Analyst Rates This Potential Market-Beating Growth Stock a Buy With +24% Upside

Description

Laurentian Bank analyst John Chu reportedly maintained his buy rating on **Ag Growth International Inc.** (TSX:AFN) on Thursday and increased his target price on the stock to $68 from $65, tipping the stock for a further 25.89% upside from its $54.02 trading price at market close on March 14.

The analyst update was made after Ag Growth delivered record-breaking fourth-quarter 2017 financial results that significantly beat analyst forecasts, prompting a mild rally of 2.2% on the lightly followed stock during trade on Thursday.

Ag Growth is a manufacturer of agricultural equipment, including seed, fertilizer, grain, feed and food handling, blending, and storage and conditioning equipment. The company's revenue is recognized in two categories: commercial and farm segments. The company has manufacturing facilities in Canada, the United States, South Africa, and Brazil, and Italy with a global distribution channel.

Strong growth outlook

On the back of stellar performance in 2017, where fourth-quarter revenues grew to 36.9% to $173 million year on year, Ag Growth management has given a very optimistic revenue-growth outlook for 2018, mentioning that the company has a record order backlog for 2018, just as it was at the end of 2013.

The strong growth outlook has strengthened the Laurentian Bank analyst's prior belief that Ag Growth's 2018 financial performance is poised to be great, thereby necessitating his upward revision of his price target on the stock from $65 a share to $68 and maintaining his buy rating on the stock.

Moreover, Ag Growth has generated massive growth mainly through acquisitions made in 2016 through 2017. Operational synergies and wider market reach will probably see the company accelerate its top-line and bottom-line growth going forward.

Potentially undervalued

John Chu strongly believes that on a forward-looking basis, Ag Growth equity is significantly undervalued. “Driven mostly by moving our valuation period to reflect 2019 earnings; 17 times P/E multiple is unchanged. AFN is trading at 16.5 times forward P/E (about an 8% discount to historical average of 18 times).” The analyst is quoted as saying to the *Globe and Mail*.

Complementary dividend

Ag Growth pays an attractive $0.20 dividend per share every month, which is good for a forward yield of 4.4% at the current $54.68 stock price — a great boost to the total return on the equity investment.

Favourable tax rates to boost bottom line

Ag Growth’s effective tax rate declined from 36.4% in 2016 to 25.5%, and management is optimistic that the company will see the rate decrease further in 2018 going forward as a result of U.S. tax reform.

Tread with caution

An investment in Ag Growth is not without risk.

The company significantly increased its leverage in 2017 to finance acquisitions. Total long-term debt increased from $207 million, or 23% of assets, in 2016, to $302.86 million (27% of assets) during 2017, and total corporate liabilities have increased to over 74% of corporate assets, up from 71% by the end of 2016.

Increasing leverage is good when the business maintains profitability growth but could hurt heavily should recent acquisitions fail to integrate well into the main business, synergies fail to materialize, and profitability suffers, threatening the dividend payout sustainability.

However, the majority of the company’s long-term debt will fall due in 2021, giving management some time to deal with the future obligations without panic.

Investor takeaway

There is some impressive growth happening at Ag Growth, and analysts and investors are taking notice. While the consensus price target on the stock gives it a big +24% upside, investors must look for possible catalysts that would drive the share price to this target level.

That said, opening a long-term position on the growing stock could be rewarding over the next three to five years, as management consolidates recently acquired assets into the fold, potential synergies get realized, and the company expands global market reach and improves bottom-line margins.

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Date
2025/08/25
Date Created
2018/03/16
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