Poker Face: Corporate Tells And How To Spot Them

by Glenn Curtis (Contact Author | Biography)

Just because a company in which you own stock reports a negative quarter doesn't mean that you should head for the hills. In fact, sometimes it makes sense to stand firm (or even add to your position). The key is in knowing how to decipher the company's ability to handle the situation.

How can you do this? Let's take a look.

Effective Communication

Is the company communicating with the investment community or is it holed up in its office, refusing to take investor calls? Effective communication, especially during times of crisis, is paramount.

Shareholders should watch out for specific communications from the company that will quantify the problem in terms of dollars and cents, and outline the situation in detail. Perhaps most importantly, the company should provide its shareholders with a thorough synopsis of how the problem will be solved. For example, does the company plan on discontinuing a particular product line, enacting massive layoffs or closing distribution facilities?

Management's solution may not always be effective. Still, the fact that the problem is being quantified and addressed to the best of the company's ability signifies that some thought has gone into the process and a resolution is being sought. In short, it's a good sign that management has its shareholders' best interests at heart. (To learn more about common communication methods used by companies, read *Correspondence That Pushes The Envelope*.)

Frequent Conference Calls and Press Releases

Companies that conduct conference calls and issue press releases on a frequent basis after a major stock blowup are telegraphing that they recognize the importance of keeping the retail investment community informed.

Determining how many calls or press releases are justified depends on the situation. Companies that conduct conference calls or disseminate press releases once per quarter (in addition to the regular earnings calls) are usually perceived to be better communicators. The shareholders also tend to be better informed. Again, it depends on the situation. In some cases, weekly or biweekly calls can be appropriate. (For more insight, read *Conference Call Basics*.)

New Blood

Outside professionals in the industry are not always a guarantee for success, but they can often see things from a new perspective and make decisions that many management teams can't. Companies often hire individuals with histories of conducting successful turnarounds who have operated in crisis situations.

Also, look at how the new individuals will be paid. If, for example, a significant amount of the new employee's salary has been taken in stock options, it's a good sign that the individual thinks the situation is resolvable. (To learn more, read *The Controversy Over Option Compensations*.)

Tangible Evidence That Management Is Solving the Problem
If a company posts a major net loss, management should outline corrective actions that are to be taken. Selling or writing off the responsible divisions or products should also be considered, but it's up to you to ensure that the corrective action has actually taken place. Far too often, management plans to take action but procrastination causes the problem to grow.

Ensure that gross margins are improving and that the company has established new distribution channels or major new customers - those relationships can help overcome tough times. Look for hard, tangible evidence of a resolution. Bottom-line results, not promises, drive stock prices. (Find out a company's history, current progress, and future potential by reading *SEC Filings: Forms You Need To Know*.)

Road Shows
Most companies don't go on the road to visit with institutional shareholders and the public unless they have an upbeat story to tell. When a company goes on a road show, investors should be notified so they can purchase stock. In short, this is another good sign (albeit a somewhat subjective one) that the company may have a handle on the situation.

Cost Cutting
When times are tough, companies should be seeking ways to cut costs. Confirm whether the company has instituted an aggressive cost-cutting program and if management is forgoing perks such as annual bonuses, first-class air travel and country club memberships.

Those efforts should encourage a response from the income line. Net margins should increase, and year-over-year and monthly improvements should be evident. All of these observations are great signs that the company is on the road to recovery. (For more information on the distribution of corporate compensation, read *Pay Attention To The Proxy Statement*.)

Stock Buybacks
A company can do many things with its cash. It can issue a dividend, save it for a rainy day or make an acquisition. In any case, when a company decides to go into the open market and accumulate shares of stock, it's usually an indicator that its board of directors sees better days on the horizon.

There are many reasons to sell stock. There is usually only one reason to buy stock - to make money. (For more insight, read *A Breakdown Of STock Buybacks* and *How Buybacks Warp The Price-To-Book Ratio*.)

Bottom Line

When it comes to determining a company's level of control over its problems, there are never any guarantees. However, if several of the above signs are present, it is usually a good sign that the company is headed in the right direction.

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