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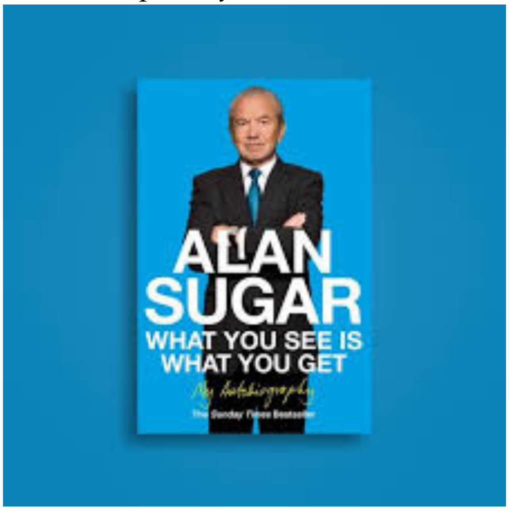
TOSSERS IN THE CITY

"I have absolutely no respect at all for the brokers, fund managers and all those other tossers in the City".

This sentence was taken from page 337 of Alan Sugar's autobiography, "What you see is what you get". He wrote this after an employee of Nomura (the biggest Japanese stockbroker) had lost him a small fortune trading the Japanese stock market.

Having experienced this loss he decided that from that day on he would invest his cash in property sticking to a "*pretty damn boring*" philosophy of buying "*a building that is occupied by a well- known and respected tenant, in a good location.*"



This is just one of many interesting opinions he expresses about the investment world in the book and as much as I would have liked him to have learned a different lesson from his Nomura experience, (do your homework and find a better fund manager or invest in a passive/index equity fund) I still think it is worthwhile for people to hear what he has to say, and given that I have never seen this book on any recommended investment reading list, I thought I might share his thoughts on one of the most central questions in investment: how to value a business.

I would guess that he didn't set out to write a case study on investment theory and I would also guess that he doesn't realise that he has written what I believe is a fascinating insight into how he valued his business and how he believes the stock market can get it badly wrong, but I would go as far as to say that students of business could learn a significant amount from him.

How to value a business

Valuing a business is at the heart of what any investor does. From a theoretical perspective a Discounted Cash Flow (DCF) Model is the best way to value any business but the term DCF does not appear in the book. I think Alan might describe anyone using a DCF as a bit of a "tosser" because it involves so many assumptions!

In the book, he first mentions valuation when he writes about the original flotation of Amstrad on the London Stock Exchange back in 1980. He suggests that the way used by investment bankers to value a company at that time was to compare it to companies in the same sector, but the problem with Amstrad was that it was in a new sector for the London market. On page 204 he states: *"as Amstrad was rather unique, there was no sector to compare us with and as such he had to 'stick his finger in the air' and break new ground and invent a P/E"*
On page 205 he further goes on to state "*when you cut all the bullshit and highly technical nonsense, at the end of the day, the value of the company was simply fixed at what Tim fancied, as indeed there was no direct comparison to Amstrad"*

That may have been what happened in 1980 but I somehow have my suspicions that in 2019 when a company in a new sector comes to the market the same approach is probably used. When Pinterest or Zoom or Lyft were about to be listed, I would guess that the investment banks involved struggled to find comparable companies and therefore ended up 'sticking their fingers in the air'. This is how you can have a situation where the Zoom share price goes up 72% on the first day of trading or Pinterest trades up 28%.

The next time Alan mentions Valuation is in relation to the situation he found himself in 1992. By that stage he says on Page 389: "*I guess the market was losing confidence in us, seeing us shrinking our subsidiaries, shutting things down in Hong Kong, selling off computers at low cost and with profits dropping year on year".* In other words, the excitement of 1980 had turned into the pessimism of 1992 and the Amstrad share price had collapsed resulting in a valuation where "*the market value of the company was below its asset values- lower than the cash balance in the company! I commented on this several times in the media, explaining that this was crazy".*
Alan felt that the 23p share price at the time was such a bargain that he could make a killing by buying out all the other shareholders at 30p a share. His investment banker said to him that *"30p was below the total asset value of the company",* hinting that if he wanted to buy all of the shares that he would have to pay more than that. Alan said that *"If the share price was fifty or sixty pence now, I'd be quite happy".*
I find this interesting because there had been a price in the market of 23p and yet Alan Sugar thought the intrinsic value of the business was worth at least double that at 50p to 60p. He thought that buying at 30p was what Ben Graham or Warren Buffett would call buying with a large margin of safety, but in the end the big shareholders rejected the 30p offer because they too woke up to the idea that it must be worth at least its liquidation value.

Moving forward to September 1993, Alan heard about a Danish company called Dancall that was about to go into bankruptcy because it had run out of money just before they had launched their new product. He went off and visited them and once again he felt that the pessimism was too great because he says on page 394 that "*what I saw in this organisation was a little pot of gold".* This time it was the liquidators that had priced a business below its intrinsic value rather than the stock market because Alan was able to buy it from them for £6m.
By 1997 Dancall had developed and was selling a mobile phone that Alan realised was fairly advanced for the time. He thought that somebody like Siemens might be prepared to buy Dancall to get their hands on the technology so he contacted his bank, Rothschild to see if they could find a buyer. Once again Alan was faced with a

situation where the investment banker did not know what Dancall was worth so Alan said *"This company will not be sold by Amstrad unless we are offered at least a hundred and fifty million US dollars"* while at the same time he admits that he thought it was worth around $30m because he says *"If someone had offered me £35m there and then, I'd have bitten their hand off"*.

In the end he didn't sell it to Siemens but he did end up selling it to Bosch for the $150m and as he says himself "*What an amazing coup!"*

Moving on to the year 2000 and instead of the pessimism of 1992, Alan found himself caught up in the crazy optimism of the dot com mania. On page 506 he describes this amazing time: "*Amstrad shares were starting to rise for no reason other than we were in the technology business. We hadn't done anything – there were no massive profits. It just goes to show how stupid the stock market can be.*

On page 511 he goes on to say the following: "*the email phone was launched on 29 March 2000 at quite a big bash organised by Nick Hewer. On the day, the share price rose to 610p putting a market capitalisation on the company of £500m. There was no rationale behind the share price rise, we were simply caught up in the internet boom, which had just peaked out by then."*

Finally, in 2007 a combination of reasons led to Alan deciding to sell Amstrad. BskyB paid £130m for it and I presume that Alan regarded this as a fair price (given that it had minority shareholders, the independent directors must have believed that to have been the case).

Implications

What Alan describes in this period between 1980 and 2007 is an Amstrad share price that starts off in 1980 at what he thinks is a reasonable price, to being ridiculously cheap in 1992, to being crazily overpriced in 2000 and back to fair value in 2007. This goes against the academic theory that share prices are always fair value. I would personally back up Alan in his assertion that share prices can go from being ridiculously cheap to being crazily expensive and I reject the idea that the stock market always fairly reflects what something is worth.

It also reminds me of another crazy aspect of "ivory tower" thinking because in the hypothetical situation that the Amstrad share price had fallen from 23p to 20p on the day before Alan announced that he was trying to buy back Amstrad, academic theory would say that Amstrad was riskier at 20p than it was at 23p even though it was clearly cheaper!

Conclusions

The tossers in the city and in academia that don't accept that there are times when the stock market can go a bit crazy should be sent off to Alan's boardroom and with a little luck there is a good chance that they would end up being fired!