



Warren Buffett Just Invested Billions in This Sector; Should You Join Him?

Description

Yesterday, investors had the chance to learn from the best as billionaire investor Warren Buffett appeared on CNBC.

The chairman and CEO of **Berkshire Hathaway Inc.** (NYSE: BRK.A)(NYSE: BRK.B) mused about all sorts of topics, including U.S. tax policy, why Berkshire Hathaway only owns stocks in its various pension funds, U.S. Federal Reserve policies, and even touching on his pleasure in watching LeBron James end up back with the NBA's Cleveland Cavaliers after a four-year pit stop in Miami.

But Buffett really stole the show when he announced Berkshire's latest acquisition. Berkshire agreed to buy Van Tuyl Group, which is one of the largest operators of car dealerships in the U.S. The purchase price wasn't disclosed, but Buffett did drop a few hints about the size of the transaction, saying that Van Tuyl did \$9 billion in revenue last year, and it was large enough to be included in the Fortune 500 list of largest American companies.

Buffett is bullish on the sector, saying "We will hear, I predict, from hundreds of dealerships in the next year" who would be interested in joining the newest jewel in Berkshire's crown. Buffett sees huge potential for consolidation in the industry over the longer term, since there are thousands of small to medium-sized dealerships in the country each owned individually.

How can Canadian investors play the same trend? It's easy. They can just buy **AutoCanada Inc.** ([TSX: ACQ](#)), which is a Canadian version of what Buffett just bought.

AutoCanada rallied on the news yesterday, closing up more than 6% to \$57.24 per share. Even after yesterday's pop, shares are still down more than 35% since peaking in June for just over \$90 each.

AutoCanada owns 33 auto dealerships mostly across western Canada. Since its IPO in 2010, sales have risen \$869 million to over \$1.4 billion in 2013, with expectations that revenue will hit \$1.9 billion in 2014. Earnings have seen a similar growth pattern, increasing from \$0.73 per share in 2010 to an expected \$2.43 in 2014.

Analysts expect the growth to continue in 2015, estimating that earnings will rise more than 50% to

\$3.67 per share. If analysts are right, AutoCanada is trading at a pretty reasonable 16 times price-to-earnings ratio. That's practically a steal for a company increasing earnings on a 50% annualized basis.

Of course, AutoCanada can't sustain 50% earnings growth forever. Heck, they probably can't even maintain it for more than a few years. But there's still plenty of potential in its market. AutoCanada's management sees the same sorts of opportunities in Canada that Buffett sees in the U.S. Even in Canada, there are thousands of small to medium-sized dealerships ran by sole proprietors who are nearing retirement. Selling these to AutoCanada is the perfect solution.

It's obvious the potential is there. What should investors pay for it?

Let's be conservative and assume 10% earnings growth going forward after 2014. As a reminder, the company is expected to earn \$2.43 per share this year.

- 2015 — \$2.67
- 2016 — \$2.94
- 2017 — \$3.23
- 2018 — \$3.56

At a 10% growth rate, investors are paying 16 times earnings for the company's 2018 earnings. That's not exactly great, but keep in mind that this is sort of a worst-case scenario. And even then, it doesn't turn out to be a horrible investment. That scenario would likely see the stock remain flat, or perhaps decline a bit. Growing earnings at 10% a year is hardly a disaster, after all.

Will Buffett's foray into the sector spark a new wave of interest in AutoCanada? Perhaps, but I can see the name selling off some more if the market continues to be weak. Investors looking to get in would be smart to wait a little while for a better price. But long term, it looks to be a pretty good bet.

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