Value Investors: 3 Dirt-Cheap Stocks Trading at a Massive Discount to Book Value

Description

Walter Schloss was quietly one of the best investors you've never heard of.

Schloss — who is perhaps best known for working alongside a young Warren Buffett at Ben Graham's office in New York — started his own fund in 1955. Over the next four-and-a-half decades, he delivered a 15.3% annual return for his investors, far outpacing the S&P 500, which returned right around 10% annually.

To put that into perspective, $10,000 invested with Schloss in 1955 would be worth more than $6 million by the time he retired from his fund in 2000.

Schloss was a true contrarian back before that term really existed. He put his fund's cash into boring assets trading at a big discount to book value, focusing on the replacement value of those assets. Eventually the stock price would recover to intrinsic value, Schloss would sell, and the process would repeat itself.

Canadian investors looking to build a Schloss-inspired portfolio of cheap price-to-book value stocks need to read this. Here are three ultra-cheap stocks to get you started.

Senvest Capital

Senvest Capital (TSX:SEC) is a Montreal-based portfolio manager that invests in real estate and worldwide stocks for its clients, while also holding some of these assets itself. Senvest's portion of these portfolios was worth $843 million as of the end of June, while the stock trades at a market cap of just $418 million. That puts shares at a steep discount to book value of approximately 50%.

There are several ways the company could shrink the discount to book value. It could announce a big share buyback at a price between the current price and book value. It could spin out some of its assets to investors in the form of a special dividend. Or it could agree to get acquired by a traditional wealth management firm, a company just interested in Senvest's wealth management clients.

One thing that isn't helping the price-to-book discount is the absence of a dividend. Senvest shareholders aren't even paid to wait.

Despite Senvest persistently trading under book value for years now, the stock has been more than a satisfactory investment over the long term, compounding by more than 14% annualized over the last 20 years.

Melcor REIT

Alberta real estate is not a sexy sector today, a fact that is well reflected in **Melcor REIT's** (TSX:MR.UN) persistently low share price. The company, which owns 36 office, retail, and industrial properties primarily in Alberta, currently sees its shares trading at a mere 53% of book value.

This is a classic Schloss investment opportunity. Commercial real estate in Alberta will eventually recover, likely when energy rallies in a sustainable way. The issue is, nobody knows when it'll happen. This creates a massive opportunity for the patient investor to get in today. Shares could easily double when investors get bullish on Alberta again.

Meanwhile, Melcor pays a great dividend as a consolidation prize. Shares currently yield a robust 8.6%.

Crescent Point

Virtually every stock in the energy sector trades at a big discount to book value, so investors should limit themselves to some of the best names in the sector. **Crescent Point Energy** (TSX:CPG)(NYSE:CPG) is well regarded, and it's easy to see why.

Crescent Point's emphasis on low-cost assets is looking like a big win in today's market. It has plenty of production today, and it also sold non-core assets in Utah and southeastern Saskatchewan for a nice gain. This move should bolster the company's balance sheet nicely, all while improving cash flow on a per-share basis.

In fact, the company is projected to generate between $350 and $550 million in free cash flow in 2019. The stock has a current market cap of under $3 billion. It doesn't take a math genius to see the company is very cheap on a price-to-free cash flow perspective.

Shares are also very inexpensive on a price-to-book value basis, with shares trading hands today at just 43% of stated book value. And remember, energy companies come with a lot of operating leverage built in. If the market recovers, shares could surge way past book value. We're talking returns of 500% or even 1,000% here.

The bottom line

As Walter Schloss showed us, good things happen if you buy stocks trading at low price-to-book value ratios. Eventually these companies recover and investors are rewarded. I'm sure these three stocks will eventually do the same, too.

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