AutoCanada Inc.: A Falling Knife or a Smart Buy?

Description

AutoCanada Inc. (TSX:ACQ) is reporting fourth-quarter and year-end results today, and with the shares trading at $20.49 at the time of writing, which is 77% lower than highs that were hit in June 2014 and 14% lower than one year ago, investors are left with one question: Is this a great buy, or am I catching a falling knife?

With a concentration of dealers in Western Canada, the company has certainly felt the effects of weak energy markets, as Canadians in that energy-driven economy have lost their jobs, experienced lower disposable income, and have been subject to difficult economic times.

But with oil making a comeback and continuing to trade above $60, we may be in for a recovery in AutoCanada's western markets.

Consensus expectations are calling for EPS of $0.37 in the fourth quarter compared to $0.28 in the same period last year. That's a 32% increase in earnings. The full year 2017 should see an 11% increase in earnings.

Looking further ahead, 2018 expectations are calling for EPS of $1.99 and 2019 expectations are for EPS of $2.31, which means the stock is trading at 10.4 times and nine times, respectively, despite big increases in earnings.

The company is free cash flow positive and remains in a good position to consolidate its markets.

So, the story is still very much a consolidation story, with the market continuing to be fragmented, leaving AutoCanada room to continue to acquire dealerships and drive growth.

Admittedly, the company's balance sheet has a lot of debt, with a debt-to-capitalization ratio of 64%, but if we do in fact see a recovery in western markets, this would drive cash flows, earnings, and, ultimately, the stock higher.

We must recognize that while regionally we can expect strength in Western Canada, country wide, there is pressure on future car sales, as interest rates are rising, and consumers may be in for a period of tightening their belts.

But as of February, auto sales continue to soar higher, with sales increasing 2% in February, aided by a 3.8% increase in light truck sales versus the same period last year.

So, while overall, auto sales can be expected to weaken, AutoCanada will make up for this by seeing increased sales figures in the western provinces (which make up a large percentage of total sales) and by continuing to acquire and consolidate its market.

Lastly, the shares will benefit from the fact that they are not incorporating much good news, and so they are very attractively valued. The upside is therefore big, and good news from the company upon release of its results will therefore move the needle.

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