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Investing

With a Little Help From My Friends

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One of my favorite ways to research stocks and find ideas is to simply pick up the phone and call those people I have been fortunate enough to meet over the years who have successful track records. It's easier than digging through all the filings -- and more enjoyable as well. Not everyone is willing to talk about their ideas, but over the years I have found that value investors are particularly generous with their intellectual capital and happy to talk stocks and markets for hours on end. My contact list has grown over the past few years, as some *RealMoney* readers and fellow contributors have become frequent phone and email contacts who share their thoughts and ideas.

Through a reader's email, I made the acquaintance of the good folks at the Adirondack Funds, based in a small town in upstate New York. I wrote about this fund earlier this year when the managers took the time to talk about stocks and mentioned some ideas that turned have turned out pretty well so far this year. They must be doing something right, as according to Morningstar the Adirondack Small Cap Fund (ADKSX) is pretty handily beating the market over the one-, three- and five-year periods. Being a deep-value guy, I like the fact that the stocks held in the fund have an average price-to-book ratio below 1 and a price-to-cash-flow ratio down below 4. Since that's is the type of stock I look for when investing, I was interested to hear their thoughts about the current market.

Late last week I caught up with Matthew Reiner and Steve Gonick, two of the principals at Adirondack Funds. They described the current market environment as "tricky" -- an assessment with which I completely agree. Although volatility is good for value investors, since it allows us to put Mr. Market to work for us in our efforts, they pointed out that the macro conditions are very tough right now and described themselves as cautious about the economic outlook. They are looking for stocks that are somewhat independent of the macro environment.

One area where they have been searching for value is in post-bankruptcy reorganization equity. This piqued my interest, as it is an area that has been extremely lucrative for me over the years. Adirondack is still actively buying most of these names, so they are reluctant to name them. However, it doesn't take much energy to conduct a Google search for stocks that have recently emerged from bankruptcies. Interestingly, Daniel Loeb of Third Point, an activist and value hedge fund, addressed this asset class in some detail in his latest shareholder letter; he said that he too was accumulating post-reorg equity. With two successful managers mentioning these stocks, my interest level jumped, and I'll be writing about this subject later in the week.

One stock Adirondack mentioned sounds very interesting. I did well with newspapers back in 2008, when the industry was pronounced dead by many market observers. Journal Communication (JRN) has assets beyond the newspaper business -- it also owns TV stations, another industry hit hard by the recession. Advertising dollars have been tough to come by for both groups, as advertising dollars have flowed to the Internet and cable TV networks.

Journal Communications has done many things right in the past three years, such as developing local and Internet content to diversify the business -- it now has 26 community websites -- but the most beneficial action the company has taken has been to reduce its debt. Journal Communications has paid down the debt it took on to fund the acquisition of TV stations in the middle of the decade and has been cutting its costs aggressively. Its balance sheet repair is working, and now the company has just around $118 million in debt. Since Journal generated about $65 million in free cash flow in 2009, it is easy to see that it can continue to pay down its debt over the next few years.

Adirondack also mentioned SeaChange (SEAC) as a value stock worthy of further investigation. This provider of digital-video systems is one of the largest suppliers to Comcast (CMCSA) for its on-demand systems. Initially, the company sold its services as a turnkey system providing both the hardware and software for the on-demand industry. However, other companies have entered the hardware side of the business, including giants such as Cisco Systems (CSCO) . As a result, prices and margins on that side of the business have declined, and it is much more profitable to unbundle the system and just sell the higher-margin software.

SeaChange has been moving in that direction. There is activist pressure, most notably from noted activist hedge fund Ramius, for the company to sell its remaining hardware business and concentrate solely on the software side of the business. Given the growth potential of on-demand video, the stock is cheap at just 10x earnings.

There are many ways to search for great ideas. Catching up with smart friends and colleagues who have done well in the markets is easily one of the most enjoyable.

At the time of publication, Melvin held no positions, although positions may change at any time.

Tim Melvin is a writer from Stevensville, Maryland, who spent 20 years a stockbroker, the last 15 as a Vice President of Investments with a regional firm in the Mid Atlantic area. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks. Melvin appreciates your feedback; click here to send him an email.
