Thomson stock set for breakout

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Analyst thinks shares poised for 20% gain

You don't have to be a savvy technical analyst to recognize that Thomson Corp.'s share price has shown a frustrating up-down, up-down pattern over the past few years.

The stock (TOC/TSX) has bounced between about $40 and $45 with remarkable consistency since 2002, leaving many investors with the impression that it was going nowhere over the longer term. The shares closed yesterday at $44.06, up 49 cents, putting them at the upper range of this pattern and, if history holds true, ready for the next downward leg.

But wait, there's hope for investors who have reached the end of their patience. Thomson has recently been showing signs of breaking out of this range -- which has made money for no-one but the most nimble of traders -- thanks to a new focus on growing internally, cutting costs and streamlining assets.

"Whether the new direction succeeds remains to be seen but, in our opinion, there is little downside risk and the likelihood of the stock breaking out is higher now than at any time since we initiated coverage in 2002," said **Oded Levi**, an analyst at Toronto-based **Veritas Investment Research.**

He believes the stock is worth at least $48 right now, which would take it close to a four-year high. And if revenue and earnings growth come close to management expectations, **Mr**. **Levi** thinks the stock can hit $53, representing a 20% bounce and a welcome change from its recent wanderings.

The problem with Thomson Corp. in recent years -- at least from a short-term shareholder's perspective -- is that it has concentrated on expanding its global empire of specialized electronic information publishing at the expense of increasing its earnings.

The company, which has its official headquarters in Toronto but conducts most of its business out of Stamford, Conn., snapped up a total of US$12.3-billion worth of companies and assets over the past 10 years. These acquisitions have included TradeWeb, a fixed-income market place, and NexCura, a provider of medical information. The company is divided into four groups: Thomson Legal and Regulatory; Thomson Learning; Thomson Financial; and Thomson Scientific and Healthcare.

In the process of making these purchases, Thomson has moved further and further away from its roots as a newspaper owner. At the same time, it has expanded its annual revenues to US$8.7-billion in fiscal 2005 from US$7.3-billion in 2002 -- representing overall growth of 19%.

Trouble is, earnings on a per-share basis have been relatively flat over the same period, leading to concerns Thomson might not be able to generate the sort of rising profits that turns investors' heads. As a result, the share price has shown little direction.

"We continue to believe that only a boost to organic growth, a focus on returning cash to shareholders and a cooling down on acquisitions will enable Thomson's valuation to exit the range of the past few years," **Mr**. **Levi** said.

Thomson's fourth-quarter results show the company is now moving into a phase that could satisfy these demands.

It raised eyebrows in February when it reported earnings of US62 cents a share in the fourth quarter of fiscal 2005, well ahead of the US55 cents consensus estimate from 13 analysts. Analysts were also impressed with the fact that Thomson bumped up its dividend by 10%, bringing it to US88 cents a share annually, and announced that it would buy back US$300-million worth of its own stock.

As well, Richard Harrington, Thomson's chief executive, told shareholders the company will concentrate more on integrating its recent acquisitions rather than making substantially more of them.

"The good news is that management is expecting the majority of the growth to be generated organically, compared to 2005 when half of the 8% growth was generated organically," said Andrew Mitchell, an analyst at Scotia Capital.

In a recent research note, he raised his target price on Thomson shares to US$45 (the shares also trade in New York), a 19% increase over yesterday's close of US$37.68, and argued that Thomson was an excellent alternative to high-flying energy and materials stocks.

"In our minds, Thomson is an attractive and defensive free-cash-flow growth story that offers a safe haven from commodity cycles," Mr. Mitchell said.

Of course, not everyone has become convinced that Thomson has turned an important corner. "We still believe the variables required to drive Thomson out of its historical trading range of $40 to $45 are at least another 12 to 18 months away," said Amy Glading, an analyst at CIBC World Markets.

However, even she inched up her target price on Thomson -- to US$40 from US$39 previously, based on rising free cash flow, a heftier dividend and the sale of some assets.

Another dividend increase could also be in the cards.

"Thomson has the free-cash-flow firepower," Mr. Mitchell said, "to accelerate dividend growth into the mid-teens and still aggressively buy stock."