A Top TSX Dividend Stock to Buy in October 2020

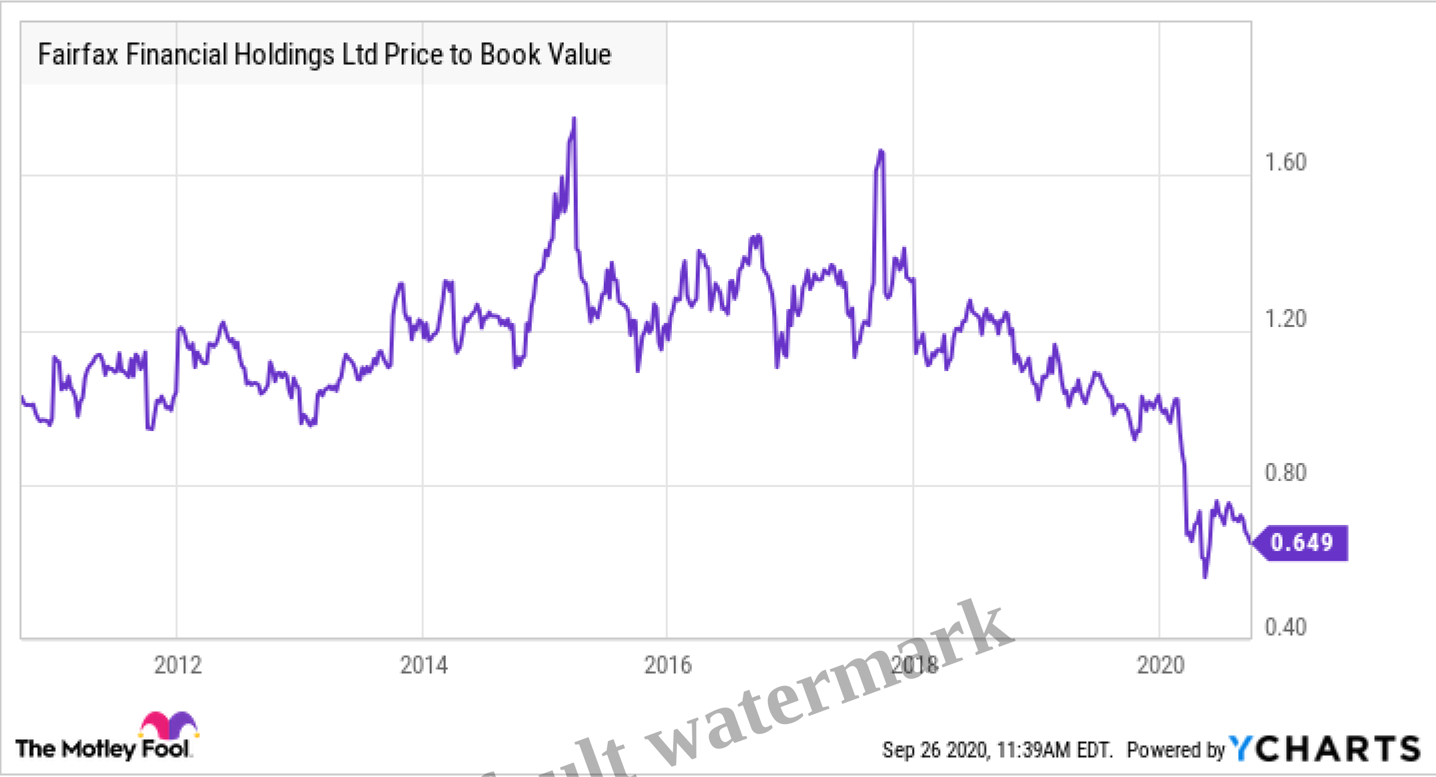
Description

Fairfax Financial Holdings (TSX:FFH) is sometimes dubbed the Canadian version of **Berkshire Hathaway**. Similar to Berkshire, Fairfax generates premiums from its insurance businesses as a source of low-cost capital to invest for higher returns.

However, while Berkshire stock has largely recovered from its year-to-date selloff, Fairfax stock remains very much depressed.

FFH data by YCharts. A chart comparing the year-to-date price action of Berkshire and Fairfax stocks.

If you ask me, Fairfax is deeply discounted right now. At $374 and change per share, the value stock trades at only about 65% of its book value. Even if it only reverts to its book value, it'd represent whopping upside of 54%.



FFH Price to Book Value data by YCharts. A chart displaying Fairfax stock's price to book value history.

Importantly, Fairfax's book value per share has increased in the long run. Since its foundation in 1985, the company's book value per share has compounded at 19.3% per year, while its total returns have been 17.8% per year.

Right now, there's a huge discrepancy between its price to book and book value per share. This gap will narrow at some point as the stock price recovers.

FFH data by YCharts. A chart showing Fairfax stock's book value per share versus price to book.

Management noted that the poor performance of compounding the book value per share by 2.1% and investment returns of 2.3% per year between 2011 and 2016 were due to its hedging and having a cautious outlook on the markets at the time. From 2017 to 2019, these performance metrics markedly improved to 12% and 5.6%, respectively.

In 2019, Fairfax experienced a book value growth of 14.8%. The good news is that it expects this kind of growth to continue.

Recent results

In the second quarter, Fairfax wrote gross premiums of US$4.7 billion, up 8.5% year over year. The growth of net premiums written was 6%. Its consolidated insurance businesses would have been solidly profitable with a combined ratio of 91.2% were it not for COVID-19 losses, which should be viewed as a black swan event. Still, the company managed to report net earnings of US$435 million thanks to net gains on investments.

Insider buying

There's only one reason for insiders to buy shares. They believe the stock is too cheap to ignore and that the stock price will go up. In June, Prem Watsa, Fairfax's chairman and CEO, bought US$149 million worth of shares for US$308.64 per share. Currently, the stock is even cheaper, trading at a discount of more than 9% from that level!

The Foolish takeaway

Investors should beware that Fairfax's earnings will be volatile due to the inherent volatility of the financial markets. At the end of the second quarter, Fairfax had 35% of its investments in cash and short-term investments that provides the liquidity for it to take advantage of mispriced opportunities in the markets.

Fairfax stock trades at a 16-year low valuation. As a result, it's a deep discount stock that can deliver very strong price appreciation once it demonstrates it can persist its book value growth.

Investors should not forget that the dividend stock pays a yearly dividend of US$10 per share in January. Now is a good time to buy the value stock on a dividend yield of 3.5% for big total returns.

Analysts have a 12-month average price target of US$422 per share on FFH stock for near-term upside potential of 50% based on the recent quotation of about US$280 per share.

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