1 TSX Stock That Can Beat the Market in 2020

Description

When I had written about this stock on April 1, it was trading around $30. Today, it has increased by 10% to over $33 a share. A 10% increase in less than two months is a good return during normal markets. In a market affected by a pandemic, it's a fabulous return. And this increase isn't just because all stocks had dropped in March. The company I am writing about is a business that will continue to function at optimum capacity in good times and bad.

Stella-Jones (TSX:SJ) supplies North America's telecommunications and electrical companies with utility poles and railroad operators with railway ties and timbers. It also supplies lumber for residential and commercial applications, including marine applications. Most of its business hasn't been impacted by the pandemic.

The company's services have been deemed essential, and this has reflected in its reported numbers for the first quarter of 2020. Sales for Q1 hit a record of $503 million, up $62 million, or 14%, compared to $441 million in the same period in 2019. Gross profit was $80 million, up 19% from last year's $70 million. However, EBITDA remained stable at $63 million, negatively impacted by a $7 million mark-to-market loss on diesel derivative financial instruments.

COVID-19 impact on this TSX stock

The good numbers aside, even a company like Stella-Jones won't be immune to the impact of COVID-19. The second quarter, which has traditionally been a growth quarter for the company will take a hit in 2020. The company has said as much.

It expects a slight decline or no improvement in sales for utility poles, railway ties, and other industrial product categories. It expects weaker demand for residential lumber. At $71 million, residential lumber accounted for 14% of Stella-Jones's Q1 sales. This was due to increased demand in both Canada and North America. Expect this number to be significantly lower in Q2.

Stella-Jones has lowered its EBITDA expectation by $20 million, to between $300 million to $325 million for 2020. EBITDA margins will also be lower. The company expects that for EBITDA to settle on the lower end of the estimate, the economy would have to be impacted severely. It is likely that cash flows will be in the range of $310 million to $315 million.

The company's forecast is also reliant on the assumption that the restrictions imposed by the government will be gradually lifted by the end of Q2. As of now, Stella-Jones assumes that when it comes to volume, it's going to be "no growth and all related to maintenance replacement."

While it is possible that Stella-Jones customers might delay capex spends, the company says no customers have spoken on those lines as of now. "They are in majority faced with aging infrastructure, and they're all mindful of executing that part of the maintenance." This bodes well for Stella-Jones.

Cash flow from operating activities was $69 million in the first quarter. The company has an additional $108 million of borrowings under its credit facilities. This should tide over Q2 as restrictions lift.

The Foolish takeaway

Stella-Jones stock is trading at a forward price-to-sales ratio of one. Its price-to-earnings multiple of 12 and five-year PEG ratio of 0.73 make it an attractive bet for value investors. Analysts tracking the stock have a 12-month average target price of $42.25. This is 28% above the current trading price.

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