5 Reasons Why Earnings Quality Will Continue for This Dividend Stock

Description

Earnings per share (EPS) for this company grew 125% in the most recent quarter compared to a year ago. No, this is not some high-flying tech stock, but **Norbord Inc.** (TSX:OSB)(NYSE:OSB), a public company since 1995 that makes wood products that go into homes (think plywood).

Despite the impressive earnings report, this stock has fallen. Here are reasons for and against buying Norbord stock now.

In favour of Norbord

1. Although the stock is up 25% year to date, the stock is still fairly priced. The forward price-to-earnings ratio (P/E) is still deeply discounted. Compared to other companies in this sector, where the average P/E is 13, Norbord has a P/E closer to eight. (Read: value play)
2. The company has more free cash on hand this year than ever before.
3. Return on equity is currently 45%, which is both high for this sector and market-wide.
4. After a reported 1.3 million "housing starts" in the U.S., the next census report will be released Dec 19. This is an easy monthly index to follow. Although home building is looking favourable on both sides of the border, it is the U.S. market that should be the focal point for investors, because 91% of Norbord products end up being used in the U.S.
5. Norbord's stock price is down 7% in the last month; it's been down for about nine consecutive weeks. Why is this a good thing? The stock is currently holding at the 200-day simple moving average, and this is a classic sign of how far the stock is likely to drop.

Sell while you're ahead

Meanwhile, in August, **Brookfield Asset Management Inc.** announced it was decreasing its ownership in Norbord from 53% down to 40%. This may explain a lot of the stock price tumble, since 10 million shares were dumped to the market and have been up for grabs.

EPS were $4.42 in 2017, but the company estimates they will drop to $3.91 and $3.31 for 2018 and 2019. A patient investor could be rewarded if the 2020 EPS estimates were to pan out, because the company forecasts a jump up to $4.76. But you have to take this forecast with a grain of salt, since there are a lot of macroeconomic factors that could affect this company over the next three years.

Norbord's dividend history is choppy, with a four-year period where it seems the company paid zero dividend. Current yield is high and fairly robust at 4.27%, but there are more consistent dividend-paying stocks out there.

A counterpart in this sector

West Fraser Timber Co. Ltd. (TSX:WFT) would be another sensible investment choice in the sector. EPS over the last five years have been over 80%, which is higher than Norbord. West Fraser is a pure softwood lumber play, whereas Norbord provides more upstream products. West Fraser's stock could grow faster than Norbord, but without the dividend income. In recent years, West Fraser has had excellent months (positive 22% return) and bad ones (negative 23% return). These numbers are useful when thinking of your risk tolerance. Norbord has been steadier; its best- and worst-performing months were positive 26% and negative 16%, respectively.

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