Should You Join Warren Buffett and Invest in Restaurant Brands International Inc.?

Description

When Burger King and its wealthy backer 3G Capital acquired Tim Hortons back in 2014, many Canadian investors were heartbroken. Not only was one of Canada's iconic brands going to be held by a U.S. parent, but Tim Hortons shares had been a terrific investment since the company was spun off of its former parent.

But not all is lost, since the combined company is still available as an investment. **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR) boasts a pretty impressive shareholder list too, with both Warren Buffett and Bill Ackman owning substantial parts of the company. Buffett owns 8.43 million common shares, while holding $3 billion worth of preferred shares. In total, his investment is worth about $3.5 billion.

While Ackman's stake isn't as large as Buffett's, he still owns nearly 38 million common shares, good enough for a current value of more than $2.1 billion. When Ackman announced his investment back in January, he held out hope that the company's very generic name meant it would make more acquisitions over time, a strategy he liked.

Many investors, happy to be on the same side as these two heavyweights, would be satisfied to buy shares just on that reason alone. But investing isn't quite that simple. Let's take a closer look at both the positive and negative aspects of an investment in the company.

The bull case

As far as I can tell, there are two main parts to the Restaurant Brands's bull thesis.

The first is the growth potential, as Ackman touched on. The combined company is now the third-largest fast food company in the world, which gives it all sorts of clout. Perhaps a stock like **Wendy's** might be a little big for the newly combined entity to swallow, but there are plenty of smaller fast food chains out there that can be acquired.

The other big thing going for Restaurant Brands is 3G's reputation as managers who are aggressive cost cutters. Buffett knows this firsthand, as he teamed up with 3G in the big Heinz deal of 2013. Under 3G's leadership, Heinz closed plants, laid off more than a thousand workers, and cut other costs. Those cost savings were a big part of what made the deal successful.

Investors are confident that 3G can do it again with Restaurant Brands. The formula is simple: 3G comes in, cuts a bunch of costs, uses the earnings to pay back some of the debt, and then re-levers the balance sheet to acquire a new prize. It's the same formula that's worked a bunch of times in the past.

The bear case

The bearish case surrounding Restaurant Brands is mostly based on valuation. Investors are paying a steep price for 3G's expertise and the company's growth potential.

Earnings have been negative over the last 12 months, so let's look at the price-to-free-cash flow ratio instead. Excluding the effect of Buffett's large preferred share position, the company still trades at a pretty expensive valuation of 23.6 times trailing 12 month free cash flow. If you include Buffett's preferred shares as equity, the ratio balloons to close to 30 times trailing free cash flow.

I realize there's a growth case to be made for the company, but the large debt load means there won't be any big acquisition anytime soon. It owes more than $12.1 billion in long-term debt compared to total assets of $19 billion. And out of those assets, more than $14 billion worth are of the intangible variety. I'm not sure I'd be lending the company any additional money for a big acquisition without seeing it pay down some debt first.

There's a lot to like about Restaurant Brands's business. It can easily scale up, since 99% of its restaurants are owned by franchisees. It has other growth potential. And it has some very influential wealthy investors in its corner. But for my portfolio, I'll pass. It's just too expensive.

CATEGORY

1. Investing

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