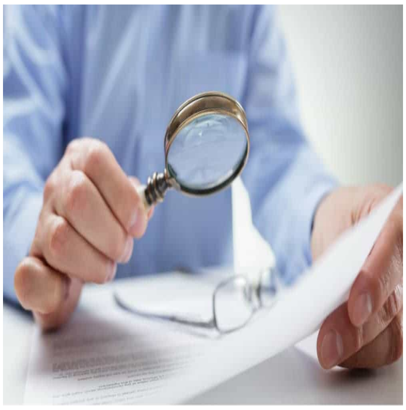

Passive-Income Seekers: Why I'm Watching This 8.9% Yielder Very Carefully

Description

I've been quite critical of restaurant stocks the last few months, not because they are necessarily doing anything wrong, but just because they operate in an industry that will be largely affected, as consumers inevitably decide to tighten their belts and reduce their debt levels.

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While most restaurant royalty companies face this increased risk going forward, and a lot of them have already been sold off to reflect the risk, the data (negative same-store sales growth) has been backing up my theory; however, some stocks have been a lot more resilient.

One stock I have talked about before, that is in a slightly better position than some of its restaurant peers is **Pizza Pizza Royalty** (TSX:PZA).

Pizza Pizza has been a stock I've talked about all year that I've been on the fence about. It's been paying out more than it's been earning, but the amount is so small and insignificant, it has basically been buying itself more time to improve the menu and ultimately increase its same-store sales.

Although with many restaurant royalty companies, I've expressed caution and warned others to do so. As consumers have tightened their belts, Pizza Pizza doesn't face this risk as much because it's more of a low-cost option when considering fast food.

In fact, one of the main things Pizza Pizza has had to face the last few years is the increased competition from new and exciting fast-food places that usually have healthier options but come with a steep price tag.

These companies will have a hard time going forward, so it will be interesting to see how Pizza Pizza is affected and how it can respond.

In the meantime, however, I'm watching Pizza Pizza very carefully, because of the declining chance that its dividend will remain sustainable.

For a while, it has been paying out more than it's earning, and the excess portion of the dividend is coming out of its cash reserve, which has been depleting every quarter ever since 2018 when its stock began to fall.

So far in the first three quarters of 2019, Pizza Pizza's payout ratio has been 106%, and the company has funded roughly $875,000 of that dividend, or 6% of the 106% out of its capital reserve, which now stands at $3.3 million.

Eventually Pizza Pizza is going to have to figure out its lack of same-store sales, as the company continues to post either flat or slightly negative growth.

A solid fourth quarter could change all of that, though, as it's historically Pizza Pizza's best growth quarter and could make up for the unsustainable payout ratio it's reported in the first nine months.

Going forward for investors, watching the level of its cash reserve is key, as once it gets low enough, the company will have to trim the dividend for sure, so paying attention to same-store sales, the payout ratio and consequently the reserve amount are the three most important things to watch to stay ahead of the market.

For now, it seems the dividend, which yields 8.9%, is safe, but that's only for now. Investors who are considering taking a position to capture that attractive dividend should be warned to tread carefully, take only a small position, and watch carefully as it reports its fourth-quarter earnings early next year.

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A dividend cut, though it would probably only be small, will likely send the share price tumbling initially, so knowing not to panic sell if you are caught holding it could be critical, too.

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2019/12/05
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