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Fund offers top-tier businesses at one bargain price

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Fabrice Taylor, CFA, publishes the President's Club investment letter. His letter and The Globe and Mail have a distribution agreement.

If you didn't invest in CBOE Holdings a year ago, I'm going to guess that you wish you had, because you'd be up almost 40 per cent. The same holds for Bank of America (up 35 per cent), Manulife (43 per cent) and dozens of other beaten up financial firms.

Most of these stocks are likely to keep rising, but if you find it hard to buy stocks that are up a lot, you can buy these shares for about 65 cents on the dollar by buying shares in Urbana Corp.

Urbana is a closed-end fund, meaning it's similar to a mutual fund, except there are limited redemption rights. Like a mutual fund, Urbana isn't an operating business. It's a collection of investments, mostly publicly traded. So, it's easy to calculate what the stock is worth by adding up the value of all the investments, subtracting any liabilities and dividing by the number of shares outstanding.

Like most listed closed-end funds (Urbana trades on the TSX), the shares trade for significantly less than what they're worth – about 35 per cent less. And since Urbana owns lots of shares of all the companies mentioned above, you can buy those shares for a lot less than what they're worth.

If you know something about closed-end funds, however, you'll likely tell me that my thesis rests primarily on the discount to value closing. But that's not the only thing recommending these shares. While it's never a mistake to buy something for less than it's worth, I also think Urbana's portfolio is very promising, which is why I'm an investor.

Let's start with the discount though. At 35 per cent, it's hefty but it's been as big as 50 per cent. What determines the size of a discount?

The liquidity of the underlying portfolio is one factor. The more readily tradable investments in the fund, the lower the discount. Urbana's portfolio is reasonably liquid given that 80 per cent of investments are big and listed. Those that aren't are mostly profitable and some pay dividends, which provides some measure of liquidity.

Management is another factor. Almost all closed-end funds trade for a lot less than what they're worth, typically about 30 to 50 per cent. You'd think they'd all buy back their shares. But they don't, because they're typically paid a percentage of the assets they manage. Buying back shares may be good for the stock price, but it's not good for fees.

Urbana, on the other hand, has aggressively bought back its stock. Unlike the vast majority of chief executives that have buyback plans, CEO Tom Caldwell actually follows through. He buys the stock back when he can't find a better investment. And as a substantial shareholder, he thinks more about the stock than his fee.

Since the latest buyback plan kicked in last August, allowing the company to repurchase 5.4 million shares, Urbana has bought and cancelled 4.4 million. The share count has dropped by 28 million shares, or almost a third, in only four years.

Urbana recently started paying a 5 cent dividend as well. This will also help close the discount.

I also think the value of the underlying investments will trend up. In particular, I look at potentially big things from two holdings.

The first is a big investment in the Bombay Stock Exchange. In a recent conversation, Mr. Caldwell conceded that this one has certainly not worked out so far. He paid $32-million for the stake and it's now carried at less than half that. The perennial hope has been that the Bombay Exchange would go public, unleashing big gains for its long-suffering shareholders. Mr. Caldwell believes, and hopes, there's a better than decent chance it happens this year.

Another interesting investment is the Canadian Securities Exchange, of which Urbana owns almost half (the financier Ned Goodman, of Dundee Corp. fame, is the other principal shareholder.)

The CSE is meant to be an alternative to the TSX Venture Exchange, and it has gained market share so far. I believe that with Mr. Caldwell and Mr. Goodman at the helm, the business, which is currently about break-even, has a very good chance of making it. If so, it could over time add a lot of value of the portfolio.

To sum up, Urbana gives investors access to top-notch businesses at a fraction of the cost. Plus, you get Mr. Caldwell's stewardship. This adds up to a narrowing discount on a growing asset base and the scope for more dividends – all in one tidy package.