This Stock Is Up 1,726%, Can it Keep Going?

Description

If I had a time machine, I would be tempted to go back to January 2010 and invest all my money in **AutoCanada** (TSX: ACQ), right after its IPO. Since the company has gone public, it's returned an astonishing 1,726%. And that's not even including dividends. That's the kind of stock that can take five years off an investor's retirement age.

With returns that impressive, you'd think AutoCanada invented some sort of cool technology or overhauled the sector entirely. But the truth isn't nearly that impressive. It just buys car dealerships, consolidating an extremely fragmented industry. There are thousands of individuals across the country who own one dealership, and are starting to reach retirement age. AutoCanada swoops in, acquires the assets, and the owner gets to enjoy retirement. It's a great ending for everyone, especially investors.

There's no doubt the company has delivered some impressive results. But once you dig a little below the surface, I'm not sure AutoCanada is worth the lofty valuation the market has given it.

Let's look at its growth record first. In 2010, the company had operating profits of $27.8 million on $869 million in revenue. By 2013, it had grown revenue to $1.4 billion and operating profits to more than $60 million. Operating profit is hovering between 3% and 4% of revenue, and net profit margins are even worse, checking in at about half that. 2013's net earnings were $1.86 per share, putting the company at a price-to-earnings ratio of more than 46 times.

If I were going to pay 46 times earnings for a company, I would want one that doesn't have such thin margins.

Analysts are expecting the company's growth to accelerate. Revenue is projected to rise to $1.9 billion in 2014, and reach $2.8 billion in 2015, which is double 2013's number. Earnings are expected to skyrocket right along with sales, checking in at $2.57 per share in 2014 and $3.92 per share in 2015. That's some seriously impressive growth.

The company currently owns five **General Motors** (NYSE: GM) dealerships, out of its 33 dealership portfolio. Because General Motors doesn't allow a corporation to have full ownership of one of its dealers, the company's CEO is forced to personally take a stake in the dealership, via a different company, which is then controlled by AutoCanada, with the CEO retaining majority voting rights. Often, senior management will hold a stake in these shell companies as well. It's a little odd, and certainly exposes the company to more CEO risk than a lot of investors might be comfortable with.

Additionally, AutoCanada owns 11 Chrysler dealerships, with the majority of those being located in Alberta and B.C. According to the deal it has with Chrysler, the company's sales cannot exceed 8% of Chrysler's nationwide sales, 15% of any province's sales, or 30% of any metropolitan market. Currently, the company accounts for 6.81% of Chrysler's Canadian sales, 16.34% of Alberta's sales, 21.43% of British Columbia's sales, and 44.81% of Edmonton's sales. Alberta and B.C. are the company's biggest markets, so it must iron out a new agreement with the car maker.

Still, there are plenty of other opportunities for growth, especially in the east, where the company only has three dealerships in Ontario, one in New Brunswick, and one in Nova Scotia. Management has said it is seeing a considerable increase in owners who are looking to sell. This is enabling it to pick and choose the best opportunities.

Ultimately, investors are paying a rich price to own a piece of AutoCanada. It does have impressive growth potential, but there are some risks in place that may cause the company to not execute as well as investors hope. If I wanted exposure to the auto sector, I'd probably do it through **Magna** (TSX: MG)(NYSE: MGA), **Ford** (NYSE: F), or General Motors. AutoCanada is just too expensive for me. Saying that, if the company can grow as fast as analysts estimate, it could easily see another 50% upside from here. There's that much potential in the market.

CATEGORY

1. Investing

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2. NYSE:GM (General Motors Company)
3. NYSE:MGA (Magna International Inc.)
4. TSX:ACQ (AutoCanada Inc.)
5. TSX:MG (Magna International Inc.)

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Date
2025/06/28
Date Created
2014/06/20
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