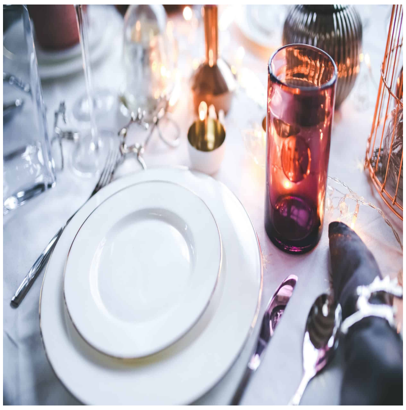

# Will Cara Operations Ltd. Ever Reach Full Potential?

## Description

For shareholders who've held shares of **Cara Operations Ltd.** (TSX:CARA) since the initial public offering (IPO) over one year ago, the returns have been disappointing and patience may be wearing thin. Shares are down more than 25%, as the company is trading at a trailing price-to-earnings (P/E) multiple of almost 15 times.



Although this multiple may not seem exorbitant to investors, it is critical to evaluate the financials on a quarter-by-quarter basis to figure out just what is happening with this company. When considering the four quarters of 2016, the total revenues for the year were nothing short of $463 million with the fourth quarter contributing more than 37% of that total. Given that the quarter, which ends at Christmas every year, accounts for far more than one quarter of the revenues, investors may be taking a little more risk by holding this name in comparison to other restaurant names.

To make this comparison, investors can consider shares **McDonald's Corporation** (NYSE:MCD) as an example. For fiscal 2016, the company's revenues for the four quarters broken down by percentage was 24% (Q1), 25.4% (Q2), 26% (Q3), and 24.5% (Q4). The number may not perfectly add up to 100% due to rounding.

As a result of this risk, investors need to be more diligent before paying an exorbitant multiple for Cara shares. Although the current P/E is only 15 times, the company still depends on the fourth quarter to make a significant amount of the profit. Of the total earnings for the year, the fourth quarter accounted for 29.5% of the total bottom line. Clearly, Cara is attempting to maximizing the higher revenues during this quarter, but considering that the earnings (as a percentage) are less than the revenues for the biggest quarter of the year, investors may need to ask more of company management. The flow through from revenues to earnings is negative.

What is currently skewing the trailing P/E multiple is the earnings of the first quarter of fiscal 2017. Although Cara reported a bottom-line profit of $0.72 per share, it needs to be noted that of the ~$44 million of profit, approximately $20 million was from a recovery in income taxes. Earnings per share were no more than $0.40 for the quarter. Given this new lower number, investors can decide if they are willing to pay the same $24 per share (or so) at a higher multiple.

By backing out the amount contributed from the recovery of taxes paid, investors can depend on rolling earnings per share of $1.38, which leads to a normalized P/E multiple of more than 17 times. Clearly, many have felt that any more than this would not be a great bargain. After selling off post IPO, Cara shares have continued to offer very little to investors.

Given the risk/reward offered by this relatively new publicly traded name, investors need to remain diligent before investing.

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