A Transforming Growth Stock That's Largely Under the Radar

Description

The story of **Cara Operations Ltd.** (TSX:CARA) is interesting. It traded as early as 1968 on the Toronto Stock Exchange. In 2004, it was privatized by the founding Phelan family, which transitioned the company to focus its business as a branded restaurant company.

The privatization transaction was structured as a buyout, which resulted in significant debt being assumed by Cara. Further, the non-core-asset sale proceeds were reinvested into the business instead of focusing on deleveraging the balance sheet.

As a result, by the end of fiscal 2012, the company was swimming in a lot of debt — with its leverage ballooning to 6.4 times net debt to EBITDA.

Still, the company's system sales managed to increase from $1.1 billion to $1.3 billion in that eight-year period, indicating its umbrella of brands hold value.

In 2013, **Fairfax Financial Holdings** (TSX:FFH) and its affiliates swooped in to the rescue and recapitalized the company. Fairfax then appointed new management, which has transformed the company for the better.

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chicken dinner

Management

Cara's transformation has been led by Bill Gregson, who has been the company's CEO and president since October 2013 and chairman since April 2015.

He is a chartered accountant with extensive experience in retail operations. For example, he served as CEO and president of The Brick from 2009 to 2012 and helped turn the company around during that period before it was sold to **Leon's Furniture**.

Cara's multi-year transformation

Cara's operations swung from a net loss of -$42.2 million to net earnings (before tax) of $96 million from 2013 to 2016. In the same period, its assets have more than doubled to a little more than $1.3 billion. As well, its system sales grew 48.8% to a little more than $2 billion.

This is thanks to the efforts of Cara management's successful execution "to aggressively grow top-line sales, consolidate restaurant brands in the industry, drive synergies, control overhead costs and maximize earnings," said Gregson in last week's press release.

Cara's acquisitions of St-Hubert and Original Joe's last year are expected to boost its system sales to $2.7 billion and to be accretive to earnings per share on a full-year basis.

Investor takeaway

Cara has become a stronger business in the last few years thanks to its capable management team. In the meantime, cautious investors can wait on the sidelines to get confirmation from a longer track record as the company only started trading on the TSX again in April 2015.

At about $26.40 per share, Cara trades at a decent multiple of about 15.1. As the full-service restaurant business realizes operating synergies from lower food costs and sales growth from an economic recovery in the western provinces, its share price can head higher.

Some analysts have a 12-month price target of $30-32 on the stock. So, its shares can appreciate 13-21% in the near term, while shareholders get a 1.5% dividend yield that's covered by a payout ratio of about 25%.

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