27.05	$10.34	$3.96	$27.02

A Comparison of Four Listed Companies – cont.

The most striking fact about the four companies is that the current price/earnings ratios vary much more widely than their operating performance or financial condition. Two of the enterprises— eltra and Emhart—were modestly priced at only 9.7 times and 12 times the average earnings for 1968–1970, as against a similar figure of 15.5 times for the DJIA. The other two—Emerson and Emery—showed very high multiples of 33 and 45 times such earnings.

TABLE 13-2 A Comparison of Four Listed Companies (*continued*)

	ELTRA	*Emerson Electric*	*Emery Air Freight*	*Emhart Corp.*
B. Ratios				
Price/earnings, 1970	10.0 ×	30.0 ×	38.5 ×	11.9 ×
Price/earnings, 1968–1970	9.7 ×	33.0 ×	45.0 ×	11.7 ×
Price/book value	1.00 ×	6.37 ×	14.3 ×	1.22 ×
Net/sales, 1970	4.6 %	8.5 %	5.4 %	5.7 %
Net per share/book value	10.0 %	22.2 %	34.5 %	10.2 %
Dividend yield	4.45 %	1.78 %	1.76 %	3.65 %
Current assets to current liabilities	2.9 ×	4.3 ×	1.7 ×	3.4 ×
Working capital/debt	Very large	5.6 ×	no debt	3.4 ×
Earnings growth per share:				
1968–1970 vs. 1963–1965	+ 81%	+ 87%	+ 135%	+14 %
1968–1970 vs. 1958–1970	+400%	+250%	Very large	+132%
C. Price Record				
1936–1968 Low	¾	1	⅛	3⅝
High	50¾	61½	66	58¼
1970 Low	18⅝	42⅛	41	23½
1971 High	29⅜	78¾	72	44⅜

Performance Comparison of Four Listed Companies

- Profitability
  - All the companies show satisfactory earnings on their book value, but the figures for Emerson and Emery are much higher than for the other two.
  - For manufacturing companies, the profit figure per dollar of sales is usually an indication of comparative strength or weakness. We use here the “ratio of operating income to sales,”. the results are satisfactory for all four companies, with an especially impressive showing by Emerson.
- Stability: This we measure by the maximum decline in pershare earnings in any one of the past ten years, as against the average of the three preceding years.
- Growth: The two low-multiplier companies show quite satisfactory growth rates, in both cases doing better than the Dow Jones group.

Performance Comparison of Four Listed Companies – cont.

- Financial Position: The three manufacturing companies are in sound financial condition, having better than the standard ratio of $2 of current assets for $1 of current liabilities. Emery Air Freight has a lower ratio; but it falls in a different category, and with its fine record it would have no problem raising needed cash. All the companies have relatively low long-term debt.

- Dividends: What really counts is the history of continuance without interruption. The current dividend yield is twice as high on the “cheap air” as on the “dear pair,” corresponding to the price/earnings ratios.

- Price History: Both eltra and Emhart sustained price shrinkages of more than 50% in the 1969–70 price break. Emerson and Emery had serious, but less distressing, declines; the former rebounded to a new all-time high before the end of 1970, the latter in early 1971.

General Observations on the Four Companies

- **Emerson Electric**: has an enormous total market value, dwarfing the other three companies combined.* It is one of our “good-will giants,”. High valuations entail high risks.
- **Emery Air Freight**: must be the most promising of the four companies in terms of future growth, if the price/earnings ratio of nearly 40 times its highest reported earnings is to be even partially justified. This is a remarkable achievement indeed, but it raises the question whether future profits may not be vulnerable to adverse developments, through increased competition, pressure for new arrangements between forwarders and airlines, etc.
- **Emhart and eltra**: It appears that neither of these companies possesses glamour, or “sex appeal,” in the present market; but in all the statistical data they show up surprisingly well.

Conclusions

- Many financial analysts will find **Emerson and Emery** more interesting and appealing stocks than the other two— primarily, perhaps, because of their better “market action,” and secondarily because of their faster recent growth in earnings. Under our principles of conservative investment the first is not a valid reason for selection—that is something for the speculators to play around with. The second has validity, but within limits. Can the past growth and the presumably good prospects of Emery Air Freight justify a price more than 60 times its recent earnings? For the careful investor who wants to be reasonably sure in advance that he is not committing the typical Wall Street error of overenthusiasm for good performance in earnings and in the stock market
- Both **Eltra** at 27 and **Emhart** at 33 have the earmarks of companies with sufficient value behind their price to constitute reasonably protected investments. The two companies will meet our seven statistical requirements for inclusion in a defensive investor’s portfolio.

A Final Observation

An experienced security analyst, even if he accepted our general reasoning on these four companies, would have hesitated to recommend that a holder of Emerson or Emery exchange his shares for eltra or Emhart at the end of 1970—unless the holder understood clearly the philosophy behind the recommendation. There was no reason to expect that in any short period of time the low-multiplier duo would outperform the highmultipliers. The latter were well thought of in the market and thus had a considerable degree of momentum behind them, which might continue for an indefinite period.