Restaurant Brands International Inc.: Its Next Deal Could Be All Stock

Description

Where there's smoke, there's fire.

Investment professionals are already weighing in on the future acquisition possibilities for **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR) just days after it announced it was buying **Popeyes Louisiana Kitchen Inc.** (NASDAQ:PLKI) for US$1.8 billion in cash.

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3G Capital, Restaurant Brands's majority owners, are serial acquirers; they won't stop at just three brands when there are so many fast-food concepts in need of their help.

Franklin Bissett Investment Management analyst Jayson Moss believes Popeyes is just the tip of the iceberg: "It seems like Restaurant Brands is just getting started here," Moss told the *Financial Post*. "They're going to look to build the company through accretive acquisitions."

Aaron Cowen, the chief investment officer of New York–based Suvretta Capital Management, believes 3G Capital could be better at delivering shareholder value than Warren Buffett himself.

Speaking of Buffett, Cowen & Co. recently floated the idea of Dairy Queen as Restaurant Brands's next acquisition; most investors, Cowen suggests, believed it would go after **Yum Brands**, **Inc.,** which owns KFC, Pizza Hut, and Taco Bell. Now that it's got Popeyes, a deal seems unlikely.

However, because **Berkshire Hathaway Inc.** (NYSE:BRK.A)(NYSE:BRK.B) is Restaurant Brands's fourth-largest shareholder with 8.4 million shares, Dairy Queen could be a natural fit for both buyer and seller.

How much would it cost Restaurant Brands?

Well, Buffett is said to have paid US$585 million in cash and stock for Dairy Queen in 1998. Dairy Queen's estimated revenues in 2014 were US$4.1 billion. Assuming revenue grew by 5% the last two years, today they would be around US$4.5 billion.

Restaurant Brands is paying 20.6 times EBITDA for Popeyes. Currently, investors value its stock at

13.3 times EBITDA. It has EBITDA margin around 44.1%, while Popeyes is currently at 32.5%. Restaurant Brands's goal is to push that margin higher while increasing revenues exponentially.

Berkshire Hathaway doesn't disclose Dairy Queen's financial information, so let's assume that it has a similar EBITDA margin as Popeyes. Based on the US$4.5 billion figure from above, we're looking at US$1.5 billion EBITDA for Dairy Queen, which translates to an enterprise value of US$19.5 billion — not much less than what investors are willing to pay for Restaurant Brands.

Some investors think Restaurant Brands's stock is too expensive, but if these Dairy Queen numbers are anywhere close to accurate, I think it's fair to say that paying US$5 billion more for three well-known restaurant chains isn't asking too much.

Why an all-stock deal?

There are two reasons.

First, Buffett already owns a bunch of Restaurant Brands stock. If he sold Dairy Queen to them, he'd get a whole bunch more, ending up with a big chunk of a fast-food conglomerate with four solid brands. 3G Capital would get a partner it could trust if it were to dilute its ownership position with an all-stock deal.

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Second, and this is especially true if you fall in the "expensive" camp when it comes to its valuation, is that it's smart to use company stock when it's expensive and cash and debt when it's not.

Buffett knows this all too well and would probably be willing to structure some kind of preferred arrangement to make it worth his while.

3G Capital is smart enough to know it's got enough on its plate right now, but in a year's time — and if Restaurant Brands's stock price is higher — don't be surprised if Buffett and the 3G Capital swing an all-stock deal that brings Dairy Queen into the fold.

I've heard crazier ideas.

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