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Not-to-be-missed tips for value hunters

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My recent column detailing the 10 investment traps I've identified prompted several readers to ask if I have a comparable list of the opposite – types of opportunities that are likely to lead to good investment outcomes.

I do, and happily it's a bit longer than the list of traps. Given that the first step to successful investing is knowing which ponds to fish in, here are the 15 most common types of value opportunities I have been able to capitalise on in my investing career:

● Out-of-favour blue chips. Even the greatest companies encounter problems or otherwise fall out of favour. We bought **McDonald's** a few years ago when it fell below $13, believing in its assets and that it could return to its former glory through better management. The shares now trade above $50.

● Turnrounds of broken businesses. It's difficult to fix a truly broken business, but when it happens, the returns can be extraordinary. One of my best investments ever was **CKE Restaurants**, which engineered a spectacular turnround at Hardee's due to its new Thickburger menu. The shares, as low as $3 in 2003, are now above $20.

● Cyclicals at the bottom of the cycle. Success here usually involves correctly anticipating when a cyclical industry will rebound, though precision is not necessary as long as the company has a strong enough balance sheet to weather the tough times.

● Distressed industries. Our buying auto-systems maker **Lear** last year below $20 when its prospects were considered most bleak is a successful example of buying a good company in a distressed industry. Its shares have more than doubled off their lows.

● Overlooked small-caps. Among the 5,000 or so publicly traded US stocks that have no analyst coverage are fine businesses that are cheap because no one is paying attention to them or the stocks are thinly traded. A good example we've owned for years is **Weyco Group**, which makes Florsheim shoes.

● Fallen growth angels. When high-growth companies slow down, growth and momentum junkies often sell indiscriminately, which can create great opportunities for value investors. Just be careful not to anchor on the stock's previous price or earnings multiple, which are no longer relevant.

● Growth at a reasonable price. These are also high-quality growth businesses, but the stocks haven't fallen. They may not appear cheap on traditional valuation metrics, but can be excellent investments if the high growth can be maintained. **Starbucks** over the years has been a great example.

● Piggybacking on activism. There are select opportunities to invest alongside experienced activist investors pushing for prudent change. One of our most profitable investments over the past two years, for example, was following Pershing Square and Trian Group into **Wendy's International**, which has more than doubled.

● Spin-offs. Many significant stock-price inefficiencies can occur when a company is spun off. A recent example we currently own is Mueller Water, which operates largely under Wall Street's radar and is uniquely positioned to benefit from needed investment in US water-system infrastructure.

● Post-bankruptcies. There are also many reasons why companies emerging from bankruptcy can be inefficiently priced, not the least of which is investors' reticence to back a recent loser. We've almost tripled our money in less than two years owning shoe retailer Footstar, which came out of bankruptcy with a solid balance sheet and plan for reviving itself.

● Let someone else do the investing. Certain public companies, including **Berkshire Hathaway** (which we own), **Loews**, **Leucadia National**, **Alleghany** and **White Mountains Insurance** are structured as investment vehicles for proven value investors. At a reasonable price, it can pay to let these investors do the heavy lifting for you.

● Free/mispriced option. In these situations, one or more ongoing businesses justifies the current market price and an investor gets a valuable option – in the form of a new market opportunity or turnround of a floundering business – for almost nothing. In Wendy's, we thought the value of its Tim Hortons restaurant franchise was worth the entire stock price two years ago, so we were getting the Wendy's brand restaurant and franchising business for free.

● Declining cash cow. At the right price – and if management wisely milks the business and allocates capital – the stock of a declining business can be a great investment. The shares of **Deluxe**, the leading check printer that many investors had abandoned, have tripled over the past year thanks to cost cutting under a new chief executive.

● Oddball companies. Certain companies have revolutionary business models that are poorly understood, resulting in cheap stock prices. Classic examples are **Southwest Airlines**, **Dell** and **Kinder Morgan**.

● Discount to the sum of the parts. Many companies lend themselves to valuing their different pieces and can be a great buy if the whole is trading at
a sufficient discount to the pieces. We own **Tyco** because we think the three companies

that will emerge from it in the next few months are worth more than $40, versus today's share price below $33.

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