Here's what my value investing students picked as the top stock pick of 2021

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My January-February value investing MBA class at the Ivey Business School is over. As with every year, students had to find a potential value stock, value it and make a recommendation to buy or wait.

It has been more difficult to find undervalued stocks this year. During my late-spring classes in 2020, it was like picking daisies in the valley because of the pandemic-induced stock market panic and sell-off. But with the market having more than recovered from its losses since last March, the picking has not been easy. Despite that, once more my students proved that a diligent investor can always find undervalued stocks, in every market. The top pick in this most recent MBA class was **Enerflex Ltd.**

Enerflex EFX-T (/investing/markets/stocks/EFX-T/) -0.45% ▼ passed the student screens required for a stock to be considered not only as a possible value stock, but also as a possibly undervalued stock. EFX had a price-to-earnings ratio of 6.9 times, a price-to-book of 0.4 and market capitalization of about $600-million (as at Feb. 2).

Calgary-based Enerflex supplies products and services to the oil and gas

industry. There are four main reasons the students liked the company:

- First, its strategic product positioning. Enerflex is well placed to benefit from the projected demand increase for natural gas, as it caters to the global demand for natural gas compression and processing, and maintenance.
- Second, its global presence, which includes operations in Canada, the United States, Latin America, Europe, Australasia, the Middle East and Africa.
- Third, strong fundamentals. The company has had steady, positive and growing operating margins, which remained high even through the aftermath of the financial crisis and steady through the oil and gas plunge of 2014. Sales have also grown over these periods. Enerflex has always been conservative with debt financing, maintaining its debt-to capital ratio, on average, around 30 per cent, which is well below the industry average of 50 per cent. Until 2020, when it temporarily cut its dividend because of COVID-19, Enerflex had raised its dividend annually for nine consecutive years, with an average five-year dividend yield of 2.5 per cent. Management has indicated it is focused on continued dividend growth.
- Fourth, a focus on recurring revenues. The company's products and after-market services are a source of recurring revenue that offer higher margins relative to manufacturing and serve as a source of stable, predictable financial performance. Enerflex currently generates more than 50 per cent of its revenue from recurring sources and aims to increase this number.

Enerflex, with a market share of just under 4 per cent, serves a subsector of the market characterized by a fair degree of concentration, with the top five players catering to 80 per cent of the market. The next 10 players have market

shares ranging between 0.5 per cent and 4 per cent. Students felt that there may be further industry consolidation of smaller players such as Enerflex.

Given the reasons mentioned above and particularly the stability of the company's operating margins, which have varied, in general, between 8 per cent and 12 per cent over the past 13 years, and considering the industry in which it belongs, students concluded that EFX has a medium business risk. With a seven-year average debt-to-capital ratio of 30.7 per cent, students felt that EFX has medium financial risk. This led to a cost of capital (at the Feb. 2 valuation) of 5.1 per cent. The company's adjusted return on invested capital was about the same as the cost of capital.

Intrinsic value was estimated to be $20.26 and the entry price $13.51. With the stock trading at the time of valuation at $6.70, EFX was a strong buy. Even at Wednesday's closing price of $8.84, and despite a sharp increase in interest rates since Feb. 2, EFX continues to be a strong buy – intrinsic value is now estimated to be $18.96 and entry price, $12.63.

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