Should You Buy Cara Operations Ltd. After its Acquisition of the Keg?

Description

Vaughn-based **Cara Operations Ltd.** (TSX:CARA) shook up the Canadian restaurant world after it announced on January 23 that it would acquire The Keg for $200 million in cash and shares. Cara already owns and operates a number of casual dining chains, including Swiss Chalet, East Side Mario's, Milestones, and others. Cara is also planning a name change to disassociate itself from its past business of providing airline food.

Keg Royalties Income Fund (TSX:KEG.UN), an unincorporated trust, which owns the trademarks and other properties of Keg steakhouse restaurant and bars, released its 2017 third-quarter results on November 2, 2017. Keg Royalties saw gross sales rise 1.6% to $147.8 million, and in the year-to-date period, gross sales increased 4.2%. Same-store sales climbed 3% in Canada and 5.2% in the United States.

Cara stock shot up 10% on the day the deal was announced. Should investors be excited about the Keg addition to the Cara stable? The Keg possess over 100 steakhouses in the U.S. and Canada, which will add to the 1,250 locations Cara boasts with its other chains. However, the Keg also offers a dynamic experience that differs from its other casual dining chains.

Casual dining chains have experienced a steady decline in the years following the 2007-2008 Financial Crisis. Millennials in particular are more geared towards staying in or dining out at quick-serve-style restaurants. The Keg brand has attempted to branch out to younger clientele with its "Why Not Tonight" ad campaign, which frames the Keg as a spot to hit for drinks or appetizers.

Cara released its 2017 third-quarter results on November 3, 2017. System sales increased by 36.9% on the back of its St-Hubert and Original Joe's acquisitions. Operating EBITDA also grew by 30.1% to $48 million.

In the nine months leading to the end of the third quarter in 2017, Cara had completed major renovations on 47 corporate and franchised restaurants. This is in an effort to revamp brands and improve e-commerce applications. Although quick-serve restaurants were first on the scene, casual dining chains have also moved in to make offerings through delivery platforms like UberEATS and

SkipTheDishes.

Restaurant food prices are projected to rise by 4-6% in 2018, according to the Canada Food Price Report released by the University of Guelph and Dalhousie University. Canadians will also be dining out more in 2018, which will apply pressure to retail grocers.

The rise of delivery platforms and changing millennial dining habits do not necessarily point to an existential crisis for casual restaurant chains. Cara franchises will be forced to adapt and retool going forward, and perhaps cut into quick-serve arenas by catering more specifically to mobile delivery platforms.

Cara last announced a quarterly dividend of $0.10 per share, representing a 1.5% dividend yield. Shares have increased 3% so far in 2018. I like the Keg acquisition, but Cara does not offer a substantial enough dividend for me to buy it with the restaurant industry in its current flux.

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