Contrarian Investors: Be Careful With AutoCanada Inc.

Description

Many aggressive contrarian investors may think that **AutoCanada Inc.** (TSX:ACQ) is a promising long-term turnaround candidate, but so far, many investors have lost their shirts by trying to catch a bottom in the stock which appears to be a value trap. Shares of ACQ are now down over 78% from their all-time high, and there doesn't appear to be any incoming catalysts that could propel the stock out of the hole that it dug itself.

Growth-by-acquisition business model not going well

AutoCanada is a Canadian auto dealership company with the ambitious plans of consolidating the fragmented Canadian auto dealership industry through acquisitions. With more dealerships under its belt, synergies may be unlocked that will result in increased long-term profitability.

The growth-by-acquisition business model sounds promising, but unlike most successful industry consolidators, AutoCanada has been unable to increase its free cash flow. In Q1 2017, AutoCanada saw free cash flow decrease to $0.64 million — substantially lower than the $4.05 million it had in the year earlier.

Tough sell in Alberta

To make matters worse, most of AutoCanada's dealerships are in the struggling province of Alberta, which I believe will continue to be a huge drag. If oil prices remain lower for a longer duration, it's possible that many Albertans may have to postpone their vehicle purchases until times improve.

Auto dealerships are extremely cyclical businesses, and during a cyclical downswing, investors in the stock will take a hit. Of course, the exposure to Alberta is already baked in to the stock price right now, but many investors should still be cautious as things could potentially get even worse in the Albertan oil patch; if this happens, new vehicle purchases may be out of the question for the next several years.

Dirt-cheap valuation

AutoCanada is expected to continue to face headwinds in the coming months, but the stock is extremely cheap right now with a 1.2 price-to-book multiple, a 0.2 price-to-sales multiple, and a 5.2 price-to-cash flow multiple, all of which are lower than the company's five-year historical average multiples of 3.2, 0.4, and 18.9, respectively.

Although it's cheap, I don't see the stock rallying by a meaningful amount in the near term as the headwinds are just too great right now. Prudent contrarian investors would be better off looking elsewhere.

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