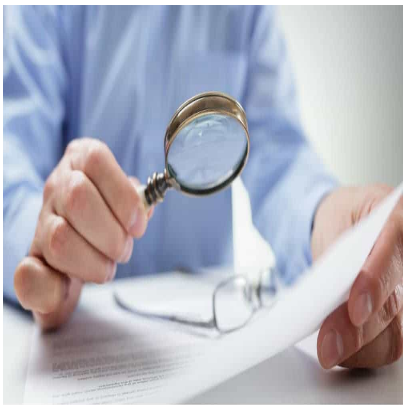

Is This 9% Yielding Stock Worth the Risk?

Description

Often, buying shares of companies with strong branding can be a great way to build wealth over the long term. Some companies own a virtual treasure trove of brands that many consumers can recognize. When these companies fall out of favour, investors can sometimes make out like bandits by purchasing the shares of these companies at a massive discount to their brand value.

But determining whether a company is a worthwhile investment or a falling knife can be difficult. To do so, it becomes necessary to dive into the company's balance sheet and income statement to determine whether these are valuable opportunities or value traps.

Dorel Industries Inc. (TSX:DII.B) is one example of a potentially mouth-watering value opportunity. The company owns a number of highly recognizable baby brands like Cosco, Maxi-Cosi, and Safety 1st. Its sports products like the Cannondale and Schwinn bike brands are used by recreational and professional athletes alike. The company also owns a number of home brands throughout North America. This brand portfolio certainly offers significant value.

It also appears to be a significant value play. Currently, the company is trading at a trailing price to earnings ratio of 14 times earnings and a price to book of 0.4. This kind of cheap stock makes value investors drool. Add that cheap valuation to a dividend of just under 10% and things are starting to look very attractive.

But is the stock unreasonably cheap or is it cheap for a reason? Unfortunately, this stock might be cheap for a reason. Its book value is low, but it you drill into the balance sheet, you will soon discover that a large amount of its book value is attributed to goodwill. Goodwill is largely the proclaimed value of the company's intangible assets, such as the value of the Schwinn name. In fact, Dorel's goodwill is valued at far more than the company's tangible assets like its plants and equipment.

On the positive side, revenue has not been shrinking, thereby indicating potential positive momentum, as there is continued demand for Dorel's products. In the third quarter of 2018, Dorel grew its revenue by 4.3%. Unfortunately, the earnings side was not positive. Net income decreased 27.8% year-over-year in the third quarter, which was in large part due to the negative impact of the demise of Toys R Us. The tariffs imposed by the United States and China also impacted 2018 results, and will most likely continue to do so for the foreseeable future.

Dorel is a tempting value play that bottom-feeding contrarian investors might want to consider. It's admittedly a high-risk investment, but its well-known, desirable brands and low valuation are potentially attractive at this price point. The factors that have negatively impacted the company, such as the bankruptcy of Toys R Us and U.S.-China trade relations are important, but over the long term, they may do nothing more than offer potential investors a point to buy in.

But if you buy into this stock keep in mind that you might be in for a bumpy ride. The 9% dividend yield is most likely not safe at these levels, although you could get lucky. If you purchase this stock, you no doubt believe in the strength of the brands. This is a contrarian investment that's only appropriate for high-risk investors who are looking for undervalued stocks.

CATEGORY

1. Dividend Stocks
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