BUY ALERT: Transcontinental (TSX:TCL.A) Is Set to Soar Post Q2

Description

Transcontinental (TSX:TCL.A) announced its second-quarter results yesterday. As expected, the COVID-19 pandemic took a toll on its printing business. However, the company has started seeing green shoots, which should support the upside in its stock.

Transcontinental's packaging business continues to remain strong and is likely to drive organic sales in the coming quarters. Besides, cost control measures and operational efficiencies should continue to support margins.

The company's steady cash flow generating capabilities enable it to reduce debt and pay dividends. Also, Transcontinental has multiple growth catalysts, which provides a strong foundation for a massive rally in this small-cap stock.

Organic sales to improve

The closure of non-essential services amid COVID-19 outbreak remained a drag on its revenues and profitability. The printing business, which accounts for about 47% of its revenues, took a significant hit.

Also, Transcontinental's divestitures of non-core businesses further affected its top line.

Transcontinental's overall sales and profitability marked a decline in the second quarter, reflecting weakness in the printing business.

Transcontinental's second-quarter revenues fell 18.5% year over year. Meanwhile, adjusted operating and net earnings declined by 18.1% and 17.1%, respectively.

Despite challenges, its underlying business continues to impress. The company's packaging business (accounting for more than 50% of its revenues) is witnessing a strong uptake in demand from the food and beverage industry.

Moreover, management expects organic sales to improve in the packaging business in the second half of the current fiscal. While its printing business could continue to face challenges, the segment is witnessing a gradual recovery in volumes, which is encouraging.

Also, Transcontinental's rapid cost reduction initiative, a decline in raw material costs, and organic sales growth should continue to support its operating margins in the coming quarters.

Further, Transcontinental expects to generate positive cash flows in the coming quarters, which is likely to support its investments in growth initiatives, reduce debt, and increase future dividend payouts.

Investors should note that the company has successfully managed to reduce its debt. Transcontinental's net debt to adjusted EBITDA ratio has declined from 3.1 in fiscal 2018 to 2.4 at the end of the second quarter of the current fiscal.

Attractive dividend play

Transcontinental is also an ideal stock for investors seeking safe and reliable passive income. Transcontinental is a Dividend Aristocrat and has consistently raised its dividends since 2010. The company's dividend per share has increased by a CAGR of 10.6% since 2010.

In 2019, Transcontinental paid a dividend of $76 million. Investors should note that its 2019 dividends reflected only about 18% of its cash flow from operations. The low ratio indicated that future payouts are pretty safe. Its stock offers an attractive forward dividend yield of 7%.

Transcontinental trades cheap

Transcontinental stock is trading cheap, which should further support the upside. It trades at next 12-month EV-to-EBITDA ratio of 5.0, which is not even half of the industry average of 10.9.

Meanwhile, Transcontinental stock trades at the forward price-to-cash flow ratio of 3.2, which is well below the industry average of 15.5.

Bottom line

Improving underlying business prospects, solid dividend yield, and low valuation indicate that Transcontinental stock is set to soar high in the future.

CATEGORY

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