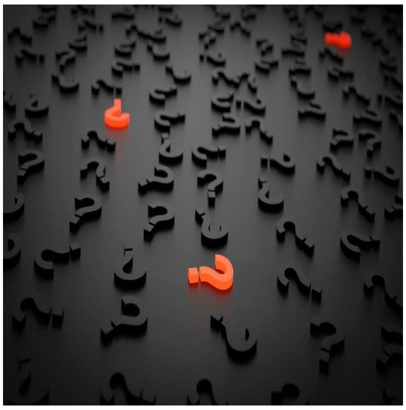

Is Aecon Group Inc. (TSX:ARE) a Buy on Dipping 25%?

Description

Aecon Group Inc. (TSX:ARE) stock fell about 25% from a high of about $20 per share to below $15 per share as of recent trading after the Canadian government blocked a state-owned Chinese company from taking over Aecon because of national security.

The Chinese company's bid price was $20.37 per share. With Aecon now trading at a roughly 26% discount from the bid price, should investors be jumping in?

First, let's determine whether Aecon is the type of business you would like to own.

What does Aecon do?

Aecon is a leading Canadian construction and infrastructure development company. It provides integrated turnkey services to clients in both the private and public sectors. It primarily operates in the segments of infrastructure (about 35% of revenue) and industrial (62%).

Aecon and its predecessor companies have helped build many of Canada's most famous infrastructure landmarks, including the CN Tower, St. Lawrence Seaway, the Vancouver SkyTrain, etc.

Balance sheet

At the end of March, Aecon’s long-term debt to adjusted EBITDA (excluding convertible debentures) was 0.8 times and long-term debt to adjusted EBITDA (including convertible debentures) was 1.9 times, which were slightly lower than its three-year average of 0.9 times and two times.

Its net debt to EBITDA has been more volatile. At the end of March, it was 0.4 times, which was within the three-year range of 0.1 and 0.5 times. Thus, its balance sheet strength aligns with that of its recent past.

Valuation and returns potential

At under $15 per share, Aecon trades at a forward price-to-earnings multiple of about 18, which is cheaper than its larger peers, which are trading at a forward multiple of closer to 20.

The analyst consensus from **Thomson Reuters Corp.** has a 12-month target of $18.70 per share on the stock, which represents about 25% upside potential. Adding in its roughly 3.3% yield, today’s buyers can potentially get a near-term return of about 28%.

Investor takeaway

The construction sector is cyclical. However, Aecon had a backlog of $4.6 billion of projects at the end of March, which increased 5.7% year over year; management estimates further growth to that backlog.

If the energy and mining sectors continue to improve, it’ll certainly be a tailwind for Aecon, and the company could experience an upcycle for the next year or two.

Notably, in the last recession, the stock fell about 67% from a peak of $23 per share to a trough of $7.50 per share. So, you probably don’t want to hold Aecon through a recession.

For a big margin of safety on the stock, look for an entry point closer to $10 per share.

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