Up 72%: Does This Dividend Stock Have More Upside?

Description

Stella-Jones (TSX:SJ) had its initial public offering (IPO) in 1994. It has been a fantastic investment since then. Even if you'd bought the stock in 2008 right before the last recession, the investment would still have quadrupled — delivering market-beating annualized returns of 12.7%.

The stock fell about 37% from earlier this year to as low as $24 in the March market crash. From the low point, it rose 41% to roughly $34. After some consolidation, it broke out and had another nice run up to $41.40. If you've been calculating, that's a whopping upside of 72.5% from $24 to $41.40 per share!

Does the dividend stock have more upside? Let's take a deeper dive into Stella-Jones.

Why the dividend stock has done so well

Stella-Jones has essentially expanded its capabilities and markets through acquisitions over the last two decades or so. In 2000, it made its first acquisition for poles — Guelph Utility Pole. In 2005, it made its first acquisition for ties and gained its entry into the United States. Then, in 2012, it acquired its first pole-treating facility in the United States. Several years later, it made its way into residential lumber through the strategic acquisition of RAM Forest Products in 2015.

Management has been stellar in its capital allocation, which is evident in its return on equity that has stayed between 11% and 19% since 2010.

Additionally, Stella-Jones is a Canadian Dividend Aristocrat that has increased its dividends for a number of years. Its five-year dividend-growth rate is about 15%. It last increased its dividend by 7.1% in Q1; it was welcoming to see, as many other companies had their dividends cut.

What's the upside potential of the dividend stock?

Currently, the stock only yields 1.5%. It's therefore better to focus on the long-term growth and total returns potential of the dividend stock.

In May, management reduced the company's guidance for 2020. Due to the uncertainty surrounding COVID-19 and a weaker economy, Stella-Jones revised its EBITDA expectation to $300-$325 million for 2020. Based on the midpoint of the guidance, it would imply flat growth versus the 2019 EBITDA of $312.9 million.

The updated guidance reflects "either no improvement or a slight decline in sales volume for utility pole, railway tie and industrial product categories and weaker demand for residential lumber compared to 2019."

Analysts have an average 12-month price target of $42.50 on Stella-Jones. This represents near-term upside potential of only 2.6%.

Due to the recent run-up and flat growth in the near term, there should be little upside for Stella-Jones for the remainder of the year. Moreover, the company will be reporting its Q1 results in the upcoming Wednesday. If it reports greater-than-expected impacts from a weaker economy due to the pandemic disruptions, investors could get a buying opportunity on a dip.

Longer term, the demand for Stella-Jones's quality pressure-treated wood products will still be there from North American utilities, telecoms, railway companies, and construction companies. Additionally, it can make some accretive acquisitions at discounted prices in today's distressed environment. Therefore, the stock has double-digit growth potential over the next three to five years.

The Foolish takeaway

Stella-Jones stock is close to fully valued for the near term, as it expects to have flat growth this year due to lower economic activity. Consequently, interested investors are better off looking for a lower entry point over the next six months.

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Date
2025/07/20
Date Created
2020/07/31
Author
kayng