Looking at Cara Operations Ltd. for the 1st Time

Description

Coming to the market in April 2015, shares of **Cara Operations Ltd.** (TSX:CARA), which began trading at $31.26, are now valued at approximately $25.50. Although early investors have not done as well as they would have liked, it is important to realize that stocks should be bought on a go-forward basis and not because of the past performance of the security.

I'm looking at this company for the first time, and the brands in the arsenal are very impressive: Swiss Chalet, Milestone's, Montana's, Kelsey's, Harvey's, Bier Market, Prime Pubs, Casey's, and East Side Mario's. Many of us, as expert "food consumers," can attest to the diligence of the business operations. On many occasions, we've had excellent dining experiences at these establishments.

No dividends have been paid during fiscal 2016, although the company made a profit of $2.09 per share in 2015 and $0.90 per share through the first three quarters of fiscal 2015. Given the most recent rolling four quarters, the share price of approximately $25.50 is at a cost of approximately 12.5 times earnings. New investors purchasing shares today will be paying 12.5 earnings.

Given the growth in revenue from $271 million in 2013 to $282 million in 2014 to $326 million in 2015, investors have a lot to get excited about. The compounded annual growth rate in revenues is 9.7%. Through the first three quarters of 2016, revenues have been $287 million, which translates to approximately $383 million on an annual basis. Let's not forget, the fourth quarter includes the holiday parties, which will be reported shortly. The expected revenues of $383 million could be much higher.

Why buy a restaurant stock?

The beauty of Cara Operations is that approximately 88% of locations are franchised locations. The company itself does not operate the majority of locations; instead, it collects the royalty fees. The risk (or lack of risk) becomes apparent when evaluating the income statement. Currently, the cost of goods sold (COGS) represent approximately 20-25% of revenues, whereas other competitors have COGS which are much higher (up to 75%, in some cases).

Looking at COGS is important to understand who is holding the risk. The argument of having over 1% more or 1% less when measuring COGS as a percentage of revenue is not the basis for making or not making an investment. When you invest in a high-quality company, the very fine details will be taken care of over time. In the case of Cara Operations, there is a lot of potential to monetize the revenue stream and profits instead of retaining the cash inside the company.

In the coming year, there are a number of possibilities, including expansion, a dividend initiation, or a share buyback which would reduce the total number of shares outstanding. Depending on the dividend-payout ratio, the company could easily reward investors with a 1% yield at the time the dividend is introduced. Time will tell.

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