Should You Buy This Quebec Company Trading at Less Than Book Value?

Description

There are a lot of great Quebec stocks — something I've written about several times over the last couple of years, most recently in April when I recommended **Lassonde Industries Inc.** (TSX:LAS.A), **Stella-Jones Inc.** (TSX:SJ), and **Richelieu Hardware Ltd.** (TSX:RCH).

However, none of these three stocks trades for less than 2.8 times book value, let alone below book value. All great stocks, the trio is representative of the idea that you pay a little more for quality.

Buying stocks trading below book value is difficult to do in a market where the average TSX stock is trading at 1.8 times book value. A quick screen suggests there are currently 67 TSX stocks with a P/B less than one.

In January, Fool contributor David Jagielski examined three stocks trading below book value and liked two of them, so it is possible to find good companies with stocks trading below book value.

Quebec's leisure company

One of the 67 stocks in the stock screen mentioned above is Montreal-based **Dorel Industries Inc.** (TSX:DII.B), a manufacturer of strollers, infant car seats, bikes, and home furniture. It currently trades at just 0.6 times book value, which means its stock price is less than the company's net worth (total assets minus total liabilities).

The father of value investing, Ben Graham, loved these kinds of situations, because the math always came out in the wash. To take this one step further, Graham looked for companies that were trading at less than 66% of their net current asset value, which is defined as current assets less total liabilities. There are even fewer of these value plays today.

FYI, Dorel has a net current asset value of -$33 million, so not even its stock, which is trading at less than book, would be of interest to Graham.

Should you buy Dorel?

If you just go by the P/B ratio, the answer would be yes.

However, nothing in life is that simple. You also need to assess the health of its business and its ability to grow sufficiently to make the potential reward worth the downside risk.

In early January, I'd suggested that Dorel, one of the dogs of the TSX in 2017, had a 50/50 chance of rebounding in 2018. More than four months into the year, it's going in the opposite direction, down 18% year to date through May 8.

In the past, Dorel has had moments of brilliance — up 29% in 2016 and 44% in 2012 — but the rest of the time it's been hopeless, seriously underperforming the TSX, which hasn't exactly warranted positive press in recent years.

On May 4, Dorel announced weak Q1 2018 earnings that included a US$12.5 million impairment as a result of the bankruptcy of Toys "R" Us in the U.S. Excluding this impairment and other one-time items, Dorel earned US$15 million on US$642 million in revenue. While revenues were flat year over year, earnings declined by 35% from a year earlier.

In the past decade, Dorel's best year in terms of operating income was 2010, when it made US$161 million on US$2.3 billion in revenue, an operating margin of 6.9%. It closed out 2010 with a market cap of $1.15 billion.

Today, Dorel has operating profits of US$119 million on US$2.6 billion in revenue, an operating margin of 4.6%, or 230 basis points less than in 2010. It currently has a market cap of $818 million.

The bottom line on Dorel

If you consider 2010 vs. 2018, it's easy to see why its market cap today is 30% less than it was eight years ago. If you look at the company's P/B valuation in 2010 — Dorel stock traded at one times book back then compared to 0.6 times book today — you ought to come to a slightly different conclusion.

Disappointed by Dorel's performance the last two years, I'd be hesitant to wholeheartedly recommend its stock. However, I don't think there's any question it's a potential value play, but I'd only place a bet if you can afford to lose the money and don't need the funds for the next two to three years at the earliest.

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2. TSX:LAS.A (Lassonde Industries Inc.)
3. TSX:RCH (Richelieu Hardware Ltd.)

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