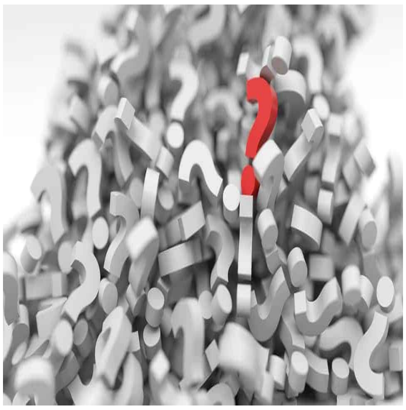

Who Turned Out the Lights at Badger Daylighting Ltd.?

Description

Badger Daylighting Ltd. (TSX:BAD) nosedived 14.27% last Friday following an announcement from activist short-seller Marc Cohodes that he'd gotten a short position in the stock approximately four months ago.

In a previous piece, I'd stated that Badger was ridiculously overvalued with a price-to-earnings multiple of 41. Mr. Cohodes also believes that Badger is overvalued and could drop by a substantial amount going forward.

Badger is a rather underrated company that not many investors have been talking about until Mr. Cohodes made his short position public. Badger is in the business of exposing underground infrastructures like pipelines, electrical lines, or any other buried apparatus that needs to be brought to the light of day in a process called "daylighting."

Daylighting is a non-destructive process that uses pressurized water to break through solid ground. Badger's hydraulic-powered machines are attached to trucks that are able to move to areas of interest. It sounds like an incredible technology. It offers an environmentally friendly and cheap way to expose underground assets.

The process of non-destructive excavation is intriguing, but it's not groundbreaking (no pun intended). Mr. Cohodes points out in his short thesis that there's a low barrier to entry, and competition is likely to heat up in the future, which will be another headwind to drag Badger down.

Badger CFO Jerry Schiefelbein responded to the lack of moat criticism by stating, "It's not just digging holes in the ground," and that the company's size is the "advantage" that it will have over competitors looking to enter the industry.

I'm not sure that qualifies as a moat, especially considering that the company isn't operating in the most efficient manner of late. Badger's recent earnings report was very underwhelming; high operating costs and sub-par margins should be ringing alarm bells for shareholders.

With the U.S. set to increase infrastructure spending, I believe this is a huge opportunity for hydrovac companies like Badger. However, Badger could potentially be kissing a gigantic opportunity goodbye if its management team doesn't make its operations more efficient.

Margins are already poor right now, and mounting pressures from the competition may become too intense if management cannot turn things around.

Takeaway

Although Badger may seem like a decent investment, Marc Cohodes makes some very good points. The stock is still overvalued, the business is not efficient, and there's no moat.

I'm not sure if the management team has what it takes to make Badger an efficient operator. If they're able to improve operational efficiency and margins, I'd give Badger another look, but right now, it simply doesn't make sense to own a poorly run company without a moat at a premium valuation, even if there are promising growth prospects.

Mr. Cohodes has a very impressive track record, and if he has a short position in one of your portfolio's holdings, then you should strongly reconsider your long position.

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