This Insanely Cheap Dividend Stock Is Poised to Soar in 2020

Description

Value investing is beginning to make a comeback, and long-suffering investors are thrilled about it.

I'd argue value investing never really died in the first place, it just evolved into the Warren Buffett-inspired model of buying excellent companies at reasonable prices. Many traditional value investments, meanwhile, continue to be cheap because no one really wants to own them. They're cheap for a very good reason, in other words.

But every now and again, a good company falls through the cracks and becomes obscenely cheap. I believe we have that situation today with **Transcontinental** (TSX:TCL.A). Let's take a closer look at this opportunity.

The skinny

Transcontinental has really transformed itself over the last five years. It has gone from a strictly printing business — printing everything from newspapers and flyers to magazines and paperback books — into a diverse company with significant packaging assets.

The big acquisition to push the company into the packaging space was its 2018 deal to buy Coveris Americas, a US$1.3 billion deal that effectively doubled the size of the company. Coveris Americas's products included all sorts of different products, including fruit bags, shrink bags for meat products, and even packaging for bags of dog food.

There were just a couple of problems with the big acquisition. Many investors thought the price tag of 10.3 times the company's trailing EBITDA was a little much. Transcontinental was forced to take on a lot of debt to finance the deal, which it's still having to deal with 18 months later. And, most importantly, the new crown jewel hasn't been performing up to expectations, which has pushed Transcontinental's overall profitability lower.

This has caused shares to crater. The company's stock was approximately $30 per share when the deal was announced. After a series of disappointing quarters created selling pressure, Transcontinental shares bottomed under $14 each. That's a decline of more than 50% in just over a year. Ouch.

The good news is the company just got a boost from its most recent quarter. Revenues did slip by 3% on a year-over-year basis, but EBITDA and adjusted earnings did increase. And cash flow from operations got a big boost, jumping 17%. The company also booked US$75 million on the sale of a building in California, the proceeds of which will be used to pay down debt.

Investors must remember that even through this transformation, Transcontinental still generates gobs of profit. Over its last four quarters, the company has generated $2.72 in adjusted net earnings per share. That puts shares at just 5.8 times adjusted earnings, which is insanely cheap. Analysts predict earnings will stay in the $2.50-per-share range for 2019 and 2020, too.

Get paid to wait

Transcontinental has quietly amassed one of Canada's top dividend-growth streaks. It has hiked the dividend by an average rate of 11% each year from 1993 to 2019.

Dividend growth will likely be closer to the 5% range over the next few years, as the company pays down the debt acquired from the Coveris Americas deal, but that is offset by what's become a very enticing dividend yield. The stock yields a very succulent 5.6%.

Sometimes, a struggling company like Transcontinental will slash the dividend. I don't think that's likely to happen here. Remember, the payout ratio is still a very reasonable 32% of adjusted earnings.

The bottom line

At some point, Transcontinental will emerge from this tough situation victorious, posting excellent results from its latest prized acquisition. When that happens, shares could easily flirt with $30 again, representing upside of close to 100%.

The only problem is, we don't know when this will happen. I think the company has begun to turn the corner and 2020 will be a great year, but I might be premature. This is why if you're interested in the opportunity you must buy shares today, before the good news comes out. By the time that happens, it'll mostly be too late.

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