What's the Big Issue With AutoCanada Inc. (TSX:AQN) Stock?

Description

AutoCanada (TSX:AQN) stock tumbled 26% on elevated trading volume on Friday, August 10 after reporting second-quarter results after market on Thursday. The share price weakness continue to date, leaving investors wondering if there will be an end to the automobile dealer's woes.

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One of the worst retail stocks of this year so far, AutoCanada is undergoing significant changes and increased financial performance uncertainty. I will highlight some of the issues that were instrumental in orchestrating the recent plunge.

CEO and CFO resignations

Since a letter from institutional investor Clearwater Capital Management Inc. on June 11 called for a strategic review of the company's operations, the company has seen a serious senior leadership shake-up, but the latest departures usually produce violent shakeups on any listed stock.

The company's Chief Executive Officer Steven Laundry stepped down on August 9 (effective immediately), and Christopher Burrows resigned from the chief financial officer (CFO) position effective August 10.

AutoCanada has commenced a search for a new CFO, meaning that until then, the company has no CFO, although the outgoing CFO has been retained for a three-month advisory role to allow for a smooth transition. This follows the abrupt departure of the chief operating officer (COO) in July.

The company has lost a CEO, CFO and COO in rapid succession, which may not be a favourable position for a listed company. The execution uncertainty under a new executive team brings unprecedented levels of volatility on the stock.

Further, there was movement in the board of directors this month too.

Two new independent directors were added to the board, and Chairman of the Board Paul Antony has assumed the role of executive chairman. While this is not likely a problem, having an executive chairman of the board could be viewed as a sign of limited board independence.

Limited board independence isn’t so good for a listed company’s corporate governance profile, and some investors may feel their interests are no longer well represented.

Poor financial performance

The company’s second-quarter revenue was down 1.6% as compared to the same period last year, and same-store sales declined by 5.1%. This is a scary development that is likely to hold out for some time, and the latest results were worsened by a 14% increase in operating expenses from a comparable period in 2017.

New vehicle sales saw a 6.9% drop, and the 18.8% increase in used vehicle sales did not add much gross profit, as the segment contributed 9.4% to total gross earnings.

That said, the 6.6% growth in parts, service and collision repair sales is encouraging, and the segment contributed 43.3% to corporate gross profit. The smallest segment, finance and insurance, recorded a 2.4% drop in revenue, but this segment generated 25.5% in corporate gross profit last quarter.

The weak operating performance was worsened by asset impairment write-downs, led by the Grossinger acquisition, where management now expects a longer timeline to operational profitability than anticipated.

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The resultant plunge into a quarterly loss and negative free cash flow from a positive profit and cash flow growth during the same period last year was disappointing.

Worse market outlook

The demand outlook in the North American market isn’t encouraging, and fellow contributor Ambrose O’Callaghan made a good highlight of the impending trouble. Management isn’t optimistic either, stating that many analysts are predicting that the U.S. market has entered a correction that may last two more years, while the Canadian economy may undergo a correction too.

The talk of trade wars that may result in auto tariffs on U.S. exports also adds to the stock’s valuation discounts.

Investor takeaway

There is hope in AutoCanada’s strategic plan that targets addressing the deficiencies in integration of previously acquired stores and improving margins. This plan contemplates an improvement to EBITDA of more than $30 million within 18 months, and if successful, could help reduce the impact of a softer market.

That said, there is an execution risk on the new strategic plan, and the new leadership may have inherited a bad business that may prove harder to fix.

Legendary investor Warren Buffett is on record saying that when a management a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact. I hope this will not be the case here.

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