



RRSP Investors: Avoid This 1 Stock... for Now

Description

North West ([TSX:NWC](#)) is engaged in retail business in underserved rural communities and urban neighbourhoods. The company provides food, family apparel, housewares, appliances and outdoor products, with food accounting for most of its revenue.

The company's two reported segments are Canada and International (which consists of the United States, Caribbean and South Pacific). Business is seasonal whereby sales are lowest in the first quarter and highest in the fourth quarter.

The company reports a market capitalization of \$1.36 billion with a 52-week low of \$27.22 and a 52-week high of \$33.16.

Intrinsic price

Based on my calculations using a discounted cash flow (DCF) valuation model, I determined that North West has an intrinsic value of \$26.61 per share.

Assuming less than average industry growth, the intrinsic value would be \$25.42 per share and higher than average industry growth would result in an intrinsic value of \$27.92 per share.

At the current share price of \$27.75, North West is trading at its fair value. Thus, I recommend that RRSP investors avoid the stock for now and wait for the price to dip below intrinsic value [before buying in](#).

North West has an enterprise value of \$1.7 billion, representing the theoretical price a buyer would pay for all of North West's outstanding shares plus its debt.

One of the things to note about North West is its acceptable leverage with debt at 21.2% of total capital versus equity at 78.8% of total capital.

Financial highlights

For the nine months ended October 31, 2019, the company reported a strong balance sheet with retained earnings of \$213 million, up from \$202 million as at January 31, 2019.

This is great news for investors, as it suggests that the company's surpluses in previous years were reinvested into the company to fuel growth.

North West reports cash and equivalents of \$52 million with short-term debt obligations of \$22 million, which means the company has enough cash on hand to cover its current liabilities. I am partial to companies in this position, as it demonstrates fiscal responsibility on the part of management.

Revenues are up materially from \$1.481 billion in 2018 to \$1.541 billion in 2019 (+4.1%) with an increase in COGS from \$1.005 billion to \$1.046 billion (+4%) for gross profit of \$495 million for the period (gross profit margin of 32%). Pre-tax income of \$88 million, down from \$98 million in 2018.

From a cash flow perspective, the company increased its capital expenditure spending from \$65 million in 2018 to \$85 million in 2019 (+31%) which suggests the company is investing in itself.

Further, the company increased its long-term debt by \$65 million and \$73 million in 2019 and 2018, respectively. Although the company's debt to total capitalization is acceptable, at 20.1%, I would like to see management make an effort to reduce its debt.

The company is a [dividend paying entity](#) with a current dividend yield of 4.76% achieved by a \$0.33 dividend paid quarterly.

Foolish takeaway

Investors looking to buy shares of a grocery company should avoid North West for now. The company reports solid financials with positive retained earnings, increasing revenue and continue profitability.

Despite this, however, management hasn't made a concerted effort to offset increases in long-term debt. At its current share price of \$27.75 at writing, the company is trading at a premium to its intrinsic value of \$26.61.

RRSP investors should follow the stock and wait for prices to dip below intrinsic value.

CATEGORY

1. Investing

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