



AutoCanada Inc.: If You're a Believer, Now Is the Time to Buy

Description

On the surface, the annual results looked absolutely stunning.

Sales were up 57.2%, going from \$805.7 million to \$2.2 billion. Same-store revenue increased by 8.9%, while same-store profits rose 7.9%. Net earnings were up more than 26%, rising from \$1.83 per share to \$2.26 per share, putting the company at just 15 times earnings. Considering the alternatives in today's frothy market, shares of this company looked to be a screaming buy.

Then why exactly are **AutoCanada Inc.** ([TSX:ACQ](#)) shares down more than 20% during trading after the company's earnings were announced last week?

With the annual results came expectations for 2015, and they were not pretty. Management noted that sales at the company's Alberta-based dealerships are falling off a cliff so far this year. Sales at the company's Chrysler dealership in Calgary fell 17.5% in January, while its Japanese and Korean-brand dealerships fared poorly as well, with sales declining 10.2% and 33.3% respectively. Dealerships at other locations in the province are also taking it on the chin.

2014 was a banner year of acquisitions, increasing the total number of owned dealerships from 31 to 48. The problem is the majority of those purchases came in Alberta, most notably the \$91 million spent to acquire Hyatt Group, six dealerships located in the Calgary area.

All-in, approximately 50% of AutoCanada's revenue comes from Alberta. With the province's economy struggling from the bloodbath in the energy market, it's no surprise investors sent AutoCanada shares reeling. Unless oil heads higher in a hurry, the province's economy could take years to recover.

Over the short term, things don't look good. But if you adjust your focus to five years from now, the thesis for AutoCanada doesn't change. It's still on the cusp of a massive growth opportunity.

The future of consolidation

What do Warren Buffett, Bill Gates, and Eddie Lampert have in common, besides being billionaires?

They're all big investors in auto dealerships.

In October, Buffett announced that **Berkshire Hathaway** had agreed to buy Van Tuyl Group, an Arizona-based company that owns 78 auto dealerships. That deal officially closed last week.

Both Gates and Lampert have big positions in **AutoNation Inc.**, one of the largest groups of car dealerships in the United States. Gates owns 15% of the company, while Lampert owns 12%. According to rumours, even billionaire George Soros is interested in making a major investment in the sector.

What do all these billionaires see in auto dealerships? The answer is the same reason why investors should be bullish about AutoCanada over the long term—consolidation. In the U.S., ownership of the nation's 17,000 dealerships is spread out over 8,000 owners. There's a massive opportunity ahead for a few players to become giants in the business.

Same story in Canada

In Canada, the dealership sector might be even more fragmented than in the U.S.

There are 3,000 dealerships in the country with approximately half belonging to a larger group. AutoCanada, with its 48 dealerships, is the largest consolidator in the country.

There are many owners who may have one or two dealerships and are approaching retirement age. These owners could either leave the business to family or try to run it with a manager in place. But most will at least look at selling. After all, who wants to worry about a business like that during their golden years?

If AutoCanada can capture just a small portion of those 1,500 independent dealers, it could easily double its revenue and profit again in the next five years.

A value play?

Although analysts expect the company to earn \$3.09 per share in 2015, those estimates came out before management announced how bad Alberta's sales have been so far this year. Let's be conservative and assume the company earns \$2 per share. That still only puts shares at 15.5 times expected earnings.

Plus, investors are now getting a generous dividend to wait. Shares currently yield 3.1%, which is the highest dividend the company has ever offered. Dividend growth has also been stellar, but expect that to slow as management switches to debt payoff mode.

A recovery in Alberta combined with a few more acquisitions paints a very rosy picture for this stock, provided it can get through the downturn unscathed. Considering the size of the potential market, AutoCanada shares could be very higher five to 10 years from now.

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