



## TFSA Investors: This Food Service Company Is a Perfect Long-Term Investment

### Description

The Canadian food service industry is huge, in 2018 sales were estimated at around \$87 billion. Moreover, that number is expected to grow another 16% by 2022. Canadians love their food, and they want the household brand names they have come to know and love.

The impact of online ordering and companies like SkipTheDishes has continued to drive growth in the food service industry. In addition, people are living busier lives, making it more convenient to order out or go to a restaurant.

One company that has been expanding its operations in the food service industry and growing through acquisitions is **Recipe Unlimited** ([TSX:RECP](#)). Formally known as Cara Operations, it operates a portfolio of restaurants from fine dining or casual dinners to quick-service restaurants.

The company has 1,382 total restaurants, 55% of which are located in Ontario. Of the massive Canadian food service market, Recipe has approximately 4% market share, with total system sales of \$3.5 billion in 2018.

[Recipe](#) is the owner of iconic Canadian dining brands such as Swiss Chalet, Montana's, East Side Mario's, Harvey's and more. One of the most recent acquisitions the company did involving The Keg has continued to increase its diversity, giving the company exposure to the more expensive end of the dining scale.

Looking at the past performance of the company, the growth it's achieved has been impressive. Since 2013, system sales grew at compounded annual growth rate (CAGR) of 21%. During that time, margins increased substantially as operating EBITDA had a CAGR of 36%.

During the 2015 IPO, management set 2022 targets of total system sales between \$2.5 and \$3 billion. It also set a target to get its operating EBITDA margin of sales up to between 7% and 8%. To date, Recipe has exceeded and revised the system sales goal higher to \$2.9-3.7 billion. It has also increased its EBITDA margin by 290 basis points from 3.5% pre-IPO to 6.4%, on pace to reach at least 7% by 2022.

Going forward, management will continue to focus on improving the same-restaurant sales metric, which has seen minimal growth the last five years.

The company has been prudent in trimming the slack from operations. Unsuccessful stores are being closed to strengthen the entire network of stores. Additionally, new locations are being opened each year; in 2018, new additions minus the restaurants it closed totalled 61 new restaurants for the network.

Since 85% of the restaurants in its portfolio are operated by franchisees or through a joint venture, the company has a low capital operating model. Management is guiding toward \$60-65 million of capex in 2019, mostly accounting for new restaurant openings under the Keg brand.

Free cash flow in 2018 was roughly \$80 million. With a market cap of \$1.6 billion, this implies Recipe has a price to free cash flow of 20 times — not a bargain but not overvalued, either. From a debt standpoint, the company looks well stabilized. Net debt/operating EBITDA is just 1.6 times, which is manageable moving forward.

The business is a well-run organization with a strong return on equity above 15%. Lately, the company has also been buying back shares to increase shareholder value. In addition to the buybacks, the company pays a dividend that currently yields 1.6%. At just a 37% payout ratio, the dividend is sustainable.

The stock has gone sideways in the last few years, reflecting potential headwinds investors see going forward. Firstly, Recipe's exposure to Alberta is quite high at 13%, or 173 total restaurants. This has put a dampening effect on same-restaurant sales numbers. Additionally, as dining out is discretionary, the company is at risk that consumers ratchet back their spending as we reach the end of the economic cycle.

For the long term, Recipe Unlimited is a great company. Impressive growth and high returns on equity make it an ideal investment. The acquisitions it has done are attractive, and given a pullback in the stock, it could be worth entering as a long-term investment.

## **CATEGORY**

1. Dividend Stocks
2. Investing

## **TICKERS GLOBAL**

1. TSX:RECP (Recipe Unlimited)

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