



Is This Stock a Contrarian Dream?

Description

Another dividend bites the dust. A year ago, I thought that **MTY Food Group Inc.** ([TSX:MTY](#)) would be a great stock to own in a recession. It consists primarily of cheaper, fast food restaurants that I thought would be in high demand as incomes shrank. It turns out that this is not the case when a global pandemic brings all human contact to the bare minimum.

The stock has been decimated along with many other companies in the industry. A further kick in the pants came from the bricks and mortar shutdown. MTY group operates fast food stores primarily located in these locations, so they could not even benefit from mobile orders to the degree that other fast-food restaurants were able to adapt.

The slashed dividend

There's good news and bad news regarding the dividend. The bad news is that there will be [no dividend payout](#) for now. The dividend is gone for now, so people relying on the dividend for income are out of luck. This is very unfortunate news for a company that's been raising its dividend for years.

Until the economy got hammered, this company maintained a very low, responsible payout ratio that was around 20%. When people were actually going out to eat, that payout ratio was easily maintained.

The operations

This is one example of a stock that was hit with the perfect storm. It solely consists of restaurant brands. Some, like Baton Rouge, are sit-down restaurants. Others, like Coldstone Creamery, rely on drop-in business to drive sales.

Before the pandemic, this was a great name to own. While it seems laughable now, the diverse spread of its operations across the United States and Canada seemed to act as a hedge against a downturn in any specific region. It's a great strategy, unless there happens to be a global pandemic.

The first quarter demonstrates the power of its strategy. In its Q1 2020 report, MTY group stated that its system sales had risen by 45% year over year. The company increased free cash flow by 23% over

the same time period. In theory, the fantastic free cash flow should have powered dividends and dividend growth easily going forward if the restaurant apocalypse hadn't occurred.

Apart from the dividend, pre-pandemic MTY also repurchased 181,044 shares, increasing shareholder value over time and was done out of cash on hand and free cash flow.

A value proposition

In my view, the operational strength of this company leads me to believe that this is a once-in-a-lifetime opportunity to take a contrarian position in a company like this. At the moment, this company is trading at less than its book value.

I will not look at earnings at the moment, seeing it probably won't have much for the time being. The thing is, though, once people start leaving their houses again, cash flow will come back online.

After all, how often has the entire global economy shut down? Never before in my lifetime, that's for certain. Furthermore, people will probably start going to malls and restaurants sometime in the future. Sure it might take a while, but I think that there will be a demand for food at some point.

Risks

The company has net debt, which is not the greatest when we may be facing a global shutdown and ensuing recession. Therefore, the fairly large long-term debt load, large in terms of debt-to-equity at the current share price, is a risk, to be sure.

But if cash flow and earnings come back online in a decent time frame, the debt will not be an issue. The company currently has more than enough cash on hand to meet any current debt obligations.

I rarely say this, but I'm glad that MTY decided to suspend the dividend. This was a prudent move given this very unusual situation. Many companies might have tried to keep their dividend with their cash on hand. In the end, that could have resulted in disaster.

The bottom line

I am taking a small position in this stock as a speculative and risky play. I believe that this [could more than double](#) when the economy gets back on track. It was such a strong company before the pandemic and likely will recover quickly once things get started. It is a risk-reward contrarian bet — let's hope it continues.

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Author

krisknutson

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