This 1 Stock Is Hard to Swallow

Description

It has been said that Harvey's makes your hamburgers a beautiful thing.

Unfortunately for investors, this slogan does not apply to its parent company's stock price, which is definitely not a beautiful thing. The stock I'm referring to is **Recipe Unlimited** (TSX:RECP), the parent company of Swiss Chalet, Harvey's and Milestones, just to name a few.

The stock opened at $25.99 on January 2, 2019. As of September 19, 2019 the share price stood at $25.40. Over the past nine months, the stock price has decreased by 2%. Recipe Unlimited is not a good investment due to the lack of a competitive advantage and negative working capital.

Lack of a competitive advantage

At the end of the day, Recipe Unlimited owns a bunch of restaurants that serve food. If you were to ask me what makes it different from other restaurants, I would simply say that one chain costs less money, the other one costs more money and the other one costs the most money.

Below I've provided a brief description of the company's restaurant brands (acquired through acquisitions), and I will leave it up to you to determine whether Recipe Unlimited has found a competitive advantage in the cutthroat restaurant industry.

Swiss Chalet specializes in rotisserie chicken and ribs. Given that customers can purchase a whole chicken from **Costco** for around $5 and a chicken meal from **Loblaws** for the same price as one entrée, this is definitely not unique.

Harvey's specializes in grilled burgers. It's similar to a Burger King but with greater customization and slightly higher prices. It differentiates itself with chains like **Shake Shack**, Five Guys, **McDonalds**, and many more.

Milestones: People who want an experience like The Keg but aren't willing to pay $80 a person for a decent meal.

East Side Mario's is seemingly Italian, but the portions are very small for what you pay. If it were a proper Italian restaurant, then customers would need to be carried to their car. Similar to Swiss Chalet, there are better restaurants at more reasonable prices.

Negative working capital

This is the first company on the **TSX** that I have analyzed that has a negative working capital.

Working capital is the metric used by investors to determine whether there's an excess or deficiency of current assets to current liabilities. It's an important metric, as it determines if the company has enough assets to cover its obligations and if there are additional assets to be put toward growing the business.

As of fiscal year-end 2018, Recipe Unlimited has $200 million in current assets and $461 million in current liabilities for a working capital deficit of $261 million. This is very bad scenario, as if the company's creditors were to ask for payment all at once and the company did not have an operating line, it would essentially have to liquidate assets to pay its creditors.

As an investor, you don't want a company that puts itself in this position.

Summary

On the surface, Recipe Unlimited seems like a good company with revenues increasing each year for the past five fiscal years. As you dig deeper into the company, many issues arise including its lack of a competitive advantage and its negative working capital which poses a risk for investors.

Overall, you should avoid Recipe Unlimited, despite what my colleague says.

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