



Should Value Investors Bet on SNC-Lavalin Group Inc.?

Description

The Canadian market is littered with battered and bruised companies right now and value investors are wondering which stocks have the ability to bounce back in a big way.

Here are the reasons why I think **SNC-Lavalin Group Inc.** (TSX:SNC) could be one of those stocks.

Tough times

SNC-Lavalin is battling wars on many fronts including the seemingly endless troubles relating to dodgy deals the company signed with Libya's former regime. The employees connected to the contracts are long gone and SNC thought it had finally put all the troubles behind it, but that isn't the case.

Earlier this year, The RCMP filed corruption charges against the company and that could lead to a 10-year ban on bidding for Government of Canada contracts.

SNC gets a lot of business from the government, so the charges really took the wind out of the stock's sails. Investors watched the price tank nearly 20% over the course of a few weeks following the RCMP announcement.

At that point, the value crowd started to really crunch the numbers and the smart money realized the stock was oversold. The shares rallied in the second quarter, but have recently pulled back again.

New deals

Since the RCMP statement, SNC has won a number of new contracts, including a multi-decade deal to build, operate, and maintain Montreal's new Champlain Bridge. Analysts think the contract could be worth \$3-5 billion. SNC is a 50% partner on the project.

SNC and its partners have also been picked to manage Atomic Energy Canada Limited's Canadian nuclear laboratories.

The federal government isn't the only one handing out lucrative deals to the embattled company.

Ontario recently selected SNC and its partners to design, build, and maintain the Eglinton Crosstown LRT Project. Estimates put the value of that project at more than \$5 billion.

These new contracts don't guarantee that SNC is out of the woods with the RCMP, but a number of analysts believe the end result of the legal process might not be the worst-case scenario.

Turnaround efforts

CEO Robert Card took over in October 2012 and immediately launched an aggressive turnaround plan. Cost cuts and a reorganization are driving more efficiency into the operations, but the company is also struggling with weakness in the oil and mining industries.

Earnings, dividends, and share buybacks

Despite the tough market conditions, SNC is still profitable. The company reported Q1 2015 earnings of \$0.68 per share, a 10% increase over the same period in 2014.

SNC pays a dividend of \$1 per share that yields about 2.4% and management plans to repurchase up to 10% of the outstanding stock.

Way too cheap

The thing that gets most value investors excited is the fact that the company appears to be extremely undervalued. Right now you can buy the stock for \$42 per share.

The company is planning to divest its stake in the Highway 407 toll road and analysts estimate that could fetch as much as \$3 billion, which translates into about \$20 per share based on the float of about 150 million shares.

SNC finished Q1 2015 with \$2 billion in cash, cash equivalents, and short-term investments. Long-term debt was \$865 million, so the difference of \$1.135 billion accounts for about another \$7.50 per share.

At the end of Q1, the company reported a revenue backlog of \$11.6 billion. This doesn't include SNC's share of a number of new deals announced during Q2. A conservative estimate would put the current backlog at about \$13 billion. Margins will vary on those projects, but the overall quality of the portfolio should be pretty good.

So, investors are essentially paying just \$14.50 per share for the revenue backlog plus the rest of the company's assets and its ongoing operations.

Management expects the engineering and construction (E&C) unit to earn \$1.30-1.60 per share in 2015. At a conservative value of 13 times earnings you get roughly \$17-21 per share in value just for the E&C business. One estimate puts the value as high as \$29.

Should you buy?

The company continues to win big contracts and there's a real possibility that a suitor could take a run at SNC while its stock price is so depressed. At this point, the downside risks look limited and the upside potential could easily be 30-50% in the next couple of years.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ATRL (SNC-Lavalin Group)

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