Are There Painful Times Ahead for Restaurant Brands International Inc.?

Description

Ever feel like you hit *publish* on an article and then everything just blows up?

That's how I feel with **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR). I published an article on June 19 presenting a case for investing in Restaurant Brands, talking about how its Popeyes Louisiana Kitchen brand that it paid US$1.8 billion for would become an incredibly important piece of the business.

On that same day the Great White North Franchisee Association (GWNFA) filed a class-action claim against Restaurant Brands. It is seeking $500 million in damages because of the company's "lack of transparency and unwillingness to answer important questions."

What's going on?

The GWNFA is a group of Tim Hortons franchisees who are arguing that the $700 million they have paid to the national advertising fund since 3G Capital acquired Tim Hortons has not be used properly.

Rather than each franchisee having to invest in marketing, the management company collects 3.5% of gross sales and then does ad campaigns to boost sales for the franchisees. The GWNFA is arguing that Restaurant Brands is failing at this.

But there's more going on here underneath the $500 million class-action suit. Part of it has to do with the cost cutting and margin boosting that 3G Capital brings to any project it works on.

According to a *Bloomberg* article, restaurants are being charged an additional US$13,750 for coffee every year. Even though that only adds $0.02 per cup of coffee, it's irritating the franchisees.

The franchisees believe that Restaurant Brands is looking to get rid of the older, smaller franchisees and bring in larger franchisees. If we look at how Restaurant Brands has expanded overseas, that's not terribly unrealistic.

Restaurant Brands used the master franchise joint venture (MFJV) model to rapidly grow in China, Brazil, Russia, and many other countries. Essentially, the company launches a JV with one franchisee in a region and then works with them to open multiple stores.

By doing this, it can streamline its supply chain and work with one partner versus having to work with the small, distributed network that it currently has. If this is the real motive, I expect this war between Restaurant Brands and GWNFA will get a lot worse.

As an investor, what should you do about this?

Since this class-action suit was filed, shares have given up about nearly 5% of value, dropping from close to $82 a share to under $77. Restaurant Brands is incredibly expensive, so this sort of a pullback provides an opportunity.

However, the markets don’t like bad press, and part of winning a class-action suit is keeping the message in the press as much as possible. Therefore, I anticipate that the GWNFA will continue to hit Restaurant Brands hard, reminding customers about the “evil corporate overlord.”

While there’s no denying that Restaurant Brands is run by incredibly efficient operators, this drama could force shares even lower. The business is doing well despite this chaos, but the markets are going to be turbulent.

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