How to Catch a Falling Knife at Empire Company Limited

Description

For most investors who have been long the stock market, the past few months have been very exciting and very lucrative. For shareholders of **Empire Company Limited** (TSX:EMP.A), however, their tune will be much different this coming holiday season. Year-to-date, shares have fallen over 40% with almost half of this decline coming in just the past week. No one except the Grinch is happy about this.

Coal has been stuffed into many investors' stockings this year. It's just been that kind of year for shareholders of Empire Company Limited. Most of the time, coal under pressure leads to the expected, but every now and then something special happens.

"A diamond is but coal which performed well under pressure." -author unknown.

In a current state of comparison to a falling knife, Empire Company Limited is doing terribly. The 10-day, 50-day, and 200-day simple moving averages (SMAs) are all trending downwards without respite for many months. With no technical indicator to show a basis for any sort of bottom, this trade is currently very risky.

On a number of occasions in 2016, the 10-day and 50-day SMAs caught up with one another, and there was a potential for a bottom to form. Not once did the share price hold, reaching new bottoms every time.

Why is this time different?

As we are well aware, the lower a share price declines, the greater the yield offered to new buyers. In the case of Empire Company Limited, the current dividend of $0.10 per quarter translates to a yield of 2.67%. If you are not excited about this, you should be. Let me explain.

Since 2006, the dividend has increased every single year. In fact, the CAGR (compound annual growth rate) of the dividend has been 15.8% per year since 2006. This is a significant increase over an 11-year period. The average payout ratio since 2012 (excluding 2016) is 23.62%. In 2016 the company took a major write down due to an acquisition, and the net loss was $7.78 per share.

The CFO (cash from operations) has been consistent in 2016 with the previous three years, proving business is continuing as usual.

Is the dividend sustainable?

Excluding the loss in fiscal 2016, the company has been a consistent performer and a low dividend payer. At such a low price and a dividend payout which is significantly less than both the net earnings and the CFO, the company might be a big winner in 2017. It might be the diamond in the rough.

How do we enter the position?

In a risky situation like this, the right play is to ease into a position slowly. With no clear bottom, the best idea might be to figure out the total allocation to the security and split the amount over a number of different purchases–potentially three or four different entry points several weeks apart.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)

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