10 Small Cap Values as Markets Stabilize

As markets have rebounded we have started to see some bifurcation as phase one of the bear market sell-off sold off nearly every stock regardless of fundamentals which creates opportunity for investors. I have recently spent time highlighting some of the higher quality mid-cap and large cap quality companies for long-term investors and now am applying a similar methodology that provided ten stocks of interest.

These stocks cleared all the hurdles showing a history of above industry-average growth, positive ROIC, healthy margins, strong Free Cash Flow (FCF) and a pristine balance sheet. I will briefly touch on each of these names below as well as how they fit into the COVID-19 era.

Snap-On (SNA) is the largest name on the list with a $7B market cap and after being a favorite short the last few years shares are now looking quite attractive. Snap-On is a leading provider of tools and diagnostics to the vehicle services industry and vehicle repair remains an essential business. Although it could face some headwinds from work-at-home with less miles driven the larger tailwind of increasing average age of vehicles and a slowdown in new/used car purchases as well as consumer budget constraints puts it in a good position coming out of the economic lockdown. SNA is planning on expanding its presence of franchises, extending services to critical industries and building out its business in emerging markets. SNA shares are currently trading 7.8X FY20 EV/EBITDA, 9.85X trailing earnings and offers a 3.55% dividend yield with a strong balance sheet.

Gentex (GNTX) is a $6.1B auto parts provider focused on automatic-dimming rearview mirrors and electronics. GNTX clearly faces some headwinds near-term with the halt in auto production but is positioned in digital content opportunities and specific key technologies across the automotive industry. It should be positioned to further capture higher content per vehicle and unlike most of its peers it carries zero debt. GNTX is also expanding to other markets with a recent key contract with Airbus in Aerospace. GNTX shares currently trade 14.4X trailing earnings, 9.3X EV/EBITDA and 15.8X FCF with a 2% dividend yield. GNTX also has a strong cash position and should be able to withstand the weakness in global vehicle production better than peers and if consolidation were to continue in this industry it would be a primary target.

FLIR Systems (FLIR) is a $4.85B maker of thermal imaging systems and other threat-detection solutions. It has 59% of its business as Thermal and 49% as Non-Thermal with key technologies including Thermal Sensing, Unmanned Solutions, Machine Vision, Integrated Systems, Radar, Lasers, Navigation, AI and more. FLIR could be an intriguing play on COVID-19 with its solutions for unmanned solutions to enhance decision making in public safety. FLIR has a $9B opportunity through 2023 with contract awards it has already won. FLIR is shifting its portfolio after a disappointing quarter. Shares remain a bit rich on valuation at 27.5X trailing earnings, 11X FY20 EV/EBITDA and 20.8X FCF with a 1.97% dividend yield. FLIR has strong operating cash flows and a good cash position with a solid balance sheet.

ITT Inc. (ITT) is a $4.52B maker of engineered critical components and technology solutions for industrial markets. It revenues are divided into Motion Technologies, Connect/Control and Industrial Process. It has exposure to some troubled industries currently with 58% Transportation, 32% Industrial, and 10% Energy while 30% of the business is after-market. ITT has been a strong margin expansion story the last few years and shares currently trade 14X trailing earnings, 7.8X FY20 EV/EBITDA and 21X FCF with a 1.33% yield. ITT trades just 7.4X cash with very little debt. ITT estimates will likely be revised lower but it is a quality company that will emerge strongly out of this environment when the economy picks back up.

Deckers Outdoor (DECK) is a $4.32B footwear company with key brands like UGG, Teva, Hoka, and Koolaburra. DECK has been growing its DTC business which is key for this environment to more than 35% of sales. It is an omni-channel leader with 37% of sales coming from International markets. DECK shares have seen operating margins expand 700 bps since 2017 and achieved a 20%+ ROIC in 2019. Shares currently trade 14.6X trailing earnings, 2X Sales, 15X FCF and 7X cash with negligible debt obligations. DECK has leading brands that will likely gain market share coming out of this downturn and has cheap valuation and a stellar balance sheet.

Texas Pacific Land Trust (TPL) is a $4B manager of land and resources such as oil & gas, grazing, and other specialty leases. TPL is fully exposed to the Permian Basin so it does face headwinds from Oil prices declines and a potential slowdown in production but in 2019 generated $230M in FCF and carries zero debt with $304M in cash. Its inventory is below $40/bbl for breakeven and also has diversified revenue streams through royalties, water and surface. It is a unique play versus peers with its lack of debt, 40% ROIC and 80%+ EBITDA margins. Its fixed fee revenue streams insulates it from commodity price fluctuations. TPL shares currently trades 12.5X trailing earnings, 10X EV/EBITDA and yields 1.95%.

Acuity Brands (AYI) is a $3.73B provider of lighting and building management solutions and is a leader in connected systems and smart lighting allowing for intelligent spaces. It has a comprehensive product portfolio across all indoor and outdoor applications including IoT. Its business mix is split evenly between new construction and renovation while non-residential is 85% as compared to 15% residential. It is a market share leader in an estimated $20B+ North American market. AYI currently trades 12.3X trailing earnings, 7.2X EV/EBITDA and 8.35X FCF with a small 0.56% dividend yield. It has a very strong balance sheet with $350M in cash and Debt/EBITDA at 0.58X. AYI has faced execution missteps over the last few years but shares are now looking like an attractive value.

Watts Water Tech (WTS) is a $2.9B provider of products and systems to manage and conserve the flow of fluids and energy in residential and commercial markets. WTS receives 65% of revenues via Repair/Retrofit and 35% with new construction while 60% is non-residential and 40% residential. It sees key megatrends as Safety/Regulation, Energy Efficiency, and Water Conservation driving business. WTS is going to see some negative revisions with exposure to Sports Complexes and Hospitality Venues but is positioned well as a necessity spending item for these businesses. WTS shares remain a bit rich on valuation at 21.85X trailing earnings, 11.1X EV/EBITDA and 21.85X FCF with a 1.1% dividend yield, but a company deserving of a premium valuation. WTS is a strong cash generator and effectively deploys capital while generating a 13.4% ROIC in 2019 and seeing margin expansion.

Diodes (DIOD) is a $2.26B company that is a leading global manufacturer and supplier of high-quality, application-specific standard products within the broad discrete, logic, analog and mixed-signal semiconductor markets. They serve the consumer electronics, computing, communications, industrial, and automotive markets. DIOD has diverse end-market applications and a large number of customers that will allow it to weather the storm better than many peers. DIOD trades 15.35X trailing earnings, 1.8X Sales, and 17.2X FCF. It has very little debt and trades 8.6X cash. DIOD has a strong history of operations and management has maneuvered well on the supply side the last few months and although demand-side implications remain to be seen, it is a quality name at attractive levels.

SciPlay (SCPL) is a $1.06B maker of digital games for the web and mobile platforms that includes social casino games and casual family games. It has 7 core games and has seen momentum in user-based metrics. It sees room for further margin expansion with strong operational leverage as games scale and enter a growth phase. SCPL is now trading 17.4X trailing earnings and just 9.55X cash with no debt. SCPL is a growth story trading at cheap valuation while positioned well for an environment with casinos shutdown and consumers looking to stay entertained with an increase of free-time.