Why Dividend Investors Might Dump Restaurant Brands International Inc. for a Very Special Small Cap

Description

Restaurant Brands International Inc. (TSX:QSR)(NYSE:QSR), the parent of Tim Hortons and Burger King, doesn't report second-quarter earnings until August 4, but its stock moved to a 52-week high July 21 in anticipation of good results.

While you might be tempted to buy the momentum stock ahead of earnings in order to benefit from any pop that results from beating analyst expectations, if you're a dividend investor you'll want to pass on Restaurant Brands's 1.3% yield, opting instead for a small-cap competitor that hits well above its weight.

I'm talking about **A&W Revenue Royalties Income Fund** (TSX:AW.UN), the limited purpose trust that doesn't actually operate the restaurants, but makes money from the trademarks it licenses to A&W Food Services of Canada Inc., a franchisor of more than 800 restaurants coast to coast.

Dividend investors will love its 4.5% yield—almost four times what Restaurant Brands provides its shareholders. Yet A&W Revenue Royalties has just $56 million in net debt compared to $8.1 billion for its much bigger rival.

Normally, us Fool contributors tend to stick with the big boys on the TSX where market caps run in the billions, not millions, but this is as much a story about why buying Restaurant Brands is a mistake at these prices as it is about blowing the horn of a small cap that's caught the eye of Arrow Capital fund manager Veronica Hirsch.

The veteran manager appeared on *BNN's* "Market Call" on July 21 with her three top stock picks. One of them was A&W Revenue Royalties Income Fund.

Hirsch's rationale for investing in the limited purpose trust is two-fold: A&W's healthier approach to fast food is attracting millennials; given that most of A&W's locations are in the suburbs, its expansion to urban areas is a no-brainer that will provide lots of future growth for the Vancouver-based franchisor.

Why is that important? The fund gets paid 3% of the sales generated by A&W Food Services.

Over the past eight quarters A&W restaurants included in the 3% royalty calculation increased an average of 7.6% on a year-over-year basis. With new stores coming on stream from initiatives like the one adding franchisees in urban locations, the cash flow can only go in one direction: up.

So, if A&W Food Services adds 30-40 stores each year at approximately $1.3 million in revenue per store, the income fund gets $1.3 million of that (give or take adjustments for closed stores) on an ongoing basis. It becomes an annuity of sorts yielding 4.5%.

If you're an income investor, this stock absolutely has to be at the top of your list.

That said, it's not as if the guys from 3G Capital aren't good operators because they are. Warren Buffett doesn't partner with dummies. If you want to invest in Canada's biggest restaurant stock because you feel safer with a large cap, go right ahead. You'll likely do very well long term.

Just remember that Restaurant Brands currently trades at 59 times earnings compared to a multiple of 22 for A&W Restaurant Royalties. You'll pay more—for less.

However, if you strive for above-average dividend income and a very nice capital appreciation kicker to boot—A&W delivered an annualized total return over the past five years of 16.1%—you might want to broaden your horizons.

After all, good things often come in small packages.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:QSR (Restaurant Brands International Inc.)
2. TSX:AW.UN (A&W Revenue Royalties Income Fund)
3. TSX:QSR (Restaurant Brands International Inc.)

Category

1. Investing

Date
2025/08/26
Date Created
2016/07/22
Author
washworth