Why ShawCor Ltd. Deserves a Spot in Your Portfolio

Description

Recent government hurdles concerning the Keystone XL pipeline in the United States and the Energy East pipeline project in Canada illustrate the specific risks associated with investing in pipeline constructors.

However, you can be bullish on the pipeline sector as a whole while mitigating specific project risks by investing in **ShawCor Ltd.** (TSX: SCL).

Diverse geographical exposure

Contrary to companies like **TransCanada Corporation** (TSX: TRP)(NYSE: TRP) and **Inter Pipeline Ltd** (TSX: IPL), ShawCor generates its revenues worldwide and throughout multiple projects. As of last year, revenues were diverse, with 36% percent of sales coming from Asia, 28% from Canada, and 22% from both the United States and Latin America. This allows the company to mitigate the uneven sales that come with this sector.

ShawCor segment Image not found or type unknown *Source: Company filing, annual report 2013*

Thus, contrary to the pipeline constructors who are heavily exposed on certain projects, ShawCor can benefit from the overall worldwide expansion of energy transportation via pipelines.

Long-term growth still intact

Although the last quarter saw a decrease in revenue on a year-over-year basis of 3.5%, it was mostly expected by analysts based on the completion of big projects in Asia and the Gulf of Mexico. That being said, the company still kept a healthy EBIT margin of 15.7%. Meanwhile, the company is still doing strategic bolt-on acquisitions to increase its offering in the pipeline-coating segment with the completion of the Desert acquisition.

Given the strength of the balance sheet — net debt is at $628 million inclusive of the Desert acquisition — and the expanding economics of the business, I see future acquisitions in the near term for ShawCor. There will be a lot more room for growth in ShawCor's future, albeit a bit lumpy due to the exposure to heavy projects.

Healthy bidlog and backlog

During the second quarter of 2014, ShawCor's backlog increased to $684 million, up 6.5% on a quarter-over-quarter basis. Any increase in backlog is good news considering that major projects in the Gulf of Mexico and Asia are nearing completion. The projects being completed in Asia produced a higher margin mix that helped the company arrive at such strong EBIT and gross margin.

At the present mid-teen levels, margins are more in line with the long-term trend and additional expansion would come from future acquisitions helping the company to deliver a stronger product mix.

Bidlog was also very strong at over $1 billion for the quarter thus solidifying management's expectations of higher top-line and bottom-line growth in 2014 and 2015. During the last conference call, management mentioned that the recent bidlog activity was well dispersed geographically, which again helps the company manage revenues.

The bottom line

I like ShawCor's exposure to the pipeline sector and I believe it will see increased activity in the coming years. One just has to look at the $70 billion deal made this week between **Kinder Morgan Inc** (NYSE: KMI) and **Kinder Morgan Energy Partners LP** (NYSE: KMP) for further proof.

Management is strategic and methodical in acquiring additional technologies to bolster its offering. Granted, this is not a dividend stock, far from it, but investors thinking about ShawCor should look for an increase in earnings power rather than the dividend.

CATEGORY

1. Investing

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1. NYSE:KMI (Kinder Morgan Inc.)
2. NYSE:TRP (Tc Energy)
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4. TSX:TRP (TC Energy Corporation)

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