TFSA Investors: 3 Telltale Signs of a Potential Multibagger

Description

Have you ever turned $10 into $100 — or even $1000? If you've been investing for at least a few decades, you've probably seen some stocks deliver those multi-fold returns. However, spotting these so-called multibaggers early is extremely difficult.

There's simply no way to tell whether a company is going to fail miserably or deliver single-digit returns for the next few decades, forever doomed to grow at a snail's pace.

Nevertheless, there are some telltale signs of potential multibaggers that every growth-oriented investor should be aware of. Here are the top three.

Massive market size

Investors tend to overlook the importance of market size when considering growth stocks. If the market is limited, there's simply no way a company can exceed it.

Take the Canadian telecommunications market, for example. In 2019, the industry's total revenue was $67.6 billion. The top three companies dominate the market and split tens of billions in revenue between them, which means their growth prospects are limited to the growth of the overall market: a mere 1.5% to 2% annual growth.

It's safe to say a major telecom stock isn't going to deliver a multifold return. However, smaller companies in bigger markets, such as **Shopify** (market value: US$57 billion) in global ecommerce (worth $29 trillion) or **Maxar Technologies** (market value: $1 billion) in the commercial space sector (worth $262 billion) have much better chances of delivering jaw-dropping growth rates.

Relatively higher valuations

Another defining feature of potential multibaggers is that they tend to trade at seemingly unreasonable valuations. Shopify, for example, has always traded at a high price-to-operational earnings ratio. It currently trades at 20 times book value and 40 times sales per share.

In recent years, demand for growth stocks seems to have outpaced supply. High valuations are a natural consequence, and it appears that growth-seeking investors may have to simply pay the price for these rare commodities.

As Warren Buffett once said, “It’s better to pay a fair price for an excellent company than pay a great price for a mediocre one.”

Durable competitive advantages

No matter how large a market or industry, no company can sustain long-term growth without some competitive advantage. Every hyper-growth company offers a unique service or irreplaceable good that helps it dominate the market.

These advantages could be tangible (such as property or rare equipment) or intellectual (such as patents, copyrights or exclusive deals with major partners).

Shopify is trying to create a competitive advantage by building out a fulfillment network, while **Drone Delivery Canada** has exclusive deals with airlines and **Open Text** has proprietary software.

These competitive advantages secure the company’s long-term growth and help its stock deliver multi-fold returns to investors who’ve taken the time to understand the market potential and business model.

Bottom line

It’s impossible to predict whether a stock will deliver multi-fold returns quickly. However, small companies in relatively large markets with high valuations and competitive advantages usually grow much faster than the average corporation. Growth-seeking investors need to monitor these stocks closely.

Even a few well-chosen multibagger stocks can make a drastic difference to your overall performance.

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