The Naughty Step

Diary of a Private Investor Colm Fagan Update 13 9 April 2019

When children misbehave, their parents put them on the naughty step. I tried the same with a misbehaving investment, but to no avail.

I bought my first shares in Samsonite, the luggage company, in May 2017. For a time, it was my blue-eyed boy. It was quoted on the Hong Kong stock exchange, the touch of the orient adding to its allure.

The main attraction was the price. I reckoned that Samsonite was cheap for a luxury brand. Someone close to me, who knows far more about luxury brands than I do, scoffed at my suggestion that it qualified as a luxury brand. It didn't have any of the cachet of top names like Cartier, Louis Vuitton, Prada, Rolex, Hermès, I was told.

I conceded that it wasn't in the same league as those top brands, but neither was the price, I argued. The difference between Samsonite's share price and those of the owners of top brands was more than the difference in quality, I said, adding that Cristiano Ronaldo was global ambassador for one of the Samsonite brands. Surely that had to be a positive?

They say that the worst thing that can happen to a gambler is to win their early bets. That was my experience with Samsonite. The price increased from the HK$29.60 at which I made my first purchase in May 2017, to HK$30.83 in August, when I more than doubled my holding. The price had increased again, to HK$33.98, by the time I bought my third tranche in November 2017. At this point, Samsonite had risen to #5 in my list of top holdings. I bought again in January 2018, at HK$34.70 a share, causing it to edge ahead of Apple as my fourth biggest holding. At this point, Samsonite accounted for 8.5% of my total pension and other investments. From this lofty vantage point, I could admire a substantial unrealised gain on my investment, "unrealised" being the operative word.

Then disaster struck, on the very day I was heading off to the US on holidays, planning to spend some of my still-unrealised gains. That morning, a short-seller issued a report accusing the company of various shady dealings. The report claimed that Samsonite was only worth half its current market value. The shares were suspended on the stock market as the company struggled to draft a response. When the dust finally settled, on the day I was returning to Ireland, the share price had fallen to HK$26.50. My beautiful unrealised profit had turned into an ugly unrealised loss.

The main fallout from the affair, other than a substantially reduced share price, was the sudden departure of the Chief Executive who, it was alleged, had been falsely claimed to have a doctorate from a US university. He wasn't the first, and won't be the last, senior executive to be accused of embellishing their CV.

I decided to put Samsonite on the naughty step and to leave it there until after the results for 2018 were announced, at which time I would decide its fate.

The results for 2018 were announced on 13 March last. At first glance, they looked good: sales up 9%; profit margins up, operating profit up 10%. But published profits were down over 25%. The new Chief Executive, who had been promoted from CFO after the departure of his un-doctored predecessor, stressed that published profits included lots of negative once-off factors. When these were excluded, adjusted net income was up 13% on 2017.

I'm always suspicious of the term "adjusted net income". Adjustments, like beauty, can be in the eye of the beholder. To some extent, management can decide what to include and what to exclude from the calculation. For Samsonite, my suspicions were heightened by the cash flow statement, which didn't show the higher sales and profit margins translating into hard cash. I decided to sell my entire holding, proving that some naughty children really are sold to the gypsies (grandchildren, please note). The average sale price of HK$24.63 meant I was incurring a significant loss, not just in percentage terms, but also in hard cash, because of the high proportion of my overall wealth represented by Samsonite. Sore.

The final humiliation was the discovery of an Instagram photo of an impeccably suited Ronaldo, Samsonite's brand ambassador. By his side was a beautiful, petite, and most importantly, expensive …… Louis Vuitton suitcase.

Humiliation has its consolations. My willingness to suffer the occasional humiliation is one of the reasons why I can expect to earn significantly more – on average – than could be earned from risk-free assets. Yes, I could avoid humiliation by taking less risk, but at a cost. I reckon that a "safe" investment strategy would reduce my expected investment return by 4% a year or more, on average. For that, I'm prepared to look foolish every now and then.