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Why I am still cautious on AutoCanada

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When AutoCanada Inc. announced late last year that CEO Pat Priestner would move into a new "executive chairman" role, the company said he would focus his attention on things such as acquisitions, a key element of the deal-driven company's growth.

The trouble, though, is an increasing number of Mr. Priestner's deals involve auto dealerships partly or fully outside the AutoCanada umbrella. And as he sells his own shares of AutoCanada stock to finance these acquisitions, it raises the question of how well his interests remain aligned with AutoCanada's shareholders.

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As we examine this issue, let's make this clear upfront: Mr. Priestner is engaging in these deals with the knowledge of the AutoCanada board, and most of what can be known is disclosed to shareholders via the company's securities filings.

Additionally, it is not a new phenomenon at AutoCanada: For several years, inquiring shareholders have known AutoCanada and Mr. Priestner were navigating a thicket of potential conflict.

I outlined some of these issues in May, 2012, in a column called "Why AutoCanada is a (cautious) buy *[http://www.theglobeandmail.com/globe-investor/investment-ideas/why-autocanada-is-a-cautious-buy/article4178633/]*."

Anyone who yielded to my yellow light missed out on an sevenfold gain, from $13 to more than $90, in the next two years, suggesting most shareholders did not care about AutoCanada's potential conflicts. Yet they were very real: Given that major manufacturers Honda, Ford and Toyota would not allow publicly traded companies such as AutoCanada to own dealerships, the company decided that its executives, particularly Mr. Priestner, could own these franchises individually. In June, 2011, the company expanded this allowance to any dealership the company "chooses not to purchase."

In addition, the company was paying more than $10-million to Mr. Priestner's CanadaOne Auto Group for rent on 13 of the dealerships it owned. (The rent figure did not include maintenance and taxes, which AutoCanada was responsible for.)

In the nearly three years since that column, a lot more than the stock-price gain has happened. AutoCanada has continued to grow, to 46 dealerships from 14 in 2006, in part because it's been acquiring a number of General Motors dealerships.

But because GM, like the aforementioned manufacturers, has an aversion to public companies, AutoCanada established a new corporation, Dealer Holdings Ltd., to own them.

Mr. Priestner has 100-per-cent voting control of DHL and he and other, undisclosed AutoCanada officers have a nearly 40 per cent economic stake in it. (AutoCanada notes it places a member on the DHL board, and there is a shareholder agreement that restricts Mr. Priestner's ability to make decisions without AutoCanada's consent.)

The DHL relationship requires over a page of disclosure in AutoCanada's annual information form, but less is known about what Mr. Priestner is doing outside the realm of his AutoCanada partnerships.

Analyst Varun Mehrotra of Veritas Investment Research, in issuing a "sell" rating on AutoCanada shares in December, says industry sources tell him Mr. Priestner now owns seven Toyota, Ford and Lexus dealerships in Toronto, Edmonton, Wiinpeg and Lloydminster, Alta. Mr. Mehrotra notes this is comparable in size to a dealer group AutoCanada paid $100-million for in June. After an AutoCanada stock offering last year in which CanadaOne Auto Group grossed $203-million, Mr. Priestner's stake in AutoCanada is worth about $80-million, Mr. Mehrotra notes.

Tom Orysiuk, promoted to AutoCanada CEO on Mr. Priestner's ascension to chairman, says AutoCanada has not commented on Mr. Priestner's private holdings, does not track their value, and believes not disclosing his outside holdings to its shareholders fits in with its "exemplary" disclosure. (Mr. Orysiuk is also a shareholder in CanadaOne Auto Group with Mr. Priestner, who was involved in answering The Globe's questions on this matter.)

At least one of AutoCanada's relationships with Mr. Priestner has been lessened: In November, 2013, it purchased 11 of the 13 pieces of real estate it was leasing from CanadaOne for $57.8-million. The deal did not include the two leased parcels in Edmonton, where Mr. Priestner owns two Toyota locations, according to Veritas's Mr. Mehrotra. As to why CanadaOne didn't sell all 13, Mr. Orysiuk will only say "The assets sold were the ones that the parties were able to agree upon."

In announcing the deal, AutoCanada independent director Gordon Barefoot said the company "looks forward to the significant cash flow savings to the company." Which leads to my question: If the company can increase its cash flow by purchasing the locations, and the locations had been owned for several years by a group controlled by the CEO, is this not plainly a conflict of interest that has harmed AutoCanada?

“No,” says Mr. Orysiuk, noting the properties were leased at fair market values determined by independent valuators and approved by the board’s independent directors. And the purchase price was evaluated similarly, he says. The change in interest rates, land values and rents over time “resulted in the purchased properties being cash flow accretive.”

“In summary,” Mr. Orysiuk writes in his e-mailed responses, “the company has adopted a strategy which, in addition to have been long disclosed, is one which the company believes to best able to deliver long-term shareholder value in an industry that is somewhat complex and which has required the company to grow in innovative ways that deliver value. The company and its entire management team are wholly committed to executing on its strategy as we believe it has proven that it can deliver that value.”

One company’s “innovative” solutions to its industry’s complexity can also be seen as endlessly, willfully entangling its executives’ personal interests with its own. AutoCanada shareholders should be mindful.

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