3 Reasons This Industrial Stock's Not Ready for the Scrap Heap

Description

If I told you at the beginning of the year that **Linamar** (TSX:LNR) stock would be down more than 30% heading into the final month of the year, I'm guessing most in the know would have scoffed at the idea.

Yet, here we are at the beginning of December, and Linamar stock is facing down a significant loss.

There hasn't been a lot of good news in the automotive sector in 2018. The November 26 announcement from **General Motors** that it is cutting 14,000 jobs, and shutting five North American plants including the one in Oshawa certainly didn't help investor enthusiasm for auto parts manufacturers, but the company's overall business isn't nearly as stuck in the mud as its stock price suggests.

Here are three reasons why I feel this way.

Earnings and revenues still good

Linamar reported third-quarter earnings November 7 that included an 18.6% increase in revenue to $1.8 billion and a 13.7% increase in operating earnings to $161.4 million.

There's nothing terrible about those numbers.

The company is well on its way to generating more than $1 billion in annual adjusted EBITDA, the first time in the company's history.

Sure, you could argue that the 19.9% decrease in its transportation segment's operating earnings in the quarter on a 4.9% increase in revenue, is a sign the troubles facing the automotive sector are real and growing.

Problems in Europe overblown

However, that would neglect the fact its European business' customers faced lengthy delays due to the worldwide harmonized light vehicles test procedure for CO2 emissions.

"Really that's the key story for the quarter, is the impact in Europe thanks to WLVTP," CEO Linda Hasenfratz stated in Linamar's Q3 2018 conference call. "You don't see $100 million in sales float out without feeling some impacts from that. And our customers were absolutely not giving visibility on the depths of the issue."

How big an impact were the delays in Europe regarding earnings?

In Q3 2017, earnings in Europe dropped 8% or $30 million. Due to WLVTP, European earnings in this year's third quarter were down 22% or $100 million.

MacDon and Skyjack deliver

Fortunately, its industrial segment contributed in a big way in the quarter, making up for the lost income and then some, with revenues and operating earnings up 86.2% and 121.3% respectively.

A big chunk of that is due to its acquisition of MacDon, a Winnipeg-based manufacturer of agricultural equipment it acquired in February for $1.2 billion, but it's also because of Skyjack's market share gains during the quarter.

In Q3 2017, the transportation segment accounted for 76% of Linamar's operating earnings; in Q3 2018, it was 54%, as the industrial segment and MacDon brought new balance to its revenue and profit streams.

The bottom line on Linamar stock

Linda Hasenfratz believes that between the company's opportunities to gain market share in the automotive segment combined with the strong performances of both Skyjack and MacDon, that Linamar's future growth is all but assured.

Trading at 4.9 times its forward 2019 earnings estimate of $9.83 a share, the lowest level in a decade, it's hard to imagine that Linamar stock will have a poor repeat performance in 2019.

And while there are macroeconomic concerns to worry about, like ongoing steel and aluminum tariffs that will hurt customer profits, other than that, I see a business that's doing just fine and trading at a 30% discount from 2017.

It's not time to give up on Linamar stock.

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