Einhorn Dislikes Caterpillar Inc.: Should You Sell Finning International Inc.?

Description

Greenlight Capital hedge fund manager David Einhorn told a packed house this week in New York that he was shorting **Caterpillar Inc.** (NYSE:CAT), the construction and mining equipment maker, which has lost one-third of its value over the past two years due to the ongoing commodities bust.

While analysts are calling for approximately 6% more downside on Caterpillar stock, Einhorn believes that the real number is more like 50%, suggesting this time next year it could trading in the $30s.

Who should you trust?

While Einhorn's been wrong before (haven't we all?), he's not the only big hitter who's pessimistic about Caterpillar's prospects. James Chanos of Kynikos Associates, one of the first to predict Enron's demise back in 2001, is also betting against its stock. That doesn't jive with analysts' opinions. Out of 22 ratings on the stock, only three have it as a "sell."

Let me stop this conversation before it goes any further. Nine times out of 10, I'm going to take the opinion of two billionaires over a bunch of paid mouthpieces. Sure, it's in Einhorn's best interests to walk down Caterpillar's stock price, but his performance—16.5% annual returns over the 20 years—suggests he should at least be taken seriously.

So, what's the play on **Finning International Inc.** (TSX:FTT) given Einhorn's dislike for Caterpillar? Should you be selling Finning stock at the moment and avoiding it if you don't already own it?

Absolutely.

Forget the fact that Finning's stock is up almost 19% year-to-date through May 10. That might be best described as a dead cat bounce. A sure sign that its stock price could be headed lower is the May 9 announcement by Finning that it was intending to repurchase up to 16.8 million of its shares, effectively reducing the total outstanding by almost 10%.

When your business is in the dumps, it's best to put on a brave face by signaling to investors that management believes its stock is cheap. We are then supposed to get on the bandwagon, creating an artificial floor price for its stock. However, what happens if this is really just the precursor to the second leg of its move lower, the first being its two-year decline in 2014-2015 that saw its stock lose 27% of its value?

Shareholders lose twice.

First, investors will see their holdings reduced in value; the second kick in the groin is that management will overpay for many of the 16.8 million shares it intends to buy back over the next 12 months. It's a double whammy because very few companies know how to repurchase shares when the stock price is below its intrinsic value.

Getting back to Einhorn, who also had a bad year in 2015, he sees Caterpillar's annual earnings around the $2 level for the next two years, and as we all know, earnings drive stock prices. More importantly, that's 75% less than what it earned in 2012. As far as haircuts go, that's a big one.

Why should Finning be any different? It shouldn't. There are better TSX stocks to own.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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Date
2025/08/16
Date Created
2016/05/11
Author
washworth