

# RADAR CRITERIA: MANAGEMENT

## MANAGEMENT IS (NEARLY) EVERYTHING FOR THE SMALL COMPANY

**IN THIS SECTION  
WE WILL REVEAL  
THE CRITERIA THAT  
UNDER THE RADAR  
REPORT USES  
TO SCREEN THE  
COMPANIES  
WE COVER.**

In Geoff Wilson's ratings system, out of his five criteria for stock selection, management ranks in the top two.

Wilson's portfolio of companies is focussed on small cap stocks, or companies with market caps of less than \$300 million, because he says he realises that there is an "asymmetry of information" in the market.

This means that the market is not always aware of "material" information relating to small caps. Put another way, often investors are slow on the uptake in matters relating to small companies, whether it be official announcements, or market information. There is often a big discrepancy between what is known, versus what is happening.

This means that an investor in small caps relies heavily on what management tells them about the status quo regarding operations and finances.

Wilson's team gets very close to management when it perceives that the company is in danger of falling over because of too much debt, but every fund manager we have spoken to in small caps looks to management first before investing in a company.

Some look for charismatic managers that are good at sales, others look for industry operators that have a strong understanding of the mechanics of running the business in question.

### Here are some criteria that Under the Radar Report takes into account:

- Years the operator and the team have worked in the industry in question.
- Their base level of pay – we would be unhappy if the base salary exceeded the average profit after tax forecast for the next two years.
- Accessibility – how easy is it to contact different members of the team.
- The stake senior management has in the success of the company.
- The history of the chief executive and the chief financial officer.
- The influence of the non-executive directors – particularly the chairman.

As you can tell from the above, the criteria of experience counts a lot more for us than whether the managing director or chief executive is a good salesperson.

This is because many of the companies we look at are turnarounds. In many cases, these turnarounds have new management. It always takes time for investors to trust new management, because invariably they have been burnt by the old ones.

**Just because a business was successful, doesn't necessarily mean that this will translate to being a successful listed company. Managing expectations is everything.**

In these situations, being conservative pays dividends. So for small caps, a conservative management is a good thing. This means one that doesn't over promise and under deliver. And one that is competent at the basics needed to grow earnings, which is the only way to build shareholder trust.

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Collins Foods' management has learnt this lesson the hard way, having downgraded only three months after its IPO. And with someone as experienced as Russell Tate as chairman, we fervently hope it doesn't happen again. Tate has a long history in advertising. He was an executive director of ASX listed STW Communications from its IPO (as John Singleton Advertising) in 1994 to 2008. Now he is also executive chairman of Macquarie Radio Network.

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## If you back the right management in a little company, the rewards are certainly there

Of course, we are confident in the management of both the companies in this issue.

Engenco (EGN) is in the process of looking for a new managing director, to replace Vincent De Santis, who is 44 per cent shareholder Dale Elphinstone's main man (in a business sense). Elphinstone has invested much capital, both emotional and financial into Engenco. Having spoken to different managers for his group, we believe that the team understands what it takes to turn the business around. De Santis will continue to remain on the board.

Lachlan Star's Mick McMullen has experience on both the operational side of mining, as well as the administrative and deal making sides. He seems to be the full package.

A manager needs to sell the story first to his team, who then have to implement it. He or she then needs to gain the confidence that the company's targets will be met. This must happen before investors in the company are made aware of its ambitions.

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