Add Some Income to Your Portfolio With These 2 Royalty Companies

Description

Owning royalty companies is a great way for investors to earn income. Unless something major happens to the company, the cash flows are generally steady, and if it's a well-run business, over time, the dividends should continue to increase.

In Canada, consumers love to eat out. The food service industry does over $25 billion in revenue annually, and it grows around 3.5% a year. As the world gets busier, more people will look to quick-service restaurants and delivery services for quicker and convenient options. This will continue to drive growth in the industry.

Two companies that are in the food service industry and have well-established brands in Canada are **Pizza Pizza Royalty** (TSX:PZA) and **A&W Revenue Royalties** (TSX:AW.UN). Both companies pay monthly dividends that are funded by a top-line royalty or a royalty on sales from the restaurants.

Essentially, for investors, because the royalty is based on sales, you just need people to eat at the restaurants, and you can collect your dividend. The importance of profitability or expenses is minimized, and the focus is solely on sales numbers.

This means the most important metric to look at is same-store sales growth (SSSG). If SSSG can at least stay flat over the long term, then the dividend should remain stable. Furthermore, if the company can increase its SSSG, the dividend will most likely follow suit, as many of these companies pay dividends near a 100% payout ratio.

On the contrary, if the company has a prolonged period of negative SSSG, it may be forced to cut its dividend.

Pizza Pizza

Pizza Pizza has a market cap of about $320 million with its royalty pool that includes 660 Pizza Pizza restaurants and 112 Pizza 73 restaurants. The pool receives a 6% royalty on sales from its Pizza Pizza restaurants, and a 9% royalty on sales from the Pizza 73 restaurants.

Pizza Pizza's dividend currently yields 8%. It has kept its dividend flat since 2016, as it has struggled to grow its SSSG the past few years. If Pizza Pizza can't continue to grow sales, and they decline meaningfully for a prolonged period, it could be a risk to the dividend going forward, but with its reserve cash, it should be sustainable for at least a few more years.

A&W

A&W is slightly bigger than Pizza Pizza, with a market cap of $540 million. The fund has a pool of 934 restaurants in Canada that pay a 3% royalty on sales.

A&W has an impressive history of raising its dividend. Since 2015, the fund has raised the dividend a whopping 10 times and a total of 32%. In 2019 alone, the company has already raised the dividend twice in just four months of declared dividends.

The dividend growth has also been driving an increase in share price. In the last five years, the stock has risen nearly 85%. This is uncommon for royalty companies, but it highlights the exceptional results A&W has seen, and the impressive increase in sales the company has experienced.

Currently A&W's dividend yields nearly 4.3%. Although this may seem quite a bit lower than Pizza Pizza, the growth in dividends is much greater, giving the company a larger premium.

Bottom line

Whether you choose Pizza Pizza for the higher yield, A&W for its growth potential, or both to gain some diversity, these companies are a great option to gain monthly income and expose your portfolio to the growing food service industry.

Stay hungry. Stay Foolish.

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TICKERS GLOBAL

1. TSX:AW.UN (A&W Revenue Royalties Income Fund)
2. TSX:PZA (Pizza Pizza Royalty Corp.)

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danieldacosta