JAUGUST 19, 2024

PhilEquity
MANAGEMENT INC.

# PHILEQUITY CORNER

*By Antonio R. Samson*

## Due diligence in investment

One requirement in the process of acquiring a company as an investment is “due diligence”. This is a process that assures the buyer that care has been taken in determining the true value of an acquisition, and hence the price offered for it. Aside from the usual financial analysis like profitability, growth, liquidity ratios, debt burden, and aging of payables, there is the inquiry into hidden risks, like possible off-book transactions or pending litigations that can affect the valuation.

Due diligence for an acquisition is conducted not just by accountants but also lawyers and auditors so that a valuation can be arrived at which may include the goodwill (or its opposite) from the company’s reputation, management, and market standing.

Should an investor who puts money on a stock (sometimes a lot of money) simply rely on some “hot tip” from a parent or a friend? Is there also a need for due diligence and some research in making personal investment decisions?

First time investors, like those coming into sudden wealth with early retirement or the achievement of an Olympic feat attracting tons of cash, need to pause before plunging into an investment like opening a car repair shop near a road widening project.

The way people decide on investments can seem even more casual than looking for a portable wheelchair. (Can this fit in the trunk of the car?) And investments are not limited to listed stocks. One reads too often about yet another scam featuring high returns every month that has taken in supposedly wealthy (and presumably financially savvy) investors to appreciate the need for due diligence. A simple investment rule states that “if it’s too good to be true, it isn’t.”

The rise of “private banking” (or wealth management) in the big banks as well as investment companies and mutual funds has allowed investors to tap financial advisers that provide due diligence as part of their skills set.

A report (complete with pie charts) on how the investment client’s placement or its net asset value stands, even daily. The client is asked about his investment goals, whether growth, high risk, or a conservative fixed income stream. The risk appetite of the client is the first to be determined.

Doing away with basic financial information is a recipe for buyer’s remorse. Why did I get into that investment? What was I thinking? The company has no assets, only business plans which consist of a wish list of favorable events taking place.

Here are some things to note.

Do you just leave it to the experts? While this seems to be sound advice, it begs the question of which experts do you leave your money with. Experts managing funds have track records and these must be examined. (Still part of research.) How well did the fund do against the PSEI? They have records stretching back over fifteen years. The simple test of performance can be requested from the fund being considered.

Listed companies have a full-time Investor Relations (IR) unit which deals with researchers and provides statistics on earnings, competition, market share, and changes in management. While only investment research groups, business media, and stockholders (sometimes) are invited to these briefings, the results (including “our take”) are made available to the investors. Usually, these statistics are posted on the company’s web site.

News items in the business papers, interviews of the CEO, and company reports of the stockbrokers provide many insights into the company that can allow the investor to make intelligent decisions. In fact, the absence of information, or the frequent postponement of stockholders’ meetings, delayed releases of financial performance are warning signs on the company’s prospects.

There is no such thing as having too much information on an investment or stock that one wants to buy. Even if the information is negative, the investor discovers when to sell and cut losses.

It should be back to basics and taking a healthy long-term view on good companies with a good reputation and a competitive business model. Due diligence goes beyond numbers. It looks for a good narrative with a consistent plot. As in all investments, the question is always about timing, on when to take the profit or loss.

*Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity’s managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 8250-8700 or email ask@philequity.net.*