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open road

MOTORING + TRAVEL

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Value investing with Roger Montgomery

Invest, don't speculate

Many investors believe they are investing when they buy a share, hoping it will go up. But betting on 'up' and 'down' is no different

to betting on 'red' or 'black' in roulette, and yet many who wouldn't dream of gambling do so on the stock market every day.

A business is for sale and it holds the exclusive distribution licence for a fast-moving consumer good. Last year the business made a cash profit after tax of \$10 million. This business is for sale for \$15 million.

Would you buy this business? It has no debt and the licence runs for another 25 years. My hope for you and your family is that you would buy it.

Now suppose that in the first year of owning the business, you collect a \$15 million profit, followed by \$25 million, \$30

million, and \$50 million. Just by looking at the business performance, you can determine that you have made the right decision to purchase it.

Suppose the same business is for sale, but you are only able to acquire 50 per cent. The remainder of the company is listed on the stock exchange. Nothing has changed except that 50 per cent of the business trades on the stock market as shares and in the five years you have owned it, the shares have fallen from \$50 to five cents.

Do you feel uncertain about whether you have made the right decision? Many people would. They are focused on the wrong

thing. Don't take cues from the share price. You still made a great decision to buy the 50 per cent of the business as you have kept 50 per cent of the profits reported previously. You could take some of those profits and buy the rest of the company very cheaply.

Focusing on price leads to speculation and speculating is not investing.

Roger Montgomery recently sold his top-performing funds management companies. He is writing a guide book to safely buying the best stocks. Visit www.rogermontgomery.com.

The independent advice in this column is not necessarily supported by NRMA.

