Can This Stock Achieve its 20% Annual Growth Target?

Description

Even as interest rates remain historically low and economic growth slows to a crawl, investment firm **Brookfield Business Partners** (TSX:BBU.UN)(NYSE:BBU) has set itself an ambitious target: 15-20% annual growth in underlying assets.

The firm is an independent subsidiary of the **Brookfield Asset Management** investment group that focuses on industrial and business service companies across the world. It acquires small- and mid-sized businesses and deploys capital and operational expertise to improve efficiency, expand margins, and increase cash flow.

The improvements in operations and finances of the underlying firms are ultimately reflected in Brookfield's steadily expanding book value and stock price. With over 100 investment professionals on the payroll, decades of experience, and over $7.7 billion in capital, the management team is confident it can deliver double-digit growth for its shareholders over the long term.

However, as economic growth slows across the world and even Warren Buffett struggles to perform, a 20% growth target seems too good to be true. Investors need to consider the company's track record, portfolio positions, and valuation to make a fair assessment of Brookfield's potential.

Track record

BBP's track record is complicated by the fact that it is a spin-off of a much larger and more established investment group. Brookfield Asset Management completed the spin-off in mid-2016. Over the past three years, the company has managed to more than double assets, funds from operations (FFO), and earnings before taxes, interest, depreciation, and amortization (EBITDA).

100% growth in three years implies an annually compounded growth rate of 25%, which means BBP has exceeded its long-term growth target over the first few years of its existence as an independent public company.

Portfolio

According to the company’s latest annual report, 64% of the portfolio is split evenly between assets in Europe and North America. Asia accounts for 10%, while South America accounts for 20% of the portfolio, with the balance invested in the Middle East.

BBP’s largest holdings are concentrated in industrial operators, like graphite electrode leader GrafTech, and infrastructure providers, like nuclear power plant service provider Westinghouse. Over time, management says it will add new sectors and diversify the portfolio further.

A combination of high barriers to entry and steady cash flows make BBP’s underlying portfolio much more robust. With its access to leverage, resources of the parent company, focus on alternative assets with high barriers to entry, and international diversification, I believe a steady double-digit growth rate is certainly possible.

Valuation

According to the company’s latest report, it is on track to sustain a $1.3 billion FFO run rate this year. Meanwhile, the company’s market capitalization is $4.1 billion, which means the stock trades at a price-to-FFO ratio of 3.15.

That’s surprisingly low for a company that has proven its ability to create value and sustain double-digit growth rates. Part of the reason for this undervaluation could be BBP’s less-than-impressive dividend yield. At just 0.64%, this stock will barely move the needle for income-seeking investors. However, as cash flows expand over time, I would expect this dividend payout to steadily climb as well.

I believe BBP is grossly undervalued and deserves closer attention from long-term investors.

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