

Value lurking in companies off the coverage radar

By **DEREK DeCLOET**

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When renowned investor Peter Lynch was managing billions of dollars for Fidelity, he had a list of things he looked for in a company. One was that it did something disgusting or ridiculous. Another was that it was virtually ignored by brokerage firm analysts.

On both counts, **Maple Leaf Foods** fits the bill. It's hard to imagine a more repulsive business than shearing the meat off pig carcasses, wrapping and sending it off to your local grocery store.

Analysts, it seems, are turned off for a variety of reasons, beyond their desire to avoid getting pig's blood on their Guccis. Maple Leaf isn't very liquid for a company of its size (\$2.1-billion in market capitalization) because the McCain family owns about one-third of the stock and the Ontario Teachers Pension Plan owns another third. It doesn't do a lot of deals, and it isn't running to the market every four months to raise more money (although it did sell stock last year to help pay for its \$500-million acquisition of Schneider). It isn't burdened by way too much debt or in need of a restructuring.

In short, it's far too bland for Bay Street's tastes: too much bacon, not enough sizzle. Only four sell-side analysts cover Maple Leaf, according to Bloomberg data, and of those, only one recommends the stock (National Bank Financial's David Newman, one of the sharper minds in that business). If you're following the Lynch principles, this makes Maple Leaf worthy of investigation, since any company that's so shunned by the brokerage community can't be all bad.

Across the Prairies from Maple Leaf's giant slaughtering factories, there's another company that does have a sexy story to tell. **Thunder Energy** has all the right attributes for today's market. It's a junior energy play tapping reserves of natural gas and coal-bed methane in Alberta and British Columbia.

Better still, from the Street's perspective, Thunder has hired two investment banks to help it explore "alternatives" -- i.e., converting the producing assets of the company into an income trust and spinning out the rest.

This announcement, naturally, created plenty of excitement among those who follow the stock, and helped obscure the fact that the company also made a radical cut to its estimate of its energy reserves.

For a company of its modest size (about \$420-million in market cap), Thunder's trading volumes are pretty high. More than a million shares trade on a busy day, and the average is close to 275,000, far more than the activity in Maple Leaf. If it goes the trust route, it will have to do regular financings to fund acquisitions. Do we need to add that its brokerage analysts are tripping over each other at conference? Fifteen of them cover the stock, according to Bloomberg (10 of them say "buy" or "hold").

This is not to say that Thunder is a bad company, or that the restructured entity (if that's what comes out of its strategic review) will be a poor investment. But extreme popularity is something for an investor to be wary of -- even now. During the 1990s, a handful of research departments became cesspools of conflicts of interest, as analysts sought to win over the CEOs who could bring their firms deals (and fees).

Then came the crash, the outcry and Eliot Spitzer bearing subpoenas. Regulators rushed to print new rules to regulate research and to prohibit analysts and investment bankers from sharing the

same table in the Merrill Lynch cafeteria.

In some respects, it has worked, and the quality of research has improved. But that's not the same as saying that brokerage-firm research is now designed for you, the investor, rather than to generate corporate finance fees. It's just that the biases come out in subtler ways -- for example, too much coverage of a speculative company, not enough coverage of a solid but boring one.

Another change to come out of the post-bubble reforms is the rise of independent research firms, those with no investment banking departments. One such firm, **Veritas Investment Research**, last week published its own views on Maple Leaf, arguing that the company is "not just a pig killer" but a diversified and well-run outfit with the potential to earn a lot more than last year's \$107-million profit. Using a reasonable multiple, the firm's analysts say the stock is worth a lot more than the current \$17 a share.

They've made a good argument. Just don't expect to hear about it from your broker.