STOCKS DOWN UNDER

15 AUG 2022

ASX Top 200 Stocks Down Under

> *Every time one person buys, another sells, and both think they are astute.*
>
> **- William Feather (1889-1981), Printing magnate, author**

EAGERS AUTOMOTIVE

Car salespeople you can trust

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Stocks Down Under rating: ★★★★

ASX: APE
Market cap: A$3.5BN

52-week range: A$8.65 / A$17.50
Share price: A$13.10

Few ASX companies have been through a more eventful three years than Eagers Automotive. It's been through a merger with one of its industry peers, a share price crash triggered by a negative trading update and then the pandemic, which had a significant impact on the sector beyond the closure of brick-and-mortar dealerships. The stock has substantially recovered from where it was a couple of years ago, but has stagnated for the last few months.

Share price chart

Source: Tradingview

Eagers has been around for a long time

Eagers owns and operates motor vehicle dealerships, selling new and used vehicles as well as parts and services. It has an 11% market share in the new vehicles market although its share of the used vehicles market is just over 3%. Eagers is based in Queensland, but has operations all over Australia and is the leading automotive retail group in Australia and New Zealand.

This company began back in 1913 when Edward Eager founded a family automotive business. It has grown over time through acquisitions, with two of note being the merger with listed A.P. Group in 1991 and the acquisition of AHG in 2019.

2020 was a better year than 2019 – yes, you read that correctly

When the latter deal was sealed in September 2019, Eagers' shares were trading at over $14. But just six months later, at the end of March 2020, they were trading below $3. Obviously, there was the Corona Crash, but for Eagers, the crash began in November 2019 after a negative trading update. New vehicle sales in Australia had declined for the 19th month in a row and were down 8% in the first 10 months of 2019. Consequently, the company's profit for the first 10 months of FY19 (which for Eagers is the same as the calendar year) had dropped 6%. Come late February 2020, at the height of the Corona Crash, the company released its results and the market did not react kindly.

Eagers recorded an underlying operating profit before tax of $100.4m in FY19, down from $103.5m in FY18. However, it made a statutory loss after tax of $80.5m, down from a $97.5m profit the year before. Factors causing the swing included impairments of goodwill and tangible assets, acquisition costs and new accounting standards.

But despite the Corona Crash, 2020 turned out to be a better year for the company. Although dealerships had to close their doors for some periods, there was an unexpected boom in car sales due to COVID-19. Major catalysts were record low interest rates and pandemic stimulus. But there were other underlying factors as well, including people shunning public transport (for fear of the virus), inability to travel interstate or overseas and, at the vintage end of the market, some even saw certain vehicles as an investment option.

In FY20, the company recorded a statutory profit after tax of $156.2m with an operating profit of $209.4m and $8.74bn in revenue. FY21 was even better with a $456.8m statutory profit and a $401.8m underlying profit before tax although its revenue fell to $8.67bn. During FY21, Eagers implemented the merger with AHG, made further acquisitions and was planning to set up shop at the new Brisbane Auto Mall.

Back to difficult times

Despite Eagers' FY21 results, shares are down over 10% in the last 6 months. A lot of this can be blamed on the current equity market environment, Australia's shift to living with COVID and the anticipation of rising rates. Investors believe the latter two factors might cause demand for cars to slow if they have not already. The statistics in this regard are mixed – sales in the March quarter were 0.5% lower than last year, a decline but not a substantial one. However, Eagers has been hit by the current supply chain shortages – specifically shipping delays and semiconductor shortages. Eagers' new vehicle order bank growth is up 215% in 12 months and the gap between orders and deliveries has grown wider.

The company's most recent update came on 12 July in which it announced it expected a pre-tax profit for 2HY22 to be $246m – ahead of the $225-$240m guidance it gave just 2 months earlier. In the years ahead, consensus analyst estimates anticipate revenues to grow but for EBITDA to stagnate. In FY23, analysts expect $9.2bn in revenue and $533.2m in EBITDA, while for FY24, $9.4bn in revenue and $533.5m in EBITDA are expected.

Eagers isn't expensive at just 9.3x EV/EBITDA, although its multiples actually increase for later years as consensus EBITDA estimates come down from FY23 through FY25. So, Eagers could potentially one for the short term, but not the long term. We also like that Eagers has $326m in available cash, $843.1m in available liquidity and low gearing of just 28%, all of which provides the company with ammunition for potential M&A activity. The company will release its full year results on 25 August.

Management team has been around the block

If you did want to take a more bullish outlook on Eagers, longer term, the top reason would be the company's management team. Most of its board members have been with the company for several years and have presided over substantial long-term growth – in 2000, it only recorded $500m in revenue, but today that figure is over 15 times higher. One of the company's directors is Nick Politis, who has a 25%+ in the business and has been a recent on market buyer of shares – he bought over $1.5m in the month of April and another $1.6m in the second half of July. While no one else has as big a stake, most other board members and executives have been around long term. Although CEO Keith Thornton has only been steering the ship for a year, he has been with the company since 2002 and in an executive role since 2007.

We acknowledge market conditions for car dealers are not ideal, given the supply chain issues. But we don't think investors should underestimate the impact management teams can have, even in the worst of times. Given Eagers' management team, the company's long term track record of growth and its reasonable valuation, we're going to give Eagers four stars assuming it can defy consensus estimates for stagnant revenue and earnings and grow both of them.

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