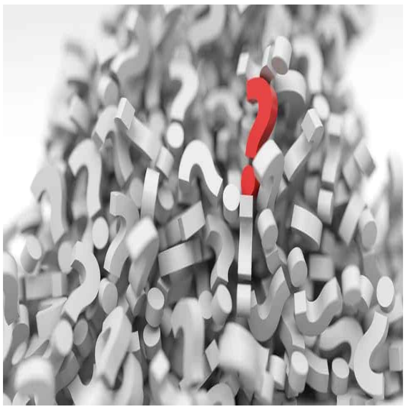

Is Linamar (TSX:LNR) Still a Buy After Missing Expectations?

Description

We're currently operating in a market that couldn't care less if a stock beats analysts' estimates by 25%, but if it misses by a penny, look out.

Linamar Corporation (TSX:LNR) announced Q1 2018 results May 15. Analysts were expecting EPS of $2.42; Linamar came in five cents short at $2.37 a share, 7.7% higher than a year earlier.

Not cool, investors said, sending its stock down 12% in the two weeks of trading since. Like I said, investors have no patience for earnings misses in an economic environment where most companies are routinely beating analysts' estimates.

Should Linamar shareholders be worried? Well, yes and no. Here's why.

Why should you be worried about Linamar?

If you look at the company's market snapshot for 2018 and 2019 in its Q1 2018 conference call slides, you'll see that it doesn't expect much growth from its automotive light vehicle and commercial truck businesses over the next two years.

Add to that a 4.2% decline year over year in the transportation segment's operating profits, and you're right to be concerned about its core business (transportation accounts for 79% of overall revenue) losing momentum.

However, if you exclude currency, operating earnings in the transportation segment would have increased slightly. Also, factor in the fact that North American auto sales are contracting at the moment and you've got a business delivering record revenues and content per vehicle despite the headwind in its largest geographic market.

The other thing to be worried about is its level of debt as a result of its February $1.2 billion acquisition of Winnipeg-based MacDon, a maker of agricultural machinery. A year ago, Linamar had net debt of $1.06 billion, or 0.97 times pro forma EBITDA. In Q1 2018, it was $2.16 billion, or 1.79 times proforma EBITDA, which is double what it was a year ago.

The company does plan to get the level of debt back below 1.0 times EBITDA within 18-24 months.

Why shouldn’t you be worried about Linamar?

Linamar set a record for content per vehicle (a key productivity indicator for the automotive business) in all three of its geographic operating regions: North America at $170.02, 9.1% higher year over year; Europe at $76.66, 16.1% higher; and Asia Pacific at $9.80, 7.6% higher than a year earlier.

In 2014, Linamar’s North American automotive business had $130.57 in content per vehicle. Today, it’s 30% higher. In Q1 2018, despite a 2.2% decrease in the number of vehicles produced, Linamar increased its content per vehicle and sales by 9.1% and 6.9% respectively.

What do they say about making lemonade out of lemons? That’s exactly what Linamar is doing and it’s a big reason why I continue to love its stock.

Now consider diversification of earnings for a moment.

A year ago, the company’s industrial segment had operating earnings of $45.8 million, or 23.8% of Linamar’s overall operating profits. In Q1 2018, they were $74.7 million, or 34.8% of Linamar’s overall operating profits, an 11 percentage point increase.

If you’re a shareholder, that’s something to celebrate.

“The key to continuing our strong performance is an intense focus on new business wins, which we are delivering on in spades in the most opportunistic sourcing environment in the automotive sector we have ever seen,” said CEO Linda Hasenfratz. “Concurrently excellent growth opportunities in robust markets for our Skyjack and MacDon businesses is painting an excellent picture of global prosperity for Linamar in the future.”

Sure, NAFTA negotiations are weighing heavily on the automotive industry in Canada, but Hasenfratz seems quite upbeat for a company that’s about to get a smack down. I suspect she realizes that Trump isn’t about to throw Detroit’s big three under the bus just to make a point on trade.

The bottom line on Linamar stock

Hasenfratz bought 2,000 shares of Linamar stock on May 23 at more than $68, the first shares purchased by the Linamar CEO since the end of 2017.

To me, when CEO’s buy stock on the open market, it’s always a good sign.

In five years’ time, Linamar missing the estimate by five cents will be very much in the rearview mirror. In my opinion, it’s still a buy.

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