



Will Restaurant Brands International Inc. Rise 25% in 2017?

Description

Restaurant Brands International Inc. ([TSX:QSR](#))([NYSE:QSR](#)) had a great year in 2016, delivering a 25.2% total return to shareholders—more than 10 percentage points higher than its total return in 2015.

This past year was so good that out of 45 service-related TSX stocks with a market cap of \$1 billion or more, QSR had the 12th-highest return ahead of long-time performance stalwarts such as **Dollarama Inc.** and **Alimentation Couche Tard Inc.**

While there's no question the people behind Tim Hortons and Burger King are good operators, investors have to be wondering if QSR can deliver a repeat performance in 2017.

I think it can—but to do so, it has got to do a good job in these three areas.

Long-term debt

Interest rates in the U.S. are on the rise. Clearly, the Bank of Canada can't keep them down indefinitely. Companies with excessive debt are going to be hit hard by rising rates, and none more so than QSR, which borrowed heavily to buy Tim Hortons back in 2014.

As of the end of September, it had US\$8.4 billion in long-term debt, or 43.8% of its total assets. By comparison, Montreal's **MTY Food Group Inc.** ([TSX:MTY](#)), itself a multi-concept franchisor, had \$176.4 million in long-term debt, or 21.8% of its total assets, as of August 31, 2016.

So, while MTY paid approximately \$1.1 million in interest on its long-term debt through the first nine months of its fiscal year, QSR paid US\$349.6 million in interest on its long-term debt through the first three quarters of its fiscal year. Therefore, although QSR's long-term debt was only 48 times MTY's long-term debt, its interest payments were 318 times as large.

That should be a concern. However, most of its long-term debt doesn't come due until 2021 and 2022. If the company can cut US\$500 million in long-term debt in each of the next four years, that would cut between US\$74 million and US\$112 million in annual interest payments, depending on the interest rate it could negotiate in 2021.

Free cash flow

Debt repayment, dividends, additions to working capital, share repurchases, and acquisitions are all uses of free cash flow, which is defined as a business's excess operating cash flow after accounting for the capital expenditures required to keep the business running.

In the trailing 12 months ended September 30, QSR's free cash flow was US\$1.1 billion—significantly higher than prior to its acquisition of Tim Hortons. If it can continue to grow operating earnings by 10-20% each quarter for the next 12-24 months, the company's free cash flow by the end of 2019 could easily be US\$2 billion or more.

That leaves CEO Daniel Schwartz with plenty of options, including paying down debt and possibly acquiring another asset-light franchise in Asia or another high-growth region outside North America.

Comparable-store sales growth

Like the retail industry, you can open lots of new restaurants, but if the new locations you opened 15 months ago aren't growing at a decent pace, it's not worth the money you'll spend on marketing, etc.

In the first three quarters of fiscal 2016, QSR saw Tim Hortons and Burger King's comps increase by 3.3% and 2.2%, respectively. While both of those numbers aren't nearly as good as its comps in the first nine months of 2015 when both brands were delivering 5% or more, they're still pretty solid.

Keep an eye on its comps outside Canada and the U.S. in 2017. Both brands are doing a good job increasing sales at stores open more than 13 months. Tim Hortons's international stores had Q3 2016 comparable store sales growth of 8.4%, while Burger King had good success in the quarter in both its Asia/Pacific and Latin American stores where comps increased 5.3% and 9.5%, respectively.

Equally important, Tim Hortons's U.S. stores saw 4.5% comparable stores sales growth in Q3 2016—20 basis points higher than the comps a year earlier. If it can keep that up, you'll see stores outside the Great Lakes states.

Bottom line

QSR made great [strides](#) in 2016. I see no reason why that won't carry forward into 2017 and beyond.

Its stock is not cheap, but long term, you'll do well. In 2017, I think shareholders have a very good chance of seeing another 25% upside.

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Date

2025/07/22

Date Created

2017/01/04

Author

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