



*I've just sold some stock. Do you have the same model in platinum...?*

"Any event-driven fund that focuses on Spinoffs as an alpha-generating strategy should subscribe to their service. [Other funds] will be very happy with the product and service."

*- Madal Gopal, Former Analyst, \$7bn NY Investment Fund*

## THE INVESTOR'S EDGE

Biweekly Education Saving You Time & Money in Investing

### This is Why You Should Ignore Insider Selling

Benjamin Franklin said there were only two things certain in life: **death and taxes**. Some things may be obvious, but not quite certain. Insider selling is one of those in my opinion.

As markets and companies become more in-line with fair value, it can become much harder to extract value from companies, particularly with the shift and impact in technology, governments, regulatory changes and the general environment. This can give rise to a few different variables that I've seen affect executives over time. Sometimes, this motivates them to do something with the company for the good of the shareholder. These can take the form of Spinoffs, restructurings, buybacks, special dividends or other value creating scenarios. We are seeing a lot of that now. Particularly near or close to the market's tops and bottoms are where there can be good investor opportunity. We will save that for another time.

On the flip side, corruption, pressure and greed can affect a small few. We have seen a couple of examples in the last few weeks. Elizabeth Holmes, CEO of blood-testing company Theranos, was charged with ["massive fraud,"](#) and former company President Ramesh "Sunny" Balwani was also charged. According to the SEC, Holmes is "stripped of control of the company she founded, is returning millions of shares to Theranos, and is barred from serving as an officer or director of a public company for 10 years." The SEC said the company — at one point valued at \$10 billion — hosted "misleading technology demonstrations" and made misrepresentations to commercial partners and government entities. A Wall Street Journal investigation from 2015 found that Theranos was using traditional machines bought from companies like Siemens AG for the vast majority of its purportedly innovative blood tests and that it was failing to report test results that questioned the precision of their own technology. On the same day, a former Equifax executive was charged with [illegal trading before the massive data breach was made public.](#)

Well, what should you make of all this? Here is what I think. There are two things certain in the investment world that you cannot spot until much later: **Selling by insiders who know bad news is coming or executives straight up cooking the books.**

Firstly, selling by insiders is the least important thing we look at. Insiders sell stock for a variety of reasons. New car, new house, divorce (happens a lot), share price run-up and wanting to take some profit, to pay taxes, and a host of other things, including just taking some money off the table. The selling doesn't necessarily mean they don't like the company. The selling could be for other reasons, like taking account of stock options they were given for nothing. Everyone loves to realise some free money, right? It's human nature. The selling also might be due to windows of opportunity when they can trade, authorised by the company. All in all, don't take selling by insiders too much into your investment thesis. You can always check the facts to a certain extent. Unfortunately, you are not going to get the above reasons officially from the company very often. I'd much rather devote the time and energy of my team to the "buys," or outright stock market purchases. Fraud we can discuss another time, but if someone is putting up fake numbers, there really isn't much you can do about it. Analysing whether the company is good or bad because of the numbers is the real game. Sometimes funny accounting can be spotted, but straight up lying? Unfortunately, nope.



***Executives will sell stock for a variety of reasons – like this nice pad!***

So, what should you concentrate on? Concentrate on buying. This is quite a big topic, so here are three areas where you could start.

1. **Only look at open market purchases** – Stock options and exercise of options are not really purchases. Only when the executive puts his hands into his pocket and purchases stock in the market should it raise your awareness.
2. **Who is the executive?** – If you see the CEO, CFO or Chairman buying, it's usually significant. These are the guys "in the know" and they have the best handle on where the company is going. If they are all buying together, this is a very strong signal. Alternatively, non-executive directors can be good people to watch too. They sit in on board meetings and have no real constraints on buying stock.
3. **Quantify how much they are buying** – For example, if a CEO owns 10,000 shares and he buys 100, it's not that great a signal. However, if he buys 5,000 shares, that's 50% of his current holdings. Additionally, work out how much they earn and how much of their own money they are putting up for the stock purchase.

Lastly, incentives and pay linked to share prices are something else you should be looking at and we do here. We will save this for another time, however.

The Edge takes insider buying very seriously when we see it. It is a real key ingredient that investors generally know about, but fail to analyse properly. After 20 years doing it, we think it is an area you should be looking at. Call us for more information. I'd love to hear from you.

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	2014 Q3 AEO	2014 Q4 AMZN	2015 Q1 INDV	2015 Q2 PYPL	2015 Q3 ADS	2015 Q4 HPE
Ticker	AEO US Equity	AMZN US Equity	INDV US Equity	PYPL US Equity	ADS US Equity	HPE US Equity
Company Logo						
What Was the Situation?	The arrival of retail turnaround specialist Jay Schottenstein and accumulation of 32.5% of insider buying gave confidence to a promising redirection of a significantly underperforming company.	The Edge saw hidden value in the potential Spinoff of Amazon Web Services (AWS) when the market was quiet. The segment continued to be the primary driver for consistent revenue growth.	A Spinoff from Hockitt Benckiser in Dec. 2014. The Edge urged investors to ignore the Parent and focus on INDV for its insider buying ahead of the Spin, strong management, new products, and likelihood of a takeover.	The Edge highlighted the benefits of eBay's move to Spinoff its digital payments arm PayPal in July 2015 to clean its portfolio of services and create a more focused marketplace business.	ADS reshuffled its management, introduced a new product line, performed a strategic review, and had activist investors backing a strong balance sheet in this multi-catalyst turnaround story.	Following its Spinoff from HP, Inc. in Oct. 2015, HPE went on to perform two Reverse Morris Trust splits of the Software (DXC) and Enterprise (MFGP) segments in 2017.
Portfolio Return (%)	37%	93%	55%	36%	26%	48%
Index Return (%)	-4%	-7%	-5%	-1%	-7%	25%

  

	2015 Q1 RR/	2016 Q2 BCO	2016 Q3 MET	2016 Q4 ARNC	2017 Q1 DATA	2017 Q2 SCAB
Ticker	RR/ US Equity	BCO US Equity	MET US Equity	ARNC US Equity	DATA US Equity	SCAB US Equity
Company Logo						
What Was the Situation?	A management restructuring coupled with activist involvement and potential Spinoffs, Rolls Royce already had negatives priced in and a strong position for a turnaround in the European automotive space.	A strong management, led by turnaround specialist and new (as of June 2016) CEO Doug Pertz, is focused on improving operational efficiencies and expanding its high value and technology-driven services.	A Special Situation turned Spinoff, the Edge highlighted the potential benefits of separating its US retail unit in April 2016. The Spinoff of BrightHouse Financial was subsequently announced that following July.	The market struggled to follow the split, as Alcoa (Parent) transformed into Arconic while the Spinoff took the Parent's name and ticker. Heavy insider buying coupled with strong fundamentals produced a solid investment.	CEO Adam Selipsky (who grew AWS from scratch) took over the undervalued tech company in Sep. 2016, and set to improving DATA's business model, cloud subscription system, and long-term takeover potential.	Europe's largest private forest owner is a strong takeover target due to its high margin profile, diverse timber product range, and wide geographic reach. The new management is led by Forest segment veteran Ulf Larsson.
Portfolio Return (%)	22%	87%	41%	49%	68%	50%
Index Return (%)	14%	13%	39%	10%	29%	3%

"Being clients for over 5 years and given we've over \$25bn AUM and 20 analysts, [The Edge is] in an extremely rare position of being the only external advisor we trust."  
- Portfolio Manager, \$25bn NYC Investment Management Firm

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- Jagdish Mehta, Chersus Holdings LLC

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