This Stock Is Hitting All-Time Highs: Here's Why There's 18% More Upside to Come

Description

We Fools don't put too much weight on Wall Street ratings. The long-term track record of analyst calls is mixed at best, so it's crucial to do your own homework.

That said, assessing the *reasoning* behind a particular upgrade or downgrade can be extremely helpful. If the case makes sense, you might be on to a legitimate opportunity.

Methanex (TSX:MX)(NASDAQ:MEOH) could be one of those situations. Shares of the methanol producer are hitting all-time highs thanks in part to a favourable opinion from Wall Street last week.

Let's take a closer look, shall we?

The upgrade

Raymond James upgraded Methanex from "market perform" to "outperform" last Thursday, boosting the stock as much as 6%. Along with the upgrade, Raymond James analyst Steve Hansen raised his price target on the stock to US$90 from US$72, representing about 18% worth of upside from where it sits today.

So, why is Hansen so bullish on the shares? Simple: it all boils down to the price of methanol.

Hansen notes that methanol prices have remained remarkably resilient in 2018, despite several headwinds. In addition, methanol's forward price looks increasingly positive. Thus, Hansen expects a favourable impact on Methanex's earnings and free cash flow profile over the medium term.

Fundamental strength

To be sure, Raymond James isn't exactly going out on the limb with this call. The bullish stance also reflects Methanex's recent operating results and capital returns, which have been rock solid.

In Q2, for instance, the company posted earnings of $143 million as revenue jumped 42% to $950 million. Management cited healthy methanol demand from energy-related and traditional chemical applications as well several industry production outages for the tight market conditions.

During the quarter, management also returned a whopping $241 million to shareholders through stock buybacks and its regular dividend. Over the first half of 2018, the company has bought back 3.85 million common shares of the 6.6 million approved under its share-repurchase program.

“Our balanced approach to capital allocation remains unchanged,” said president and CEO John Floren. “We believe we are well positioned to meet our financial commitments, pursue our growth opportunities and deliver on our commitment to return excess cash to shareholders through dividends and share repurchases.”

So, while Raymond James’s upgrade has helped lift the stock in recent days, Methanex already had some pretty strong operating *and* price momentum working in its favour. In fact, Methanex shares are now up more than 150% over the past two years.

The bottom line

I wouldn’t buy Methanex based on Raymond James’s upgrade alone. Sure, the price of methanol has held up well, and its forward price certainly looks positive, but to me, that’s too speculative of a reason to take a chance on the stock.

What’s far more important is Methanex’s shareholder friendliness and current valuation. As I mentioned, management does a solid job of returning capital to shareholders. And with a dividend yield of 1.8%, along with a PEG ratio of 0.7, the stock doesn’t seem overly expensive, even after this recent run.

So, overall, I’d view Methanex as a well-managed dividend play with some attractive tailwinds at its back, as opposed to a pure bet on methanol prices. In other words, it’s a solid *long-term* opportunity.

Fool on.

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