



Are AutoCanada Inc. Shares Worth \$90 each?

Description

Before his high profile acquisition of Duracell last week, billionaire investor Warren Buffett was busy snatching up a company with a far less recognizable brand name, auto dealership operator Van Tuyl Group. The amount he paid for the company was not disclosed, but Buffett acknowledged the company does approximately \$9 billion in annual revenue.

There's more to the deal than just acquiring car dealerships. Buffett sees Van Tuyl as the beginnings of a huge consolidation in the industry, since there are thousands of dealerships in the U.S. run by a single individual or a family. As these owners start to reach retirement age, Buffett predicts many of them will pick up the phone and negotiate a deal with Van Tuyl.

Of course, shareholders of **AutoCanada Inc.** ([TSX: ACQ](#)) are already familiar with this business model. Over the last two decades, the company has acquired 46 auto dealerships across the country, with the majority located in Alberta and British Columbia. The company has been on an acquisition spree in 2014, acquiring nine separate dealerships in five transactions.

This led to outstanding sales growth in the third quarter. Sales jumped to \$733 million, from just \$402 million in the same quarter a year ago, good enough for an 82% increase. Net profits were also up significantly, rising from \$9.6 million to \$17.7 million. Those are some pretty solid growth numbers.

And yet, as the company was delivering those great results, shares dropped sharply. After starting the quarter at \$80 each, AutoCanada's shares finished it trading at just \$55 each. So what happened?

Well, as is the case sometimes with growth stocks, shares just got a little ahead of themselves. At the beginning of July, when shares traded hands at \$80, AutoCanada's trailing 12-month earnings were just \$1.92. That put the shares at a 41 times the price-to-earnings ratio. That's an expensive multiple, even for a growth stock.

But now, times have changed. Currently, AutoCanada trades at just \$57 per share. Its blowout third quarter bumped trailing earnings to \$2.15 per share. That drops the P/E ratio to 26.5x earnings. It's still expensive, but much less so than before.

Analysts continue to be bullish on the stock too. The consensus estimate for 2015 earnings is \$3.42 per share, thanks to its recent acquisitions adding to the bottom line. That gives the company a forward P/E ratio of just 16.6 times earnings.

To put things in perspective, compare AutoCanada to most of Canada's largest companies. Where else can you find a company growing revenue at 80% per year while trading at a P/E ratio of less than 20? Most blue-chip stocks have similar P/E ratios, but with growth of only 2-5%.

Huge price targets

Usually I don't put a whole lot of credibility in analyst price targets. While they have access to a lot of great information, ultimately an analyst's guess isn't much better than mine. But with AutoCanada, I think they're onto something.

Even after the stock declined from its highs of over \$80, analysts have maintained their bullish ratings. Analysts at **Bank of Nova Scotia** have a buy rating on the stock, with a target price of \$93, which is approximately 50% higher than the current price. **Royal Bank of Canada** and Canaccord Genuity aren't quite as bullish, but their analysts still have price targets of \$80 and \$81, respectively.

Once you factor in the growth from the company's most recent acquisitions, these price targets don't seem outrageous. Look at it this way. In a year, if the company maintains its current 26.5 times earnings multiple and manages to earn the \$3.42 per share analysts expect, that puts the share price at \$90.63. That estimate might even end up being conservative, especially if the company can make another acquisition or two.

Based on the potential growth, it appears AutoCanada shares could be much higher a year from now. But based on the size of the potential market, this is much more than a year-long story. Shares won't be this cheap for long.

CATEGORY

1. Investing

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1. TSX:ACQ (AutoCanada Inc.)

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