BRP Inc. (TSX:DOO): Buy on the Dip?

Description

BRP (TSX:DOO), one of the world's leading manufacturer of powersports vehicles, announced September 11 that two of its controlling shareholders were participating in a secondary offering that will see 8.7 million shares sold to the public at US$47 a share.

The reaction was swift and immediate, sending DOO stock down by more than $11 by the end of the week's trading.

Now the question for investors is whether this is a sign that BRP's best days are behind it or merely a long overdue appropriate correction.

As someone who's been on the DOO bandwagon for more than two years and recently made it my favourite Quebec stock to own, it's never a good thing when the stock you're recommending takes a big hit immediately after publication, but that's the nature of the beast.

If you know anything about BRP, you're likely aware that Bain Capital and the Beaudier Group (its controlling shareholders) have owned the company in whole or in part since 2003 when it was spun out from **Bombardier** and then listed on the TSX in May 2013.

Bain is a private equity firm. Its sole purpose is to find companies to buy that are either struggling financially or in need of a growth spurt. In the case of BRP, it was the latter.

Over the next 10 years, it went to work expanding the company's product offering and geographical reach, especially into the U.S., where its side-by-side vehicles (SSVs) rule the powersports industry.

It was only a matter of time

The typical private equity investment is 5-7 years. Get in, fix what needs fixing, grow the business, and get out with a nice profit in your pocket.

“There’s no benefit for a private equity firm to keep holding the business if they think they’ve turned a nice profit on it,” Morningstar equity analyst Jaime Katz told *The Globe and Mail.* “Their business is investing in struggling businesses and turning them around and taking the profit. It’s not about staying invested in really good businesses closer to the peak of the cycle.”

Although Bain and Beaudier aren’t holding all of their shares from the IPO — they sold 14.8 million earlier in the year at $54 a share — after this secondary offering, they’ll still own close to 50 million shares representing 70% of the votes, leaving them very much in control.

You can expect both groups to continue selling shares throughout 2018 and into 2019. I’d expect Bain to exit its position entirely while the Beaudoin and Bombardier families likely would try to retain some sort of controlling interest.

Suffice to say, the added liquidity will be both a boon and a bust to the company’s stock.

“If you look at the average daily trading volume, it’s like 220,000 shares. You’re putting 8.7 million shares into the market,” Katz said. “There’s going to be a complete oversupply relative to demand on the shares that are out there.”

However, to partially remedy that, the company has listed its shares on the Nasdaq Exchange. Trading under the symbol DOOO, shares began trading September 14.

I expect the additional interest from U.S. investors should help reduce the downside from such a big offering.

Should you buy on the dip?

I’m a little gun-shy after both BRP and **Dollarama** — two of my three Quebec stock picks from September 9 — took big, double-digit hits to their share prices last week.

However, those willing to hold for the long-term (3-5 years or more), should not be dissuaded from buying DOO stock (or DOL, for that matter), merely because of a little uncertainty.

Uncertainty provides opportunity. If you’ve got the stomach for it, I’d consider buying on the dip, leaving cash reserve should it fall into the $50s.

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