Investors Alley

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Your **Money**

The fine print offers clues to investing success

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Asking a person for investing advice, even a professional, will net different answers based upon whom you ask. From investing in products and companies you patronize to chasing the newest, hottest IPO's and stocks, there are all sorts of wacky (and some, not so wacky) ways experts advise investors on beating the market.

In my opinion, the best strategy for picking stocks is sound research. My company, New Constructs relies on a number of pieces of information to determine a company's relative financial health, but one of the easiest ways for investors to make their assessment is to analyze the fine print in a company's annual report. Many investors pay attention to the earnings reports in order to make their assessment of a company's health. But reading the fine print in annual reports can provide invaluable clues about the real health of a company. Earnings reports are intended to help the company and Wall Street sell stock – not inform investors.

In this post-Enron and HealthSouth era, where companies 'cook the books' in order to please shareholders, very few people are looking out for the individual investor. Reported earnings can be misleading because they omit important financial facts that can only be found in the notes of the financial statements. But by knowing what to look for, investors can get on an even footing with Wall Street insiders and learn what's behind the smoke and mirrors of reported earnings.

Some of the things investors need to look for in the notes include heavy use of stock options (which used to be omitted from employee compensation expense), serial charge-offs, off-balance-sheet financing or badly funded pension plans. These are facts that usually go unreported in earnings reports.

By digging into the notes, we were able to find that Perrigo Company's (NASDAQ: PRGO) management has written off 35 cents for every dollar of net assets and that analysts looking at National Healthcare Corp., (AMEX: NHC) are likely overlooking the fact that the company is carrying $366 of off-balance sheet debt when they rate it as a stock to "Hold."

As companies work harder and harder to manage earnings, investors have to work harder and harder to understand the company's true health of a company. More of the information required to understand their profitability is buried in the Notes to the Financials and many investors don't even pay attention to that section of the earnings report. Just a few years ago, before major accounting misstatements from companies like Enron and HealthSouth, annual reports were

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only 20-30 pages. Now 10K filings, the version of an annual report sent to the SEC, are often more than 200 pages in length. That's mostly because companies don't want you to know what's really going on with their earnings. As an investor, you owe it to yourself to uncover the truth about the stocks in which you are investing. That information is there if you just take the time to look for it.

David Trainer is President of New Constructs®. Called one of the best stock picker's on the planet by Erin Burnett (host of CNBC's Squawk on the Street), Trainer began his stock-picking career at Credit Suisse First Boston as an analyst. In addition, Trainer has worked for Epoch Partners (now Goldman Sachs) and the now defunct Arthur Andersen before co-founding New Constructs in 2003.