Prem Watsa Takes a Bigger Bite Out of the Restaurant Biz

Description

The press release says that **Cara Operations Ltd.** (TSX:CARA) is buying privately held Keg Restaurants for $200 million in cash and stock, but it just as easily could say **Fairfax Financial Holdings Ltd.** (TSX:FFH) CEO Prem Watsa is consolidating his company's restaurant holdings.

If you own either stock, the news should be music to your ears. Here's why.

The terms of the deal

As I said, Cara is paying $200 million to acquire the privately owned, upscale steakhouse with 105 locations in Canada and the U.S. Of those locations, 48 are company owned and 57 are franchised. As of the 52 weeks ended October 1, 2017, Keg Restaurants had $322.8 million in annual revenue and $23.6 million in operating income.

On a pro-forma basis, the merger will create a restaurant conglomerate with $3.4 billion in annual revenue and $207.9 million in operating EBITDA. With Keg included in Cara's roster of restaurant brands, it now more closely resembles Florida-based **Darden Restaurants**, a leader in the U.S. full-service restaurant industry with brands like Olive Garden and Bahama Breeze on the low end and The Capital Grill and LongHorn Steakhouse higher up the price-point ladder.

To pay for the deal, Cara is using $105 million in cash plus issuing 3.8 million subordinate voting shares to Fairfax and CEO David Aisenstat in a 51%/49% split based on their ownership interest in the Keg.

Aisenstat will continue to run the Keg as well as take management control of three of Cara's higher-end casual brands: The Bier Market, The Landing Group, and Milestones. He will also become vice chairman of Cara's board. Cara CEO Bill Gregson will remain in his position.

Premium restaurants like the Keg are doing better than the typical sit-down restaurant at a time when Canadians are visiting them on fewer occasions. Add to that the higher minimum wage, and Cara has its work cut out for it.

However, I for one think it will do just fine.

In November, I'd suggested that investors buy its stock after it dipped on concerns about its Q3 earnings. The news of the Keg has added almost 10% to its share price, and that's especially good news for Fairfax CEO Prem Watsa, who already owns a big chunk of Cara stock.

A consolidating industry

The restaurant business in Canada continues to consolidate, and the Keg acquisition is likely one of many CEO Bill Gregson will make in the next three to five years to boost Cara's average cheque.

"The Keg is acknowledged as the best operator from a service, level of consistency, food, ambiance [and] decor point of view in Canada," Gregson said about the deal in the *Globe & Mail*. Gregson added that the three brands to be run by Keg CEO Aisenstat can learn thing or two because they continue to profitably grow sales.

With the additional shares issued to Fairfax, Watsa's company will own 43.5% of the equity and 57% of the votes, putting it in the driver's seat when it comes to Cara's growth.

In September, I'd recommended that investors get back into Fairfax stock after suffering a bit of setback. It's up more than 15% since.

With this latest move to increase Fairfax's hold on Cara while Cara consolidates its hold on the industry, shareholders in both companies ought to be happy about the news, because from where I sit, the acquisition's a winner.

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