Buyer of the Overlooked and Unloved Embraces Apple

The Roumell Opportunistic Value Fund's managers usually buy micro-cap stocks, but for AAPL they made an exception

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February 14, 2013


Person standing next to logo on Apple store. (Photo: AP)

Never mind DoubleLine's Jeff Gundlach and PIMCO's Mohamed El-Erian giving the thumbs-down to Apple stock last month. When Apple (AAPL) started its fall in fourth-quarter 2012, Roumell Asset Management's Opportunistic Value Fund (RAMSX) bought the stock for the first time in the fund's history, and then went out and bought some more in the first quarter of 2013.

Considering that Morningstar ranks RAMSX in the top 1% of the 1,018 funds in its category, portfolio managers Jim Roumell and Ted Crawford of the two-year-old fund may be making a good call on Apple. RAMSX has beat the S&P 500 81% of the time on a rolling three-year basis, and the managers credit their strategy of buying companies that are out of favor, overlooked or misunderstood.

Apple, in other words.

"We bought it when it wasn't loved," Crawford said on Tuesday in New York during an interview with AdvisorOne, adding that Roumell Asset Management's deep-value investing strategy uses a combination of "scuttlebutt" along with quantitative and behavioral analysis. "The change in sentiment in Apple was sharp, quick and visceral, and visceral reactions are usually overreactions."

Crawford's primary animating principle in stock-picking is finding companies he would take private in a heartbeat. Before joining Roumell last year, he was a partner with value-oriented long-short equity hedge fund Maple Leaf Partners for six years, during which time he learned to spot stock that was selling at a big discount to what the company would be worth if it were private.

Off 30% From Its Highs, AAPL Seen as a Deep-Value Bargain

RAMSX invests in a mix of deep-value stocks, high-yield corporate bonds and cash, and the stocks usually fall into the micro-cap end of Morningstar's style map. But when AAPL fell 30% from its highs, to as low as $435 per share from its 52-week high of $705.07, Roumell and Crawford decided to grab it.

Their average cost was $500 per share for Q4 '12 and Q1 '13 combined. As of Thursday, AAPL was trading at $467.01. Roumell and Crawford have set a target price for the stock at $775.

But no question about it, Apple of late has seen little love from investors. Hedge-fund honcho David Einhorn has demanded that the company distribute a big cash payout to its stockholders, DoubleLine CEO Gundlach has called Apple "a broken company that is over-owned," and even the normally staid El-Erian questions its ability to maintain rapid growth "in the context of increasing competition and an uncertain product cycle."

'Extremely Rare Opportunity' to Buy at 7.5x Earnings

Roumell and Crawford believe that AAPL is a good bet. In their opinion, they have an "extremely rare opportunity" to own one of the best companies in the world for only 7.5 times earnings, excluding its net cash. The company, they point out, generates returns on equity of 40% and has scale, a fanatical customer base, a culture of innovation and a 20% global share of the smartphone market, which grew 45% in the third quarter.

In addition, they say, there are 5 billion "dumbphones" in the world, and they will be replaced in time with smartphones, which creates a tremendous wind at Apple's back.

"The market seems most concerned about the possibility of declining margins in its smartphone business," Crawford wrote in an email following the Tuesday interview. "If over the next couple of years gross margins fall back to where they were before the first iPhone was launched in '07, earnings would fall to around $35/share. Apple would generate $50-$60/share in cash after capex, dividends and buybacks. So at this price, if the market's worst fears are realized, the stock would still trade for a single-digit earnings multiple. We just don't see much risk in owning Apple here."

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