



## How Pizza Pizza Royalty Corp. and A&W Royalties Income Fund Can Pay You 1st

### Description

Royalty funds have a unique advantage vs. common shares in a company: they own a piece of sales instead a piece of profit. The royalty structure allows investors to collect distributions as a percentage of top-line sales regardless of the company's profitability, creating the excellent opportunity to own a piece of strong brands and growing franchise operations without much of the traditional worries associated with expenses.

Of the public royalty funds, large franchises are among the most lucrative as they tend to have stable, growing top-line figures and have scalable brands and operating procedures. During growth, profits may fluctuate while top-lines sales grow, resulting in steadily increasing distributions. Two companies showing aptitude for this model have been **Pizza Pizza Royalty Corp.** ([TSX:PZA](#)) and **A&W Revenue Royalties Income Fund** ([TSX:AW.UN](#)).

### Pizza Pizza Royalty Corp.

Pizza Pizza is one of Canada's top pizza franchises with leading market share in Ontario (28%) and a strong foothold in western Canada with the acquisition of Pizza 73 in 2007 (16% Alberta share).

Royalty rates are set at 6% of traditional Pizza Pizza Restaurant sales, 5% of non-traditional Pizza Pizza restaurant sales (kiosks, etc.) and 9% of all Pizza 73 sales. Key indicators to watch for are same-store sales growth (SSSG), total stores in the royalty pool, and total stores in the business; Pizza Pizza has consistently grown each of these by leveraging its brand, proven marketing, and SOPs, and its dividend has grown in tandem.

	2016 1H	FY 2015	FY 2014	FY 2013
Stores in PZA Royalty Pool	736	730	722	694
Stores in Pizza Pizza Ltd.	746	739	732	723
Royalty Revenues FY	Xx	34,808	33,013	31,944
Royalty Revenues Q1 & Q2	17,222	16,948	16,054	15,604

SSSG Total YoY	1.7%	4.5%	1.1%	2.1%
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Source: PPRC AIF 2015

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Source: PPRC AIF 2015

Recent investor concerns consist of the struggle in commodities stifling growth in western Canada; however, chain pizza sales tend to be fairly recession-proof with some chains even experiencing growth during tough economies. Despite this, Pizza 73 has unsurprisingly shown a setback in 1H 2016, but cash flow overall in Pizza Pizza remains strong, stifling any concerns on dividend cuts.

A royalty fund's value relies largely on distributions and so can be valued using the discounted dividend model (DDM). Assuming next year dividends are held at the current \$0.0713 per share per month, a discount rate of 7% and a conservative dividend-growth rate of 2%, we can arrive at a fair share value of \$17.11.

<b>PZA Share Price</b>	<b>2016</b>	<b>2016</b>	<b>2016</b>
Annual Distributions per Share	0.8556	0.8556	0.8556
Discount Rate	7.0%	6.75%	7.25%
Dividend-Growth Rate	2.0%	2.25%	1.75%
Fair Share Price	<b>\$17.11</b>	<b>\$19.01</b>	<b>\$15.56</b>

### A&W Revenue Royalties Income Fund

A&W has remade headlines as SSSG spiked to 5.4% YTD, royalties increased 12.5% YTD, and a second dividend hike was made in this year alone. The company has solid brand equity as the second share leader in the burger industry and claims to differentiate based itself with better quality ingredients

and better taste. Just as important is share of traffic, in which A&W takes second place as well.

While taste and quality is subjective, there is no doubting that its strategy and investments have paid off in recent quarters with growing sales rewarding investors generously through dividend hikes. However, just over a year ago, dividend increases were as rare as every four years, so recent growth numbers may have left the market overly bullish.

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Source: [www.awincomefund.ca/investors/default.asp](http://www.awincomefund.ca/investors/default.asp)

Once again, fair value for such a company can be derived using the DDM. With some fair assumption, we can arrive at a fair share value of \$31.92—a striking discount to the current share price.

<b>A&amp;W Price per Share</b>	<b>2016</b>	<b>2016</b>	<b>2016</b>
Annual Distributions per Share	1.596	1.596	1.596
Discount Rate	7.0%	7.0%	7.0%
Dividend Growth Rate	2.0%	1.5%	2.5%
<b>Fair Share Price</b>	<b>31.92</b>	<b>29.02</b>	<b>35.47</b>

### Buy or wait?

Restaurant royalties can be a lower-risk investment that can provide a generous yield boost to your portfolio, provided a reasonable price is paid. Smart investors should consider Pizza Pizza today in their yield portfolio given the margin of safety offered to today's share price. Proceed cautiously with A&W Revenue Royalties Income Fund given their recent price surge based on short-term indicators.

### CATEGORY

1. Investing

## TICKERS GLOBAL

1. TSX:AW.UN (A&W Revenue Royalties Income Fund)
2. TSX:PZA (Pizza Pizza Royalty Corp.)

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