



2 Value Stocks With Underrated Growth

Description

The Canadian market is full of intriguing value stocks that could hold their own, even as the growth-heavy trade looks to fade away at the hands of rising interest rates.

As you're probably aware by now, higher rates eat into the current value of firms that don't expect to make profits until far into the future. Indeed, the premium for growth stories was high in the back half of 2020. But the tides have turned, and many investors want to see something real. Cash flows and cash on hand are now that much more critical. If rates rise to much higher levels, I believe there's a possibility that we could see another massive leg lower for the speculative, unprofitable tech stocks that boast unrealistically high multiples.

Profitable growth companies could outperform

Think the companies with price-to-sales (P/S) multiples in the high teens or even higher. There's no telling how much downside they could have if central banks need to take their tightening cycle to the next level. Inflation looks to be heating up on both sides of the border. Investors should think carefully about valuation to ensure a reasonable margin of safety to save themselves from nasty downside, just in case they're wrong. Indeed, being humble in this kind of market can protect investors from trouble down the road, as the risk appetite fades and speculative instruments look to sink lower.

Does that mean you should pass up all (or most) growth stocks?

Definitely not!

If there's real earnings growth and a [moat](#) protecting a firm's cash flow streams and growth potential, you could have a stock that's destined to do well for years to come. Such earnings growth stocks at reasonable multiples, I believe, could be the new euphoric play moving forward.

Think companies like **Spin Master** ([TSX:TOY](#)) or **Parkland Fuel** ([TSX:PKI](#)), two cheap stocks that are capable of growing earnings at a solid rate over the next 10 years.

Spin Master

Spin Master is a toymaker that's grown through M&A and various organic initiatives over the years. The firm has a healthy balance sheet that could help it scoop up some deep-value bargains in the toy space over the next three years. If we are headed for an economic slowdown or recession, Spin could find itself wheeling and dealing again.

What I love about Spin is its ability to spot value in its niche market. Further, the company is quite innovative for a toymaker. It's produced some very intriguing toys over the years (think Hatchimals). With a fast-growing digital games business, the firm has far more durable growth than most investors expect from a mid-cap Canadian firm. Spin Master may be a relative unknown, but it boasts some of the most desirable brands in the toy scene. Think Gund, PAW Patrol, Hatchimals, and even Etch-a-Sketch.

At 18.2 times trailing earnings, I view Spin as a bargain capable of thriving over the next five years and beyond.

Parkland Fuel

Parkland Fuel ([TSX:PKI](#)) is another boring firm that's been busy on the M&A front over the years. The fuel and convenience retailer has taken a hit from the COVID crisis and has struggled to bounce back versus the likes of some of its peers. The company's balance sheet has a bit of debt weighing it down, and that could make it harder to adapt to the coming EV age.

While I'm a fan of the recent M&M meat shop deal, which [bolsters](#) the firm's frozen food offerings, I view Parkland as a very intriguing takeover target for a global consolidator. Yes, there are challenges, but I think Parkland is capable of so much more in the right hands. The \$5.7 billion firm has challenges, but for the 0.3 times sales price tag, I'd argue that investors have quite a margin of safety at today's entry point.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:PKI (Parkland Fuel Corporation)
2. TSX:TOY (Spin Master)

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