Rare Buying Opportunity in a Growth Stock

Description

Stella-Jones Inc. (TSX:SJ) is one of the best companies you can own in the materials sector. It has grown for 15 years. From 2001 to 2015, its net income grew from $0.5 million to $141 million.

Last year it achieved sales of $1.56 billion, which was 24.8% higher than 2014. In the same period its net income increased 36%.

The business

Stella-Jones is a leading producer and seller of pressure-treated wood products and related services in North America. Last year almost 80% of its sales were railway ties and utility poles. Its main clients are railway companies, electrical utilities, and telecoms, which provide necessary infrastructure for the economy.

To be safe and to aim for uninterrupted service, these companies will continue to replace old railway ties and utility poles as time elapses. So, there should be a steady demand for Stella-Jones's products.

Can Stella-Jones continue to grow?

Over the years Stella-Jones has consistently maintained a high return on equity (ROE). Specifically, in the last five years it has posted ROE of 16-18% every year. This indicates the company consistently puts capital to good use. In the last five years Stella-Jones also posted decent operating margins of 12-15%.

In October 2015 Stella-Jones acquired Ram Forest Products, which had two plants in Ontario and a vital strategic alliance with a major big-box chain. Stella-Jones anticipates the acquisition will bring sales of treated lumber and related products to 20% of total sales, which would be an increase of 11% compared with last year.

In the second quarter railway ties and utility poles contributed a smaller percentage of sales (about 63.8%) partly due to growth in the sales of treated lumber. For example, residential lumber sales contributed 27% of total sales compared to 11.7% in 2015.

Other than growing organically, Stella-Jones continues to look for acquisition opportunities to expand its reach and enhance its capabilities, so as to serve its clients better and faster.

Valuation

Consensus analysts estimate Stella-Jones will continue growing at a rate of 25% per year. Heck, even in the last recession in 2008, Stella-Jones still managed to grow its earnings per share by 10%.

Even assuming that Stella-Jones will grow at *only* an 18.6% clip in the next few years, its pullback of 16% from its 52-week high to roughly $45 per share indicates a forward price-to-earnings ratio of about 18.6, which is inexpensive.

Conclusion

Stella-Jones has averaged double-digit growth for the last five-, 10-, and 15-year periods. It has a strong track record of acquisitions and successful integrations and continues to be on the lookout for acquisitions to enhance its business.

Now that Stella-Jones's shares have pulled back from its high, it trades at a reasonable forward multiple of 18.6. The shares are trading at a fair valuation to being slightly undervalued for its growth prospects.

So, investors looking for above-average growth should consider Stella-Jones as a rare buying opportunity. Any further dips should be viewed as buying opportunities.

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1. Dividend Stocks
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1. Editor's Choice

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kayng