TransForce Inc. Stock Is Down 30% in 12 Months: That's an Overreaction

Description

Despite posting record revenues, profits, and free cash flow in 2015, **TransForce Inc.** (TSX:TFI) is down a little over 30% in the past 12 months. Based on expected 2015 profits, shares now trade at only 10 times earnings.

What's going on?

This week, **Royal Bank of Canada** released a note that it expects a bumpy 2016 for the Canadian trucking industry, citing a weak economy, too much capacity, and likely lower freight rates. It downgraded TransForce along with the rest of the industry. Still, the company remains its "top choice in the trucking space."

Has the pullback created a big buying opportunity for investors willing to look past this year alone?

Even if things turn sour, TransForce can capitalize

TransForce purposefully operates an asset-light business, resulting in impressive free cash flow generation. For example, in the past 12 months the company has produced $2.72 per share in free cash flow, resulting in a yield of roughly 14%. This isn't a one-time thing either. Since 2011 the company has averaged over $2.00 a share in annual free cash flow.

Strong cash flows allow TransForce to acquire competitors at reasonable prices, rolling up what is still a fragmented industry. Once an acquisition is tucked into TransForce's existing supply chain and logistics network, cost savings are typically substantial, meaning TransForce can extract more value out of an acquired company than it could running as an independent business.

For example, since 2011 the company has made almost $2 billion in acquisitions. Over that period operating margins have increased consistently from 7.5% to 8.6% today. Clearly, TransForce management are skilled acquirers.

So, even if the industry enters a bumpy 2016, TransForce can position its business for the long term by continuing its acquisition strategy at even cheaper prices.

Even after its downgrade, Royal Bank of Canada admitted this was a big opportunity. It believes that TransForce can "opportunistically pursue acquisitions to further bolster its positioning when markets improve," especially after the sale of its waste management business for $800 million. Total debt is only around three times EBITDA with a weighted-average interest rate of just 3.6%.

With plenty of cash, low debt levels, and a proven ability to make valuable acquisitions, TransForce may come out of any possible downturns stronger.

A sustainable dividend while you wait

Right now, 2016 holds two possibilities for TransForce.

First, the market may well remain stable, proving the recent drop in the stock price to be overdone and likely resulting in big gains for current shareholders.

Second, analysts may be correct in predicting a tough year ahead. Still, TransForce can merely up its acquisition strategy at discounted prices, boosting long-term value. Even if this option is the case, investors still get a 3.5% dividend to help them ride out the storm.

Based on 2015 estimates, the dividend only covers less than 40% of earnings, resulting in a safe, reliable income stream.

CATEGORY

1. Dividend Stocks
2. Investing

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1. TSX:TFII (TFI International)

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