



Pizza Pizza Royalty Corp.: What Industry Consolidation Means for the Stock

Description

There too many pizza joints in North America.

Domino's Pizza, Inc. (NYSE:DPZ) CEO Patrick Doyle might not have come right out and said this during his company's recent quarterly earnings conference call, but he did suggest the players in fast-casual pizza were going to change in the near future.

"I'm relatively confident at some point you'll see consolidation," Doyle said. "There's an awful lot of players who decided it would be a good idea [to open new pizza concepts] at roughly the same time. They have a similarity of offerings and approach. I wouldn't be surprised if you saw consolidation at some point."

Up here in Canada, I don't believe we've seen the same enthusiasm for new entrants in fast-casual pizza, but the comment got me thinking about the ramifications for **Pizza Pizza Royalty Corp.** ([TSX:PZA](#)).

Specifically, I'd have two questions for management if I were a shareholder.

First, would Pizza Pizza be a buyer or seller in any consolidation in North America? Second, what would this mean for Pizza Pizza's royalty agreement?

Once I answer these two questions, I'll be better equipped to answer what it means for PZA stock.

Pizza Pizza M&A

According to *Ontario Restaurant News's* 2014 report on Ontario's top 50 restaurant chains, Pizza Pizza was the number one pizza chain in Ontario followed by a close second with Boston Pizza, and Pizza Hut, a division of **Yum! Brands, Inc.**, a distant third.

Clearly, Pizza Pizza has more in common with Domino's, which was number five on the list, than it does with either Boston Pizza or Pizza Hut. With the exception of Boston Pizza and Pizza Hut, most of the entrants on the list are primarily take-out or delivery businesses rather than sit-down casual dining.

Top 15 pizza chains, Ontario

Company	2014 Revenue	2014 Units
Pizza Pizza	\$354M	545
Boston Pizza	\$302M	110
Pizza Hut	\$124M	146
Pizza Nova	\$96M	131
Domino's Pizza	\$68M	135

Source: Ontario Top 50 Chains, 2014 report. Research by Peter Elliott

It's fair to say that Pizza Pizza would benefit most from buying Pizza Nova or one of the smaller players in the Ontario market because that would allow it to remain the largest pizza chain in the province. No one else could possibly make a dent in the rankings.

Privately held by Paul Goddard, Pizza Pizza's CEO and son-in-law of Michael Overs, the founder of Pizza Pizza, I have no way of knowing whether the company is pursuing acquisitions, but it would certainly make sense.

But it also could be a seller with Domino's being a logical buyer given its ongoing international expansion and smaller footprint here in Canada. Taking out Pizza Pizza would likely make it the largest pizza chain in Canada, while also providing a major boost to its annual revenue.

The big problem for Domino's would be that it would also have to negotiate with Pizza Pizza Royalty over the value of its 6% royalty that's in place for another 88 years. It's doable, but certainly more complicated than the typical buy/sell agreement, which is why it probably hasn't happened already.

Bottom line

While it's possible that Domino's could buy Pizza Pizza and keep the brand, it's unlikely. Anyone else, including private equity, would likely retain the brand, which would keep the royalty agreement with Pizza Pizza Royalty in place.

Whether Pizza Pizza is a buyer or seller in any industry consolidation is immaterial. Pizza Pizza Royalty's stock would benefit in either scenario.

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1. NASDAQ:DPZ (Domino's Pizza)
2. TSX:PZA (Pizza Pizza Royalty Corp.)

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