

Mossberg's Investor Digest

Best Idea Profile

Alamo Group (NYSE: ALG)

DESCRIPTION:

Based just outside of San Antonio, TX, Alamo Group designs, manufactures and sells equipment used in road maintenance (i.e. snow removal, street sweepers, grass and tree trimming) and agriculture. Founded in 1969, the company has 2,500 employees located in 18 plants in North America, Europe and Australia. Products are sold through a network of independent dealers and distributors to governmental end-users, related independent contractors, as well as to the agricultural and commercial turf markets.

KEY INVESTMENT CONSIDERATIONS:

Recent acquisition of Bush Hog should be immediately accretive to earnings - Alamo Group has recently acquired the assets of Bush Hog, the leading manufacturer of agricultural mowing equipment in North America. Alamo Group paid 1.7 million shares, or about \$26 million, to Bush Hog's former owner. The purchase price was less than 20% of the \$150 million the former owner had paid to acquire the business in 2000. Bush Hog is expected to generate approximately \$110 million in sales during 2009, and should be immediately accretive to ALG earnings.

Smart acquirers – Part of the company's growth strategy is to acquire businesses or product lines that have the dominant position, or the potential to dominate in niche markets. Over the past 10 years, the company has made over a dozen acquisitions totaling approximately \$170 million in purchase price. During that time frame the company added \$45 million in goodwill to its balance sheet. With the exception of a \$5 million charge during 2008 (when the world was falling apart), the company has never taken a material charge to goodwill, which is a strong indication of how their acquisitions have performed.

The economy has limited affect on demand for this type of equipment – Just because the economy is lousy, doesn't mean that grass and trees are going to stop growing, or that snow will stop falling. If you want to drive on the roads, you have to maintain them. Also, just because the tax base has shrunk, doesn't mean that the government entities can stop maintaining the roads...it's a critical part of any economy. Just ask the Romans, maintaining the roads is like death and taxes.

Dominant competitive position in niche markets –

The Bush Hog transaction makes ALG the largest manufacturer of agricultural mowers in the world and adds to Alamo's competitive moat. The company successfully manages multiple brands, which often allows it to have more than two products in the running for competitive bids. While brands are managed separately, the company successfully leverages economies of scale (purchasing power, engineering synergies, etc.) that over a half billion in revenue run rate provides.

VALUATION:

During the first nine months of the year, ALG has produced operating margins of 4.9%. With its efficiencies of scale and pricing power, the company should be able to add at least two margin points over the next couple years, which would put its performance more in line with peers. Deere (NYSE: DE) and Toro (NYSE: TTC) both produce operating margin above 7%. With only 12 million shares outstanding, each margin point equals roughly \$0.25 to \$0.30 in incremental earnings power. Assuming multiples remain unchanged, shares could increase 20% to 40% based on earnings power alone.

(NYSE: ALG)

Investment Data (as of 12/19/09)

| | |
|--------------------------------|----------------|
| Recent Price | \$15.59 |
| 52-Week Range | 9.22 - 18.04 |
| Fiscal Year End | December |
| Dividend | \$0.24 |
| Yield | 1.5% |
| Shares Outstanding | 12 MM |
| Average Trading Volume (3 mos) | 30,000 |
| Market Capitalization | 183 MM |
| Cash | 13 MM |
| Long Term Debt | 70 MM |
| Enterprise Value (EV) | 240 MM |
| LT Debt/ Equity | 0.35 |
| Tangible BV/ Share | 12.55 |
| TTM Revenue | 456 MM |
| P/ Revenue | 0.4x |
| 2010 EPS Estimate | 1.21 |
| P/ EPS | 13x |
| TTM EBITDA | 28 MM |
| EV/ EBITDA | 8.6x |

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