Is AutoCanada Inc. the Next Great Long?

Description

After reporting earnings last week, shares of **AutoCanada Inc.** (TSX:ACQ) took a tumble on Friday, closing the week at $21.80. Shares were down almost 10% from the previous close of $24.13. If things weren't bad enough, the sell-off resumed on Monday morning as shares took another dive. Currently trading around $20.50, shares may be starting to look attractive.

To summarize, AutoCanada is in the business of consolidating Canada's auto dealerships. As of the end of 2016, the company operated 55 dealerships. Of those, only 44 offered full-year same-store numbers, meaning the company is still in the position of buying and integrating new dealerships. Investors should not forget about what it takes to purchase an auto dealership and integrate all the moving parts at the one location into the greater picture. It will take at least one year to go through the entire cycle — potentially longer to deal with any skeletons in the closet.

At the current price, new shareholders can receive a quarterly dividend of $0.10 per share, translating to a yield of almost 2%. The good news regarding the dividend is that it was already cut in early 2016. Previously, investors received a dividend of $0.25 per share. Obviously, management wanted long-term investors to be in a position of a sustainable dividend while allowing the company to expand into more locations as needed.

Although the business model of growth by acquisition has not been very popular as of late, in this case, it is important to understand the oligopoly approach to the industry. Although there are a number of car manufacturers, the reality is, each car manufacturer restricts the territory for every given location. In doing so, it is assured that no two dealerships selling the same product are in direct competition with each other. Over the long term, the consolidating car dealerships will hopefully retain some pricing power over customers.

Looking at the balance sheet, the company has a significant amount of intangible assets resulting from the purchase of many auto dealerships. Although there is very little equity remaining after backing out these amounts, it is important to measure the $330 million of debt against assets of $1.6 billion and revenues of almost $2.9 billion. In fiscal 2016, the company had total operating income of close to $41 million and cash from operations in excess of $100 million. The long-term debt should not be a concern to investors.

As this company is on the right track to long-term profitability, investors should still be cautious about entering a new position. Until a clear support level has been formed, investors may enjoy watching from the sidelines as they plan the next move.

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ryangoldsman