This Top Small-Cap Stock Belongs in Every Portfolio

Description

Although Canada's largest stocks — like our banks, telecoms, or large energy producers — get all the attention, there's a compelling case to be made for avoiding these stocks in favour of smaller choices.

A large telecom, for instance, is never going to post electric growth numbers. It'll just chug along, slowly getting bigger as it acquires a few new customers and raises prices to existing clients. But if you find the right small-cap name, huge growth can follow.

Some of these small-cap names are quietly compounding shareholder wealth at a frantic pace. Today I'd like to feature one such company, a Canadian fast food company that has quietly returned 15.2% annually since 2005. That's enough to turn a $10,000 original investment into something worth more than $70,000 today.

Let's take a closer look at **A&W Revenue Royalties Income Fund** (TSX:AW.UN).

The skinny

With a renewed focus on high-quality ingredients, clever marketing, and producing delicious food, A&W has grown into Canada's second-largest burger joint with some 960 restaurants and $1.4 billion in annual sales.

In exchange for buying a stake in the trademarks, investors are given first dibs at franchise fees paid back to the parent company. A certain percentage of these fees are immediately set aside for fund owners, which are then paid dividends from the profits. Note that as a shareholder of the income fund, investors aren't responsible for any of the costs of running a restaurant chain. Rather, those are borne by the operating company.

Recent results have been nothing short of stellar; 2018's full-year results saw same-store sales increase by an eye-popping 9.8%, capped off by a strong fourth quarter with 12.3% same-store sales growth. Net income increased by 12% for the year, thanks to new stores entering the royalty pool.

Although we haven’t seen any 2019 results out yet, the income fund is off to a good start for the year, announcing back in December that 46 new restaurants will be added to the royalty pool for 2019. That, combined with same-store sales success, should ensure 2019 will be another solid year.

There’s still plenty of growth potential, too, including adding restaurants in smaller communities in places like Ontario and Quebec, as well as more non-traditional locations in large cities. Remember that A&W has a more flexible operating platform versus some of its competitors, which means that it can put restaurants in smaller locations. And A&W has done a terrific job introducing new products, like its new Beyond Meat burger and breakfast sandwich.

Dividend growth

2018’s results were so good that A&W managed to increase its dividend three times that year while bringing its payout ratio down from 97% to just over 90%.

These distribution increases are just the latest in a long history of rewarding shareholders. Dividends have been raised ten times since 2015, including the most recent raise announced in February. Distribution growth has been approximately 5% annually over the last couple years, but that growth rate should increase if the company can continue posting over 9% same-store sales growth.

That kind of growth combined with a 4.6% current yield is nothing to scoff at. Investors can either choose to reinvest their dividends back into more A&W shares — which has been a pretty smart decision over the years — or take that cash and use it for living expenses.

The bottom line

A&W offers the perfect combination of current yield and dividend growth, making it a fantastic stock for retirees. And it has enough growth potential to interest investors who are 30 years away from retirement. In short, it’s one of those stocks everyone should own.

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TICKERS GLOBAL

1. TSX:AW.UN (A&W Revenue Royalties Income Fund)

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