SANBORN MAP CASE STUDY

WEB's mention and discussion of Sanborn Map as presented to his partners in his BLP letters. How did Buffett find this investment and how did he go about valuing it and unlocking value? Why was the market pricing Sanborn below what Buffett thought it was worth? Discuss.

From 1958 letter

Late in the year we were successful in finding a special situation where we could become the largest holder at an attractive price, so we sold our block of *Commonwealth* obtaining $80 per share although the quoted market was about 20% lower at the time.

It is obvious that we could still be sitting with $50 stock patiently buying in dribs and drabs, and I would be quite happy with such a program although our performance relative to the market last year would have looked poor. The year when a situation such at *Commonwealth* results in a realized profit is, to a great extent, fortuitous. Thus, our performance for any single year has serious limitations as a basis for estimating long term results. However, I believe that a program of investing in such undervalued well protected securities offers the surest means of long term profits in securities.

I might mention that the buyer of the stock at $80 can expect to do quite well over the years. However, the relative undervaluation at $80 with an intrinsic value $135 is quite different from a price $50 with an intrinsic value of $125, and it seemed to me that our capital could better be employed in the situation which replaced it. **This new situation is somewhat larger than *Commonwealth* and represents about 25% of the assets of the various partnerships.** While the degree of undervaluation is no greater than in many other securities we own (or even than some) we are the largest stockholder and this has substantial advantages many times in determining the length of time required to correct the undervaluation. In this particular holding we are virtually assured of a performance better than that of the Dow-Jones for the period we hold it.

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1959

Last year (1958), I mentioned a new commitment which involved about 25% of assets of the various partnerships. Presently this investment is about **35% of assets**. This is an unusually large percentage, but has been made for strong reasons. In effect, this company **(*Sanborn Map*)** is partially an **investment trust owning some thirty or forty other securities of high quality.** Our investment was made and is carried at a substantial discount from asset value based on market value of their securities and a conservative appraisal of the operating business.

1960

Sanborn Map:

Last year mention was made of an investment which accounted for a very high and unusual proportion (35%) of our net assets along with the comment that I had some hope this investment would be concluded in 1960. This hope materialized. The history of an investment of this magnitude may be of interest to you.

Sanborn Map Co. is engaged in the publication and continuous revision of extremely detailed maps of all cities of the United States. For example, the volumes mapping Omaha would weigh perhaps fifty pounds and provide minute details on each structure. The map would be revised by the paste-over method showing new construction, changed occupancy, new fire protection facilities, changed structural materials, etc. These revisions would be done approximately annually and a new map would be published every twenty or thirty years when further pasteovers became impractical. The cost of keeping the map revised to an Omaha customer would run around $100 per year.

This detailed information showing diameter of water mains underlying streets, location of fire hydrants, composition of roof, etc., was primarily of use to fire insurance companies. Their underwriting departments, located in a central office, could evaluate business by agents nationally. The theory was that a picture was worth a thousand words and such evaluation would decide whether the risk was properly rated, the degree of conflagration exposure in an area, advisable reinsurance procedure, etc. The bulk of *Sanborn*'s business was done with about thirty insurance companies although maps were also sold to customers outside the insurance industry such as public utilities, mortgage companies, and taxing authorities.

For seventy-five years the business operated in a more or less monopolistic manner, with profits realized in every year accompanied by almost complete immunity to recession and lack of need for any sales effort. In the earlier years of the business, the insurance industry became fearful that *Sanborn*'s profits would become too great and placed a number of prominent insurance men on *Sanborn*'s board of directors to act in a watch-dog capacity.

In the early 1950's a competitive method of under-writing known as "carding" made inroads on *Sanborn*'s business and after-tax profits of the map business fell from an average annual level of over $500,000 in the late 1930's to under $100,000 in 1958 and 1959. Considering the upward bias in the economy during this period, this amounted to an almost complete elimination of what had been sizable, stable earning power.

However, during the early 1930's *Sanborn* had begun to accumulate an investment portfolio. There were no capital requirements to the business so that any retained earnings could be devoted to this project. Over a period of time, about $2.5 million was invested, roughly half in bonds and half in stocks. Thus, in the last decade particularly, the investment portfolio blossomed while the operating map business wilted.

Let me give you some idea of the extreme divergence of these two factors. In 1938 when the Dow-Jones Industrial Average was in the $100-$120 range, *Sanborn* sold at $110 per share. In 1958 with the Average in the $550 area, *Sanborn* sold at $45 per share. Yet during that same period the value of the *Sanborn* investment portfolio increased from about $20 per share to $65 per share. This means, in effect, that the buyer of *Sanborn* stock in 1938 was placing a positive valuation of $90 per share on the map business ($110 less the $20 value of the investments unrelated to the map business) in a year of depressed business and stock market conditions. In the tremendously more vigorous climate of 1958 the same map business was evaluated at a minus $20 with the buyer of the stock unwilling to pay more than 70 cents on the dollar for the investment portfolio with the map business thrown in for nothing.

How could this come about? *Sanborn* in 1958 as well as 1938 possessed a wealth of information of substantial value to the insurance industry. To reproduce the detailed information they had gathered over the years would have cost tens of millions of dollars. Despite "carding" over $500 million of fire premiums were underwritten by "mapping" companies. However, the means of selling and packaging *Sanborn*'s product, information had remained unchanged throughout the year and finally this inertia was reflected in the earnings.

The very fact that the investment portfolio had done so well served to minimize in the eyes of most directors the need for rejuvenation of the map business. *Sanborn* had a sales volume of about $2 million per year and owned about $7 million worth of marketable securities. The income from the investment portfolio was substantial, the business had no possible financial worries, the insurance companies were satisfied with the price paid for maps, and the stockholders still received dividends. However, these dividends were cut five times in eight years **although I could never find any record of suggestions pertaining to cutting salaries or director's and committee fees.**

Prior to my entry on the Board, of the fourteen directors, nine were prominent men from the insurance industry who combined held 46 shares of stock out of 105,000 shares outstanding *or (0.044%)*. Despite their top positions with very large companies which would suggest the financial wherewithal to make at least a modest commitment, the largest holding in this group was ten shares. In several cases, the insurance companies these men ran owned small blocks of stock but these were token investments in relation to the portfolios in which they were held. For the past decade the insurance companies had been only sellers in any transactions involving *Sanborn* stock.

The tenth director was the company attorney, who held ten shares. The eleventh was a banker with ten shares who recognized the problems of the company, actively pointed them out, and later added to his holdings. The next two directors were the top officers of *Sanborn* who owned about 300 shares combined. The officers were capable, aware of the problems of the business, but kept in a subservient role by the Board of Directors. The final member of our cast was a son of a deceased president of *Sanborn*. The widow owned about 15,000 shares of stock.

In late 1958, the son, unhappy with the trend of the business, demanded the top position in the company, was turned down, and submitted his resignation, which was accepted. Shortly thereafter we made a bid to his mother for her block of stock, which was accepted. At the time there were two other large holdings, one of about 10,000 shares (dispersed among customers of a brokerage firm) and one of about 8,000. These people were quite unhappy with the situation and desired a separation of the investment portfolio from the map business, as did we.

Subsequently our holdings (including associates) were increased through open market purchases to about 24,000 shares and the total represented by the three groups increased to 46,000 shares *(44%)*. We hoped to separate the two businesses, realize the fair value of the investment portfolio and work to re-establish the earning power of the map business. There appeared to be a real opportunity to multiply map profits through utilization of *Sanborn*'s wealth of raw material in conjunction with electronic means of converting this data to the most usable form for the customer.

There was considerable opposition on the Board to change of any type, particularly when initiated by an outsider, although management was in complete accord with our plan and a similar plan had been recommended by *Booz, Allen & Hamilton* (Management Experts). To avoid a proxy fight (which very probably would not have been forthcoming and which we would have been certain of winning) and to avoid time delay with a large portion of *Sanborn*'s money tied up in blue-chip stocks which I didn't care for at current prices, a plan was evolved taking out all stockholders at fair value who wanted out. The SEC ruled favorably on the fairness of the plan. About 72% of the *Sanborn* stock, involving 50% of the 1,600 stockholders, was exchanged for portfolio securities at fair value. The map business was left with over $l.25 million in government and municipal bonds as a reserve fund, and a potential corporate capital gains tax of over $1 million was eliminated. The remaining stockholders were left with a slightly improved asset value, substantially higher earnings per share, and an increased dividend rate.

Necessarily, the above little melodrama is a very abbreviated description of this investment operation. However, it does point up the necessity for <u>secrecy</u> regarding our portfolio operations as well as the futility of measuring our results over a short span of time such as a year. Such <u>control</u> situations may occur very infrequently. **Our bread-and-butter business is buying undervalued securities and selling when the undervaluation is corrected along with investment in special situations where the profit is dependent on corporate rather than market action.** To the extent that partnership funds continue to grow, it is possible that more opportunities will be available in "control situations."

However, in the case of control situations increased funds are a definite advantage. A "*Sanborn* Map" cannot be accomplished without the wherewithal. My definite belief is that the opportunities increase in this field as the funds increase. This is due to the sharp <u>fall-off in competition</u> as the ante mounts plus the important positive correlation that exists between increased size of company and lack of concentrated ownership of that

company's stock.

Which is more important -- the decreasing prospects of profitability in passive investments or the increasing prospects in control investments? I can't give a definite answer to this since to a great extent it depends on the type of market in which we are operating. My present opinion is that there is no reason to think these should not be offsetting factors; if my opinion should change, you will be told. I can say, most assuredly, that our results in 1960 and 1961 would not have been better if we had been operating with the much smaller sums of 1956 and 1957.

Many times generals represent a form of "coattail riding" where we feel the dominating stockholder group has plans for the conversion of unprofitable or under-utilized assets to a better use. We have done that ourselves in *Sanborn* and *Dempster*, but everything else equal we would rather let others do the work. Obviously, not only do the values have to be ample in a case like this, but we also have to be careful whose coat we are holding.

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Notes by Other Authors

In other words, Buffett felt he had a substantial margin of safety based on the fact that the investment portfolio was worth far more than the company was being sold for in the stock market. Additionally, the company was still profitable, although the profits were deteriorating. (Buffett had asset value protection and some earnings power value.) Moreover, the value of the maps was not going away anytime soon, even if the company had to downsize. The maps were so detailed and useful that there would always be some sort of market for them. In fact, the company still exists today and still serves the insurance community.

Buffett who had ended up-- either through owning or allying himself-- with about 40% of the company's stock. It is this control that gave him an extra level of safety. He knew that once he was in control he could arrange an appropriate liquidation of stock. Once hi obtained enough shares to influence a shareholder vote, he worked out a plan with the board a plan to separate the investment portfolio from the map business. All shareholders who wanted to were taken out at fair value, and Buffett made a significant profit on his investment.

*If anything, diversification would have hurt Buffett's efforts to turn this investment into a profitable one. Left on its own, the board of Sanforn would have done thing to unlock shareholder value. In order for Buffett to fully realize his margin of safety he could not have stood by passively. He needed to actively negotiation with the other shareholders to take control, and then once in control. To develop the plan and execute it for unlocking that value. His focus was his margin of safety. TWO WAYS TO WIN. (*Source: *Trade Like Buffett).*

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In the 1960 letter to his LPs, Buffett mentioned that there was one situation that constituted 35% of the portfolio of the partnership. This would not have been considered by Graham to be an investment in the spirit of their approach since it was not diversified, despite having many of the other characteristics that Graham typically recommended. As was typical with Buffett, he did not reveal what the stock was in 1960 that took up so much of their partnership's assets. However, in the 1961 letter he did unveil this mysterious stock and put up his reasons for the investment.
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Roger Lowenstein from *Buffett:*

Sanborn Map illustrated Buffett's debt to Ben Graham. *Sanborn*'s once-lucrative map business had declined; however, the company had an investment portfolio, built up over its flush years, worth some $65 per share. And it stock, reflecting its sagging map business was trading at only $45. This was a carbon copy of Northern Pipe Line—prized by Graham for its railroad bonds. Echoing his mentor, Buffett bought *Sanborn* stock through 1958 and 1959. He was trusting in Graham's testimony: sooner or later a stock would rise to value.

But it didn't. The company's directors owned merely 46 shares and were content to let the share price languish. In fact, while sitting on that huge portfolio they had cut dividends dive times in eight years, though, as Buffett noted, it had not as yet occurred to the board to reduce the fees to themselves.

Following Graham page-for-page, Buffett became a director and lobbied the management to unearth the sub rosa value in its investment portfolio. The management resisted.

In the meantime, Buffett did not mention *Sanborn* to his investors, though he did disclose that he had put 35% of their assets into a single stock. But he and other dissident shareholders continued to put the heat on. In 1960, *Sanborn* capitulated, and agreed to use its portfolio to buy out stockholders. Buffett made roughly a 50% profit. With the cat out of the bag, he wrote to partners that *Sanborn* "does point up the necessity for secrecy regarding our portfolio operations as well as the futility of measuring our results over a short span of time.

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