Shareholders Have Feelings Too

Colm Fagan **Diary of a Private Investor** **Update 14** **7 May 2019**

Speed read:
A Lord venting his frustration helped propel me to a 25% profit on an investment. I then dumped the shares at the scent of possible trouble ahead.

Company bosses should treat shareholders as their friends. No, closer even than friends. How many of your friends would be prepared to hand you money on the vague promise that you would see them right if things went well, but they could wave goodbye to their hard-earned cash if things went badly? The Chairman's and Chief Executive's statements accompanying Annual Reports can inform shareholders, sometimes unintentionally, what companies *really* think of them. In April, I dumped shares that I had bought only six weeks previously, partly because I concluded after reading the Chairman's and Chief Executive's statements that the company didn't value its shareholders and didn't care much about their feelings.

Charles Taylor plc is a UK small cap company, meaning that it is listed on the main London stock exchange but is outside the top 350 quoted companies. It provides support services to the insurance industry.

In March, I decided to invest in Charles Taylor at £1.94 a share, mainly because Lord John Lee, a successful investor and a former Conservative MP who writes an occasional personal finance column in the Financial Times, thought they were good value a year ago at £3 a share. The company hadn't told the stock exchange of any material adverse developments in the meantime, so I reckoned its shares must be even better value now, more than a third lower. I was also reassured by the dividend of 11p a share, implying a dividend yield of close to 6%. Companies generally set dividends at a level they think can be maintained in normal circumstances, so even if the price were to fall, I would still earn a good running yield. I decided to invest only a small amount, in keeping with my recent resolution to start with a small stake in a company and to increase it only when I got comfortable with the company's strategy, its financials and its people (see diary update 11: "*The Virtues of a Small Harem*").

Charles Taylor's results for 2018 were published on 13 March, the morning after I bought the shares. I put the results aside to study later, but I was happy with the proposed 5% dividend increase. It signalled that the Board and management had confidence in the company's prospects.

The price hardly moved after the announcement, indicating that the results and prospects were broadly as the market expected. I took this as another encouraging sign. Then something strange happened. After staying almost unchanged for three weeks, the share price suddenly jumped 8% on 3rd April, to £2.16, for no apparent reason. It jumped again to £2.37 on Monday 8th April and kept rising over the next couple of weeks, hitting £2.52 by Friday 19th April. It was now up 30% on when I bought just five weeks previously. Naturally, I was happy with this turn of events but asked myself: why did the market wait three weeks before reacting so positively to the results?

I discovered that the price jump on 3rd April came immediately after an article by columnist Lord John Lee appeared in the online edition of the Financial Times. Referring to his holding in Charles Taylor, Lord Lee wrote: *"I had expected that the results would deliver a modest bounce in the share price, but hardly a movement."* He was right: the share price hardly moved before his article was published. It soon made up for lost time. The price jump of 3rd April was followed by a further boost when the article appeared in the following weekend's print edition of the paper.

It was time to do my homework on Charles Taylor, to decide whether to cash my gains or to make a serious long-term investment in the company. As always, I started by reading the Chairman's and Chief Executive's statements in the Annual Report. They painted a picture of a business going through a lot of change. Three companies were acquired in 2018 and the business undertook a major reorganisation.

Acquisitions can be good news for a company. They can also cause problems, financially and culturally. Charles Taylor's largest acquisition in 2018 was of a Latin American insurance technology business ("InsureTech" is the buzz word) called Inworx. It cost the equivalent of more than two years' dividends. Earn-outs for management could add significantly to the cost – possibly close to another two years' dividends. Charles Taylor asked shareholders to fund the acquisition. The new shares were placed at £2.60 each.

Anyone who subscribed to the share placing in May 2018 was nursing a loss of around £0.90 a share by March 2019, when the Chairman and Chief Executive were composing their statements. Yet neither showed any concern for shareholders' feelings. On the contrary, they seemed pleased to have persuaded them to pay a high price for the new shares. In the Chairman's words, the oversubscribed share placing "*demonstrates our shareholders' confidence in the Group's long-term strategy*". The Chief Executive followed up with "*we have managed proactively our financial leverage through a significantly oversubscribed share placing."* In plain English, he was trying to say that it was better to have got the money from shareholders, who wouldn't have to be repaid, than from the banks, who would demand their pound of flesh. Yes, a new share issue was better for managers; shareholders might think differently.

The Inworx acquisition could cause cultural problems. Integrating an acquired business is difficult at the best of times; it is even harder in cases such as this. Charles Taylor's Board and top management are predominantly British; Inworx's base of operations is in Latin America and presumably most of its management team are there too. Only one of Charles Taylor's eight-person board and just one of its eleven-strong Executive Committee have deep technology expertise. Will the company's Board and Executive Committee be able to rise to the challenge of integrating successfully a technology business that has its headquarters thousands of miles away in Latin America, in a different time zone, whose executive speak a different language day-to-day and who operate in a very different cultural milieu? The high earn-out element in the purchase price exacerbates the integration challenges.

Charles Taylor's finances are also a source of concern. The company lost £3.3 million in 2018, which was transformed into a profit of £22.3 million after adjusting for exceptional items. I'm always wary of such adjustments, especially when they improve the result significantly on a consistent basis. In each of the last four years, Charles Taylor's adjusted profit was higher than its published profit. Worryingly, the amount of the adjustment increased each year, rising from £1.4 million in 2015 to £4.0 million in 2016, to £7.9 million in 2017 and to a whopping £25.6 million in 2018.

The financial, strategic and cultural risks were too high for my liking, so I bailed out on 23 April, at £2.49 a share. By deciding to cut and run, I was admitting to another failed attempt to add to my harem, i.e. my portfolio of long-term holdings. There was some consolation in the form of a tidy profit from the adventure, for which I thank Lord Lee.