Should You Be Hungry for Restaurant Brands International Inc.?

Description

Restaurant Brands International Inc. (TSX:QSR)(NYSE:QSR) has all the makings for a strong stock: recognizable brands, considerable upside for international growth, and continued system-wide sales growth. However, I wouldn't start chewing down more Restaurant Brands just yet — there are potential problems on the horizon.

Let's dig in.

On August 2, the company announced its second-quarter 2017 results, which were mixed. On one hand, revenue was up to $1.132 billion from $1.040 billion in the same period in 2016. And its adjusted EBITDA was up 8.8% to $531.1 million. Looking at its network, system-wide sales were up for both Burger King and Popeyes (even though Popeyes had a 2.7% drop in comparable sales).

Here's the problem: Tim Hortons is starting to suffer. Tim Hortons's comparable sales were down 0.8%, which is the second quarter in a row the brand's sales have dropped. Looking at total system-wide sales, Tim Hortons brought in US$1.65 billion — down from US$1.67 billion a year prior.

And it's only going to get worse. On June 19, the Great White North Franchisee Association (GWNFA), which is comprised of Tim Hortons franchisee owners, filed a $500 million class-action suit against Restaurant Brands. The suit claims that Restaurant Brands has a "lack of transparency and unwillingness to answer important questions."

Their suit is built around multiple problems, but a primary one is the 3.5% marketing fee that all franchisees have to pay. In exchange for handling national and local marketing, Restaurant Brands takes 3.5% of all sales from franchisees. GWNFA is arguing that the company has not done its job with regard to marketing — maybe the sales weakness demonstrates that.

But the franchisees are also frustrated with Restaurant Brands because their costs are going up. According to a report by *Bloomberg*, franchisees are being forced to pay an additional US$13,500 for coffee per year. Although the per-cup cost for the franchisee is only a couple of pennies, they have to pass that cost on to customers who are regulars and know exactly how much they have to pay. Changes in price can have a psychological impact. Again, this could explain the sales weakness.

That being said, it’s not all bad news for Restaurant Brands. It continues to expand its operations around the world quite aggressively. This time last year, there were 4,464 Tim Hortons; now there are 4,655. Burger King grew from 15,100 to 16,000. And Popeyes grew from 2,628 to 2,768. We can expect additional growth for Tim Hortons thanks to a new master franchise joint venture in Spain, which is one of the largest coffee markets in Europe.

So, should you be hungry for Restaurant Brands, or is it time to go on a diet?

I wouldn’t start selling your shares because this company does have quite a bit of growth ahead of it, and trying to time the market is nearly impossible. However, if you’re sitting on the sidelines, it might be worth waiting until we know about the class-action suit and whether or not the company will be able to boost its Tim Hortons and Popeyes sales.

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