



How Deep of a Hole Is Badger Daylighting Ltd. in Now?

Description

When infamous short seller Marc Cohodes released his short thesis on **Badger Daylighting Ltd.** (TSX:BAD), shares took a nosedive. Since falling into the hole Mr. Cohodes kicked Badger into, the stock has enjoyed an impressive 19% rally. Despite being down about 38% from all-time highs, Badger still trades at a hefty premium.

With U.S. infrastructure spending expected to increase under the Trump administration, hydro excavation companies like Badger are poised to benefit. Badger's goal is to double the size of its U.S. business over the next three to five years while growing its Canadian business by 10-15% per year. Badger recognizes the potential opportunity in the U.S. market, and it's aiming to beef up to be better positioned to ride this tailwind.

Mr. Cohodes believes that Badger is an overvalued company with declining fundamentals and no real durable competitive advantage. The management team has fought back with an updated investor presentation of its own in which it disputed Mr. Cohodes's claims with the hopes of regaining the confidence of its investors.

The management team at Badger claims that the "Badger Hydrovac is a unique, niche business [with a] ... competitive advantage with our decentralized branch network and our large scale of operations."

The company then stated its "scale supports high fleet utilization and enables us to better manage operating costs over the business cycle. Badger has a focused strategy which is to drive profitable growth in Badger Hydrovacs."

The company pretty much stated the opposite of Mr. Cohodes's short thesis, but one thing that hasn't been addressed is the fact that the fundamentals have been on a gradual decline over the years and operating costs have not been managed in an efficient manner up to today.

Margins have slowly been declining over the years, and the return on equity numbers have taken a plunge, which indicates the management team is becoming less effective with its investment initiatives.

Badger builds and designs its own trucks, which the management team believes is a competitive

advantage since costs would be around 20% more expensive if Badger used a similar truck from another manufacturer. The company praised its trucks on their low repair costs, but investors should be skeptical as no real comparisons were made.

I don't believe manufacturing ones own truck is a durable competitive advantage. Any company in the space could create its own trucks, then Badger's advantage would go out the window.

Bottom line

The fundamentals are clearly on the downtrend, and Mr. Cohodes views this as a short opportunity. If the management team at Badger can prove they can improve the efficiency of operations, then the stock may rebound to higher levels over the next few years.

But in the more likely scenario that the management team has no answers for the declining fundamentals, Badger could be digging itself into a deeper hole over the next few years.

I'm not convinced the management team has the ability to turn things around, even after Badger's latest presentation. Competition is going to increase with time, and it's going to be even harder to turn things around.

I'd avoid Badger like the plague right now, at least until the management team can show investors a real plan that works instead of issuing vague positive statements and no promising metrics showing improvement.

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Author

joefrenette

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