5 Highly Profitable Companies Priced to Buy

Description

Context is critical in the world of investing. As are expectations. When we're evaluating stocks, we must not only understand the underlying business and how it has performed over the years, but also how the market expects that business to perform in the coming years.

One way to quickly analyze the strength of a company is by examining its return on equity (ROE) over time. Companies that are able to consistently crank out a high ROE are typically very strong. Think the Canadian banks.

However, just because a company consistently generates a high ROE doesn't mean its stock is going to be a top performer. The market tends to recognize a consistently high ROE when it sees it and typically will bid up the stock to reflect this characteristic.

This will be reflected by the stock's multiples. Companies that consistently generate a high ROE typically garner higher than average multiples.

Put 'em together

Therefore, to try and uncover attractive companies trading at reasonable, and maybe even cheap valuations, we can look for consistently high ROEs and low multiples – and specifically when dealing with ROE, price/book multiples.

You see, ROE and the P/B multiple are anchored by the same denominator – shareholder's equity. ROE is calculated by dividing net income by equity, and the price to book multiple is calculated by dividing current market value by equity.

Taking it one step further, if we divide a company's ROE by the P/B multiple, with some fancy math (not really), we're left with net income/market value, which is just a company's earnings yield (EY).

To illustrate, a company that consistently sports an ROE of 20% and trades at a P/B of 1 (EY = 20%) is much more attractive to an investor, all else being equal, than a 20% ROE and a P/B multiple of 2 (EY=10%).

Get to the stocks

Ok, ok. The following table consists of 5 companies that offer an appealing combination of consistent ROE and low P/B.

Company Name	5 Yr. Avg ROE	Current P/B	"Earnings Yield"
First Quantum (TSX:FM)	17.7%	0.98	18.0%
IAMGold (TSX:IMG)	7.4%	0.45	16.6%
Teck Resources (TSX:TCK.B)	10.8%	0.72	15.0%
Home Capital Group (TSX:HCG)	26.2%	2.00	13.4%
Brookfield Office Properties (TSX:BPO)	11.0%	0.85	12.9%

Source: Capital IQ

Foolish Takeaway

As are most things in the Canadian market, the list is resource heavy. This of course is reflective of the sharp turn these stocks have had over the first half of 2013 in relation to how well the companies have performed over the past 5 years. If the concerns over a slowdown in China, or the entire global economy for that matter, don't play out as is currently being reflected by these stocks, they are poised to soar higher. Expectations are low, and that can be a very good thing for investors.

Fool contributor Iain Butler is short $26 August 2013 put options on Teck Resources and owns shares of Teck outright. The Motley Fool doesn't own shares in any of the companies mentioned.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FM (First Quantum Minerals Ltd.)
2. TSX:HCG (Home Capital Group)
3. TSX:IMG (IAMGOLD Corporation)
4. TSX:TECK.B (Teck Resources Limited)

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