Like Caterpillar Inc. or Deere & Company? Buy Finning International Inc. Instead

Description

There have been plenty of articles recently looking at U.S.-based **Caterpillar Inc.** (NYSE:CAT). Over the past 12 months, shares have seen a rare 30% drop, erasing nearly all of the stock's capital gains over the past decade. With its price down to 11.2 times earnings and a dividend yield over 4.5%, it's no wonder why investors are getting interested. Shares in **Deere & Company** (NYSE:DE) have performed similarly, making both companies potential value picks.

However, what if there is another company with a similar exposure and valuation with less downside?

Finning International Inc. (TSX:FTT) is the largest Caterpillar dealer in the world, renting and selling Caterpillar products and spare parts primarily in Canada. As we'll see, Finning might actually be better positioned than Caterpillar or Deere, with a unique opportunity to create massive value for shareholders.

Why is it better than Caterpillar and Deere?

The stocks of major equipment manufacturers have plummeted recently, including Caterpillar and Deere, as industrial growth has been slowing to a halt in Canada. Depressed commodity prices are largely to blame.

Because heavy equipment is such a major expenditure, and lower spending will hit this area first, investors are anticipating major revenue and profit declines for manufacturers. While Finning isn't immune to this headwind, there are some important differences in its business model.

The biggest difference is that Finning doesn't have the worry about production risks. It has no factories to run, lowering its fixed costs dramatically. For example, total revenues recently fell by 8% to $3.175 billion. Offsetting this, total cost of sales decreased, as well as the costs to run the business.

So, despite a revenue drop of $250 million, gross profit fell by only $80 million and the net profit dropped only $40 million. As mentioned, Finning isn't totally immune from profits drops, but it can manage the downturn significantly better than the manufacturers themselves.

The company believes in itself

After spending over $20 million in share buybacks during the first half of this year, management has instituted an even bigger repurchase program, claiming that its shares are vastly undervalued. In total, the company has approval to repurchase 10% of all outstanding shares.

Finning's CEO laid out the case for continuing to buy back shares:

> We repurchased roughly one million of our shares during the second quarter at an average price of $23.85 and expect to continue buying back our shares. Our balance sheet is in excellent shape. If I look back at the end of the year and I say, generated that kind of free cash flow, paid out $100 million through dividends, did a strategic acquisition in the range of $200 million and $100 million in share repurchases, that feels like a pretty good proposition for shareholders as I am sitting here at the back half of 2015, and that's how I get to think about it.

Management believes in itself

Numerous times this year, management has put its money where its mouth is, buying up shares with their own money. In addition to the previously mentioned share buyback, this is yet another sign that those in the know believe the market is underappreciating Finning's potential.

On May 31, 2015, insider Kevin Lee purchased nearly $50,000 shares at $24.87 each. Director Juan Villegas bought a more sizable amount of roughly $200,000 shares in June at $23.96 each, while director David Cummings bought $220,000 in shares at a similar price that same month. While it's never a sure thing, insider buying is always a welcome sign.

A better choice any way you put it

While Finning isn't a surefire investment given the weak macro backdrop, it clearly trumps any investment in Caterpillar Inc. or even John Deere. It trades at a similar valuation despite its ability to control costs and profit declines during a down cycle. Its ongoing investments in itself, including a big share buyback, mean investors could see massive value creation during the next upturn.

If you're invested in heavy equipment manufacturers, it may be time to reallocate some of that capital to Finning International Inc.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CAT (Caterpillar)
2. NYSE:DE (Deere)
3. TSX:FTT (Finning International Inc.)

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