I Was Dead Wrong About This Grocery Stock

Description

Empire Company Limited (TSX:EMP.A) is a stock that I kick myself for not buying at the $15 per share level when I had the chance. It wasn't the kind of investment that I was used to. It was a turnaround, or contrarian play, if you will.

I thought the stock was fully valued at the time. Boy, was I dead wrong. In hindsight, I was wrong to compare its forward multiple with its long-term normal multiple. It seems that for a turnaround play, one should have focused on the potential growth (i.e., the recovery) of its earnings per share.

I was right about one thing though. In the same article linked above, I said, "To avoid catching a falling knife, interested investors are probably better off waiting for an uptick supported by strong volume before buying."

The "uptick supported by strong volume" occurred in March 2017 when the stock appreciated from ~$16 to ~$18 per share in a week. An investor who followed that suggestion would have seen their position appreciate ~35% in a year's time frame, and they would have avoided a falling knife. Generally, it's safer to invest this way in falling knives that have a good chance of recovery.

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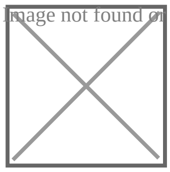

Recent results

Empire just reported its third-quarter results on Wednesday. The company saw a marked improvement in its diluted earnings per share, which were 2.5 times its earnings per share in the same quarter of 2016. This triggered a nice +4% pop on the stock.

From a technical point of view…

Notably, the stock appreciated as much as ~6.8% on the day. In other words, the pop lost steam as the trading day progressed. From a technical perspective, the trading action on Wednesday was non-conclusive.

What's positive is that the stock remains above the 200-day simple moving average, which is roughly at $23 per share. Investors should also note that there's strong resistance on the stock at ~$26 per share, and the stock needs to break that level to move higher.

How much higher can Empire go?

At $24.61 per share, Empire trades at a multiple of 22.6. However, its earnings per share are estimated to compound at a rate of 26% or higher for the next couple of years as a result of its earnings recovery. Its earnings per share are estimated to return to its fiscal 2016 level by fiscal 2019, which ends in April.

The analyst at Scotia Capital has a 12-month target of $30 per share on the stock, which represents nearly 22% upside potential. Moreover, the company offers a 1.7% yield. Seeing as Empire's earnings have been recovering nicely, management could very well increase the dividend more meaningfully than it did last year in July.

When Empire recovers its earnings per share to its previous high (expected by fiscal 2020), the stock should get to at least $30 per share. This would imply an annualized return of ~11.5%.

Investor takeaway

With Michael Medline, former president and CEO of **Canadian Tire**, at the helm, Empire should continue on its recovery. It looks like Empire is a $30 stock. We shall see if it gets there in a year or more (assuming normal market conditions).

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