MINORITY SHAREHOLDERS WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
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RESEARCH REPORTS

READ, DON'T FOLLOW BLINDLY

STOCK analysis is not a precise science as it is based on future assumptions. Analysts are licensed (by the Securities Commission) to forecast — to crystal ball-gaze, to predict.

Seldom do analysts get into trouble when forecasting target prices based on assumptions as it is difficult to say whether an assumption is wrong unless it is outlandishly or illogically wrong.

Within the parameters of reasonable assumptions, analysts make assumptions about the future prospects of a company and the surrounding circumstances, before arriving at their investment recommendations such as "outperform", "strong buy", "buy", "hold", "sell" and "strong sell", though we hardly ever see a recommendation of the last type.

Analysts work out the target prices based on suitable valuation methods. Recommendations are made based on the potential upside/downside from the current share price.

Take the case of Capital A Bhd (formerly known as AirAsia Group Bhd).

One analyst, on Jan 17, highlighted that the cause for the Practice Note 17 status was due to Capital A's balance sheet and not its cash flow.

He said the RM2.6 billion raised by Capital A could carry it through financial year 2022 when compared against the group's balance sheet position.

The analyst rated Capital A as a "buy" with a target price of RM1.31.

In a note on Jan 14, another analyst also believed that Capital A could last through financial years 2022 and 2023, provided that its monthly operating cash burn remained constant at around RM68 million to RM75 million.

This analyst rated the investment holding group with a "hold" call and a target price of 76 sen.

A third analyst did not think Capital A was out of the woods yet, rating it a "sell" with the lowest target price of nine sen among all 18 analysts covering Capital A, according to Bloomberg data.

In a note on Feb 10, the analyst expected Capital A's negative shareholders' equity situation to worsen from RM3.2 billion as at third quarter of financial year 2021 to RM5.6 billion by the end of financial year 2022.

He added that the diversification of Capital A into digital businesses remained "in the investment stage where they might consume significant amounts of cash resources, which is also because they are competing against established and well-funded competitors".

So, we have three analysts who have made three different calls based on different assumptions.

Shareholders may be at pains to consider which of the analyst to follow. The answer is probably not to follow any one of them.

Read all of the analysts' reports but make your own decision. Occasionally, you may come across one whose thought process, assumptions, rationalisation and deduction prowess are akin to your own and if so, by all means, follow that analysts' recommendations for that particular stock.

A confirmation bias is when an investor already has an idea of his investment decision.

And when he reads the analysts' reports, he is likely to affirm, acknowledge and consider those recommendations, which fit in with his preconceived investment decision.

He will tend to summarily dismiss any report that does not fit in with his preconceived investment decision.

Read analysts' reports without any bias to extract maximum value. It is not as easy as it sounds.

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The consensus recommendations

There are 18 analysts covering Capital A and they will each have his or her own recommendation.

The consensus recommendation merely tabulates how many of these analysts have "buy, "sell" or "hold" recommendations.

Sometimes, investors find comfort in these consensus recommendations to justify their investment decisions.

And if most of these analysts have a "buy" recommendation, surely it is a good bet to buy?

Herein lies the psychology of group think. Analysts may congregate towards the popular call and be hesitant to make a lonely contrarian call.

The logic is that it is okay to get it wrong if you are part of the bigger crowd as the stigma of getting the call wrong is divided among many.

But make a contrarian call and you are a loner or part of the small minority. And if you get the call wrong, the glare of attention on you is uncomfortable.

Consensus estimates are not gospel truth but a congregation of thought processes that may be a result of group think.

Conflicts of Interest

Many analysts belong to a group that is also involved in getting business from public limited companies (PLCs), such as investment banks.

If an analyst gives a particularly damning research report on a PLC, then it would be very hard for the investment bank within the group to knock on the doors of the PLC for business.

The group will have in place "Chinese Walls" to segregate the research analysis arm from the investment bank, but we all know how porous these walls can be.

There is always the perception of compromise of analyses for future business streams. This represents an inherent conflict of interest.

Some analysts may make more favourable stock recommendations to maintain cordial relationships with PLCs to have better access to the management to obtain insightful company and industry updates.

The end result is that some such analysts may mince their words in their reports.

Some investors cynically resort to giving "discounts" to analyst recommendations e.g., if the recommendation is a "strong buy", the investor ascribes a recommendation that is a notch below, which is a "buy"; and when there is a "buy" recommendation, a "hold" is ascribed by the investor.

It is time for there to be more independent research houses with no perception of bias.

Shareholders cannot but help place a greater emphasis on the recommendations of such independent research houses.

Research analysts are licensed by the Securities Commission and subscribe to high standards of integrity, skills, knowledge and are subject to continuous professional education.

In conclusion, research analyst reports are an important source of information that is useful for investors to make an informed investment decision.

Read well but do not follow blindly.

The writer is chief executive officer of Minority Shareholders Watch Group