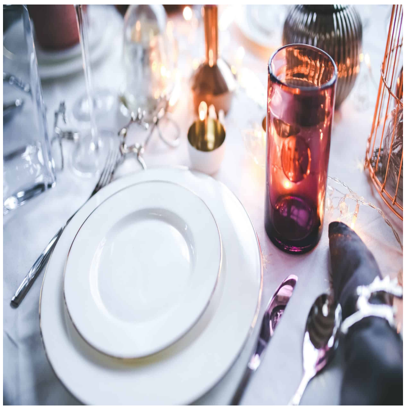

2 Reasons to Be Wary of Restaurant Stocks Right Now

Description

Shares of **Restaurant Brands International Inc** (TSX:QSR)(NYSE:QSR) have been mostly flat since it was revealed that the company would pursue legal action against several Tim Hortons franchisees. The spat emerged this spring as a number of Canadian Tim Hortons franchisees banded together to oppose the measures imposed by Restaurant Brands to improve profitability.

Restaurant Brands stock has climbed 25% in 2017 in what has been a rocky year for restaurant stocks. The company has reported positive sales growth, but Tim Hortons and Popeyes locations have posted slipping numbers in recent quarters.

There are also other reasons to be skeptical of restaurant stocks heading into the final weeks of 2017.

Slowing economic growth

Statistics Canada reported static GDP in July, which brought an eight-month growth streak to a halt. Oil and gas, manufacturing, construction, retail, and others were among those that shrank in July. Real estate and food services also saw weaker numbers.

Slower economic growth heading into the holiday season could bring about headwinds for the restaurant industry. Even with initial GDP and job strength, restaurants have broadly seen slower growth in 2017, so a downtrend in latter months may create a downward trend into next year.

The decline of casual dining

In a recent article, I covered the decline of casual dining, especially among younger generations. Shares of the chain **Boston Pizza Royalties Income Fund** (TSX:BPF.UN) have declined 4% in 2017 as of close on October 3. In its second-quarter results posted on August 10, same-store sales were down 1.6% in the quarter and 0.9% year to date. Boston Pizza also suffered from a decline in sales in oil and gas regions, while at the same time investing in online operations that will give customers the opportunity to order online.

Millennial focus on fast-casual and quick-serve restaurants presents a huge challenge for casual dining chains. Services like Uber Eats and Skip the Dishes allow customers to order in from these chains, which could spark a continuing reorientation of the business model.

What companies can duck these trends?

Restaurant Brands has reported initial success with its internal transformation. CEO Daniel Schwartz praised the progress made in a recent conference call, noting lower costs in July that will lead to higher profit margins.

Shares of **MTY Food Group Inc.** (TSX:MTY) have declined 3.5% in 2017. It owns and operates a number of quick-service brands, including Country Style, Thai Express, Extreme Pita, and others. MTY Food Group reported its second-quarter results in July and also saw sales decline in its Alberta and Saskatchewan locations. Net income jumped to $17.1 million from $8.3 million in Q2 2016. Its focus on quick-serve brands bodes well if millennial consumer trends remain consistent.

Fast-food restaurant stock **Pizza Pizza Royalty Corp.** (TSX:PZA) has declined 6.7% in 2017. Second-quarter results in August saw same-store sales increase 1.7%, and two more locations were added to the restaurant pool.

Investors should steer clear of restaurant stocks as murky economic conditions remain. Stocks that should be targeted are those in the more robust quick-serve and fast-casual sectors.

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2. TSX:BPF.UN (Boston Pizza Royalties Income Fund)
3. TSX:MTY (MTY Food Group)
4. TSX:PZA (Pizza Pizza Royalty Corp.)
5. TSX:QSR (Restaurant Brands International Inc.)

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