TFSA Investors: Where Is This $3 Billion Company Headed?

Description

Premium Brands (TSX:PBH), through its subsidiaries, owns a broad range of specialty food manufacturing and premium food distribution and wholesale businesses with operations across Canada and the United States.

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The company's revenues are cyclical in nature with the first quarter being the weakest and the second and third quarters being the strongest. Premium Brands reports a market capitalization of $3.43 billion with a 52-week low of $69.01 and a 52-week high of $98.87.

Intrinsic price

Based on my calculations using a discounted cash flow (DCF) valuation model, I determined that Premium Brands has an intrinsic value of $41.79 per share.

Assuming less-than-average industry growth, the intrinsic value would be $39.43 per share and higher-than-average industry growth would result in an intrinsic value of $44.38 per share.

At the current share price of $91.64 at writing, I believe Premium Brands is significantly overvalued. Investors looking to add a specialty food manufacturer to their TFSA should avoid Premium Brands for now.

I would recommend investors follow the stock through 2020, as there may be an opportunity to buy shares at a discount.

Premium Brands has an enterprise value of $2.35 billion, representing the theoretical price a buyer would pay for all of Premium Brands' outstanding shares plus its debt. One of the good things about Premium Brands is its low leverage, with debt at 19% of total capital versus equity at 81% of total capital.

Financial highlights

For the nine months ended September 28, 2019, the company reports an acceptable balance sheet with $24 million in retained earnings, down from $32 million as at December 29, 2018.

This is a good sign for investors as it suggests the company's surpluses in previous years have been reinvested to grow the company.

The company reports cash and equivalents of $15 million with current portion of debt of $63 million. This means the company does not generate enough money internally to cover its short-term obligations. That said, its revolving credit facilities and bank operating lines allow it to cover the shortfall.

Revenues are up materially year over year at $2.7 billion in 2019, from $2.2 billion in 2018 (+23.3%), compared to growth in cost of goods sold from $1.7 billion to $2.1 billion in 2019 (+22.8%). Pre-tax income for the period is $86 million, down slightly from $95 million in 2018.

Senior management is taking a proactive approach to debt management as indicated by repayments of $177 million of long-term debt and repayment of bank indebtedness of $15 million in 2019 and $9 million in 2018. This is offset by long-term debt draws of $260 million in 2018.

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The company is a dividend-paying entity with a current dividend yield of 2.29%, which is achieved by a $0.525 per share quarterly payment. The company's cash outflow for dividends amounted to $44 million in 2018 and $54 million in 2019.

Foolish takeaway

Investors looking to buy shares of a specialty food conglomerate should avoid Premium Brands. Despite the company's strong retained earnings, material increase in revenues, and continued profitability, I believe the current share price of $91.64 is a premium compared to its intrinsic value of $41.79.

Investors that are considering buying shares of Premium Brands should follow the stock through 2020 and wait for an opportunity to buy shares of the company at less than its intrinsic value.

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