COVID-19 Impacts on This Growth Stock: The Good, the Bad — and the Unknown

Description

MTY Food Group (TSX:MTY) stock was a darling growth stock for years! From 2001 to 2019, it was nearly a 148 bagger, generating total returns of *30% per year*.

The company franchises and operates quick-service and casual-dining restaurants across a long list of brands, including original concepts and many that it acquired over the last two decades.

Its well-known banners include Big Smoke Burger, Jugo Juice, Koryo Korean Barbeque, Koya Japan, Manchu Wok, etc. At the end of fiscal Q1, 97.8% of its 7,300 locations were franchised.

Unfortunately, the **TSX** stock has lost about half of its market value. It has been especially volatile in the last few days, as it approached Friday the 10, which was when it reported its Q2 results. The market bid up the stock by 14% on Wednesday, only to run the stock down by 7% on Thursday.

Without knowing the results of MTY's Q2 results, as of writing, I can guess that they would be pretty ugly.

The bad

The fact of the matter is that many of MTY Food Group's quick-service restaurant locations reside in malls or office towers. Many were forced to shut down during the pandemic to help slow down the spread of the virus.

For the open locations, sales will be substantially lower due to fewer people eating out. This translates to much lower cash flow generation for the company.

To get a sense of how bad things are, the company implemented drastic cost-cutting measures to quickly preserve its capital. It laid off more than half of its global workforce, reduced the salaries of its upper management, postponed rent payments, and suspended its dividend.

MTY Food Group also granted royalty deferrals for its franchisees. It even went as far as offering its franchisees the option to pay the deferred amounts early in exchange for a 40% reduction on the royalties owed. Even with that attractive proposal, only about half of the network chose to pay early, which means the remainder is really strapped for cash and could be in trouble.

The unknown

MTY expects COVID-19 to negatively impact company results for at least through Q3. As of now, even the management can't predict what the longer-term impacts might be.

For example, people might prefer to buy things online, which would lead to fewer people going to the malls and fewer people eating at food courts, where many of MTY Food Group's locations reside.

The good

No doubt there's a huge valuation cut in the stock this year, as its profitability will be terribly lower. However, on more normalized earnings for fiscal 2021, say, that could be 75% of 2019's earnings, the stock would have a fair price of roughly $37 per share.

In the short term, there's high risk and high uncertainty for MTY Food Group. As a result, the stock might have overshot to the downside.

At the end of June, MTY Food Group announced a share buyback program for July 2020-2021, which could ultimately cancel up to 5% of its outstanding shares. At the market close price of $28.84 per share on Thursday, the stock trades at a 22% discount to the fair price of $37. The company could be buying back shares at cheap valuations if it's able to survive through COVID-19 and turn the company around over the next couple of years.

The Foolish takeaway

At the current point in time, it's safest for investors to think of MTY Food Group as a potential three- to five-year turnaround investment rather than the growth stock that it once was.

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