Manager Insight

Deep-value manager finds few bargains

Blackberry is among the names that meet Tim McElvaine's "ABBA" criteria.

By Michael Ryval | 17/11/16

A deep-value investor who is known for acting independently of the way markets are moving, Tim McElvaine says there are few bargains out there in the Canadian small- and mid-cap arena, or for that matter anywhere else. But he's prepared to wait.



"I'm not finding a ton of stuff to do, but I'm way off in a corner dancing to my own tune," says McElvaine, president of Victoria, B.C.-based McElvaine Investment Management Ltd. and manager of the $29-million McElvaine Investment Trust. "And I'm confident there will be a lot to do in the future."

A 25-year industry veteran, who was formerly chief investment officer at Vancouver-based Cundill Investment Research Ltd. before setting up his own shop in 1996, McElvaine is noted for boldly stepping into areas that most would avoid or regard as foolhardy. He cites his purchase of U.S. financial stocks about five years ago, followed later by Japanese stocks. "Today? I don't see the same easy pockets. There's not a lot of margin of safety."

McElvaine is sitting on about 25% cash, which was actually as high as 40% back in 2000. However, cash is a by-product of his stock-picking process. Currently, he is running a concentrated portfolio of about 20 names that are spread across Canada, U.S., and international markets.

"With value investing, you start with a solitary idea. Then you dig a bit deeper and there's a whole clump of ideas," says McElvaine, who grew up in Kingston, Ont., and graduated from Queen's University with a bachelor of commerce. He is a chartered accountant by profession.

"I might look at the UK, but I'm happy to bide my time," says McElvaine. "There may be something to do in six months. We've gone through the shock, and the euphoria (of the Brexit vote to leave the European Union.) The next stage, usually, is a realization

that it will be tougher than they thought. I don't think the UK has quite got to that point."

About a third of the portfolio is in technology stocks and 20% in energy. "We've owned the technology names for a couple of years or longer, so part of that allocation is due to appreciation," says McElvaine, noting that his holding in BlackBerry Ltd. (BB) is up around 30% and Carmanah Technologies Corp. (CMH) is up almost four-fold. "There is a little bit of unrealized gain in there. But I haven't done any buying in the technology area this year."

Pointing to BlackBerry, McElvaine argues that the value story behind the company has improved. "They have simplified their business and their balance sheet is stronger. They are basically into enterprise management."

In BlackBerry's favour, says McElvaine, is the fact that about a quarter of its market capitalization is in cash. Although the company has some issues, he believes the stock is a keeper and has the potential to more than double its current $9.60 price. "Everything is a trade-off. You'll never get four A-pluses in a row. It all comes back to price. Is the price cheap enough to compensate for the risk? We bought BlackBerry at $7 and it was cheap enough. There was a margin of safety."

In searching for value, McElvaine adheres to a nifty acronym, ABBA. That's not the name of a 1970s-era pop group but stands for **A**ccident, **B**ird in hand, **B**rick house and **A**lignment of interest.

In addressing the first "A", McElvaine says: "Growth investors -- and I lose friends when I say this -- but their thing is to show they're so much smarter than everyone else and have out-analyzed a company and know where it's going,"

By contrast, McElvaine adds: "The value guys just try not to make dumb mistakes. When I'm buying stock I want a competitive advantage on the purchase price. I want the seller not to care about the price they're getting; they just want to get out. This happens more often that you'd think. Examples of this include how investors sold heavily when they wanted to get out of BlackBerry a couple of years ago. More recently, they wanted to get out of mining and oil and gas stocks."

The first "B" in ABBA refers to the margin of safety. The second "B" means owning a firm that can withstand shocks and unexpected bad news. Finally, the last "A" refers to owning companies whose management has some skin in the game.

McElvaine is candid enough to admit his biggest mistakes revolved around the second "B" and where companies such as Glacier Media Inc. (GVC) and Rainmaker Entertainment Inc. (RNK) were weaker than originally believed. This hit fund performance in 2008-2010, and has contributed to a compound annual loss of 2.9% for the 10 years ended Oct. 31.

Over the most recent five-year period, performance has improved. However, the fund's 5.8% annualized return lags the average 6.7% return for the Canadian Focused Small/Mid Cap Equity category.

McElvaine is an active shareholder who has served on the boards of several companies where the fund held or now holds large positions. These include Humpty Dumpty Snack Foods, Sun-Rype Products, and currently Glacier Media and Rainmaker. "If I

never went on another board, I'd be okay with that," says McElvaine. However, he feels that the latter two companies have turned a corner, with Glacier announcing a financing and acquisitions that will improve prospects for the firm.

Despite the knocks the fund has endured, McElvaine expects a turnaround in performance by holding names such as Leucadia National Corp. (LUK), a US$9.7-billion holding company with diverse interests including the broker-dealer Jeffries Group LLC. McElvaine began buying in the late 2015 at around US$17. The shares are now trading at about US$20.

"I think it's a US$30 stock so there's lots of room," says McElvaine, adding that the "B" factor, or bird-in-the-hand indicated its tangible book value far exceeded its purchase share price. As for the last "A" of the ABBA acronym, he adds: "The board owns US$600 million in shares. That's enough to hold my attention."

Michael Ryval, a regular contributor to Morningstar, is a Toronto-based freelance writer who specializes in business and investing.