



Is This Cyclical Stock at Its Absolutely Lowest Levels?

Description

Are you looking to make strong capital gains with forestry stocks? If so, **Western Forest Products** ([TSX:WEF](#)) may be a good stock for further research. It offers decent income while you wait for price appreciation.

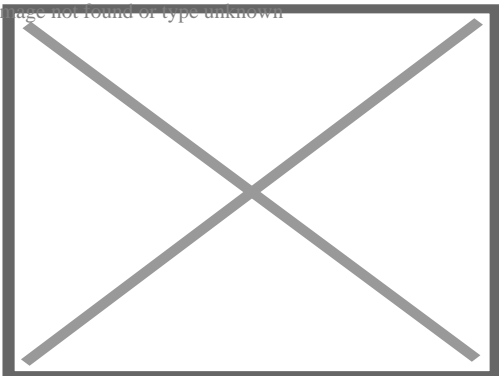
Let's explore the idea.

About Western Forest Products

Western Forest Products supplies quality and sustainable building products. Its lumber products include western red cedar and specialty lumber made for specific uses in Japan. The company's market cap is about \$710 million.

In 2018, 59% of Western Forest Products' sales were specialty lumber, 21% were commodity lumber, 13% were logs, and 7% were by-products.

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From 2015 to 2018, it increased its sales at a compound annual growth rate of 3.4%, while its net income declined more than 2% per year in the period.

In the past two years, its adjusted earnings before interest, taxes, depreciation, and amortization

(EBITDA) declined 1.6% per year. Additionally, its adjusted EBITDA margin oscillated between 12% and 13.3% in the period, ending at 12% in 2018.

Cyclicality

Here's the normalized five-year price chart of Western Forest Products compared to the Canadian market. You can easily tell that the forest product stock is more volatile than average. So, the adage of buying low and selling high is of utmost importance when it comes to investing in this forestry stock.



WEF data by YCharts. Price chart comparison between TSX:WEF and TSX:XIU.

Just like its oscillating earnings and EBITDA margin, its operating cash flow from 2015 to 2018 experienced something similar. Operating cash flow was between \$118.2-134.4 million in the period, ending at \$118.2 million in 2018.

Western Forest Products stock has traded largely in a range for a number of years. Right now, it's trading close to the bottom of that range, so it may be a good time to pick up some shares.

Valuation and upside potential

At \$1.85 per share as of writing, Western Forest Products trades at about 10.3 times 2018 earnings and about 6.1 times cash flow. At a normalized level, the stock had traded at 11 times earnings and about 7.6 times operating cash flow. These are target prices of \$2.03 and \$2.32 per share, respectively, and imply upside potential of roughly 10-25%.

Thomson Reuters is more optimistic about the stock. Currently, it has a 12-month mean target of

\$2.42 per share on Western Forest Products, which represents near-term upside potential of nearly 31%.

Dividend

Investors should note that Western Forest Products started a dividend in 2013, and it has maintained or increased the dividend since then. As of writing, the forest products company offers a juicy yield of 4.8%.

In 2018, the company paid out 29% of operating cash flow and 148% of free cash flow as dividends.

Investor takeaway

Western Forest Product's growth relies more or less on lumber prices. Furthermore, the company competes with domestic and global producers, of which some could have greater competitive advantages in terms of having lower production costs or greater financial resources.

Western Forest Product is in [a cyclical business](#) that relies somewhat on commodity pricing. Therefore, it's going to be tough for investors to invest in the stock.

That said, Western Forest Products has a clean balance sheet with only \$6 million of long-term debt at the end of 2018. And it offers double-digit upside potential while paying a yield of about 4.8%.

Adventurous investors may choose to bet a small amount in the mildly [discounted stock](#). Cautious investors should first wait to see if the stock will break below the \$1.60-1.80 per share level before investing.

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1. Dividend Stocks
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