Leaders, insights, and challenges to Canadian business. pwc Up front Summer 2013

How to find turnaround stocks

David Pett
Wednesday, Jul. 17, 2013

Is it too late for BlackBerry to recover its former glory? Geoff Robins/The Canadian Press

The *Financial Post takes* a weekly look at tools that will help make your investment decisions. This week: Turnaround indicators.

BlackBerry Ltd.'s ongoing troubles and volatile stock price may be too much bother for some investors, but the allure of possibly huge returns down the road has others unwilling to give up entirely on the smartphone maker.

"I'm concerned with BlackBerry's recent results and there are some other red flags, but it's still on my watch list and so it's possible I could step into it later in the year," said Benj Gallander, president of the Contra the Heard investment newsletter in Toronto. "If companies with beaten-up stock prices can return to form, there is a much better chance of tremendous returns."

Turnarounds are perhaps best described as the ultimate contrarian play, since they're a bet on a company most others don't believe in.

One of the most successful turnaround investors over the years has been Peter Lynch, the well-known former money manager of Fidelity Investment's Magellan fund. He believes such plays have the potential to become a "10 bagger," but stresses there is tremendous risk involved.

Mr. Lynch has identified five types of successful turnarounds including companies — such as

Chrysler, a Lynch winner in the 1980s — that are bailed out by the government.

Other types include those that surprise the market by actually turning around, ones that have a minor problem perceived to be worse than it really is, bankrupt companies that hive off healthy divisions or parts, and companies that rid themselves of unprofitable subsidiaries.

Mr. Lynch pays attention to the cash on hand and the long-term debt when evaluating turnarounds. He particularly likes to see more cash than debt, and prefers funded debt, such as corporate bonds, to bank debt and corporate paper that are due on demand.

Lloyd Khaner, general partner at Khaner Capital LP, a long-short hedge fund in New York, agrees investors should avoid names that have too much debt, noting a 70% debt-to-capital ratio is a red flag.

He also suggests avoiding companies that have management teams without any turnaround experience as well as those in dying industries.

Mr. Gallander adds troubled companies with very little or nominal debt are less likely to go bankrupt and therefore have a far better chance of rebounding.

That's one of the reasons why he continues to eye BlackBerry as a potential holding. The company has more than $3-billion in cash and no debt.

"I only look at companies that have potential for a 100% return and organizations that have at least a 10-year track record," he said. "I wouldn't be surprised if BlackBerry's stock price fell even further, and, if it does and earnings results improve, it may then be a buying opportunity."

Of course, not everyone feels the same way about Canada's best-known tech name. Alex Jurshevski, managing partner and founder of Toronto-based Recovery Partners, which specializes in corporate restructuring, thinks it may be too late for BlackBerry to recover its former glory.

"You might as well try to catch a falling knife," he said. "Think Palm Computing, Atari or Nortel. With these types of stories, once the downside momentum has gathered pace, a successful turnaround is a very low probability shot."

Posted in: Investing Tags: BlackBerry, Tools Of The Trade

More on this Story

7 stock picking behaviours you should avoid

Long-term investing requires short-term tuning

Facebook | **Twitter** | Email | Instapaper