Are These 2 the Ultimate Bargain Stocks?

Description

Every experienced investor knows that the market can sometimes get carried away with emotions. The sentiment for individual stocks and industries can swing from hyperbolic optimism to deeply entrenched pessimism. Savvy investors don't just recognize this but often use the market sentiment to their advantage.

Perhaps the best way to leverage market sentiment is to buy stocks that have seen negative sentiment swing to such extremes that the market price hovers below the asset's true value, even in their worst-case scenario. These bargain stocks are rare and not particularly sexy, but they could lead to some surprisingly good results for investors with the right mix of pragmatism and patience.

Two stocks fit this description perfectly — legacy marketing company **Yellow Pages** (TSX:Y) and struggling book retailer **Indigo Books & Music** (TSX:IDG). Both have been at the business end of technological disruptions over the past two decades that have decimated their business models and eroded shareholder value.

Now, the two companies are worth more dead than alive. Both stocks are now trading at less than the value of annual sales per share. Here's a closer look at their valuations.

Cash is a substantial portion of the stock price

Cash and cash equivalents on the book represent a jaw-dropping 52% of Yellow Pages's stock price. For every $7.7 share, there's $3.93 in cash that can be deployed in more productive assets and ventures.

However, YP also has a sizable debt load that overshadows this cash hoard. According to its latest filing, the company has $3 in debt for every dollar in cash, which means the company's net worth is effectively less than zero.

That's not the case for Indigo, which has barely any debt and $128 million in cash and cash equivalents on the book. Cash per share represents 60% of the stock's current market value. Meanwhile, the company's book value per share is $13.64.

Ideal buyout target

Indigo's stock is trading at just 60% of its book value, which may make the company an ideal target for a private equity buyout. In a previous article, I mentioned how New York-based hedge fund manager Paul Singer's Elliott Management pulled off a similar deal when it acquired Barnes & Noble for $683 million, leading to sizable gains for B&N shareholders.

There are a lot of parallels between Barnes & Noble and Indigo, which could suggest that the company is well positioned for a similar corporate action. In a hypothetical buyout, if the buyer pays just the market value of tangible assets, investors could expect a 50% return from the current price.

If I had to pick one of the two, I'd pick Indigo. The company's tangible assets and business model are less risky than the digital marketing agency strategy Yellow Pages is trying to pursue. Indigo simply offers a more valuable and robust investment opportunity.

Bottom line

At first glance, both Yellow Pages and Indigo Books & Music seem like deeply underappreciated value investment opportunities. However, a closer look at fundamentals reveals that Indigo is probably the better bet.

Nevertheless, investing in a company with absolutely no future prospects for growth, based on the hope of a potential buyout is a risky and speculative strategy that isn't well suited to most investors. Proceed with caution, if at all.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:IDG (Indigo Books & Music)
2. TSX:Y (Yellow Pages Limited)

PARTNER-FEEDS

1. Msn
2. Newscred
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