Independent's day

ANTHONY SCILIPOTI was investigating accounting shenanigans at Nortel and Royal Group long before the RCMP went poking around. *–Dawn Calleja*

"I'M DRIVEN TO prove that accountants are not boring." Anthony Scilipoti is sitting on the sunny Bay Street patio of Mercatto, his favourite lunchtime hangout, slathering hot sauce onto his pollo sandwich. "I still play hockey, but now my big game is triathlon," says the executive vice-president of Veritas Investment Research Corp., the Toronto-based independent equities research firm he co-founded in 2000. "I realized about five years ago that all I did was work. And with me, it can't be something small, so I started doing triathlons. 'Go big or go home' is a line I've used many times."

That only applies outside the office, however. At Veritas—one of just a handful of indie shops in the country—the emphasis is on quality, not quantity. "We don't do maintenance research. We don't have the manpower," says 37-year-old Scilipoti. "If we can't say something interesting about a company, we don't say anything."

Cracking the deception code

Scilipoti didn't exactly dream of becoming an accountant. His plan was to practise law, until he figured out what a lawyer actually does (besides, he did lousy on the LSATs). After graduating from the U of T, he went to work for Arthur Andersen and stayed just long enough to get his CA designation—"three years, one month and three days." He went to work for his dad's furniture and shmatte businesses, while teaching accounting part-time at York University. Five months later, in 1998, Al Rosen, founder of Rosen & Associates, hired him to do investigative accounting work.

Within a year, Scilipoti, Rosen and Michael Palmer, then the head of research at First Associates, had started Veritas (under a much less catchy name),

Photograph by Christopher Wahl

focusing on "bottom-up" research—poring over the notes other analysts were ignoring. (Scilipoti and Palmer bought out Rosen in 2002.) Scilipoti's first report was on Imax. He went on to cover Royal Group and "the game of deception" that Nortel was playing, calling its implosion long before the rest of the crowd. Today, Veritas has 42 institutional clients, including the Office of the Superintendent of Financial Institutions and the Canadian Public Accountability Board—what Scilipoti calls "the auditors of the auditors." "That, to me, proves what we're doing," he says.

Ignore the IR department

Veritas was founded on a few simple principles: "Attention to detail. Always asking why. Things don't just happen," says Scilipoti. "When a company makes a decision you can't substantiate, there's an ulterior motive."

Those lessons have been drilled into the heads of Veritas's 17 analysts. "To find the answers," says Scilipoti, "we don't focus on just the company. We look at the market conditions and the market cycle. We call suppliers, then we call competitors and customers. Call the investor relations guy and you're gonna get the company line. I don't need the company line. Everyone else is giving the company line."

What they're looking for are companies with a competitive advantage and the ability to generate cash flow. Can you give an example? "Maybe, um...CAE is a good one," Scilipoti says after a long pause. "It was a fat, poorly run organization" under CEO Derek Burney, he says. In 2004, Bob Brown, the former CEO of Bombardier (another company that's taken a few beatings from Veritas), took over the Montreal-based flight-simulator maker and led a restructuring. "We went positive on it," he says. Now, CAE is the dominant player in its market and the stock has more than doubled.

Missed by a mountain

How about bad calls? Scilipoti munches thoughtfully on his chickpea salad. "I guess Intrawest," he says finally. In 2006, Fortress Investment Group paid $2.6 billion (U.S.) for the resort-management company—a 32% premium. "It got taken out higher than we thought it would be."

ILLUSTRATION Kate O'Connor

It could've been worse—they could have been touting a stock that tanked. But that one festers. "We're only as good as the last bit of research we put out."

Why indies are alone

After Eliot Spitzer started cracking down on Wall Street, it seemed the Veritas model would catch on: selling research and nothing but research, unlike the brokerages, which sell both research and investment banking services—an inherent conflict. It didn't happen. "In the U.S., numerous independent research firms sprang up," says Scilipoti. "But I think that was a short-term measure that came out of the Spitzer revolt. There wasn't an emphasis on quality. They just said, 'We need to attach an independent research report to this. Okay, here's one. Done—we've satisfied the requirement.'"

In Canada, most independent research houses were swallowed up by brokerages in the wave of consolidation that swept the country from the 1970s to the '90s. The industry ethos became "find a company, IPO it, write research on it and jam it down retail investors' throats," says Scilipoti. Now, apart from Veritas, the indie sector is made up of mom-and-pop shops with a narrow focus and few clients, in part because "there wasn't an overall government push to make it happen."

The tide will turn, Scilipoti says, the second the institutions realize they're getting crummy research from the major brokerages. "I think there will come a time when, say, Nesbitt Burns breaks away from BMO," he says. "The benefit would be to investors—to get the best possible research."

Spinning off

These days, Scilipoti is mostly responsible for drumming up new business. His latest project: working with RBC (the company's first, and largest, institutional client) to launch an exclusive fund based on Veritas's top ideas. "It won't infringe on the rest of our business," he says, "because we're doing the research already."

As for his own plans, he'd like to go back to teaching, but only after he's written a book. "It'd be about accounting, business, investing, life," he says. "It's all intertwined—the things I've learned from my life that have made me a better investor." ■

The truth is out there...

But for retail investors, it's a little tougher to find. "All the odds are stacked against you," says Scilipoti. "Less access to management, less access to market information." Here are his tips on how to level the field.

1 Your No. 1 rule should be to **not lose money**. Get your head around that. If you're only looking for home runs, you're going to have a lot of strikeouts.

2 If a company is resorting to accounting largesse, it's usually because the **underlying operations are not sustainable**.

3 Read the notes on financial statements—that's where the **good stuff's hiding**.

4 **Don't trust** management.

5 If things are **too good to be true**, they usually are.

6 **Pay more attention to cash flow** than to earnings. A company is the present value of the future cash flow that it's going to generate.

7 **Focus** on management incentive plans.

8 Before you buy a stock, you have to know when you're going to sell it. That's the hardest decision. You have to **take away all the emotion**.