Down 32% in 2019: Is This Restaurant Stock a Contrarian Buy or a Value Trap?

Description

Value investing has always been attractive to long-term investors. The successful hunt for an undervalued stock has created significant wealth. However, in some cases, investors get caught in a value trap.

Even though the stock has a low valuation multiple, trades below its book value and has a high dividend yield, it might continue to underperform the broader markets and peers due to weak fundamentals.

One such company that is attractive to value investors is **Recipe Unlimited Corp.** (TSX:RECP). The stock has declined by 32% in the last year and is down over 50% from its record highs.

It has a market cap to sales ratio of 0.84 and an enterprise value to sales ratio of 1.24. RECP stock is trading at a forward price-to-earnings ratio of 10.7 with a forward dividend yield of 2.4%. So, is now the right time to double down on this stock?

Slowing revenue growth

Recipe Unlimited Corp is a Canadian full-service restaurant operator and franchisor. It has four business segments: corporate restaurants, franchise restaurants, food processing & distribution, and central operations.

The company has several restaurant brands, including Harvey's, Swiss Chalet, New York Fries, East Side Mario's and Montana's. RECP sales rose from $463 million in 2016 to $1.19 billion in 2018. However, this growth is expected to decelerate in the next few years.

Analysts expect sales growth of 5.5% in 2019, which could fall to 0.7% in 2020. In the September quarter, RECP's key metric, same-store sales, fell 3.1% compared to 2.2% in the first nine months of 2019. Its adjusted earnings in Q3 fell 22% as well.

The company's press release states, "Recipe and the full service industry, as a whole, continue to face headwinds due to caution in consumer spending; more restaurant seats in the market, and continued staffing and wage pressure due to a four decade low in unemployment."

What's next for investors?

Analysts expect Recipe's earnings to fall by 10.2% in 2019 and then gain 15.3% in 2020. Restaurant businesses are generally safe bets and Recipe has a wide enough reach to get investors attracted.

Recipe has 24 brands and 1,375 restaurants. Over 85% of these are operated by franchisees or joint venture partnerships. It has restaurants in 10 locations including Canada, U.S., Bahrain, China, Oman, Qatar, Panama, Saudi Arabia, Macao, and the UAE.

In the first nine months of 2019, the company bought back 10% of shares outstanding, which indicates that management is optimistic about long-term prospects. This buyback will also help to boost the company's bottom line.

Further, analysts expect free cash flow per share to increase in 2020, despite subdued growth in sales, which will mean that Recipe Unlimited has enough room to increase dividend payments as the payout ratio currently stands at 50%.

The upcoming results and company guidance will be critical for investors. Should Recipe Unlimited manages to beat consensus estimates and provides robust guidance, given its low valuation metrics, the stock will soar.

In the December quarter, analysts expect RECP to post revenue of $333 million and earnings of $0.44.

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