# This Small-Cap Stock Needs Roadside Assistance

## Description

If I told you about a retailer that grew same-store sales by 4.6% in the most recent quarter, you might assume I was talking about **Canadian Tire Corporation Limited** or a couple of the other successful TSX stocks investors are fond of.



You might also assume that the good news would lead to the stock in question going up in value as investors rushed in to buy it.

In the case of **AutoCanada Inc.** (TSX:ACQ), you'd be wrong.

Since the Winnipeg auto dealership group announced its first-quarter results May 3, AutoCanada has lost 17% of its value despite growing same-store revenue by 4.6%. That's not good news for a stock that hasn't had a winning year since 2013.

If there's a stock in need of roadside assistance, it's definitely AutoCanada.

**How low can it go?**

The state of AutoCanada's stock price is a vexing situation for me because I recently recommended the small-cap stock to Foolish readers, arguing that its free cash flow yield of 10.7% made it a compelling value proposition.

Trading at $22.21 on March 23, the news that it was acquiring 14 car dealerships in the Chicago area, the company's first foray into the U.S., I was convinced that it would keep moving higher — and it did for a couple more days, hitting $23.85 in mid-April only to give it all back and then some over the next three weeks.

Now trading at $17 and change, I'm wondering how low it can go and whether or not investors ought to consider taking a flyer on AutoCanada stock.

To determine this, I have to consider whether anything has changed in a material way in the past three weeks that alters the company's intrinsic value.

**What's the big headwind?**

Fool contributor Ambrose O'Callaghan mentioned in late March that auto sales in Canada were slowing and for that reason, he preferred **Leon's Furniture Ltd.** over AutoCanada.

It seems O'Callaghan was on to something because sure enough, AutoCanada saw revenues for new vehicles drop by 4.5% in the quarter, while sales of used vehicles were also down by 4.5%. Overall, AutoCanada's revenues in Q1 2018 were $620.5 million, 2.9% lower than a year earlier.

To make matters worse, its gross margins lost 70 basis points in the quarter to 16.8%. When you're not selling as many vehicles year over year and you're making less per vehicle, your revenues and profits will likely be lower, which is exactly what happened.

As a result of AutoCanada's tepid report, CIBC World Markets' analyst Matt Bank downgraded the company's stock from "outperform" to "neutral," thereby indicating that slower growth is going to affect the multiples that investors are willing to pay for its stock. For this reason, he lowered the 12-month price target from $27 to $22, an 18.5% cut.



That hurts.

**An alternative view**

Forgetting for a moment the same-store sales growth in the quarter, consider a couple of other positives from its earnings report.

First, despite lower gross margins and revenues, it did manage to increase operating profits in the quarter by 1.7% as a result of lowering its operating expenses by 2.4%, which demonstrates that it's doing a decent job keeping on an eye on overhead.

Second, although sales in Canada are expected to slow from the record-setting pace at which they started the year, 2018 will likely still be strong by historical standards. With higher margin products such as light trucks and SUVs continuing to grow as a percentage of the vehicles it sells, margins shouldn't deteriorate too much from where they were in the first quarter.

With the U.S. economy strong, the Chicago acquisition will begin to pay dividends in the second quarter and beyond.

So, while the analyst isn't confident that AutoCanada can deliver the goods, I believe the foray into the U.S. is the beginning of a new and exciting chapter in the company's history.

As it diversifies its revenue base on a geographic basis, thereby reducing the importance of the Alberta market, it provides less risk for investors considering its stock.

**The bottom line on AutoCanada**

I thought it was a buy at $22. At $17, investors who can stand a little risk shouldn't have a problem buying AutoCanada stock at 20% off.

As with all retail, buyers love a deal.

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**Date**
2025/08/23
**Date Created**
2018/05/10
**Author**
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