Two Hidden Gems Trading Below Book Value

Description

One of the most common ways to begin the process of finding a potential gem for your portfolio is by using a stock screen. With the help of RBC's screening function (password required), I screened for stocks using the following parameters: low P/B, low P/E, and low debt levels, yet above average ROE. And with this, I uncovered two very profitable companies that are trading below book value and are definitely worth a closer look. Who doesn't love a sale?!

Aastra Technologies Ltd (TSX: AAH)

Aastra Technologies is in the communications equipment industry, specifically the enterprise communications market. The stock is trading at $19.40, with a book value of $25.82. That's a 24% discount to book value. Furthermore, the company has an industry leading ROE of 11%, a dividend yield of 4.1%, strong cash flows, negligible debt, and is trading at 4.6 times cash flow and 12 times earnings.

Aastra has a great track record of profitability and returning cash to shareholders through share buybacks and increasing dividends. The company is consistently profitable and its share buyback program has reduced the float by 20%. A special dividend was recently paid to shareholders as the company believed that this was the best use of capital.

To help give these figures a bit more perspective, **Polycom Inc.** (NASDAQ: PLCM) is also in the communications equipment industry. This company is far less profitable and doesn't pay a dividend. Yet it is trading at 58 times cash flow and 18 times earnings.

Is Aastra's valuation justified or does it mean a big opportunity?

For starters, Aastra has been hit by its heavy exposure to Europe. 2012 was challenging due to weak macro-economic conditions in Europe, which represents 80% of revenue. Through this, management has continued to focus on improving operations to maintain profitability and market share in core markets in Europe and North America as well as increasing its presence in strategic markets in Asia-Pacific, South America and the Middle East. And now it looks like Europe is seeing signs of improvement.

Also, the industry is experiencing a contraction of the traditional Private branch exchange or PBX market, and Aastra derives a significant portion of its revenue from PBX products and related accessories. Investors are worried. But in response, the company has continued to invest in new product development, responding to the needs of customers and trends in the market. As their market has evolved from proprietary to internet protocol (IP) networks, Aastra has strategically invested to take advantage of this trend.

Aastra has partnered with **Microsoft** on different programs in order to reduce the overall cost and complexity of office communications systems. Aastra's Microsoft Lync phones, for example, are Internet Protocal (IP) phones that make it possible to enjoy the benefits of the Microsoft Lync without having a phone connected to an operating PC.

Aastra's management team have proven themselves to be good stewards of capital, Aastra's products are well respected, and they are investing in new product development in order to successfully change with the industry. All this, along with a discounted stock price and very impressive financials, makes for a very compelling opportunity.

Hammond Power Solutions (TSX: HPS.A)

Hammond Power Solutions is another very well managed company trading at a discount. It is the largest manufacturer of dry-type and cast resin transformers in North America. Customers are from the oil and gas, mining, steel, waste and water treatment, and wind power industries. The benefits of these transformers is that they reduce electricity usage, thereby reducing cost and environmental hazards.

Hammond is currently trading at $7.76, and has a book value per share of $8.91. This represents a 13% discount to book value. The company generates strong cash flows, and was free cash flow positive over the last 4 years. Last year's ROE was 9.8%, the dividend yield is 2.6%, and the stock is trading at 5.8 times cash flow and 9.6 times earnings.

Recent results have been relatively weak, as customer activity has slowed, but Hammond is globally diversified with a very strong balance sheet and should continue to weather the storm until business improves again.

Bottom Line

It's always a good exercise to step back from the headlines and shift our focus to concentrate on what we know makes a great stock. Low valuation, a strong balance sheet, and solid profitability are three primary ingredients that screens can help us identify. However, it's important to remember that screening can only help to point us in the right direction, as it has done in this exercise. There's more to finding great stocks than simply keying on a few attractive metrics.

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CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HPS.A (Hammond Power Solutions Inc.)

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