



Value Investors: Don't Miss Out on These 3 Hidden Gems

Description

It seems like the stocks that make up the TSX 60 Index get all of the attention in Canada.

That's the index filled with all of Canada's household names. These are the titans of Canadian industry, companies the average person just can't avoid. Thus, it's where a large portion of our investing dollars go as well. Legendary investor Peter Lynch told investors to "buy what you know." Canadians have done just that.

But there's one big argument for buying smaller stocks, and that's the inefficiency of the market. Look at it this way: if Canada's largest company—which is currently **Royal Bank**—comes out with a piece of news, it's immediately dissected by hundreds of analysts and investors who know the company well. If **Laurentian Bank** releases an important piece of information, most investors will likely ignore it. They just don't care about a bank with a market cap of \$1.5 billion. It's too small.

Thus, I believe investors looking to smaller companies can more easily identify mispriced assets. That's the first step to market-beating returns.

Here are three cheap smaller companies to get an investor started.

Slate Retail

In a world where Canada's top retail REITs barely yield 5%, investors have another option. They can invest in **Slate Retail REIT** (TSX:SRT.UN) and collect its 7.2% yield.

Slate is a Canadian REIT that owns grocery store anchored properties in so-called secondary markets in the United States. These are cities such as Charlotte, Atlanta, and Richmond, to name a few. It pays a dividend of US\$0.81 per year after just announcing a dividend hike.

Slate's growth has been remarkable. Two years ago, Slate owned 29 different properties consisting of 3.4 million square feet of gross leasable area. Those numbers have ballooned to 68 different properties and 7.9 million square feet. And since the U.S. retail market is still quite fragmented, Slate still has plenty of acquisition potential.

And yet, Slate doesn't get nearly the respect it deserves. It still trades at a discount to its net asset value and just a little more than 10 times 2017's projected adjusted funds from operations, which is a REIT's equivalent of earnings.

Perhaps this is because of the company's small size. It has a market cap of less than \$500 million. All I know is the stock is cheap compared to larger peers.

Empire Company

Although **Empire Company Limited** ([TSX:EMP.A](#)) hardly qualifies as a small company—it's the owner of Canada's second-largest grocery chain and has a market cap of \$5.5 billion—many investors are still ignoring it in favour of other grocers.

Empire acquired Safeway's Canadian stores back in 2014, paying \$5.8 billion for their prize. A few years later this looks like a massive overpay, as weak sales in Alberta, Safeway's largest operating area, have hit both the top and bottom line.

Empire has been cleaning house, including firing its CEO and writing down billions of intangible assets off its balance sheet. It has also launched programs designed to bring business back to affected stores, including lowering the prices on thousands of staples.

Empire is far cheaper than its peers on a number of different metrics, including price-to-sales, price-to-book value, and, most importantly, price-to-forward earnings. In 2015, before Alberta's economy was rocked, Empire earned \$1.51 per share. If it can earn that much again, investors are getting in today at just over 13 times earnings.

Capital Power

Capital Power Corp. ([TSX:CPX](#)) is a free cash flow machine that is being unfairly punished for its exposure to the Albertan power market.

Capital Power has six coal-fired power plants that will become worthless in 2030 because of Alberta's new regulatory environment. It's likely the company will get a very large payout to compensate it for the loss of potential earnings. Preliminary numbers say that payout could be as much as \$1 billion, which is a lot for a company with a \$2 billion market cap.

In the meantime, the company pays a succulent 7.4% dividend it can easily afford. Shares are also cheap on a number of different metrics including price-to-book value.

Think cheap

Slate Retail REIT, Empire Company, and Capital Power are cheap stocks the market has discounted. They are the kinds of companies that should deliver outsized returns going forward.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CPX (Capital Power Corporation)
2. TSX:EMP.A (Empire Company Limited)
3. TSX:SGR.UN (Slate Retail REIT)

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Author

nelsonpsmith

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