



## This Capital Goods Stock Is Ready to Bust Out

### Description

**Stella-Jones Inc.** ([TSX:SJ](#)), the Quebec-based manufacturer of wood railway ties and hydro poles, has gotten lost in recent years as news stories about the cannabis industry have taken centre stage in Canada.

So, I was happy to see a Fool contributor other than myself writing about the wood products company recently. Ambrose O’Callaghan included it in a group of four manufacturers that offer up a tasty dividend.

“Sales climbed 0.5% year over year to \$398.8 million in the first quarter. In Q1 the company acquired Prairie Forest Products in Manitoba and Virginia-based Wood Preservers Incorporated,” O’Callaghan [wrote](#) May 23. “A higher Canadian dollar weighed on sales, but Fed tightening south of the border and NAFTA anxiety could generate continued downward pressure in the latter half of 2018.”

You see, Stella-Jones sells 70% of its products in the U.S., so any uptick in the Canadian dollar means lower revenues when those sales are converted to Canadian dollars. Like most Canadian exporters, a lower dollar is a boon to revenue and profits.

### The 30% Club

I first discussed Stella-Jones in September 2016, congratulating it for having joined the 30% Club — an organization that’s focused on boosting gender diversity amongst businesses around the world — by appointing a third woman to its board and in doing, so bringing the number of women up to the magical 30%.

“MSCI studied more than 4,000 companies between December 2009 and August 2015,” I [wrote](#) September 16, 2016. “It found that companies with strong female leadership (three women board members or more) generated an annual return on equity of 10.1%, 270 basis points better than those with fewer than three women board members.”

I’ve been writing about Stella-Jones ever since.

I most recently discussed its stock in April, [suggesting](#) that with the North American economy going strong, eight consecutive years of dividend increases, and a group of products that aren’t going to

disappear anytime soon, now is the time to buy the company's stock that's been range bound since the beginning of 2016, trading between \$42 and \$52.

I'm a fan of Quebec-based companies and Stella-Jones; although operating in a boring business, this is one of the better ones.

### **I'm not the only fan**

CIBC World Markets analyst Hamir Patel initiated coverage of Stella-Jones June 5, with an "outperformer" rating and a 12-month target price of \$55, 15% higher than where it currently trades.

Patel feels railroads and utilities are going to start buying more railway ties and hydro poles in the second half of 2018, leading to more robust organic growth, something it hasn't seen for a while. As a result, the healthy margins it generates from its wide-moat business will begin to return.

"Due to safety concerns, railroads and utility companies tend to be cautious about deferring replacement spending on ties and poles," Patel wrote in a recent note to clients. "Over 2017-2020, we foresee SJ growing EBITDA at a CAGR [compound annual growth rate] of 9.3 per cent, with EBITDA margins expanding from 12.8 per cent to 14.5 per cent over this period (which may even prove conservative considering margins averaged 15.5 per cent over 2012-2016)."

### **The bottom line on Stella-Jones**

The company has 50% and 40% market share in railway ties and hydro poles, respectively. Once the orders start growing again, investors can expect the earnings revisions to come rolling in.

The stock has a current free cash flow yield of 6.6%. Anything over 8% is considered value territory. By the end of 2018, I wouldn't be surprised if it wasn't sporting an FCF yield of 10% or more.

Come the fall, look for good things to happen for Stella-Jones' stock, with it testing its all-time high of \$54 sometime in the first half of 2019.

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