Would You Buy a $1 Bill for $0.59?

Description

If the answer to the question in the title is "yes," you've identified yourself as a value investor. Value investors, such as the legendary Warren Buffett, like to buy assets for less than they're worth. Sometimes the undervaluation is intangible and less than obvious. Other times it could be hard to ignore.

Fellow Fool contributors Joey Frenette and Will Ashworth may have just uncovered an example of the latter — a company that is well recognized but has been the victim of savage disruption over the past few decades and is now worth more dead than alive.

The company is the humble Toronto-based book and general merchandise chain **Indigo Books & Music** (TSX:IDG). IDG's business model and future prospects have been absolutely decimated by the rise of e-commerce in general and **Amazon** in particular.

The company struggled to keep up with the changing landscape, but it made efforts to restructure the business and focus on online sales in recent years. That strategy doesn't seem to be working out, as sales are still declining and profits are non-existent. The stock has, unsurprisingly, suffered as a result.

Investors who've held onto the stock since Amazon launched in the 1990s have seen over 77% of their investment eroded very painfully and gradually over the past 20 years. The stock has halved in market value over the past year alone.

However, this recent decline puts the stock in a unique position. The market value of each share is now just 59% of the company's tangible book value per share. In other words, if you bought the whole company, halted operations, and sold off all its assets, you could nearly double your money. That's effectively like buying a dollar for $0.59.

That would put Indigo in the cross-hairs of value-oriented institutional investors, family offices, or hedge fund managers with the resources available to pull off a complete buyout.

Earlier this year, New York-based Paul Singer's Elliott Management pulled off a similar deal when it acquired Barnes & Noble for $683 million, including debt. Investors will recognize Barnes & Noble as another bookstore that fell victim to Amazon's stunning rise.

At $6.50 a share, the Barnes & Noble offer was a 43% premium to the retailer's 10-day volume weighted average closing share price. This means even savvy investors without the resources to buy the whole company benefited from the deal.

Singer acquired the firm for roughly its book value at the time. In fact, he paid five times annual cash flow for the acquisition. Meanwhile, Indigo's stock trades at two-and-a-half times annual cash flow. The company also has $129 million in cash on its books, which represents $4.7 in pure cash for every $8 stock.

If the company manages to get a deal similar to the Barnes & Noble one, the upside could be as much as 50% based on the stock's current value.

Bottom line

There's no doubt that Indigo is in deep-value territory at the moment. That could make it an ideal target for a buyout, either from the management or external investors looking for a quick return. Value-oriented investors with a dose of patience may want to take a closer look at this opportunity.

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