



2 Resto Franchisors Could Benefit From Higher Food Costs

Description

The consumer discretionary sector showed spunk leading to the market selloff last week. Despite the prevailing negative sentiment over rising inflation, the sector gained 0.37% instead of losing. Restaurant franchisors, in particular, might even benefit from economic re-openings and higher food costs.

Some market analysts think that **MTY Food Group** ([TSX:MTY](#)) and **Restaurant Brands International** ([TSX:QSR](#))([NYSE:QSR](#)) deserve serious consideration. While the stocks underperform year to date, the return of more Canadians to their offices could boost the respective businesses.

Although returning to status quo isn't happening yet, the landscape is shifting from the work-from-home environment to the traditional face-to-face setup or a flexible arrangement. However, the revenues and expenses of MTY and RBI might increase due to inflation.

Top- and bottom-line growth

MTY has yet to report its Q2 2022 results, although the business perked up in the preceding quarter. In the three months ended February 28, 2022, revenue and net income increased 18.1% and 24.2% versus Q1 2021. However, expenses grew 15.57% year over year.

The \$1.18 billion company is a large franchisor of multi-branded restaurants (6.704 locations) in Canada. According to management, the first quarter of 2022 showed signs of pandemic recovery. MTY's system sales for the quarter increased by 46% versus Q1 2022, while digital sales climbed 14.14% year over year.

MTY's quick-service restaurants contributes 75% of total system sales followed by fast casual (14%) and casual dining (11%). Because of new retail listings and the expansion to new territories, revenues from food processing, distribution, and retail jumped 27% compared to the same quarter last year.

According to management, it expects the restaurant industry to remain challenging in the future due to labour shortages and supply chain disruptions. The return of sales to pre-pandemic levels for many of

its brands is an encouraging sign. Still, only a healthy general economic environment and strong consumer spending would increase sales revenue significantly.

At \$48.47 per share, this consumer discretionary stock underperforms year to date (-22.81%). But in the last 20.02 years, the total return is 22,702.31% (31.16% CAGR). Based on market analysts' forecasts, the return potential in 12 months is 5.96%. The overall return should be higher if you include the 1.73% dividend.

Recovery to pre-pandemic levels

RBI sunk from the [pandemic's fallout](#) in 2020 but recovered in a very short time. The current share price of \$62.75 is 59.91% higher than its COVID-low of \$39.24 on March 18, 2020. Investors are down 16.49% year to date, but enjoys a juicy 4.46% dividend.

The \$28.37 billion franchisor is the parent company of Burger King, Popeyes, and Tim Hortons. However, Tim Hortons could be the growth driver in 2022. Management reports that sales of coffee and doughnut chain are rebounding to pre-pandemic levels.

Meanwhile, Burger King recently formed a partnership with leading global children's entertainment company **Mattel**. King Jr. Meals will feature new collection of diverse Barbie premium dolls and classic Hot Wheels vehicles. The burger chain aims to recapture the leadership position by simplifying the menu to create efficiencies and improve sales.

Less-expensive options

The quick-service restaurants of MTY and RBI should do better than upscale dining amid rising food costs. Lydia Boussour, Oxford Economics's lead U.S. economist, said, "Some consumers are more likely to trade down from pricier dining experiences to less expensive fast-food options in this high inflation environment."

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