

Berger's 12 Inviolate Laws of Performance

A manifesto the modern investor can live with.

By John Berger

If you think about it, you really don't need someone to tell you the things you are about to read. But the establishment investment community has assaulted the good common sense of most participants in the stock market, replacing obvious logic with their home-brewed arcane formulations.

As a direct result of this misinformation and class warfare, millions of innocent Americans have seen their retirement funds invested in money-losing companies which subsequently failed, both as businesses and investments.

Vigilante Analyst is an attempt to redress this injustice and to demand changes in a flawed system, by educating and empowering individual and institutional investors. The philosophy of analysis that guides the Vigilante is as follows:

1) In order to make money, you've got to make money.

It is almost always disingenuous for a company to say it is performing well when it is losing money on a GAAP EPS basis. Governments and charities don't have to make money, but corporations do.

2) There is a reason certain accounting principles are generally accepted.

Companies should be evaluated primarily according to generally accepted accounting principles (GAAP). Exceptions exist, but they should be few and far between.

3) One-time costs are costs that only occur once.

Companies which make a habitual practice of acquisitions, restructuring and incurring other "one-time" costs should be evaluated on the basis of known patterns of behavior. In other words, it is not acceptable to simply dismiss (or erase via pro forma reporting) spending driven by management's ongoing strategy as "unusual costs."

4) Risk is an inescapable element of life.

Risk factors that are built into a company's inherent profile should not be dismissed as "one-time," "nonrecurring" or "unusual" costs when they occur. These risks can include but are not limited to factors such as weather, actuarial costs, pensions, fires, floods and the market price of shrimp.

5) Without dividends, stock isn't worth the paper it's printed on.

Companies which do not offer dividends as a matter of ongoing policy are redistributing wealth from their shareholders to themselves. Here is the entire (and only) point of investing: You give a company money, the company uses the money to run its business, and you share in the profits. If you aren't getting a dividend, you aren't sharing in the profit, and thus your investment is entirely meaningless except as a form of recreational gambling.

6) "Pro forma" is Latin for "not true."

Pro forma earnings reports are often (not always, but often) meant to obscure a company's actual performance, which is usually (not always, but usually) worse than the company would like you to believe.

7) The devil is not in the details.

Details are important, but dwelling on minutiae doesn't make big problems go away. If a company is losing millions of dollars on an EPS basis, it is pointless to dwell on incremental changes in the obscurantist metrics companies like to tout. Companies like to tout those metrics in order to convince analysts they are doing well despite multimillion dollar losses. Depressingly, this tactic often works. In fact, analysts often volunteer an interest in minutiae, thus saving the company a lot of exhausting work.

8) If stock prices have no basis in reality, then they cannot be predicted using logic.

Stock prices have become almost entirely divorced from actual company performance, primarily because stock shares are essentially popularity polls if they are not connected to a tangible dividend plan. The disconnect is worsened by the escalating complexity and sheer size of the stock market and global economies, as well as a lack of discipline among investors and the investment community. This problem can be alleviated, but probably not entirely eliminated, if individuals and institutions demand that companies in which they invest return equity to shareholders through positive earnings and the payment of proportionate dividends. (See disclaimers.)

Until that day arrives, however, stock price cannot be considered a meaningful barometer of a company's financial health or performance. (Although certain stock-based equity arrangements can directly impact a company's results, the fault usually lies with the arrangements rather than the stock price.)

9) Dilution is the devil's playground.

Dilution is a word used to justify one of the following goals: 1) Obscuring shareholders' visibility regarding the performance of their investment. 2) Enriching companies at the expense of shareholders. 3) Manipulating stock prices in the crudest possible way.

Value cannot be created or destroyed by the manipulation of equity shares -- it is can only be reapportioned. Companies should determine an appropriate and consistent dilution which should then be maintained through careful management. There is rarely anything to be gained by after-the-fact rebalancing using techniques such as complex preferred equity arrangements, massive and/or continual share buybacks and the abuse of equity offerings as a way to fund routine operating expenses.

10) Paying dividends to shareholders creates more value than buying back their stock.

Companies can better preserve shareholder value by paying dividends than by spending money buying a stake in themselves. The shareholder sells at a discount and swallows the loss. At best, the company rips off investors who bought the stock at a premium when it was originally issued and keeps the difference. At worst, the company rips off investors and invests the ill-gotten proceeds in a company that's going down the tubes (i.e., their own).

Assuming dilution has been thoughtfully set and maintained, see above, buybacks should rarely be necessary or desirable. Excess cash should go to dividends, which simply and clearly tie the value of an equity investment to the company's profit. At best, stock buybacks temporarily manipulate share price. At worst, they enrich companies and executives at the direct expense of shareholders.

11) If a company has robust cash flow while recording EPS losses, odds are someone is getting ripped off.

Not always, but far too often. The "someone getting ripped off" can include, but is not limited to, the company's, customers, business partners and/or shareholders, and/or world governments.

12) A company is either making money, or it's not. And it's usually not hard to tell the difference.

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