Value Investors: After a Big Decline, This Stock Is Tantalizingly Cheap

Description

Earnings season can be an aggravating time for investors, especially when one of their stocks reports a crummy quarter.

It's easy to say it's just a short-term blip and the decline is a buying opportunity, but it's tough to execute the strategy. It's against human nature to buy something that has just fallen. And besides, often the stock market is right and a company deserves its fate.

The issue is determining the difference between a temporary drop and a permanent long-term decline. The former is exciting. The latter means it's time to sell, immediately. It isn't easy to determine between the two, which is half the fun of investing.

Let's take a little time to analyze a stock that just fell 30% on poor earnings. Is it permanently damaged? Or is today a buying opportunity? Let's take a closer look.

Enter Medical Facilities

Medical Facilities (TSX:DR) is a consolidator of specialty hospitals in the United States. It's been a growth-by-acquisition story, as management works with doctors who want to own a percentage of their clinic. It's a mutually beneficial relationship; the doctors provide valuable advice gained from their years of hands-on experience, and giving them an ownership stake is a great incentive to achieve better overall results.

These facilities are a little different than the usual landlord-tenant relationship. Hospitals in the United States get paid per procedure, either by the various parts of the U.S. government or by private insurance. Medicare and Medicaid are major sources of revenue for Medical Facilities because so many procedures are done to older folks.

Normally, this is a pretty solid business. People are always getting sick, and you won't find manypeople who aren't willing to invest in their health. But lately, Medical Facilities has been running into afew issues.

In its most recent quarter, these issues exposed themselves in a big way. Revenue decreased 5.2% versus the same quarter last year. Adjusted EBITDA was down nearly US$5 million, which reflects a decline of approximately 25%. The company took a one-time non-cash charge of US$29.5 million on the value of one of its hospitals, too.

Naturally, this translated into bad news for the company's payout ratio. Medical Facilities pays out virtually all of its earnings back to shareholders during a good quarter. This recent poor quarter pushed the payout ratio up to 180% of distributable cash, although management was quick to say this was just a one-time blip, and the payout ratio should go back to a more manageable level soon. Still, it was enough to lead investors to speculate the company would soon cut its generous 13% dividend.

The good news

Looking over a longer-term view, Medical Facilities is still a solid business that's now trading at an insanely cheap valuation.

Over the last year, the company generated $1.22 per share in distributable income, which we'll use as a proxy for earnings. The stock trades at $8.13 per share as I write this. That gives us a price-to-earnings ratio of under seven times.

The bottom line should improve over the long term, too. The company has nearly US$50 million in cash on its balance sheet that can be used for further acquisitions, and it recently announced it will have a stake in a new hospital being built in a St. Louis suburb.

And even if the company slashes the dividend in half — which might be prudent — investors can still enjoy a 6.5% yield while waiting for the business to recover.

The bottom line? Today is a good buying opportunity for long-term investors. Even if the future might seem bleak.

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