Restaurant Brands International Inc. Took Some Big Strides in 2016

Description

It’s customary at this time of year for investors to look back on their wins and losses over the past 12 months to identify anything they could have done differently to positively benefit their investment portfolios.

In the case of **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR), whose stock is up almost 30% with the end of the year close at hand, it’s not just a matter of chalking up a victory in 2016, but understanding why this year has been so fruitful for both the company and its stock.

These four things help explain why.

System-wide sales growth

You can only cut costs so far. Ultimately, successful businesses grow the top line. In the case of Restaurant Brands International, it grew system-wide sales in the third quarter ended September 30 by 4.8% at Tim Hortons and 7% at Burger King.

For the first nine months of the year, Tim Hortons and Burger King grew system-wide sales 6.1% and 7.5%, respectively. Annually, the two brands generate more than US$24 billion in system-wide sales—almost 100% of it through franchises.

Comparable-store sales growth

By opening new restaurants—through the first nine months of the year Tim Hortons and Burger King opened 79 and 240 restaurants, respectively—you’re definitely going to grow system-wide sales for a time.

However, it’s the sales growth of stores open more than 13 months that drives any restaurant brand in the long term. Through Q3, Tim Hortons and Burger King grew comps by 3.3% and 2.2%, respectively. While both brands have seen some deterioration in comparable-store sales growth, 2016’s numbers are still very healthy.

Expenses

If you can grow the top line while also reducing the cost of those sales, you're half way to increasing the bottom line. Restaurant Brands International managed to lower its cost of sales in the first nine months of the year by US$75.6 million, or 5.6%.

The second part of the cost-cutting equation is selling, general, and administrative (SG&A) expenses. Lower those along with your cost of sales, and your bottom line is definitely looking up. Through Q3 2016, Restaurant Brands International lowered its SG&A expenses by US$88.8 million, or 28%.

Together, those two major expenses have been lowered by $164.4 million, or 10% of its overall revenues. A couple more years doing this, and Restaurant Brands International's bottom line will look much rosier indeed.

Free cash flow

In the course of 24 months, Restaurant Brands International has become a cash flow juggernaut, increasing free cash flow five-fold to more than US$1 billion—the currency with which it will repay its heavy net debt, which stands at US$7.7 billion.

By merging the two businesses, it suddenly had US$4.1 billion in revenue flowing into its coffers, not US$1.2 billion, as was the case prior to Burger King buying Tim Hortons.

Going forward, it will be a lot tougher to increase free cash flow without lowering costs. Fortunately for investors, that is 3G Capital's specialty.

Adjusted EBITDA

It's no coincidence that Restaurant Brands International increased adjusted EBITDA (excludes non-cash share-based compensation and income, and losses from equity investments, etc.) by US$152.2 million, or 12.4% through the first nine months of the year, given its work on the expenses portion of the income statement.

Share prices follow earnings. When profits are increasing, generally, so too are share prices. The 12.4% increase helps explains the performance of QSR stock in 2016.

Another metric that can explain a stock's success is the rate at which it converts income (adjusted EBITDA) into free cash flow. In the first nine months of 2016, it turned 66% of its income into free cash flow—four percentage points lower than a year earlier.

Don't be alarmed. It's still converting two-thirds of its income into free cash flow, which will definitely come in handy to pay down its debt.

Bottom line

Proud Canadians will be happy to know that Tim Hortons did a better job growing profits in 2016 than Burger King. However, Burger King generated more profits from every dollar of revenue. In 2017, Restaurant Brands International will try to narrow that gap.

All in all, however, it's been a very successful year.

CATEGORY

1. Investing

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