How to Project Profits and Find Undervalued Opportunities

Description

Before making an investment, it is important to understand the price that is being paid per share in addition to what each share offers to investors. In certain circumstances, weighing out the share price and the dividend yield are very easy things, but when it comes to projecting profits into the next fiscal year, things can sometimes get complicated.

Luckily for many mature companies, projecting next-year profits is something that can sometimes be done fairly easily. For high-growth or cyclical companies, the task is much more difficult. Taking shares of **North West Company Inc.** (TSX:NWC) as as example, investors are able to reasonably estimate the future profits for the company for the next fiscal year.

When considering the amount of earnings and the amount of shareholders' equity over the past four years, the average return on equity (ROE) can be calculated to be approximately 20%. In fact, the ROEs for fiscal 2013 through 2016 were 20.7%, 19.3%, 20.3%, 21.3%, which is as consistent as ROEs can be.

As the shareholders' equity at the end of the previous fiscal year was $367 million, the calculation to arrive at the projected earnings per share (EPS) for the next fiscal year is:

[(ROE x shareholders' equity) / shares outstanding].

In the case of North West Company, the numbers work out as follows:

(20% x $367 million) / 48.54 million = projected EPS of $1.51.

The company has reported quarterly earnings of $0.31 and $0.17 in the first two quarters of the fiscal year. Although the first quarter met expectations, the company recognized some one-time expenses during the second quarter, leading to lower EPS. Given the defensive nature of North West Company, those making an investment in this company can set their own expectations with a few simple calculations. As North West Company is in the very defensive grocery business, earnings can be almost evenly spread over four quarters, leading to expectations of $0.38 in quarterly profits.

Given the current challenging operating environment for North West Company, this may be a case where investors want to look elsewhere for value. Investors need to find a company that will deliver!

When evaluating the same numbers for **Lassonde Industries Inc.** (TSX:LAS.A), the ROEs have averaged only 12.7%, but the company has delivered throughout the first half of the year. With the expectation of $9.85 in EPS for fiscal 2017, the company has delivered $4.62 during the first half of the year.

Although the company is fairly defensive, it should still be noted that one-third of last year's profits came in the fourth quarter. Clearly, there is a lot of potential left over for investors looking at this name!

As every company is required to report quarterly financial statements to the public, it is essential for investors to look behind the curtain and figure out just what is happening on a company's balance sheet. Although the act of investing and making money is exciting, it must never be forgotten to measure at least twice and cut once.

CATEGORY

1. Dividend Stocks
2. Investing
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2. TSX:NWC (The North West Company Inc.)

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