How to Identify Superior Growth Stocks

Description

Buying growth stocks can enhance your portfolio returns. Take a look at the price chart of **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP). Despite the stock dipping ~15% in the last few days — due largely to the release of a bearish report — amazingly, the stock is still up ~124% in the last 12 months.

One would invest in Shopify for its perceived bright future of riding on the e-commerce megatrend. The tech company has been growing its revenue at a rapid pace. In its latest quarter, Shopify's revenue was up nearly 75% from the same quarter in the prior year. However, the company is still losing money overall.

I think **Spin Master Corp.** (TSX:TOY) is a better growth stock. On top of growing revenue, it also has growing earnings and rising cash flow.

Growing revenue

In its latest quarter, Spin Master's revenue was up almost 55% from the same quarter in the previous year. And its 2016 revenue was 31% higher than it was in 2015.

Spin Master was founded in 1994 and became a publicly traded company in July 2015; since then, the stock has appreciated nearly 167%. The co-founders are still running the show and growing the company on four pillars: innovate across its business segments, increase sales in higher-growth markets, develop evergreen global entertainment properties, and make strategic acquisitions.

The results can be seen through its growing earnings.

Growing earnings

From 2015 to 2016, Spin Master's earnings per share increased by 16%. Analysts believe the company will continue growing its earnings per share by at least 13% per year for the next few years.

Growing cash flow

From 2015 to 2016, Spin Master increased its operating cash flow by 30%. Moreover, it has a pattern of growing free cash flow as well. In the trailing 12 months, the company generated US$80 million of free cash flow.

One more important metric

In the last two years, Spin Master had a return on equity of at least 41%. High returns on equity indicate management is allocating capital in the right places for high returns.

Is Spin Master a good buy now?

As recently as August, Spin Master launched its popular Hatchimals and PAW Patrol brands in China. Under current management, the company should remain a great growth stock.

At under $49 per share, Spin Master trades at a multiple of 24.3. Given its double-digit growth, the stock is reasonably valued.

Looking at the history of its stock price, you can see dramatic dips of ~10-20% from peak to trough. So, if you're looking for a bigger margin of safety, consider the stock on such dips.

Investor takeaway

To identify superior growth stocks, look for companies that grow their revenue, earnings, and cash flow at above-average rates. Such companies should also have high returns on equity and be trading at reasonable multiples. This kind of investment should lead to superior returns.

CATEGORY

1. Investing
2. Tech Stocks

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