Why Did Uni-Select Inc (TSX:UNS) Stock Fall 6.65% After Reporting Strong Revenue and Earnings Growth on Friday?

Description

One of the worst retail stocks in Canada so far in 2018, **Uni-Select Inc** (TSX:UNS), had its valuation fall a further 6.65% to $20.35 on Friday after the automotive parts, tools, and refinishing materials distributor released mixed quarterly results on August 10.

Despite reporting a strong 35.6% growth in quarterly sales for the second quarter from a comparable quarter last year and showing some impressive earnings expansion, investors could not show some love for the stock. There are some tangible reasons for this kind of market reaction.

Weak organic growth

Uni-Select's recent sales growth has been led by acquisitions, especially by the 2017 acquisition of The Parts Alliance (TPA) in the United Kingdom.

Consolidated organic growth during the second quarter was a negative 0.7%. The U.S.A. segment's 0.7% organic growth was more than offset by Canadian Automotive Group's negative 3% organic growth. This negative organic growth comes after a zero reading in the same measure during the first quarter of 2018.

Organic growth is a strong measure of business model strength and profitability sustainability.

Trouble in home market

The company's Canada segment showed some surprise weakness during the second quarter, and management has ascribed the persistently soft monthly sales to a generally weak economy. Demand just wasn't there, and no company-specific explanation could be given on this development. The company can't do anything about it but hope that demand returns to its channels in good time.

That said, the strong volume growth during the second quarter of 2017 created a higher hurdle for the Canadian Automotive Group, possibly justifying the negative 3% organic growth for the segment this year. Sometimes, some superior performance is just hard to repeat.

Canadian market performance is proving so consistently weak that management has adjusted their organic sales growth guidance for the segment for the year from between 2.5% and 4% to between 0% and 2%.

However, it was reassuring to hear management say that the company is not losing market share to competitors in the home market.

Higher net earnings, weaker operating margins

Uni-Select's net earnings for the second quarter increased by 30% to $17.9 million, and adjusted earnings grew 10.6% from a comparable quarter a year ago, mainly due to the TPA acquisition and lower U.S tax rates, but overall adjusted EBITDA margin decreased by 180 basis points.

New acquisitions have improved the absolute figures, but some internal weaknesses have been persistently driving margins lower for some time, and this negatively affects stock valuation multiples.

Is there room for recovery?

Uni-Select's U.K. operations are likely to see a seasonally softer third and fourth quarter, but new store openings expected during the second half of this year could support strong organic sales growth. The company has revised its organic sales growth guidance for the segment from 3-4% to 5-7% for this year.

Further, the U.S. segment, which contributed nearly 46% to corporate revenue last quarter, is showing some strong resurgence. Backed by strong sales seen in July and early August this year, management is guiding for a 2-4% organic growth for the year. This is after a 2.8% decline in organic sales during the first quarter and 0.7% organic growth last quarter.

That said, margin improvements are necessary to sustain better valuations. It is encouraging that the company's 20/20 strategic initiative in Canada is promising to generate significant cost savings in the near future.

Most noteworthy, the company has shown some strong growth in free cash flow and improved liquidity during the first half of the year, and that's a positive.

Investor takeaway

Uni-Select's 20/20 strategy in Canada could preserve margins, while the return to organic growth in the U.S. FinishMaster segment can be expected to generate desired top-line and bottom-line growth — great for equity valuation. The depressed demand in Canada is concerning, but U.K. growth through the TPA acquisition and subsequent strong organic growth in that segment could reasonably be expected to shield the consolidated corporate performance from further degeneration.

There is room for some recovery in Uni-Select Inc stock going forward.

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