New Year’s Resolution: AutoCanada Inc.

Description

My New Year’s resolution is to expand my horizons and learn what new companies are out there, so I decided to get a leg up by looking at **AutoCanada Inc.** (TSX:ACQ).

It’s an interesting story. The company is currently in the process of consolidating the car dealership business in Canada. As of the end of 2014, the company owned a total 48 car dealerships, which increased to 54 by the end of 2015. As of the end of the third quarter of 2016, the number totaled 60 dealerships.

In 2014, shares touched a high above $90 per share on the expectation of very large increases in profit due to the consolidation. It didn’t materialize. The problem with exuberant expectations is that they often result in disappointment.

When a company opts for the strategy of consolidation to become a dominant market player, the reality is that consolidation takes time. The integration takes even longer. If everything goes well, then the profitability will follow.

Whether investors like it or not, there will be purchases of dealerships that take much longer to bear fruit than what is otherwise expected. In the past year, this has led AutoCanada to write down a significant amount of goodwill and/or intangible assets, which caused a significant loss to shareholders.

The good news is, the loss was due to a write down and not due to a decrease in the company’s operations. Although things did slow down in western Canada, the business remains excellent, and AutoCanada continues to sell and service automobiles without fail.

Shares are now trading at approximately $23.50 and have a dividend yield of almost 1.75%.

It’s been a terrible two years for long-term shareholders. In 2015, the quarterly dividend was $0.25 per share, which was reduced in the second quarter of 2016 to $0.10 per share. It seems with the weakness in western Canada, management erred on the side of caution rather than paying out capital.

I look forward and not backward. In this case, there is opportunity to invest in a company where management has hopefully learned their lesson.

When considering this security, it is important to understand the metrics that should be used to measure the company’s progress.

The first metric is the gross profit margin, which has been fairly consistent at approximately 16.5%. The second is, of course, revenues on a constant basis. Given the increase in total dealerships, it is essential to estimate what is happening on a per-dealership basis. In retail, this would be referred to as same-store sales.

Given the dividend cut earlier this year, this situation could be similar to a loaded spring ready to bounce at some point down the road. In tough times, most people will favour fixing an old vehicle instead of buying a new one. But that can’t go on forever, and eventually, demand will come back.

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