Get Promising Growth From This Proven Dividend Stock

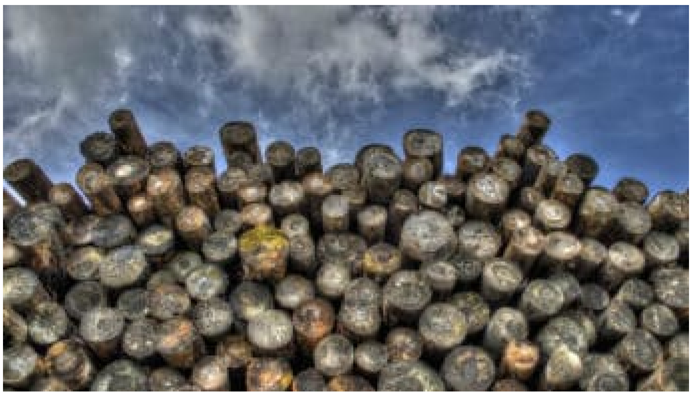
Description

After correcting about 11% from its high, **Stella-Jones** (TSX:SJ) stock is worth another look by investors who are seeking a quality, growth-focused dividend stock.

Much of the negative sentiment around the stock had to do with the news of president and CEO Brian McManus stepping down from his roles on October 11.

McManus has helped drive tremendous shareholder value over the past 18 years, during which the stock delivered total returns of just under 28% per year! Eric Vachon, who has been with the company for 12 years and currently serves as VP and CFO, will serve as interim CEO.

SJ stock is starting to look attractive. At about $42.55 per share as of writing, it trades at a forward price-to-earnings ratio of about 17.2. Analysts have an average price target of $52.88, which represents 24% near-term upside potential.



The business

Stella-Jones is the North American leader in manufacturing pressure-treated wood products. It has wood-treating facilities at strategic locations in the United States and Canada.

SJ is known to make strategic acquisitions as a part of its growth plan. For example, in April, it completed a tuck-in acquisition in Ontario, which helped expand its residential lumber operations in Canada. These operations contributed 13% of sales in the first quarter.

Stella-Jones's primary products are utility poles (39% of sales in Q1) and railway ties (37%). So, its key customers include America's largest railroads, telecom providers, and electrical transmission utilities. As railroads, telecoms, and utilities are essential for the economy, so is Stella-Jones, which ensure their safe operations.

Profitability

Revenue growth tends to help earnings grow. So, generally, it's better to invest in businesses that grow their revenues over time. Stella-Jones's three-year revenue growth is just under 11% per year, which is quite good. Its trailing 12-month (TTM) revenue is more than $2.1 billion.

Over the past three years, the company's EBITDA, a cash flow proxy, has essentially remained flat at about $244 million. It had largely to do with margins compression due to several reasons, including higher lumber costs and softer pricing for utility poles and railway ties in certain regions.

Specifically, its EBITDA margin fell 410 basis points to 11.5% from 2015 to 2018. This also resulted in earnings per share decline of -3% over the period.

Thankfully, the company saw its EBITDA margin rebound to 14.5% in the first quarter. And this year, its margins are expected to be higher year over year with improvements across all product categories.

Higher margins will primarily be driven by increased pricing and volume for railway ties coupled with improved product mix for utility poles.

Dividend

Investors should focus on SJ stock's dividend growth and not its yield. The company offers a small yield of 1.3% as of writing, but its dividend growth has been phenomenal — a compound annual growth rate of just under 25% since 2004. Its five-year dividend-growth rate of just below 15% was still very impressive.

From 2015 to 2018, SJ stock paid out less than 28% of its free cash flow as dividends. So, its payout ratio of about 61% in the TTM will likely be a temporary circumstance.

Foolish takeaway

If you're looking for above-average growth in stock price appreciation and dividend growth, consider scaling in the stock of well-run Stella-Jones. It'll be even more attractive should the stock dip close to or below $40 per share.

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Date
2025/07/02
Date Created
2019/07/22
Author
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