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Why short reports are a value investors best friend

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Shorting is tough at the best of times and extremely challenging in the current market environment. However, we see great shorting opportunities in some faddish industries, which have benefitted dramatically from the COVID-19 lockdowns. In this environment, the skills needed to read and objectively assess potentially misleading short reports will be vital.

As outlined in the case study of Bingo Industries, my initial response to this short report was anger and frustration. Eventually, I found it a useful exercise to go through each point raised in the report. Not only did it cement for me the key risks associated with the company, but it also helped me solidify my investment thesis. Most importantly, the short report offered the opportunity to buy more shares at what we thought represented a good level.

There is no doubt some short sellers and short reports will look to price manipulate and make things up to create uncertainty and profit from that uncertainty. This is a bad thing but, in my opinion, this also happens much more frequently with market commentators who are long leaning. A short report will test your resolve but as long as you are not a forced seller, should not impact your investment given the only prices which matter are the price you bought and the price you sold your shares.

What did we learn?

1. Read a Short report objectively: It is very easy to be emotional when someone has written a piece which has a view about the future which is different from yours, especially if it is resulting in the share price to crater. This doesn't help. Read it objectively. The short report on Bingo had a lot of factual errors, however it also brought up some interesting angles which led me to do further work.
2. Understand the risks: Reading the short report helped me better articulate the risks I was facing in my investment thesis. It also directed me to some interesting points of reference (like the Sustainability Report) which helped me get a better gauge of how the business was traveling. The good thing about this is it should enable me to better track lead indicators to judge whether or not my investment case was being dismantled.
3. Honing my investment thesis: Reading through the short report a couple of times made me think, "Why do I own this company?" A useful outcome was to go over my investment thesis again to see whether there was anything material which could derail it.
4. Share price volatility created buying opportunity: The share price fell following the short report and fell to a level where it represented good value given the work we had done. Short reports are a value investors best friend as they may enable you to buy into good businesses at what you perceive to be a good price.
5. Further Research: There were a couple of areas where the short report influenced further areas of research in Bingo for our team. Doing more work on understanding exactly what happens to the 83% of materials which are diverted from landfills. Trying to understand the sustainability of this part of the business model is extremely important. Also, we are trying to get a better grasp of what items the company has capitalized and cross check the value of the assets (predominantly landfill, land, goodwill and plant & equipment) are overstated on the balance sheet (this would be a good indication of the risk that the company is over-earning).

The quality of short reports has not been of the highest quality recently, but most have at least one angle which has not been articulated by the company or the sell-side analysts. My view is that if someone releases a short report, then I need to sit up, take notice and use the information to stress test my investment thesis.

Read our case study on a short report on Bingo Industries or find out more about Perpetual's SHARE-PLUS Long-Short Fund.