Not Every Cheap Stock has Value: 1 Stock to Buy, 1 to Sell, and 1 to Hold

Description

Warren Buffett learned from Benjamin Graham, "Price is what you pay; value is what you get." The current stock market downturn has created a virtual garage sale, with most stocks trading at a 20-50% discount from their 2021 peak. But not every stock trading at a cheap price is a value stock. Value stocks are those with significant growth potential that are available at a bargain price because the market has failed to value their long-term growth.

A value stock to buy

goeasy (TSX:GSY) stock is down 45% from its 2021 peak and is trading at 7.75 times its forward price-to-earnings (P/E) ratio. This ratio compares the stock price to its earnings per share for the next 12 months. But a value investor doesn't look at a stock's 12-month growth potential, this investor is interested in its 10-year growth potential.

As a sub-prime lender for housing, point of sale, and auto loans, goeasy has proved that its business model works. The company provides small ($500-$75,000) short-term loans (nine to 84 months) and secured long-term loans. It maintains a strong balance of provisions for credit loss and the interest rate charged on a loan. It has also broadened its loan offerings and ancillary services like loan protection plans.

Over the years, goeasy has improved its customers' credit history, graduating 33% to prime credit and 60% to an increase in their credit score within 12 months. Its revenue and earnings have grown at a compound annual rate of 15.9% and 33.6%, respectively, in the last 10 years.

The company has over $1 billion in liquidity that can last till mid-2025 and help it withstand a recession. goeasy is a small-cap stock that still has a huge market to tap. If the company succeeds in growing its earnings even at half the rate in the next 10 years, a 7.75x P/E ratio is a bargain.

goeasy stock has been paying quarterly dividends since 2004 and has delivered capital appreciation since 2012. This value stock is one to buy on the dip and hold until it becomes a mid-cap stock.

A stock to sell

Cineplex (TSX:CGX) stock is down 43% from its 2021 high. The theatre chain struggles to grow its revenue due to competition from over-the-top platforms. The company is seeing triple-digit revenue growth as it recovers from the pandemic shutdown, however, once it achieves its pre-pandemic revenue, there aren't many attractive growth prospects.

The biggest drag for the company is its $1.8 billion debt against a $26.58 million cash reserve. The interest expense on the debt is enough to pull the theatre chain into a multi-year loss. It was banking on a $1.3 billion claim in monetary damages from **Cineworld** for backing out of an acquisition deal in mid-2020. But Cineworld filed for bankruptcy, reducing Cineplex's chances of receiving the claim.

Cineplex's $593 million market cap is a third of its debt, which means shareholders are buying into debt. This leverage makes it a risky bet in a weak economy. Even an 8.5x forward P/E ratio looks pricey, given the company's interest costs that could impact its profits. The stock has a limited upside, which makes it a short-term bet. If you own the stock, I believe it can recover to $12-$14.

A value stock to buy and never sell

TransAlta Renewables (TSX:RNW) stock fell 17% from its April high when it surged as U.S. President Biden announced a policy promoting renewable energy. The stock then slumped when Europe's energy crisis called for urgent energy sources, shifting attention to fossil-fuel-powered electricity. But electricity will always be in demand, and the growing climate threat along with the pressing need for energy security could accelerate renewable energy demand in the long-term.

TransAlta Renewables generates stable cash flows by developing and operating wind, natural gas, hydro, and solar power facilities across Canada, the U.S., and Australia. The company is uniquely advantaged in that it adheres to the same lucrative business model that traditional utilities follow, but because it's already renewable, it can avoid transition costs and invest primarily in growth.

TransAlta has been paying regular monthly dividends since September 2013 and has increased them five times. Although a 19.6x P/E ratio is not a bargain price, an attractive 5.87% annual dividend yield and the potential to benefit from the burgeoning green energy revolution make it an ideal long-term hold.

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TICKERS GLOBAL

1. TSX:CGX (Cineplex Inc.)
2. TSX:GSY (goeasy Ltd.)
3. TSX:RNW (TransAlta Renewables)

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