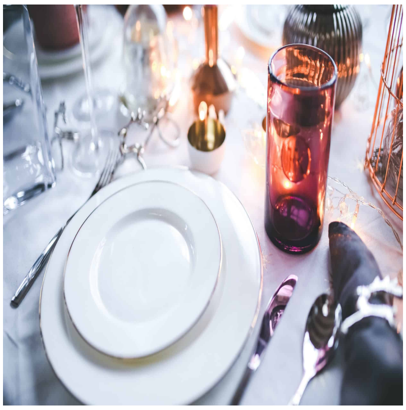

Pass on Freshii Inc.: Buy Restaurant Brands International Inc. Instead

Description

One of the most important things a new IPO can do is to deliver a solid first earnings report; **Freshii Inc.** (TSX:FRII) did just that March 22, setting the stage for the future appreciation of its stock. You'd be surprised how many freshly minted IPOs stumble out of the gate — a lot.

So, the fact that Freshii announced 34 net new openings in its fourth quarter ended December 25, 2016, the most in any three-month period in its history, along with 7.7% same-store sales growth, the 15th consecutive quarter of positive same-store sales growth, shareholders ought to be excited about the future.

That being said, if you don't own Freshii stock and are considering buying, don't. Buy **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR) instead.

Why? Earnings, that's why. Restaurant Brands has them; Freshii needs more of them. It's that simple.

One of the best investment books I've ever read is Robert Hagstrom's 1994 classic, *The Warren Buffett Way,* which examines the investment strategies of the Oracle of Omaha.

One of the financial tenets covered in the book is the "One-Dollar Premise," which requires that a public company create one dollar of market value for every dollar of retained earnings using **Berkshire Hathaway Inc.** equity holdings such as *Washington Post* and **Coca-Cola** as examples.

Of course, in those examples, Hagstrom was using 10 years of data; Restaurant Brands has only been a public company since December 15, 2014. Nonetheless, there's enough data to evaluate how it's progressing under the leadership of CEO Daniel Schwartz.

The company had retained earnings of US$231 million on December 31, 2014; on December 31, 2016, they were US$445.7 million. On December 31, 2014, Restaurant Brands had a market cap of US$7.9 billion; on December 30, 2016, it had a market cap of US$11.2 billion.

So, in the span of two years, Restaurant Brands created US$7.40 of market value for every US$1 in retained earnings, easily meeting the One-Dollar Premise.

What has Freshii done? Actually, it has done quite a bit.

It managed to produce a profit of US$1.6 million in fiscal 2016 and free cash flow of US$4.5 million compared to a US$1.7 million loss and negative free cash flow of US$3.1 million a year earlier. If you look at Freshii's financial statements, you'll see that it shows a much higher free cash flow number than I do — US$6.9 million and US$4.2 million in 2016 and 2015, respectively — because it defines free cash flow as pro forma adjusted EBITDA minus capital expenditures, wheres I used the traditional cash from operations minus capital expenditures.

Either way, it's headed in the right direction.

Unfortunately, Freshii paid a dividend to existing shareholders prior to the IPO of US$7.3 million as well as a US$4 million return of capital, increasing its deficit to US$12.9 million at the end of 2016.

While that's likely to shrink in the coming quarters given its asset-light business model, I still think it makes Restaurant Brands the more attractive stock. Check back with me in a year's time. My opinion might change.

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