The Latest Stock for the Buy-on-the-Dip Portfolio

Description

Indigo Books & Music Inc. (TSX:IDG) just might be one of the most frustrating stocks trading on the TSX. Despite nearing its five-year high of $19.50, it's up just 4.5% year to date — 230 basis points fewer than the TSX Composite Index.

How is it that Indigo, a company I recently called the retail stock to buy before the holidays, is doing so poorly, especially after delivering solid Q2 2017 earnings in early November?

Some stocks just trade this way, providing investors with a great company for the buy-on-the-dip (BOTD) portfolio.

Consider its five-year trading history

Anytime you're looking for a company to include in the BOTD portfolio, you want to go back and examine its five-year trading history to get an idea of the stock's little idiosyncrasies.

In the case of Indigo, it's had four monthly declines (calendar months) of more than 10% over the past five years: November 2013, February 2015, February 2016 and June 2016. Since the last one, IDG stock is up 13%, which trails the index by 200 basis points over 17 months.

The problem, of course, is you never know when the 10% dive is going to take place. Usually, it's around earnings, but that's not a certainty.

The plan of action

I believe that Indigo is a great stock to own for the long term, because it continues to do a good job building a more diverse business with revenues from things other than books, such as general merchandise items like toys, technology, and other lifestyle items.

In the latest quarter, general merchandise items accounted for 37% of Indigo's overall Q2 2018 revenue at $82 million. In the same quarter three years ago it was 27%, or $50.9 million.

It's not a coincidence that Indigo's operating loss was higher in fiscal 2015's second quarter when general merchandise revenues were lower. On an annual basis, it's gone from a $6 million operating loss in fiscal 2015 to an operating profit of $25 million in fiscal 2017.

With two strong quarters in the books in fiscal 2018, expect the operating profit to possibly hit $30 million — the highest it's been since fiscal 2010.

Bottom line on IDG stock

Financially, Indigo's never been stronger. It finished Q2 2018 with $171 million in cash and no debt on the balance sheet.

Indigo's stock's lost 10% or more of its value in February in two out of the last three years. Therefore, if you like Indigo as I do, you'll want to buy a half position today and keep some powder dry to see what happens this February.

Its business has been doing well lately, so it might not dip this time, but history suggests it will.

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