Warning: Avoid SNC-Lavalin's (TSX:SNC) Stock at All Costs

Description

When a stock gets beaten up, value investors start circling. I would caution investors not to fall into a value trap, however. There are times when a company is cheap because there are some significant underlying issues. Case in point: **SNC-Lavalin** (TSX:SNC).

SNC-Lavalin's legal struggles have been well documented. It has not helped the company that its bribery issues was at the heart of a Canadian government scandal. Any hopes of securing a deal with the Feds have therefore been greatly reduced.

Last week SNC-Lavalin released first-quarter results. The market did not react well, sending its share price crashing. Since releasing earnings, the company has lost 11% of its value. The company entered oversold territory and it is starting to look attractive from a numbers perspective. Year to date, it is down 36% and its value has been halved over the past year. SNC's share price has hit a 10-year low.

Does this make it a good buy? Let's take a look.

First-quarter earnings

It wasn't pretty. Last Wednesday, SNC-Lavalin reported a 73% earnings drop and revenue dropping to $2.36 billion from $2.43 billion last year. Adjusted earnings per share came in at $0.21 per share, thereby missing analysts' estimates by $0.12 per share. Cash flow was negative, and its main unit posted a surprise loss of $0.10 as compared to a profit of $0.44 per share a year ago.

Management was "disappointed" with first-quarter results — and who wouldn't be? The company is facing a hit to their brand and it is losing out on key contracts. In the fourth quarter, SNC-Lavalin said it lost out on $5 billion in contracts due to the overhang of its Canadian legal battles. It recently pulled out of Saudi Arabia, a key growth market and is in a contract dispute with a mining company in Chile.

The hits keep coming. Along with first-quarter results, the company announced it will be pulling out of 15 countries. Siting unprofitable and sub-scale operations, the company is instead focusing on *“work in infrastructure and oil and gas only in our core regions where we have strong capabilities.”*

It also announced that it will no longer bid on fixed pricing contracts in the mining industry.

Too much uncertainty

SNC is starting to look cheap on a number of metrics. It is trading at a significant historical discount to sales and book value with a cheap forward price-to-earnings of 10.99 and is undertaking a significant cost cutting program. It has a healthy backlog of projects worth $15.8 billion and despite negativity booked $3.2 billion in new projects in the first quarter. It also reiterated full-year adjusted earnings per share of $3.10 at the mid-range of guidance.

The reality however, is that there is too much uncertainty. Each quarter brings along with it more bad news. Only a few months ago, the company was a Dividend Aristocrat. It has since cut its dividend.

It was also growing at a double-digit pace, and has since been forced to pull out of its highest-growth market (Saudi Arabia). Its credit rating has been dropped to BBB and is at risk of being blocked from bidding on federal contracts. If that weren’t enough, a conviction on bribery charges could spell trouble for existing contracts. Analysts estimate that Canadian federal contracts account for approximately 50% of its current backlog.

It may seem cheap today, and there are times when it pays to be a contrarian investor. The risk however, is too high with SNC-Lavalin.

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