Should You Buy These “Net-Net” Stocks?

Description

Value investing comes in many flavours. At one end of the spectrum, investors like Warren Buffett try to buy great companies, hoping that their value will compound over time. This often means paying full price for a company’s shares.

At the other end of the spectrum are the bargain hunters, the ones who buy lower-quality businesses, and hopefully get a steep discount. The tactic was initially popularized by Benjamin Graham in books such as *The Intelligent Investor*. Nowadays, the biggest advocate for this form of investing is Robert Tattersall, best known as a co-founder of the Saxon mutual funds.

Mr. Tattersall argues that one should look for “net-nets”. To do this, start by taking a company’s current assets, subtract all liabilities, then divide by the number of shares. If the resulting number is less than (or at least close to) its share price, then the company may trade below its liquidation value. These situations are not very common, and only seem to surface when a company is facing serious problems. But they can also create great opportunities.

Mr. Tattersall identified three net-nets in January that trade on the TSX. Are they good opportunities?

Indigo: Competing with Amazon

Indigo Books & Music (TSX: IDG) currently trades at $9.35, only a slight premium to its net-net value of $8 per share. The problem is that it is going head to head with **Amazon**, and the odds are not in its favour. Investors in Toronto only need to look back to The World’s Biggest Bookstore, a storied downtown bookshop that shut down late last year.

Furthermore, nearly half of Indigo’s current assets are inventory, which is much less certain than something like cash (especially when competing with Amazon). Even a small write-down takes Indigo’s net-net figure down drastically. But to Mr. Tattersall’s credit, Indigo’s shares have performed well this year, up 12% so far.

Goodfellow: Possibly the TSX’s cheapest stock, for a reason

Goodfellow Inc (TSX: GDL) remanufactures and distributes lumber and other wood products. And it passes the net-net test. The shares trade at $9.25 per share, slightly below the net-net figure of $9.45.

There are reasons for this. First of all, the company has been struggling recently, with declining sales and very thin profit margins. Secondly, inventory accounts for over 60% of current assets. Goodfellow even has a negative cash position, thanks to $8.6 million in bank overdrafts. And the most recent financial statements aren't even audited.

Automodular Corporation: A tearful goodbye to Ford

Automodular Corporation (TSX: AM) sub-assembles modules used in auto manufacturing equipment. The company's problem is that **Ford** will be insourcing the products and services that Automodular currently provides. As a result, Automodular expects to close its two remaining facilities in Oakville Ontario.

The company has reacted by pursuing business activities in the wind energy space. And if the company doesn't succeed in these efforts, it "will not have active operations following the closure of its Oakville facilities." Yikes!

Foolish bottom line

These companies are not for the faint-of-heart, but then again it's those kinds of situations that lead to some serious bargains. Mr. Tattersall has one of the best track records in Canada, but before following his lead, it's important to know what you're getting into. Be careful.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:IDG (Indigo Books & Music)

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