MTY Food Group Inc. (TSX:MTY) Heading Higher Despite U.S. Troubles

Description

Like every earnings report, **MTY Food Group Inc.'s** (TSX:MTY) second-quarter results released July 11 had some good points and some bad points.

Trading near an all-time high, investors are betting that the problems it's facing in the U.S. are short term in nature, and the good times will continue.

Are they right? Let's look at both sides of the argument.

U.S. problems are temporary

In the second quarter, MTY's U.S. same-store sales declined by 1.6% while its Canadian same-store sales rose by 1.8%.

The company blamed cooler temperatures on the poor quarter. California, the company's largest market in the U.S., had negative same-store sales of 5.5% in the quarter versus a gain of 5.1% in the first quarter.

April was one of the coldest on record in the U.S., with San Francisco getting hail in the middle of the month. With ice cream brands like Cold Stone Creamery relying on warm weather to push sales, hail is definitely not good for business; it's easy to see why weather had a big part to play in its U.S. business taking a step backward.

Hopefully, it can take a step forward in the third quarter.

U.S. problems a sign of a bad acquisition

MTY completed its US$310 million acquisition of Kahala Brands (the parent of Cold Stone Creamery and many others) in July 2016.

“This is a turning point in MTY’s history,” MTY CEO Stanley Ma said at the time. “MTY now has a solid, profitable and scalable platform from which to grow its US and international operations.”

He wasn’t exaggerating.

Its U.S. and international business now account for 53% of the company’s locations and 41% of its overall revenue. Although its revenue growth including new stores openings in the second quarter was flat year over year, its operating profit south of the border increased by 9.9%, with its operating margin gaining 340 basis points in Q2 2018 to 38.8%, which was only marginally lower than its Canadian business.

I would rather have flat revenue and higher earnings than the other way around. That’s especially true when you take into consideration how cold it was across most of the U.S. in the second quarter.

The bottom line on MTY stock

Back in February, I wondered if the company’s roster of brands had gotten a bit bloated at 85, arguing that it should not have wasted any money buying Timothy’s, a coffee brand long past its due date, especially given the fact it already had Country Style and Van Houtte on the MTY team.

Ultimately, I came to the conclusion that it wasn’t the end of the world for shareholders, but I did feel it was worth keeping an eye on.

Fast forward to May. Fool contributor Kay Ng, who specializes in value investments, recommended that investors looking for extreme value should wait for a lower entry point — it was trading at $50 at the time — but those interested in owning a great stock at a fair price should buy away.

MTY stock is up 14% since Ng’s May article giving the thumbs up to GARP (growth at a reasonable price) investors while recommending that value investors exercise caution.

Looking at its Q2 2018 results, I see a business that continues to profitably grow from quarter to quarter despite a temporary setback in revenue growth.

If you’re holding MTY for 3-5 years, buying its stock at $58 will pay dividends down the road. However, I’d keep a little cash in reserve should it fall back into the $40s over the next 6-12 months.

MTY is a buy.

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