A Deal With Dubai Just Made This Stock a Cash Cow

Description

SNC-Lavalin Group Inc. (TSX:SNC) hit the headlines this week with a $90-million contract to design and build three brand new electric substations in Dubai. Our very own Montreal-headquartered engineering and construction giant made the deal with Meydan Group LLC., which will develop the substations for use in its Meydan One project that's set to house some 83,000 residents.

Among the projects objectives for SNC will be three two-story buildings, plus all of the electrical equipment and machinery necessary for the three new substations, which are due to go live late next year.

Generally held to be one of the stars of Canadian engineering and construction stocks, SNC is a solid dividend payer with a share price that reflects affordability and reasonable value. While some analysts might be bearish on domestic construction at the moment, would-be investors should look to the wide geographical spread of SNC's operations, its ubiquity in the engineering industry, and the good standing with which it is held in investment circles.

Let's put SNC under the microscope and weigh the pros and cons of holding this stock.

Pros

Overvalued by about $9 a share compared to its future cash flow value, SNC-Lavalin Group's multiples are indicative of moderate market-weight valuation. A P/E of 25.6 times earnings is a little higher than the TSX index average, but lower than the industry. Its PEG of 0.8 times growth is good considering that there's a 34% expected annual growth in earnings around the corner. Its P/B of 1.9 times book is a little higher than the Canadian construction industry average, but not too bad.

A dividend yield of 2.05% seriously ups the quality of this stock, making it an eye-catching pick for growth investors looking for some passive income while waiting for those tasty capital gains.

Cons

SNC-Lavalin Group has a positive year-on-year earnings growth rate covering the last half-decade, although its most up-to-date earnings report showed a dip below the average. That said, SNC-Lavalin Group's 12-month earnings growth is in excess of its five-year average by 66% to 5.5%. In short, it's had a good year, though not a great last quarter.

A low level of unsold assets make this stock one of middling health, which is let down by high debt: 66% compared to net worth. While this represents a reduction over the last five years, risk-averse investors should be aware that operating cash flow is currently negative, this debt may not be well covered. While this isn't an issue if the global economy continues to tick over, a downturn and/or drying up of new contracts may cause this debt level to become a concern.

The bottom line

Would-be investors should consider whether new contracts and attention-grabbing headlines make up for a less-than-robust balance sheet. SNC is a very stable asset to hold, with wide geographical diversity and an enviably broad spread of technical operations, making it one of the most famous names in the construction industry. With a strong past performance, that projected annual growth in earnings of 34% looks more than achievable.

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