My Favourite Dividend Growth Stock Is Trading at a Vast Discount to Intrinsic Value

Description

Restaurant Brands International (TSX:QSR)(NYSE:QSR) is the largest Canadian holding in my portfolio, not only because it has a juicy 3.1% dividend yield, but also because management has found a way to achieve an above-average level of growth at a below-average magnitude of risk.

The result is a risk/reward trade-off that I believe is among the best in the industry (if not the entire Canadian market).

For those unfamiliar with Restaurant Brands, it's the parent company behind Burger King, Tim Hortons and, most recently, Popeye's Louisiana Kitchen. The company came to be thanks to the help of the Sage of Omaha Warren Buffett, who's since been paid back $3 billion for his preferred stake. Although Buffett doesn't have as much stake in the company today, he still retains a small stake, as he's still very much a fan of the folks working behind the scenes.

Most recently, Restaurant Brands' management has been under fire over excessive cost cuts and a poor relationship with a handful disgruntled franchisees, many of which expressed their irritations through the Great White North Franchisee Association (GWNFA).

The seemingly never-ending series of negative headlines was a drag on the company's shares over the past year.

Although Restaurant Brands' management did make a few poor decisions, I believe the turmoil that ensued was overblown beyond proportion courtesy of the GWNFA, which appeared to have exacerbated matters such that every single disagreement had to make the front-page news.

Disputes between franchisees and franchisors are nothing new, as they're playing a zero-sum. Franchisees want to keep more money, and management wants to ensure a fair distribution between themselves, franchisees, and shareholders.

You bring in a new management team and you can be sure that trouble will brew — and not your steeped tea double-double with skim milk.

While Restaurant Brands' management had a tough time ironing out the wrinkles with Tim Hortons franchisees, I believe the whole debacle is nothing more than a learning experience that won't affect the company's long-term growth story. As such, I think the current discount in shares is a terrific entry point for dividend-growth investors who are looking to get a dollar for a dime.

While some of the widely publicized headlines did do some damage to the Tim Hortons' brand, a majority of the others were on non-material events that just exacerbated the volatility in an already volatile situation.

What does an isolated incident involving flying feces at a Langley Tim Hortons have to do with the stock price of Restaurant Brands as a whole? In a rational world, nothing. Given the irrational behaviour of investors, however, I wouldn't be surprised if a handful of investors sold on that news.

Don't discount the ability of Restaurant Brands' intelligent management team

Restaurant Brands' Brazilian managers in 3G Capital are well-known for driving operational efficiencies and very deep cost-cutting. They're seasoned veterans when it comes to creating long-term shareholder value, and they know how to pull the levers to achieve optimal levels of profitability and ROE (40.1% TTM).

They'll go to extreme lengths to provide a high rate of return for shareholders, but as we discovered in the case of Tim Hortons, overly aggressive cost-cutting practices conducted did more harm than good. There's only so much juice you can squeeze out of an orange until your hands become cramped.

The cost cuts at Tim Hortons went a bit too deep, causing bleeding to ensue in the form of disgruntled franchisees and backlash from employees.

This was a hiccup from a very experienced management team, but it's a much-needed learning experience that'll be invaluable for the firm moving forward, as it continues to acquire, improve, and expand. Nobody said the M&A business model was going to be a smooth ride, but for long-term shareholders, the rewards for hanging in there are astronomical.

Foolish takeaway

Restaurant Brands is absurdly undervalued given the longer-term growth opportunity at hand. New menu items and renovated stores are going to fuel same-store sales growth numbers while management puts its foot on the expansion pedal for all three of its chains.

Profound growth opportunity exists as Tim Hortons heads to China while Popeyes moves in on the Philippines market to compete with the likes of Jolibee.

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Date
2025/07/02
Date Created
2018/09/28
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