Cincinnati Model Investment Club

Considerations in Deciding to Sell a Company

August 9, 2021

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Selling is never easy. However, it helps to identify some items to consider when selling an individual company. These are not absolute sell orders. These are identifiers of deteriorating fundamentals, flags, that **may** point to a possible sell.

These flags treat selling a company for poor performance or deteriorating fundamentals separately from a decision to sell a company to improve the portfolio.

In addition, these considerations generally apply when businesses are operating under normal business conditions.

**As with any investment decision, good judgment must be exercised in evaluating the information and making the sell decision.**

 **Selling Due to Deteriorating Fundamentals on the SSG-Flags**

1. Quarterly sales growth is negative or zero in any 4 of the last 6 quarters or that growth is negative or zero for the last 3 consecutive quarters. This data is in the Sales and EPS columns under Quarterly Data in the Quarterly Data tab.
2. Quarterly EPS growth is negative or zero in any 4 of the last 6 quarters or that growth is negative or zero for the last 3 consecutive quarters. This data is in the Sales and EPS columns under Quarterly Data in the Quarterly Data tab.

Note: There may be legitimate reasons for the growth decreases. For example: Pandemic. Sale or spinoff of a major part of the company. Discontinued products or services. A situation of major expense increases beyond the control of the company. (Spiking raw material costs, for example).

1. % Pre-Tax Profit on Sales has been declining over the past 4 trailing 4 quarters. This data is in the PTP % Sales column under Trailing 4 Quarters in the Quarterly Data tab.
2. Steadily declining % Return on Equity over the last 5 years. This data is in the Evaluate Management section of the Analyze Growth and Quality tab.

 Note: true ROE can be masked by rising debt. Check % Debt to Capital metric.

1. Steadily increasing % Debt to Capital beyond 35% over the last 5 years. This data is in the Evaluate Management section of the Analyze Growth and Quality tab.

Note: A company may be able to manage Debt to Capital greater than 35%. If this is the case check the Morningstar Key Ratio of Interest Coverage. If the Interest Coverage multiple is 8 or above, that level of debt may be handled under current company conditions.

1. Upside Downside Ratio is less than 1. This data is in Section 4 in the Valuation and Return tab.
2. Compound Annual Return – Using Forecast Average P/E is less than 5% with no real near- term outlook for improvement.

Note: these last 2 metrics could be caused by an extreme rise in share price, which an investor cannot control. After evaluating all metrics, the investor must determine if the company should be held at this point or to “let a winner run.”

As a check on the SSG Compound Annual Return it may be helpful to compare the SSG number with the Manifest Infesting PAR for the company. If the 2 numbers are more than 5 points apart, something may need revisiting on the SSG.

**Note: Core vs non-Core**

**Core-don’t sell unless CAR is below current money market rate (or, perhaps 1%)**

**Non-Core-sell if CAR is below MIPAR**

**Selling to Improve the Portfolio Using Manifest Investing Metrics-Flags**

Selling to improve the portfolio would almost always be done when a replacement company is added to the portfolio. Selling to only remove a poor holding would really mean selling that company due to deteriorating fundamentals. The replacement company should improve the portfolio metrics below.

1. Manifest Investing Financial Strength score by at least 1 point. This information can be seen under the Dashboards tab, then selecting CINMIC.
2. Manifest investing Quality score by at least 1 point. This information can be seen under the Dashboards tab, then selecting CINMIC.

**Note: Core vs non-Core**

**Core-don’t sell unless CAR is below current money market rate (or, perhaps 1%)**

**Non-Core-sell if CAR is below MIPAR**

**Selling for Other Reasons**

A company does not meet the sell flags above but has not met the SSG sales and/or EPS growth forecast for 3 or more consecutive quarters. In this case all SSG judgments and forecasts should be objectively reviewed before deciding to sell. Whether considering a sell or not, a company in this situation needs a thorough review using an objective SSG.

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**Company Name:**Click or tap here to enter text. **Ticker**:Click or tap here to enter text. **Date:**Click or tap to enter a date. **Stock Watcher**:Click or tap here to enter text.

Selling is never easy. However, it helps to identify some items to consider when selling an individual company. These are not absolute sell orders. These are identifiers of deteriorating fundamentals, flags, that **may** point to a possible sell. **As with any investment decision, good judgment must be exercised in evaluating the information and making the sell decision.** *We will treat selling a company for poor performance or deteriorating fundamentals separately from a decision to sell a company to improve the portfolio.*

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| --- |
| **Selling Due to Deteriorating Fundamentals on the SSG-Flags** |
|  |  | YES | NO |
| 1. | Is quarterly sales growth negative or zero in any 4 of the last 6 quarters **or** negative for the last 3consecutive quarters? |  |  |
| 2. | Is quarterly EPS growth negative or zero in any 4 of the last 6 quarters **or** negative for the last 3 consecutive quarters? |  |  |
| Note: There may be legitimate reasons for sales or EPS performance as described in 1 and 2 above? A pandemic? Sale or spinoff of a major part of the company? Discontinued product or service? A situation of major expense increases beyond the control of the company? (Spiking raw material costs, for example). |
| 3. | Has the % Pre-Tax Profit on Sales been declining over the past 4 trailing 4 quarters? |  |  |
| 4. | Has the % Return on Equity been steadily declining over the last 5 years?Note: true ROE can be masked by rising debt. Check % Debt to Capital metric. |  |  |
| 5. | Has % Debt to Capital been steadily increasing beyond 35% over the last 5 years?Note: a company may be able to manage Debt to Capital greater than 35%. In this case check the Morningstar Key Ratio of Interest Coverage. If this multiple is 8 or above, that level of debt may be handled under current conditions. |  |  |
| 6. | Is the Upside Downside Ratio less than 1? |  |  |
| 7. | Is the Compound Annual Return-Using Forecast Average P/E less than 5% with no near-term outlook for improvement? |  |  |
| Selling to Improve the Portfolio Using Manifest Investing Metrics-Flags |
| Note: selling to improve the portfolio would almost always be done when a replacement company is added to the portfolio. The replacement company should improve the portfolio metrics as shown below: |
| 1. | Is the portfolio Manifest Investing Financial Strength score improved by at least 1 point? |  |  |
| 2. | Is the portfolio Manifest Investing Quality score improved by at least 1 point? |  |  |