



STOCKTRADES PREMIUM COMPANY SUMMARY

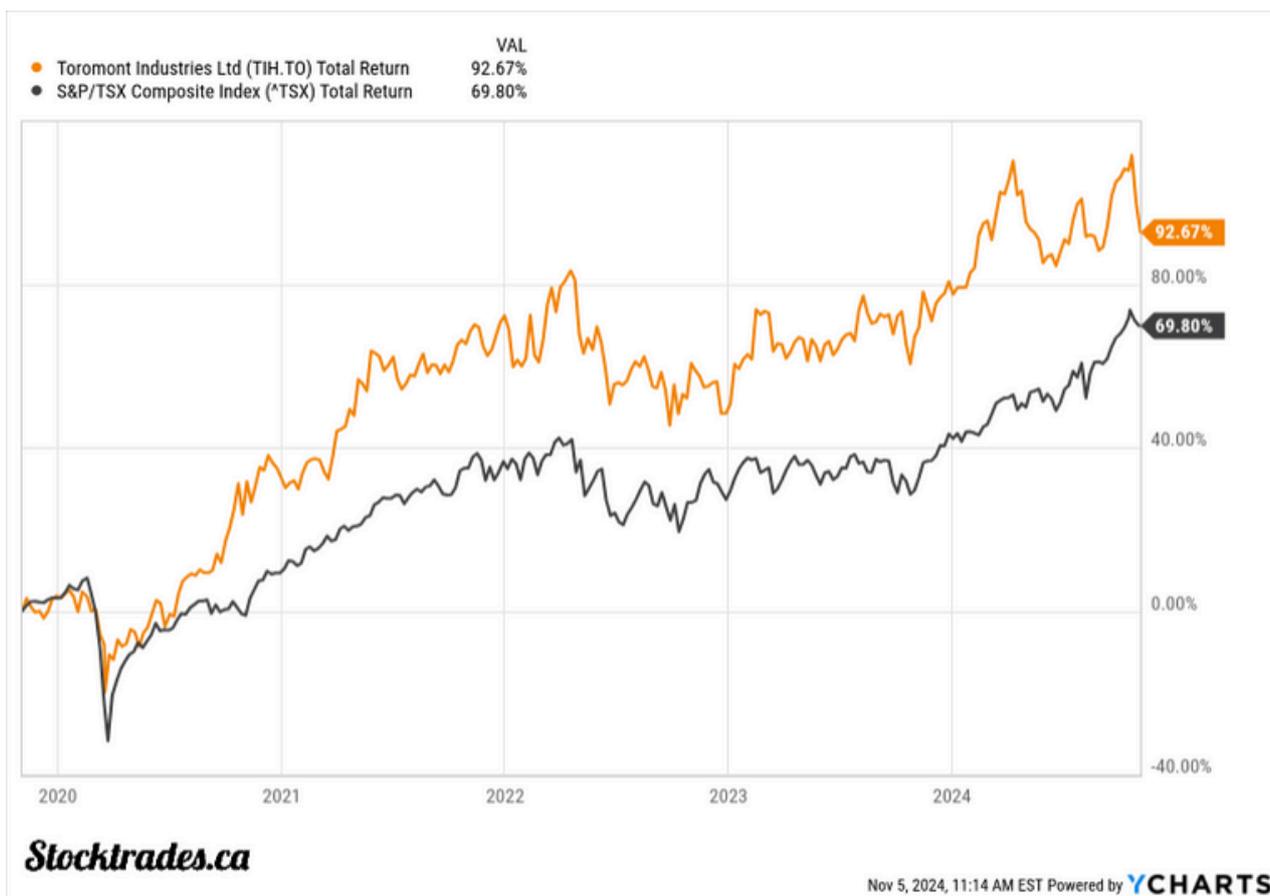
TOROMONT INDUSTRIES

TIH.TO

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Stocktrades Premium



Toromont Industries Ltd is a Canadian industrial company. The company operates two business segments: Equipment Group and CIMCO. The larger segment by revenue, Equipment Group supplies and rents mobile and stationary machines used in road building, mining, aggregates, public infrastructure, residential construction, power generation, agriculture, forestry, truck engines, industrial, demolition and waste management. CIMCO offers solutions for designing, engineering, fabricating, and installing industrial and recreational refrigeration systems. The company operates majorly in Canada and derives a smaller portion of sales from the United States of America and other regions.

Focus Areas	Score (0/100)	Focus Areas	Score (0/100)
Valuation	65	Dividend	95
Profitability	80	Outlook	71
Risk	84	Debt	50
Returns	57	Growth	32
Overall	64		

*Our Risk Rating: Our opinion of the overall risk an investment presents. Can be shown as Defensive (DEF), Moderate (MOD), or Aggressive (AGG). By no means is this an indication of future potential gains or lower volatility.

PROS

- A decade-long history of strong returns on capital and equity
- The company's debt structure and balance sheet are sound
- The company's free cash flow per share has grown by over 550% over the last decade
- Although the company isn't cheap by any stretch, it is trading at a double-digit discount to historical averages across virtually every metric. The last time Toromont has been this cheap, shares went on to outperform the market over the next 5 years
- After a relatively flat 2024, the company is expected to get back to double-digit growth in 2025
- The company has a 34-year dividend growth streak and double-digit annualized dividend growth
- Although the company's primary mining exposure is to gold, the growth of the EV sector presents new opportunities with different precious metals
- Toromont's backlog is hovering near all-time highs

CONS

- The company is heavily exposed to the Canadian economy and Canadian mining sectors
- It relies on the strength of Caterpillar sales
- As an industrial player, it is prone to cyclical economic conditions, which could cause short-term weakness in share price
- The Canadian economy could continue to weaken amidst higher inflation and the possible reluctance of the Bank of Canada to continue lowering rates
- The company is known to issue shares

OVERALL THESIS

We love rock-solid compounders here at Stocktrades, and Toromont is just that. The company is one of the largest Caterpillar dealers in North America. It generates the bulk of its revenue (more than 90%) from its equipment segment. Its CIMCO segment makes up around 10% of revenues and primarily focuses on developing industrial-grade refrigeration systems. Think of things like freezers for food processors and even ice hockey rinks.

The company is now at what we believe to be the bottom of a cyclical downtrend. Looking to the company's record-setting backlog and order numbers, we can see that activity is going to start picking back up. The company has stated that orders have remained relatively cautious from customers due to the higher interest rate environment, and if the Bank of Canada continues to reduce interest rates, we should see a pickup in economic activity on practically all fronts, including oil and gas, mining, and construction. Toromont has significant exposure to all this through both the selling and renting of heavy-duty equipment.

The company's backlog numbers haven't been this high in nearly 15 years. Although it is a smaller portion of revenue, its CIMCO segment is benefitting significantly from companies that wish to improve energy efficiency and reduce greenhouse gas emissions. Ultimately, global warming and the demand for companies to reach carbon neutrality should be a tailwind for this end of the business.

Despite some reasonably harsh economic circumstances, the company has continually maintained 15%+ returns on invested capital and 20%+ returns on equity. It takes on debt sparingly, and with only around \$600M in long-term debt, while trailing twelve-month free cash flows come in at \$470M, the company is going to be able to continue to invest more capital back into the business and generate long-term shareholder returns.

At this point in time, we view the company as somewhat of a value play with a strong element of dividend growth behind it. The company is currently trading at 10.2X EV/EBITDA, which represents a double-digit discount from historical averages. Typically, whenever we see Toromont hit these types of valuations, it tends to go on an upwards run afterwards to get back to historical averages.

To cap this off, we have a company with a 34-year dividend growth streak and a 5-year average dividend growth rate of 10.5%.

POTENTIAL RISKS

With Toromont being a supplier of heavy equipment and refrigeration systems, it generally benefits more from a healthy economy. This is precisely why the stock is caught up in a bit of a downtrend, trading sideways for the better part of two years. If the economy continues to weaken, rental and equipment sale demand will no doubt fall, causing results to slump. Outside of the economic cyclical nature of the company, it also has heavy exposure to the mining

industry, and as such, when commodity prices fluctuate, results will often fluctuate. During periods of high oil and gold prices, companies will often purchase and lease more equipment to take advantage of higher prices. When commodities dip, they'll do the opposite.

Beta	2.43
Alpha	-6.4
Our Risk Rating	Mod*
Max Drawdown	73.6%

The company is also heavily exposed to the Canadian economy. Considering Canada's exposure to the demand for heavy equipment (precious metal mining, oil and gas extraction), this is to be expected, but it is still somewhat of a risk. A weaker Canadian economy could ultimately produce weaker results.

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Finally, although Toromont has ultimately been the better company and has had a larger presence over the years, it does have some competition in North America via Finning, another Caterpillar retailer. Although there is plenty of space for both in the sector, the possibility of Toromont losing market share to Finning must be considered.

VALUATION

	TTM	5 Year Average	Industry Average
P/E	19.14	20.66	14.53
P/S	2.08	2.11	0.74
P/B	3.49	3.86	2.19
P/FCF	35.26	29.6	51
PEG Ratio (FWD)	N/A	N/A	N/A

Toromont is trading at a discount to both its 5- and 10-year historical valuations on practically all fronts. If we include its valuation on an EV/EBITDA basis of 10.2X, this is also trading at a double-digit discount.

Over the last decade, whenever valuations on an EV/EBITDA basis have gotten this low, a large stock price runup has followed.

For example, when the company traded at 9X EV/EBITDA in 2016, its shares would go on to double over the next 3 years. When it traded at 9X EV/EBITDA during the COVID-19 pandemic, its shares would double over the next 2 years.

In 2023, the company hit 10X EV/EBITDA, and its share price would go on to increase 30% over the next year.

Should we expect Toromont's share price to double now that it sits at these lows? It is unlikely, but it's also important to understand we don't need the company's share price to double over the next couple years to make this a viable investment.

If we consider ourselves to be in the bottom of a cyclical downtrend in the economy, Toromont should be able to benefit from its valuation trending back toward historical numbers. A pickup in the Canadian economy and mining sector would fuel bottom-line growth in the future, ultimately driving its share price upwards as well.

It's not just me who views the company as undervalued either. Toromont has been known to issue shares in the past to provide funding. However, at this point in time, the company has begun to repurchase shares, a sign management sees not only a discounted share price but also a promising future outlook.

COMPETITOR ANALYSIS

	TIH	CAT	FTT
P/E	19.14	17.80	11.66
P/S	2.08	2.07	0.54
P/B	3.48	2.2	9.6
P/FCF	35	19	17.2

The first thing you'll likely notice from the competitor analysis is the fact that Finning, arguably Toromont's largest competitor, trades at a large discount in terms of valuations. However, when we consider the two companies' operational results, we're not surprised that Toromont trades at a premium. Toromont has a stronger and more consistent history of cash flow growth, higher returns on capital, and nearly double the operating margins. Although there is no guarantee this strong gap in performance will continue, it has done so for long enough that we are comfortable paying the premium valuation for Toromont today.

DIVIDEND ANALYSIS

Dividend Yield	Earnings Payout Ratio	5 Year Dividend Growth %	Dividend Growth Streak
1.6%	27%	13.3%	34

Toromont is one of the strongest dividend growth stocks in the country, with a consistent history of double-digit dividend growth and a 34-year dividend growth streak. With as strong of returns on capital that Toromont has, the company doesn't necessarily prioritize the dividend.

In fact, historically, investors have been better off letting the company invest the money internally to generate strong shareholder returns. This is a significant reason why the company has grown the dividend at a double-digit clip for a long time yet still only yields in the 1.6% range.

Its payout ratio sits at just 25%~, which likely means the company will be able to continue to grow the dividend at a double-digit clip regardless of economic circumstances. As long as the company can continue to provide strong internal returns with the earnings it generates, it is unlikely the company will become a high-yielding option for Canadians. However, because the dividend is just one element of total returns, we're perfectly fine with this.

RECENT EARNINGS

Earnings Estimates	2024	2025	2026
EPS	\$6.24	\$6.63	\$7.26
Revenue	\$4.74B	\$5.1B	\$5.36B
EBITDA	\$874M	\$912M	\$975M
EBITDA Margins	18.4%	18.9%	19.6%

Toromont reported a mixed third quarter. Revenue of \$1.338B topped expectations for \$1.28B, but earnings per share of \$1.58 missed estimates for \$1.68.

On a year-over-year basis, revenue is up by 14%. Its Equipment segment grew by 14% year-over-year, and its CIMCO segment, the one that primarily focuses on refrigeration, grew by 17% over the same period.

The company's gross margins declined to 24.5% on the quarter, which is a 410 basis point (4.1%) reduction on a year-over-year basis. This drove the vast majority of the decline in overall operating income.

The company's gross margins are often cyclical based on the amount of support revenue it generates, as this is typically the higher-margin, more profitable segment of its equipment sales. Lower product support revenues relative to its total revenues often lead to a weaker margin profile.

As mentioned, operating income declined by 12% as the company realized lower margins on the quarter along with higher spending in terms of future growth initiatives.

Bookings increased by 4% on the quarter, primarily driven by the Equipment group. The company states it lost some bookings in its CIMCO group to a major competitor. This isn't all that surprising, as it has less of a moat in the CIMCO segment. Overall, the Equipment segment saw bookings increase by 12%, while CIMCO grew only 1%.

Of note is that the company is realizing stronger booking activities, particularly in the CIMCO segment, in the United States versus Canada. This makes sense, as the Canadian economy is struggling much more than the United States.

The company's overall backlog came in at \$1.1B, which is down slightly from the \$1.2B reported in September 2023.

Overall, it was a relatively strong quarter considering the economic backdrop the company is operating in. The long-term thesis of an economic rebound and a discounted valuation remains well intact. I will continue to add shares on a routine basis moving forward.

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