



These 3 Top Contrarian Picks Have Huge Upside Potential in 2017

Description

Investing doesn't have to be complicated. All we need to do is buy low and sell high.

Life is far more complex than that, of course, but the message still rings true. We need to buy stocks when they are beaten down and getting no love from investors. As Warren Buffett has said, we pay a lot for a cheery consensus.

The problem is separating stocks with fixable problems from those with a one-way ticket to bankruptcy. Investors can do that by insisting on companies with a moderate amount of debt, the ability to generate solid cash flows, and, ideally, that are trading at a discount to their book value. It's all about owning a company that's just temporarily depressed.

Here are three beaten-up Canadian companies with huge upside potential in 2017.

TransAlta

TransAlta Corporation ([TSX:TA](#))([NYSE:TAC](#)) suffered from one big overhanging issue in 2016. The Alberta government announced plans to eliminate all of the province's coal-fired power plants by 2030. Approximately 40% of TransAlta's cash flow comes from coal-fired assets in the province.

This problem is no longer that big of a deal. The province agreed to pay TransAlta \$37.4 million per year until 2030 for unfairly shortening the life of its assets. Now the company is just waiting for Alberta's power prices to recover for it to get another big boost.

In the meantime, TransAlta still generates a decent amount of free cash flow. Over its last four quarters, the company has produced \$363 million in free cash flow, putting shares at less than six times that metric.

It's also cheap on an asset basis. Shares trade at approximately 40% under book value. Or, to put it another way, TransAlta trades at about the value of its stake in **TransAlta Renewables**. Investors are getting all the legacy assets for free.

Dream Office

Dream Office Real Estate Investment Trst ([TSX:D.UN](#)) had a rough 2016. Management wrote off the value of much of the company's Albertan assets, and weak cash flow caused the company to slash its dividend by a third.

But 2017 should be much better. Alberta, a region that represents about 30% of the company's net operating income, is recovering. Management is looking to sell non-core assets and use the proceeds to strengthen the balance sheet. And the new dividend of 8% is easily sustainable.

And, perhaps most importantly, investors are buying at a significant asset and earnings discount. Dream shares trade hands at approximately 20% under book value and at just 7.2 times projected funds from operations for 2016. Stocks don't get much cheaper than that.

Fairfax Financial

Fairfax Financial Holdings Ltd. ([TSX:FFH](#)) is a little different than most insurance companies. CEO Prem Watsa has bet hard on both the stock market declining and deflation. When Donald Trump won the White House, equities rallied and inflation expectations increased. Thus, Fairfax shares sold off.

This represents a good opportunity to load up on a proven winner at a bargain price. Remember, Watsa has increased book value by nearly 20% per year since taking over more than 30 years ago. Insurance operations have improved as well. Fairfax is such a good underwriter that it regularly makes a profit on its insurance operations alone. Investment gains are gravy.

Fairfax shares are trading right around book value, a very reasonable valuation. Investors buying today are paying fair value for the assets while getting the management expertise of Prem Watsa for free. That's an investment I'll gladly make.

The bottom line

TransAlta, Dream Office REIT, and Fairfax Financial are all experiencing temporary problems, giving long-term investors the opportunity to pick up shares at a nice discount. Since all three companies are so cheap versus long-term averages, I think 2017 could see all three go significantly higher.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:TAC (TransAlta Corporation)
2. TSX:D.UN (Dream Office Real Estate Investment Trust)

3. TSX:FFH (Fairfax Financial Holdings Limited)
4. TSX:TA (TransAlta Corporation)

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