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AutoCanada's shares are simply too cheap to ignore

When writing about car dealership owner AutoCanada Inc., the supply of bad puns is nearly endless. For a number of years, it was accelerating, driving in the fast lane, its shares speeding ahead.

In the past year-plus, however, AutoCanada hit a speed bump, or maybe even threw itself into reverse. The shares hit a 52-week low Wednesday. You might say they've landed in the ditch.

The remarkable reversal – at Wednesday's low of $16.20, they were off more than 80 per cent from their high in June, 2014 – has turned one of the Canadian market's top growth stories into something completely different: a long-term value pick. Investors who can look past the recent troubles at AutoCanada, says analyst ***Kevin Dusseldorp*** of ***Veritas Investment Research Inc.,*** should see that the company has a "runway built for takeoff." (Note to Kevin: Let's keep the wheels on the ground – that's an airline pun.)

Veritas' current "buy" recommendation is noteworthy, because it was one of the few firms that doubted AutoCanada during the company's remarkable three-year run starting in late 2011, when the stock gained more than 2,500 per cent. The company's story was compelling: As the only publicly traded Canadian auto seller, AutoCanada was methodically acquiring dealerships, improving their efficiencies and adding substantially to its profits each year.

Nothing much has really changed with AutoCanada's model. The problem is that the company is based in Edmonton, and just under half of its dealerships are in Alberta. In the first three quarters of 2015, ***Mr. Dusseldorp*** says, new vehicle sales were down 10.3 per cent in Alberta and off 15.9 per cent at AutoCanada's locations in the province. AutoCanada's Alberta gross profits were down 20 per cent, he says.

That pretty much ends the growth story, at least for now. Bay Street analysts, whose recommendations are driven in part by 12-month price targets, are having trouble seeing "catalysts" to meaningfully improve the stock in the next year, what with the oil price outlook and AutoCanada's own earnings guidance. As a result, just five of nine have "buy" ratings, with four "holds" in the mix.

"AutoCanada provided what we view as the most cautious commentary we can remember from the company," analyst Derek Dley of Canaccord Genuity said in November when AutoCanada released its third-quarter numbers, and he cut his target price to $28 from $33 as a result. "The company commented it remains unsure of when the Alberta new carsales market will show signs of improvement."
The sharp decline in share price has also meant a collapse in the company's forward price-to-earnings multiples, from a high of 30 in mid-2014 to less than nine today, a level not seen since 2012, per S&P Capital IQ. That's simply too cheap by most analysts' estimations.Applying a multiple similar to car dealer peers can yield a target price of $33, as RBC Dominion Securities' Steve Arthur calculates; Hilda Maraachlian of Cormark Securities Inc., who says AutoCanada deserves a below-peer multiple because of a high level of uncertainty in its forecasts, places a $26 target on the stock instead.
The shares have fallen so far, in fact, that Ms. Maraachlian's Street-low target is a 42.8-per-cent gain from Thursday's close; the analysts' average of $30.88 represents a 69.7-per-cent gain.

AutoCanada has responded to its challenges with an eye to cost management, a renegotiated credit line to give it more breathing room, and an intent to continue acquiring six to eight new dealerships a year, particularly outside the oil provinces.

It has not, however, moved away from a series of transactions in which it co-invests in dealerships with founder and executive chairman Pat Priestner, a policy created in part to work around several auto manufacturers' reluctance to allow publicly traded companies to own their dealerships. This, and other potential conflicts from related-party transactions, have been a matter of concern to me and ***Veritas. Mr. Dusseldorp*** says he'd like to see Mr. Priestner agree to sell his interest in the dealerships to AutoCanada if the manufacturers ease their ownership restrictions. I find the issue much more palatable at a P/E of nine than a P/E at 30.

Veritas' Mr. Dusseldorp, who places a fair value of $28 on the shares, said in December when the stock was at $22 that it was trading close to his estimate of the value of AutoCanada's existing batch of dealerships. That meant, he said, that "investors are getting the company's future acquisition potential for free."
"Now that," he adds, properly returning to the well of auto puns, "is a deal worth driving off the lot."

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