DavidsTea Inc. Is a Better Buy Than Restaurant Brands International Inc.

Description

Right out of the gate, **DavidsTea Inc.** (NASDAQ:DTEA) was an IPO winner.

It opened trading June 5, 2015, with such optimism, closing its first day as a public company at $27, a 42% increase on the $19 IPO price; then the wheels fell off.

Its first quarterly report as a public company was a mess, optically speaking. Reporting a loss of $93.2 million wasn't the problem. What really bothered investors was the $300,000 decrease in adjusted net income combined with a projected second-quarter adjusted loss of between $1.9 million and $2.2 million.

Oh, and one other little problem—U.S. investors weren't nearly as familiar with DavidsTea as they were with Tim Hortons and Burger King owner **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR), which had its own IPO only a few months earlier at the end of 2014.

Fast forward to April 2016 and DavidsTea is still feeling its way.

At the end of March, co-founder David Segal announced he was leaving the company, and then news hit that the company might be skirting U.S. labour laws in an effort to keep labour costs down. By no stretch of the imagination is DavidsTea the perfect company–far from it. But it's making progress.

So, why do I think DavidsTea is a better buy than Restaurant Brands International?

One word: growth.

CEO of DavidsTea Sylvain Toutant said the following about its growth last year in Canadian Business:

"There's room for about 550 stores in North America and 250 will be in Canada and 320 in U.S. If you start looking at the math, if the U.S. was as developed as Canada probably you could open 2,300 stores in U.S. If you look at the 550 versus the 160 we have now, you're still looking at a decade of growth."

The company finished fiscal 2015 with 193 stores in North America—156 in Canada and 37 in the U.S. Its American business currently accounts for just 14% of revenue. With up to 17 stores being added in the U.S. in 2016, it will take almost 17 years to build its footprint down south.

Sure, Canadians prefer tea more than Americans, but for those who do enjoy a cup of brew, the experience of the loose-leaf product will ultimately allow it to win over tea lovers one purchase at a time.

Currently, DavidsTea has a market cap of less than $300 million. With same-store sales growth of mid-single digits expected in 2016 along with adjusted EBITDA of at least $31 million, it's currently valuedat less than 10 times EBITDA, slightly lower than Restaurant Brands International. While Tim Hortons's same-store sales are similar to DavidsTea, it doesn't have nearly the same growth trajectory.

For Restaurant Brands International's market cap to double from its current $12.5 billion, it's got to come up with some serious revenue-generating ideas. DavidsTea, on the other hand, only has to bring more stores to market without blowing its brains out when it comes to expenses.

If it continues to do that over the next four to eight quarters, a double to $600 million, in my opinion, is almost a lock.

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Date
2025/08/26
Date Created
2016/04/21
Author
washworth