Will These Dividend Stocks Double in 2017?

Description

As 2016 draws to a close, many investors are taking advantage of tax-loss selling to reposition their portfolios for 2017. This means punting some of this year's biggest losers and buying stocks viewed as more stable.

But this may very well be the worst time to sell. Reversion to the mean is a powerful thing in investing. And many of these losers are statistically cheap. Some of the world's best investors have made careers of buying cheap stocks when they're out of favour and holding until things start to look better. It really can be that simple.

Unfortunately, that's easier said than done. There's a reason why these companies are undervalued: they've disappointed investors. Most have terrible near-term prospects. And it's hard to find a bullish analyst–folks who are paid a lot of money to fully examine all of the ins and outs of a particular business.

But for investors who are willing to be patient, these kinds of stocks represent significant upside. Here are two I'm keeping my eye on as the calendar turns from 2016 to 2017.

Empire Company

There are a lot of people suggesting that **Empire Company Limited** (TSX:EMP.A) might be permanently broken.

I'm the first to admit things look pretty bleak in the short term. The company bet big on Alberta with its 2014 acquisition of Safeway–a $5.8 billion deal that looks like a huge overpay today. It was a classic case of buying at the exact wrong time.

But at the same time, the company is cheap on a number of other metrics. It trades at approximately 14 times forward earnings expectations–a very reasonable valuation in today's market. Its price-to-sales and price-to-book value ratios are far below its peers too.

Here's the way I look at it.

Empire has an enterprise value of $6.1 billion today versus it paying $5.8 billion for Safeway. Was Safeway worth $5.8 billion? No. But as a sum of the parts, Empire continues to be cheap. I think it has nice upside potential for 2017, and the 2.7% dividend is a reward for waiting.

TransAlta

TransAlta Corporation (TSX:TA)(NYSE:TAC) shares are finally poised to do well in 2017 after several years in the dog house.

After more than a year of uncertainty surrounding Alberta's plan to move the province completely away from coal-fired power by 2030, the companies impacted by the decision reached a deal with the province. TransAlta will be receiving nearly $40 million per year until the 2030 deadline. This should give it at least a portion of the capital needed to convert some of its coal plants to natural gas and pay down some of its inflated debt load.

The other potential catalyst is an increase in spot power prices in the province. Even though most power is sold at fixed rates, floating rates can still have a big impact to the company's bottom line. Spot power prices are close to multi-year lows. Even a small improvement could be a big boost to the bottom line.

TransAlta has quietly generated $300 million in free cash flow over the last 12 months versus a market cap of less than $2.2 billion. Or, looking at it another way, the company trades for just barely more than its stake in **TransAlta Renewables** is worth. Investors are getting the legacy coal assets (plus much more) thrown in for free.

TransAlta shares currently yield 2.9%. After two separate dividend cuts, it looks as though the current dividend is sustainable. In fact, I wouldn't be surprised if management hiked the payout in 2017.

The bottom line

In today's fully valued market, it's hard to find bargains. Most stocks are quite expensive.

TransAlta and Empire Company are two rare exceptions. Sure, both don't really look that good in the short term, but I truly believe that both companies are poised to recover nicely in 2017. They're the kind of dividend stocks that could easily double.

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1. Dividend Stocks
2. Investing

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