Lumber Stocks Popped 3-7%: Is This the Start of a Sector Rally?

Description

Foolish investors that took my advice on January 17, when I'd recommended small-cap **CanWel Building Materials Group Ltd.** (TSX:CWX), would have ended the March 9th trading day up 7%.

Canfor Corporation (TSX:CFP) continues to rally into 2018. This stock popped 3.7% for the day and is now approaching its all-time high of $31.80.

West Fraser Timber Co. Ltd. (TSX:WFT) is another market beating lumber pick, up 3.6% in one day.

Should we be bullish on Canadian lumber stocks?

The U.S. is the largest importer of Canadian lumber — a trade relationship that primarily services the home-building industry. January 2018 home-building numbers were up 7% compared to 12 months prior. This is part of a larger, multi-year trend; the demand for homes continues to grow. Meanwhile, the price of softwood lumber has increased dramatically. This is a growing concern for home builders and a tailwind for lumber producers. According to the National Association of of Home Builders (USA), lumber and its installation cost account for 18% of the cost to build a new home. That is a decent chunk of the building budget.

Companies selling lumber to the U.S. last year ought to have made good money, and many did!

How did high-yielding **Norbord Inc.** (TSX:OSB)(NYSE:OSB) do on March 9th's punch up? It's up 3.2%. This $4 billion market cap company has a long history, with 76% of its business stemming from North American operations.

Here are some recent highlights.

Things to like about Norbord

Norbord pays a 4.7% dividend, but it has a healthy 31% payout ratio. In the lumber sector, where product takes decades to grow, an overly generous dividend should be seen as a red flag. There areno red flags here.

From a forward valuation point of view, Norbord is cheap. The forward price-to-earnings multiple will be eight if the company hits its earnings targets. This is not only far below its five-year average of 21, but also below the sector’s average.

Institutional ownership of this stock is high, which means this company is likely held in good regard among money managers.

Norbord caution

Company insiders have not been optimistically gobbling up more share. It has been the opposite, with management selling shares. Is this a sign that management does not expect stellar performance?

This stock got hammered during the subprime mortgage financial crisis. A decade later, the company is still far off its all-time high of $150 back in the 90s. This recovery is too slow for this stock to be considered a core holding.

As of February 2018, the company has roughly $550 million from two senior debt securities. For this borrowed money, the company pays 5.4% and 6.3% in interest (to bond holders), and these deals will close out in 2020 and 2023. Will Norbord continue to need to borrow? Likely not. The 2017 EBITDA was $650 million, which is strong earnings and could be used to settle up debts, just like what Norbord did on debt owing in 2017 for a previous bond.

Take-home message

Norbord has underperformed compared to competitors, but it now appears to be attractively priced. The secular tailwinds could give Norbord an added boost. The positive trend in home-building markets north and south of the border is a healthy sign for Canadian lumber producers.

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Date
2025/07/03
Date Created
2018/03/13
Author
bmacintosh