The Stock Picker's Guide to Liquor Stores N.A. in 2014

Description

Liquor Stores N.A. (TSX:LIQ) is Canada's largest retailer of alcohol, operating under the Liquor Barn and Liquor Depot banners in Alberta and B.C. It operates 174 stores in Alberta and 35 in B.C., as well as small operations in Alaska and Kentucky, with 20 stores and 11 stores, respectively. The stock has a current monthly dividend of 9 cents per share, which is an annual yield of 8.75%.

Over the past year, Liquor Stores has been one of the worst-performing non-resource stocks on the TSX. It's fallen almost 40% during that time, due to a number of factors. Investors started selling off interest rate-sensitive stocks during the middle of 2013, hurting many REITs and other similar low-growth, high-yielding names. The company also started to report slowing same-store sales, which will put major pressure on most retailers. Additionally, the government of B.C. announced that at some point it might be willing to allow grocery stores to sell booze.

There are other factors putting pressure on the stock. Barriers of entry to opening a liquor store are fairly low, so we're seeing all sorts of Mom and Pop stores pop up, especially in Alberta, Liquor Stores' biggest market. It also has to deal with grocery store competition, as both **Loblaw** (TSX:L) and Sobeys, a division of **Empire Company Limited** (TSX:EMP.A), have realized that stand-alone liquor stores are both a good use of space and offer convenience for busy shoppers. These competitive pressures aren't about to go away.

Most Canadian provinces don't allow private companies like Liquor Stores to operate within their borders. The liquor business is controlled by provincial governments, and there aren't even rumors that any provinces are mulling privatization. And why would they? Provincial governments can use all the revenue they can get, and operating a liquor monopoly is a pretty easy way to be profitable. Not only do they make money selling alcohol, but they also get provincial taxes on each bottle sold. Would you get out of that business?

Let's take a look at Liquor Stores' balance sheet. Since it grew mainly by acquisition, it's not exactly pristine. It boasts $532 million in assets, but more than $320 million of those assets are goodwill and intangible. These amounts are very high, and I'd be looking for a write down at some point in the future. It also owes more than $155 million in debt, mostly in the form of convertible debentures. While this isn't an excessive amount of debt, investors have to keep in mind that this debt must be paid before any dividends, putting that yield at risk.

The payout ratio for that dividend is currently 144%, which needs to be remedied, and fast. It has increased its borrowing during 2013, meaning it is currently borrowing to pay its dividend. Unless Liquor Stores finds a way to increase earnings, the dividend is at risk in the medium term.

Generally, alcohol is considered to be a recession-proof business, but I don't think it's as bulletproof as people think. Often people switch from premium wine and beer brands when times are good to lower priced brands when the economy is a little weaker. While they still get the sale, margins are affected.

Foolish bottom line

Even though Liquor Stores is trading at near 52-week lows, I don't think it represents good value at this point. The balance sheet isn't great, it doesn't really have any competitive advantage, and the dividend is at risk. I would avoid the stock at these levels. I think you'll be able to pick it up cheaper in the future.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)
2. TSX:L (Loblaw Companies Limited)

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