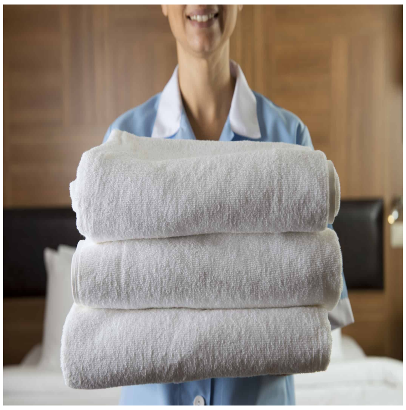

With Inflation Surging, Is K-Bro Linen a Good Defensive Stock to Buy?

Description

Investors have been airing their dirty laundry lately, dumping shares of struggling growth stocks in favor of more reliable businesses that can maintain strong margins through this period of higher inflation.

One stock that could fit the bill is the little-known **K-Bro Linen** (TSX:KBL), the largest operator of laundry and linen processing facilities in Canada. It is also a market leader in laundry and textile rental services in the U.K. The company serves both the health-care industry and hospitality industries. And because many hospitality businesses are still recovering from the pandemic, K-Bro has a tonne of recovery potential itself. Meanwhile, its sales from health care help it diversify its revenue and operations.

Laundry and linen services are a necessity for KBL's clients, which means it should be able to pass a lot of its increased costs onto them. And there's little chance of those clients leaving: The reason health-care companies and hospitality businesses use a third-party laundry company like K-Bro is that it's much cheaper thanks to K-Bro's economies of scale. So K-Bro should have some pricing power and the ability to maintain a lot of its margins.

K-Bro reported earnings last week. Let's look at how the business performed and determine if K-Bro is one of the better stocks to buy in today's inflationary environment.

K-Bro's Q1 earnings

K-Bro's business results made it clear that the company is starting to see a meaningful recovery in hospitality.

Its hospitality revenue continued to show remarkable progress in the quarter, and although initial parts of the quarter were still impacted by COVID, revenue at the end of the quarter in March was just 10% below comparable 2019 levels as pandemic-related restrictions were eased.

As a result, on a consolidated basis, K-Bro's revenue passed pre-pandemic levels for the first time, an extremely positive sign. In total, K-Bro's revenue was up 29%, to $61.4 million, which beat analysts' consensus estimate.

Some of the demand continued to come from the health-care sector, which was up slightly year over year even though K-Bro had a strong quarter this time last year thanks to pandemic-fueled demand.

K-Bro also reported that it earned adjusted EBITDA of $7.1 million, which was slightly lower than the consensus estimate of $8 million. The miss was due to additional expenses incurred in the quarter, especially from higher natural gas prices and labour costs.

K-Bro clearly has a defensive business, but it will have to manage its costs to maintain its margins

Because inflation is so significant and costs have been growing rapidly, K-Bro has decided to lock in natural gas supply rates in the U.K. until December 2024. This should help K-Bro to forecast its costs more accurately going forward.

Plus, the company expects to continue recovering in its hospitality segment given the recent lifting of travel restrictions and increasing business and leisure travel.

On the cost side, in addition to fixing its natural gas rates in the U.K., management also mentioned that it expects to pass on the higher costs to customers with price increases.

Is K-Bro a buy today?

With the stock still having room to recover, trading at a forward enterprise value to EBITDA ratio of 9.1 times, and offering a dividend yield of 3.7%, I think it's certainly one of the best stocks to buy for the long haul.

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