This TSX Stock Is Vulnerable to the COVID-19 Pandemic

Description

Heavy engineering is generally a safe bet to put your money on during uncertain times. This industry revolves around major projects that can't be shut down easily. And if you are one of the world's largest dealers in heavy equipment, it would make sense that those projects would continue to lease equipment from you. However, the ongoing COVID-19 has resulted in widespread lockdowns, making several industries vulnerable.

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Finning International (TSX:FTT) is the world's largest Caterpillar equipment dealer that services customers in Western Canada, Chile, Argentina, Bolivia, the U.K. and Ireland. Finning sells, rents and provides parts and service for Caterpillar equipment and engines.

COVID-19 impacts business operations

The company recently announced its results for the first quarter of 2020. Net revenue came in at $1.43 billion, 16% lower than the same period in 2019. However, EBITDA was $170 million, up 5% compared to the prior-year period due to improved performance in South America. The results are decent when you consider the ongoing effects of the pandemic.

COVID-19 impacted the company's U.K. and Ireland operations earlier than Canada and South America. Equipment deliveries were delayed in all regions and rentals were lower across geographies. Further, component repair facilities saw lower productivity, and a few facilities were temporarily closed in South America. Apart from this, $4 million has been added for doubtful accounts thanks to an increase in customer risk.

Q2 looks grim

The situation appears to be continuing in Q2 as well. Consolidated net revenue in April was down 15%, which means that year-on-year, revenues are down in the 35-40% range. L. Scott Thomson, Finning International President, and CEO said, "In each of our regions, our customers have been reducing capital spending and implementing cost containment measures and business continuity protocols with a range of impacts on activity levels."

He added, "Since the middle of March, some of our customers have scaled back or in some cases, suspended operations to comply with requirements and recommendations of governments and healthcare authorities. We are having ongoing dialogue with our oil sands and mining customers to understand the risk of potential disruptions to our operations."

Finning has furloughed 50% of its staff in the U.K. because activity levels are very low. The company's oil sands producers and contractors have indicated that up to 20-30% of their truck fleets will be parked for a certain period in the second quarter.

Finning also expects a decline in construction activity due to the COVID-19 where "machine utilization hours and product support run rates are down since mid-March, but seem to have recently stabilized."

Liquidity is key amid the COVID-19

As of March 31, Finning had $260 million cash on hand. It has less than $300 million drawn on its credit facility. The company has also secured an additional $500 million committed revolving credit facility.

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The free cash flow generated in Q1 was $50 million. This might be a modest number in a normal business environment but a great number given the pandemic.

Finning will reduce its capital and fleet expenditures to between $90 million to $140 million this year. This is considerably lower compared to its earlier estimate of between $200 million to $250 million. It also reduced its inventory by $250 million in Q1.

Finning stock is down 31% from its 52-week high and has gained momentum recently, which means its dividend yield stands at 4.6%. The stock is currently trading at $17.68 and analysts expect it to hit $21.17. However, I would advise a hold on the stock right now until the world resumes economic activity.

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