Why Investors Shouldn't Follow Buffett Into Restaurant Brands International Inc.

Description

Warren Buffett is the greatest investor of all time. I think we can all agree on that.

But as time has gone on, the Oracle of Omaha has moved away from a value strategy and into something far more conservative. As far as I can tell, this has happened for a few reasons. Charlie Munger convinced him that he'd be better off to buy quality businesses at a fair price. **Berkshire Hathaway Inc.** has become so big that Buffett is limited to just taking stakes in the largest stocks. And as he's reached his 80s, it's obvious that Buffett, like many retirees, has become more conservative.

Once you understand that about Buffett, it's easy to make sense of some of his most recent deals. Take his involvement with 3G capital in taking **Kraft** private and merging it with **Heinz**. Based on the offer price, Buffett paid nearly 50 times Kraft's 2014 earnings to bring it into the Berkshire fold. Even if you take an average of the company's last four years of earnings, Buffett still paid nearly 30 times earnings for the maker of peanut butter and Nabob coffee.

I don't want to question the wisdom of such a legend, but it's hard to see the logic behind paying that kind of multiple for a company, even one as well known as Kraft.

How about Restaurant Brands?

The other high profile deal Buffett was involved in recently was the takeover of Tim Hortons by Burger King, once again backed by 3G. Buffett agreed to spend nearly US$3 billion on **Restaurant Brands International Inc.'s** (TSX:QSR)(NYSE:QSR) preferred shares, getting an annual dividend of 9% on his investment. He also got a free warrant which gave him the right to acquire 8.4 million additional shares, which was exercised pretty much immediately.

At the time Buffett defended the deal, saying that both Tim Hortons and Burger King were terrific brands with sizable moats. Tim Hortons is as Canadian as hockey or beavers, while Burger King is mentioned in the same breath as the giants of the fast food business. Plus, the deal involved food, which Buffett loves to invest in.

But once we look a little deeper, I'm not sure I see the logic. Shares of the newly combined company are expensive on pretty much every value metric. If you exclude unusual items, the company earned a little over US$300 million on nearly US$12 billion in sales in 2014. That works out to less than US$1 per share, which puts shares at nearly 40 times earnings.

If you believe analysts, 2015 won't be any better. The consensus earnings estimates for this year come in at US$0.97 per share, which is pretty much identical to 2014. Yes, the company will get some cost savings from synergies, but those look to be cancelled out by additional interest costs.

I'm not sure where earnings growth will come from either. There is potential for Tim Hortons to continue expanding across the United States, but it's facing some difficult headwinds—including entrenched competition and a lack of success outside of a small area. At least both Tims and Burger King have potential for further expansion outside of North America, but this will be heavily contested as competitors rush into the same markets.

When it comes to his involvement in Restaurant Brands International, I think Buffett should follow some of his own advice. He has often told investors to acquire stakes in great companies at fair prices. He's got the great company part down; I just think he needs to work on the fair price part. Until investors can get shares at a more reasonable valuation, I think they should pass.

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