Will the Auto Sector Exhale After Another Record Year?

Description

Canadian automobile sales rose above two million in 2017, which represented the highest number in history. However, some of the numbers were a concern for analysts. The light truck segment accounted for 68.6% of all sales in 2017. This segment includes SUVs, pickup trucks, crossovers, and vans. There was a 3.4% decline in passenger vehicle sales.

Auto sales in the U.S. declined in 2017, but still remained fairly strong. The U.S. industry has also seen a greater proportion of sales weighing in the light vehicle segments. This is a particularly interesting dynamic in both countries considering the push against carbon emissions and the concentration of electric vehicles in the passenger vehicle segment.

The top-selling brand in both the U.S. and Canada was the **Ford** F-Series. In Canada, this was followed by the Dodge Ram and the Honda Civic. Four out of the five top-selling brands in Canada were in the light-truck vehicle segment.

An uptick in sales in the latter half of 2017 made it clear that the auto sector was headed for a record year. **AutoCanada Inc.** (TSX:ACQ), which owns and operates a number of dealerships across Canada, saw its stock rise 26.9% over a six-month span as of close on January 11. However, the stock struggled to close the year, falling 3% month over month.

AutoCanada stock failed to build momentum after releasing its third-quarter results on November 9. New and used vehicle sales rose 9.4% and 2.9%, respectively, which reflected broader sales trends. Finance and insurance also generated $39.6 million in revenue which represented an 18% increase year over year.

Auto loan balances continued to grow in 2017 by an average of about 3% year over year, as reported in the late summer. The Bank of Canada is set to make its first interest rate decision for 2018 on January 17. An early hike could throw some cold water on the industry in the early stages of 2018.

NAFTA negotiations also threaten to disrupt the auto sector in 2018. Canadian officials involved in the negotiating process have said that a U.S. withdrawal from NAFTA is becoming more likely. President Trump recently said that he would be open to NAFTA discussions extending beyond the March 2018 deadline.

Some of the top Canadian auto parts manufacturers could be affected by the new auto content demands brought forth from the U.S. The demands include a NAFTA content requirement of 85% — up from the original 62.5%. Representatives also demanded a 50% content requirement from the U.S., which Mexico and Canada quickly dismissed.

Magna International Inc. (TSX:MG)(NYSE:MGA), an Aurora-based global automotive supplier, already has almost 50% of its fixed assets within the U.S. **Linamar Corporation** (TSX:LNR), however, has less than 30%, exposing it to much more risk if such demands were to be accepted.

A slowing Canadian economy and high debt will also likely affect consumer trends. Flexible credit will remain in the auto sector, which should prevent a steep drop off, but investors should expect a downtick in the industry in 2018.

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Date
2025/08/18
Date Created
2018/01/15
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