



Can Sideways Stella-Jones Inc. Soar Again?

Description

Stella-Jones Inc. ([TSX:SJ](#)) trades at nearly the same place it did a year ago, and I tried to refrain from calling it “sideways Stella-Jones.”

However, investors should not be frustrated about its price action. In fact, Stella-Jones is a wonderful company, which may be a bargain after the past 12 months’ price action.

Steady demand makes a stable business

Stella-Jones is a leading producer and seller of pressure-treated wood products and related services in North America.

There’s a steady demand for Stella-Jones’s pressure-wooded products. The company’s main clients include railway companies, electrical utilities, and telecoms.

These businesses provide necessary infrastructure for the economy and replace old railway ties and utility poles over time to maintain safe, uninterrupted services.

Last year almost 80% of Stella-Jones’s sales were railway ties and utility poles.

Track record of excellent growth

Over the long term, Stella-Jones has experienced outstanding growth, which has led to it greatly beating the market returns.

The average market returns are 10%. In the last five- and 10-year periods, Stella-Jones had average annualized returns of about 34% and 27% per year, respectively.

Other than organic growth, the company’s sharp eye for acquisitions is also a strong contributing factor of outperformance.

Growth by acquisitions

In the last 11 years or so, Stella-Jones has made numerous acquisitions. One recent acquisition was Ram Forest Products in October 2015.

Ram Forest had two plants in Ontario and a vital strategic alliance with a major big-box chain. As a result of the acquisition, Stella-Jones expects sales of treated lumber and related products to contribute 20% of total sales, which would be an increase of 11% compared with last year.

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 shows the company can consistently invest with superb returns.

Recent results

In the first half of the year, Stella-Jones generated sales of \$984 million, which was 28% higher than the same period in the previous year. Its operating income of \$137.8 million was 26.6% higher, and its take-home net income of \$89.7 million was 30% higher.

Its recent results align with its annualized revenue growth, operating income growth, and net income growth of 28.6%, 26.1%, and 24.6%, respectively, between 2012 and 2015.

Conclusion

Stella-Jones's one-year sideways action has contracted its multiple from 24.7 to 18.6, while the company has continued to deliver double-digit growth in its top line and bottom line so far this year.

Investors may be concerned with future growth and where it will come from. The most likely scenario is that management will be making more acquisitions while the company's business continues to grow organically.

Supporting evidence of that is management's ability to make good investments with consistent ROE of 16-18% in the past five years. As well, the company's organic growth contributed 10.3% and 13.4% of sales growth in the first and second quarters, respectively.

At under \$45 per share, Stella Jones may not be a bargain yet. However, it's a wonderful business that's priced at a more reasonable valuation than it was a year ago. And it's likely to be much higher five years from now.

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