3 Reasons to Get Excited About This Unloved Stock

Description

Onex Corporation (TSX:ONEX) announced its fourth-quarter earnings February 23, but the markets barely noticed. Despite delivering excellent results in 2017, Onex stock continues to tread water.

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Onex has been flat year-to-date after gains of 1.2% and 8.0% in 2017 and 2018, respectively. However, I believe there are many reasons to own this unloved stock. Here are three of them.

Reversion to the mean

The easiest way to describe reversion to the mean for beginner investors is to throw out the expression, "What goes up must come down." The expression refers to gravity, but reversion to the mean is essentially the same thing.

Whenever a stock's annual return gets too far ahead of its historical average or mean, it eventually reverts to that average or mean. In the case of Onex, it averaged an annual return of 25% between 2009 and 2015, which was almost double its 15-year return.

Since 2015, Onex has been averaging a 3% annual return, which is significantly lower than the stock's historical average. For the past three years it's been reverting to the mean, and I expect that it will do so again in the next 12 to 24 months, only to the upside. Nothing in its financial results suggests otherwise.

Onex Partners V

Onex makes money in two ways: through fees generated from the assets it manages for its limited partners and from the returns generated from capital invested in the operating companies it buys as part of its private equity operation.

In November 2017, Onex closed Onex Partners V, raising US$7.2 billion in investor commitments and thereby exceeding its target by US$700 million. As part of the raise, Onex put $2 billion of its own capital into the pot.

Over the past five years, Onex grew fee-generating assets by 20% annually and its capital per share by 10% per annum. At the end of 2012, capital per share was just over US$40; today, it's US$64.79.

Whenever you can increase these numbers over the long haul, investors can expect the share price to move higher.

Significant realizations

The private equity business is all about recycling capital.

You invest the capital, make the necessary improvements to the businesses acquired, grow them organically and through bolt-on acquisitions and then sell them for a nice profit; the process is then repeated.

In 2017, Onex' private equity business returned US$3.5 billion to its limited partners through the sale of several of its operating companies and distributions related to those realizations. Onex' portion was a little over US$1.0 billion.

Thanks to the recycling of capital along with new capital from Onex Partners V, the company has almost US$10 billion of dry powder to make acquisitions. With US$32 billion in assets under management including US$6.8 billion of its own capital, Onex' dry powder amounts to almost 30% of AUM, which means it's ready for the next correction in asset values.

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Bottom line on Onex stock

The entire Onex team has US$2 billion invested in the company's shares, its operating companies, and Onex' credit platform. The employees are putting their money where their mouths are, which is comforting for investors.

At the end of the day, Onex does not deserve to be this unloved. Eventually it will go on another winning streak. When it does, be prepared for some major gains.

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