Aecon is Helping to Build Canada – It Could Also Help Build Your Portfolio

Description

One company that is swimming against today's negative market action is **Aecon** (TSX:ARE), the Canadian infrastructure and industrial construction juggernaut. The stock is up about 5% to the $12 mark after the company issued a strong quarterly release this morning. Comments by the CEO indicate today's jump could be just the beginning.

Margin expansion

In the opening of today's press release, Chairman and CEO John Beck, who has been on Aecon's board since 1963(!), clearly stated the company's primary objective is to achieve an EBITDA margin of 9% by 2015. To put this figure into perspective, the table below outlines Aecon's EBITDA margin over the past 7 fiscal years.

	2006	2007	2008	2009	2010	2011	2012	Avg
EBITDA Margin	3.1%	5.2%	6.2%	5.5%	3.9%	5.1%	5.9%	5.0%

Source: Company reports

Beck's target appears overly ambitious given the company's historic results. If achieved however, the impact on the stock price could be dramatic.

If all other entries (except taxes) on Aecon's 2012 income statement are held constant and we tweak the EBITDA margin from 5.9% to 9%, Aecon conceivably could have earned $2.07 per diluted share. This compares quite favourably to Aecon's reported 2012 diluted EPS of $1.18.

Aecon currently trades at a multiple of 10.2 to this reported EPS figure. By 2015, if this company is earning $2 per share on the back of stronger margins, even if the multiple holds, which is unlikely, the stock price could be in the $20 range – a capital gain of 67% over a three-year period. If the company is able to demonstrate improved margins, the multiple is very likely to expand. This sets $20 as a floor for what this stock could be worth.

Seems like a stretch but…

Stranger things have happened. Aecon has historically been focused on general contracting type work, a highly competitive space. Even though it's one of the bigger players on the block, increasing prices in this type of business and expanding margins is incredibly difficult, as demonstrated by Aecon's results.

Through the recession however Aecon made several strategic acquisitions that have helped to change its business mix. The company's focus is shifting to larger, more complex turnkey projects as well as higher margin mining operations. If all goes according to plan, this new mix of higher margin work will allow Aecon to achieve its goal.

The Foolish Bottom Line

A dividend hike to $0.32 from $0.28 accompanied this morning's release. The stock now yields 2.7% which helps to boost the potential total return.

Given the relatively low multiple at which the stock currently trades, it would appear the market is dubious about the possibility that Aecon will be successful achieving its margin target. When we consider limited downside and a potential 3 year total return of more than 67% including the dividend, a compelling risk/reward scenario for Aecon's stock begins to emerge.

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CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ARE (Aecon Group Inc.)

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