Acquisitions Drive This Small Cap to New Highs

Description

In certain industries, economies of scale are critical.

Nowhere is this truer than in the automotive industry. It's no longer possible to own one car dealership. You've got to own a bunch of them to make the numbers truly sing.

Down in the U.S., we've seen the consolidation of dealerships into several publicly traded auto groups — the biggest being **AutoNation, Inc.** for new cars and **CarMax, Inc.** for used cars — but up here in Canada, things haven't moved nearly as quickly.

That's why the news that **AutoCanada Inc.** (TSX:ACQ) is buying the Chicago-based Grossinger Auto Group for $110 million is so exciting.

Not only is this the company's first foray into the U.S., but it provides the company with a platform for expansion outside Canada, where it owns 54 dealerships in eight provinces.

"This is a pivotal move for AutoCanada as this U.S. acquisition broadens our geographical reach and brand diversification through adding a combination of domestic, import and luxury dealerships to our portfolio," said Steven Landry, president & CEO. "This is exactly the kind of acquisition that will be instrumental to accelerating our growth."

The 14 dealerships AutoCanada is acquiring are some of the oldest in the U.S. Founded in 1928, it's grown to represent 12 different car brands, generating $523 million in annual revenue, putting it at the 95th spot on the *Automotive News*'s Top 150 Dealership Groups.

That's a 17% bump to AutoCanada's annual revenue and will add $0.15, a 7% increase, to the company's 2019 earnings.

An interesting dynamic

Although AutoCanada is intent on continuing its expansion across Canada, the current North American marketplace dictated it pivot into the U.S., where dealerships are selling for less than they have in the past. Meanwhile, up here in Canada, the competition to buy dealerships is significant. There are definitely more buyers than sellers.

AutoCanada’s CEO believes it can make another five or six acquisitions in 2018 given its finances are better than they’ve been in a long time.

One thing that sticks out for me in AutoCanada’s Q4 2017 report is its adjusted free cash flow of $91 million for all of 2017 — 32% better than a year earlier and the highest it’s ever been.

Based on a current market cap of $617 million, long-term debt of $332 million, and $95 million in cash, AutoCanada currently has a free cash flow yield of 10.7%; generally, value investors consider anything above 8% to be a good deal.

Bottom line on AutoCanada stock

Canaccord Genuity Group Inc. analyst Derek Dley is so impressed by the U.S. acquisition that he raised the company’s 2018 and 2019 earnings by $0.06 and $0.15, respectively, to $2.02 and $2.25, while raising its target price by $2 to $27, 15% higher than where it’s currently trading.

Frankly, AutoCanada is one small-cap stock you can’t ignore.

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