This Manufacturing Company Is Trading at Just 5 Times Forward Earnings

Description

The cycle in the automotive market is one of the most-discussed economic cycles. Every so often, the industry goes through its shifts, and after years of record auto sales, they ultimately fall. Investors have become very cautious when it comes to companies engaged in the auto market.

More often than not, when investors are being fearful, opportunities begin to take form. When the auto cycle peaks and goes into decline, the decrease in sales is usually small, yet some of the big auto players' stocks get decimated.

Finding solid companies with good assets and the track record of manufacturing high-quality parts will pay dividends in the long run. One company that is down almost 50% from its 2017 high is **Linamar** (TSX:LNR). Although Linamar is the second-largest auto parts manufacturer in Canada, the company has done well to diversify itself as a multi-industry manufacturing company.

It had 28% of total company sales in Q1 come from commercial and industrial sales, making Linamar more diversified than its auto part manufacturer peers. Despite the diversification, the stock is still being treated as though it is solely an auto parts manufacturer. The stock is now sitting just above its 52-week low.

Skyjack, its aerial work platform company, and MacDon, the farm machinery business, have had a big impact on Linamar's industrial segment, which has outperformed its auto business and driven much of the company's growth the last year.

The industrial business has been growing consistently. Q1 2019 had sales up 17% from Q1 2018. Additionally, the operating margins of the industrial business are quite strong at 16.7% compared to the transportation business's operating margins of just 7.9%.

The transportation business has been mostly flat over the last year, as the global auto industry slows down. Linamar expects this to pick up in 2020, which should help to drive better margins. Additionally, higher contents per vehicle in the first quarter for 2019 has helped to offset the decline in total sales from those regions.

The company has a few new projects starting in the commercial truck space. The company will make about 40,000 commercial truck cylinder blocks a year. In addition, the company won a new contract for commercial truck engine components, which is expected to make 35,000 a year.

Linamar is projecting higher free cash flow for 2019 due to higher earnings as well as lower capital expenditures. It has shown strong resilience, posting growth even when the auto demand has dropped off. Revenue from Q1 2019 is up 4% from Q1 2018, despite the European vehicle market being down 5.3% and the Asia Pacific market being down 6.6%.

The company has an impressive record of generating strong results. From 2000 to 2018, earnings per share grew at a compounded annual rate of 16.1%. Additionally, the debt level is manageable with net debt/EBITDA about 1.8 times.

In 2019, Linamar is projecting $500-$700 million in free cash flow, mostly from a reduction in capex. This will help to strengthen an already strong balance sheet.

The tariffs with China have impacted Linamar, but the company maintains the impact is minimal and the losses are recoverable. Even if the company's growth slows down, it is still well undervalued today.

The company pays a 1% dividend and is trading at a ridiculous discount, priced at just five times forward earnings. The price-to-book value is an astonishing 0.7 times. Additionally, the CEO just bought $2 million of stock in December, which is a positive sign for the future.

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