Is Restaurant Brands International Carrying Too Much Debt?

Description

Since the $12.6 billion merger that united Tim Hortons and Burger King, investors have been closely watching to see if the newly formed **Restaurant Brands International** (TSX:QSR)(NYSE:QSR) could be a successful addition to their portfolio.

There was lots of hope for this newly merged company with 19,000 restaurants spread throughout 100 countries. Yet there remains concern about how much cost-cutting 3G Capital would implement at Tim Hortons and whether or not it would affect Tim Hortons 75% market share in the Canadian coffee market.

Unified results

In its first annual report, Restaurant Brands managed to surprise investors with Q4 revenues of $416 million up from a pre-merger combined revenues of $265 million. Both Tim Hortons and Burger King were able to post systemwide sales growth of just over 7%. EBITDA also showed some impressive increases with Tim Hortons's EBITDA growing by 10% to $209 million and Burger King's EBITDA growing by 8.8% to $189 million in the quarter.

While investors had prepared themselves for a loss in the quarter from costs associated with the merger, the actual $514 million loss appears rather steep. Of the $514 million loss, $94 million was attributed to the acquisition and restructuring of Tim Hortons.

In 2014 combined revenues rose slightly to $1.19 billion from $1.14 billion, and Restaurant Brands suffered a net loss of $402 million.

Future expansion

A key reason that Tim Hortons agreed to this merger was that it would be able to access Burger King's ability to grow internationally. This rational is much like the earlier merger with **Wendy's Co.,** which in the end produced little expansion outside of Canada. 3G Capital is apparently taking things slow as the company has revealed that it will be "a year or so" before it takes Tim Hortons international.

Tim Hortons is hoping to follow in the steps of Burger King, which has expanded in several nations, including the Middle East, in the past few years. Tim Hortons has already begun a steady expansion into the Middle East through joint ventures and master franchise deals.

Cuts

While it is encouraging to see the impressive sales increases, there is still the matter of the debt nowon the books. The original merger deal was for $12 billion, and after equity partners added their capital, there is still $8.4 billion in net debt left on the books. It is this level of debt that will dictate every move made by 3G Capital. We have already seen the first step in 3G Capital's playbook when it laid off hundreds of mangers at Tim Hortons.

Next came the announcement that Restaurant Brands would be selling Tim Hortons' Gulfstream 100 Business Jet; this is the same cost-cutting maneuver that 3G Capital employed at H.J. Heinz Co. and Burger King. 3G Capital has a long history of extreme cutting to recoup its investment as fast as possible. Even mundane issues such as forcing executives to use Skype instead of mobile phones are well within 3G Capital hack and slash playbook.

Double double with fries

Investors should prepare for an interesting ride with Restaurant Brands, as cuts continue to push up net income and in turn, should boost the stock price. Due to limits imposed by the Canadian government, 3G Capital will be unable to be as aggressive as it usually is in terms of cuts for at least the next five years. This should help Tim Hortons' ability to maintain its massive market share in the coffee and fresh baked market without alienating or frustrating investors.

After those government limits begin to expire, it could be a very different story as at that point 3G Capital could begin the first phase of its exit strategy.

CATEGORY

1. Investing

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1. NYSE:QSR (Restaurant Brands International Inc.)
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