Indicators of a Viable Investment Opportunity

In this fourth instalment in our five-part series on competent investment management, members of the investing public are reminded that the Trinidad and Tobago Securities and Exchange Commission (TTSEC) does not provide specific investment advice to the public. This week's article will look at the indicators of a viable investment opportunity, in compliance with our obligations under Section 6(g) of the Securities Act, Chapter 83:02, pertaining to investor education, but will not seek to offer advice to the public on what products in which to invest. It will provide suggestions on parameters to look for that point to a viable investment and is intended to promote better discussions with investment advisers.

The concept of an Investment Opportunity Set is vital, as available investment opportunities hold specific importance in determining current and future market value especially in terms of companies listed on the stock exchange (as discussed by Sanjay Kallapur in his 2001 research paper[1]). These investments may include new capital expenditures made to:

Introduce a new product;

Expand production of an existing product; and

Make expenditures to reduce costs such as lease termination penalties, financing technologic enhancements to replace costly manual processes, etc.

It is noted that such information would be found in a company's prospectus offering documents, in the case of a first-time issuer, as well as in its Annual Reports.

[1] See the following link: https://www.researchgate.net/publication/241967632_The_investment_opportunity_set_Determinants_consequences_and_measurement.

A 2011 article by Evan Sundermann[2], along with a 2021 article by the Money254 Team[3], outline five (5) main indicators of a viable investment opportunity. Sundermann stated that while no one can guarantee success in the stock market, investing in companies that meet some, if not all, of these criteria can increase the chance of achieving a good return on an investment. These indicators are as follows:

CASH RESERVES: A substantial cash reserve is an indication that the company is primed for growth in one of two ways (assuming that the company's other finances are in order). Firstly, significant cash reserves may indicate the potential for increased dividend yields. Secondly, companies with substantial cash reserves are afforded greater opportunities to pay off debts and other obligations or reinvest the cash back into the company. Retiring debt and taking care of other obligations are necessary components of business which can improve a company's future growth prospects. Reinvestments can include activities such as funding research and development programmes and acquisitions of other companies. Stockpiling cash to develop new products or add on to the current business can benefit share prices and help an investor's capital gains.

HEALTHY DIVIDENDS: Besides the current dividend yield, there are three other considerations that should be noted:

Dividend History: Has the company been able to consistently pay dividends even when there are economic fluctuations?

Dividend Growth: Companies that increase their yields show that they are generating enough cash to increase yields to investors.

Pay-out Ratio: The dividend pay-out ratio provides the percentage of earnings that a company distributes to shareholders in the form of dividends and it is calculated by *dividing Dividends per Share by Earnings per Share*. Companies that have a high pay-out ratio may not currently have much room to increase their dividend yield but they can still be a solid investment. On

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[2] See the following: https://seekingalpha.com/article/287349-5-indicators-of-a-great-investment-opportunity.
[3] See the following: https://www.money254.co.ke/post/5-indicators-of-a-viable-investment-opportunity.

the other hand, companies that pay dividends but have a lower pay-out ratio are may have the ability to increase yields to investors in the future.

LIMITED DEBT: A company with a significant debt level will need to utilise its cash reserves and future earnings to satisfy these obligations and this in turn may hinder its ability to pay dividends to shareholders.

STRONG CASH FLOWS: A company's cash position is affected by its operating, investing and financing activities. An increase in cash as a result of any of these activities may not always be a sign of good financial health. For instance, an increase in cash from financing activities such as additional debt means that debt obligation will need to be repaid in the future. However, an increase in cash from operational activities may be an indication of the firm's ability to generate revenue.

COMPETENT MANAGEMENT: It is important to remember that when you buy stock you are purchasing a fractional ownership in the company. As such, it is advisable to read up on the company's management, prior to investing. Information on the company's management team can usually be sourced on the company's website. Companies need strong, intelligent and competent leadership in order to manage their assets and achieve the best possible return on investment for shareholders.

We encourage you to do your homework before making any investment decision. You can review the company's annual report and audited financial statements which are generally made available to the public via the company's website. Check to see if the entities offering the investment opportunities are registered with the TTSEC. A list of all registered investment advisers, companies, individuals and securities that are offered are available via the EASi platform on our website, www.ttsec.org.tt. Next week the final part in our five-week series on competent investment management, will end with our focus on the 'Impact of Interest Rates on Investments'.

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