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PERSONAL FINANCE

The $700 Used Book

Why all the buzz about Seth Klarman's out-of-print investing classic?

Harper Lee's 1960 novel *To Kill a Mockingbird*
quickly became a modern classic, but except for a few essays, Lee never published again. J.D. Salinger secluded himself in New Hampshire in 1953 following the success of *The Catcher in the Rye*. A few more novels and short stories followed over the next decade, but he has been mum since.

At least with Lee and Salinger, there's no problem finding their works. Not so for the sole book written by hedge fund manager Seth Klarman. His 1991 work, *Margin of Safety: Risk-Averse Value Investing Strategies for the Thoughtful Investor*, came and went without much notice at the time and is long out of print. Klarman holds the copyright but has never revised or even reprinted it.

Still, over the past few years this work has taken on iconic stature among value investors. Originally listed at $25, the title trades for top prices on the used-book market. About a half-dozen copies are for sale online: The best deal is $700 from a seller at Amazon.com (**AMZN**). Another vendor offers it for nearly $2,500.

There are other ways to get hold of it. One entrepreneur even rented it out on eBay (**EBAY**) for $75 a week, promptly drawing a customer. University libraries report it as one of their most wait-listed titles as well as one most claimed as lost. (Maybe borrowers figure they can replace it at face value.) All told, just 262 libraries worldwide report having a copy, according to the Online Computer Library Center, an international database that includes about 95% of academic libraries and 75% of public libraries.

The 249-page book is especially hot among those seeking jobs with value-oriented investment firms. "You win serious points for talking Klarman," says a newly minted MBA who got his hands on a copy prior to a late-round interview with a top mutual fund firm. "It's pretty much assumed that you've read Graham and Dodd and Warren Buffett." (Benjamin Graham and David Dodd's 1934 work, *Security Analysis*, is a seminal book on value investing, while Buffett's annual letters to shareholders are considered gospel.) "The book belongs in the category of Buffett and Graham," says Oakmark Funds manager Bill Nygren, a collector of stock market tomes.

Klarman declined to comment for this story. But by reading the book, examining regulatory filings, and reviewing his recent reports to shareholders, we were able to piece together some of his thinking.

Why does anyone care what Klarman wrote 15 years ago? The author, now 49, is one good investor. Klarman earned his MBA at Harvard Business School in 1982, graduating near the top of his class. A group of wealthy families took notice and gave Klarman $27 million to manage, which was the start of his firm, the Boston-based Baupost Group. Between its February, 1983, inception and the end of June, 2006, Baupost's largest and oldest partnership posted a cumulative return of 6,133% after fees. During the same period, the Standard & Poor's 500-stock index was up 1,517%, with dividends reinvested.

Baupost manages $6.2 billion of assets across nine partnerships, but Klarman is inaccessible even to the well-heeled: The firm turns away new investors. When it was still accepting clients, you needed a referral from an existing client before Baupost would take your money.

Since Klarman and his book are hard to come by, here's a quick summary. The term "margin of safety" refers to the cushioning, or wiggle room, that investors should build into what they pay for a security. He doesn't claim to have invented the term, which comes from Graham & Dodd. "How can investors be certain of achieving a margin of safety?" writes Klarman. "By always buying at a significant discount to underlying business value, and giving preference to tangible assets over intangibles....By replacing current holdings as better bargains come along. By selling when the market price of an investment comes to reflect its underlying value and by holding cash, if necessary, until other attractive investments become available."

Although definitions of "underlying value" abound, Klarman's interpretation opts for a more no-nonsense view that's shorn of intangible assets such as goodwill. "Since investors cannot predict when values will rise or fall," he writes, "valuation should always be performed conservatively, giving considerable weight to worst-case liquidation value as well as to other methods."

DISTRESSED PRICES

As an investor, Klarman often seeks opportunity in idiosyncratic investments such as distressed securities and bankruptcy workouts. In the book, he describes buying Texaco (**CVX**
) bonds in the wake of the company's sudden 1987 bankruptcy. What prompted the filing was the loss of a multibillion-dollar lawsuit, not insolvency. In the ensuing panic, investors dumped the bonds, and Klarman got them at distressed prices. His bet was that

Texaco would make good on the debt, and he was right.

In the same spirit, Baupost's latest Securities & Exchange Commission filings show that the firm has a position in John B. Sanfilippo & Son (**JBSS**
), a nut-and-candy distributor whose shares plunged last year on concerns that it might violate debt covenants. There's no way to know what Klarman paid, but the stock did trade for far below book value.

Most names in Baupost's portfolio are obscure, except for its largest holding, News Corp (**NWS**). The firm has stockpiled at least $230 million worth of the media giant's A- and B-class shares. What's the play? Media companies are often sought by value investors. They can produce bountiful cash flows even when earnings look pale.

In his latest shareholder letter, Klarman reiterates one of the book's tenets: Value investors must be overweighted in patience. In the past, Klarman has parked as much as half his portfolio in cash, earning a few percentage points until he finds investments with enough margin of safety to deploy it. Rather than chase stocks and bonds, he waits for them to come to him at prices he's comfortable paying. That's a lesson worth far more than $700.

By Roben Farzad

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