Being Cautious With Toromont Industries Ltd.

Description

With a lot of talk about building a massive wall that could span the entire southern United States, shares in companies like **Caterpillar Inc.** (NYSE:CAT) have risen and maintained what can be viewed as "stretched valuations."

The good news for some Canadian investors is that shares of **Toromont Industries Ltd.** (TSX:TIH) have also increased in value along the way. Investors who have held shares for the past year have made an approximate 40% return on their investments. Things have been very good in the past year in spite of sales which are beginning to level off.

The company operates a number of Caterpillar dealerships or stores in addition to the installation of industrial and recreational refrigerator systems across North America. Although sales from this market may be taken as leading indicators of the overall economy, the reality is, with two separate lines of businesses and the potential to increase the number of stores or dealerships, it is difficult to lock down a precise direction of the underlying business.

Looking at the stock performance, the returns have been fantastic. In fact, things have been so good for existing investors that new investors may want to be extremely cautious or potentially even consider a short position on the security if this is something that fits their investment profile.

Currently trading over 23 times earnings (P/E), shares in excess of $45 are near a 52-week high and offer a dividend yield no better than 1.75%.

The reason for such a high valuation is the same as why Caterpillar in the United States is also trading at a very high P/E (52 times, to be accurate): the rich valuation is due to the potential for infrastructure investment by the new U.S. president. Assuming the go-ahead is given to build a wall coast to coast, then the amount of large machinery that will be needed to prepare the area and then build the wall will translate to higher revenues and profits for companies such as Caterpillar.

The problem for Canadian investors holding shares of Toromont is the increase in demand will not be coming in through their Canadian locations, but instead through the American manufacturers which will in turn reap the benefits.

Currently, momentum seems to be on the side of Toromont, but investors for growing revenues and dividends may need to look further.

The dividend-payout ratio was 37% for 2016, 36% for 2015, and 34% for 2014. Although the dividend has increased each year for the past four four years, investors looking for a new position may want to hold off on this particular name.

Having beat expectations for a number of years, expectations keep going higher and higher. As investors know from history, eventually the expectations will outweigh the potential and the share price has to adjust. In this case, it may be wise to wait for an adjustment before taking a position.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CAT (Caterpillar)
2. TSX:TIH (Toromont Industries Ltd.)

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