TFSA Investors: Be Wary About This 1 Stock!

Description

Alimentation Couch-Tard (TSX:ATD.B)(TSX:ATD.A) operates a network of convenience stores across North America, Ireland, Scandinavia, Poland, the Baltics, and Russia. Main revenue generators include the sale of tobacco products, groceries, beverages, fresh food, quick service restaurants, and car wash services, to list but a few.

Couche-Tard also operates stores under the Circle K banner in countries such as Canada, China, Malaysia, and Egypt.

The company reports a market capitalization of $47.32 billion with a 52-week high of $44.47 and a 52-week low of $32.44.

Intrinsic price

Based on my calculations, using a discounted cash flow valuation model, I determined that Couche-Tard has an intrinsic value of $32.49 per share.

Assuming less-than-average industry growth, the intrinsic value would be $31.79 per share, and higher-than-average industry growth would result in an intrinsic value of $33.23 per share.

At the current share price of $42.09, I believe Couche-Tard is significantly overvalued. I would recommend investors follow Couche-Tard into 2020 for an ideal opportunity to buy shares of the company. In the event of a market contraction, investors will be able to purchase Couche-Tard below its intrinsic value.

Couche-Tard has an enterprise value of $43.4 billion, which represents the theoretical price a buyer would pay for all of Couche-Tard’s outstanding shares plus its debt. One of the good things about Couche-Tard is its low leverage, with debt at 12.8% of total capital versus equity at 87.2% of total capital.

Financial highlights

For the six months ended October 13, 2019, the company reports a strong balance sheet with $9.9 billion in retained earnings. This is very good news for investors as it indicates the company's surpluses in the past years have been reinvested to fuel growth.

Couche-Tard reports cash of $1.1 billion on $1.6 billion in short-term lease and debt obligations, which is not enough to cover the current portion of its long-term debt. Given the presence of a revolving credit facility, I am not overly concerned by this, however, I would like to see a company with this history have enough cash to cover its short-term debt obligations.

Overall revenues are down materially year over year from $29.5 billion in 2018 to $27.8 billion in 2019 (-5%). Despite this, the company increased its operational efficiency which resulted in operating income of $1.5 billion, up from $1.2 billion in 2018. Pre-tax net income of $1.4 billion is up from $1.1 billion in 2018.

Senior management is committed to reducing its debt load as indicated by a $300 million repayment of senior unsecured notes, a $4 million payment on its term revolving unsecured operating credit D, and a $16 million payment on its CAPL senior secured revolving credit facility.

The company also spent $173 million on share repurchases, which is a strategy that senior management uses to indicate it believes the current share price is undervalued.

Foolish takeaway

Investors that are looking to buy shares of a convenience store company should steer clear of Couche-Tard for now. Using a discounted cash flow model, I determined the intrinsic value of Couche-Tard to be $32.49 compared to its current share price of $42.09 which is substantially higher.

Thus, I recommend investors follow Couche-Tard's stock into 2020 and wait for an opportunity to buy shares when its share price dips below intrinsic value.

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