The 1 Reason to Avoid This Restaurant Stock

Description

Foolish contributor David Jagielski recently explained why Tim Hortons's Chinese expansion is a significant risk, arguing that parent **Restaurant Brands International** (TSX:QSR)(NYSE:QSR) is being way too aggressive.

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Jagielski believes that the company should focus its expansion plans closer to home in the U.S., despite the fact Tim Hortons hasn't done particularly well south of the border.

I couldn't agree more.

Restaurant Brands has done a terrible job with Tim Hortons both in Canada and the U.S. Before it heads off to other markets, shouldn't it get its home markets fixed? Well, that's water under the bridge.

CEO Daniel Schwartz and Tim Hortons president Alex Macedo are hell-bent on making Timmies a global sensation. We know how that worked out with Burger King. There are lots of reasons to do this, but only one why it shouldn't.

It's a four-letter word

Have you guessed what the word is? It begins with D and ends with T. I'm speaking about debt. My colleague alluded to the company's leverage position in his argument against aggressive expansion.

I want to offer my two Timbits why QSR shareholders ought to be concerned about this situation, providing one huge reason why international expansion could exacerbate the problem, ultimately putting QSR stock further in a hole.

So, let's get after it.

Restaurant Brands had $11.8 billion in long-term debt at the end of September. Add in $80 million for short-term debt and $56 million for its portion of **Carrols Restaurant Group's** short- and long-term debt — it owns 20% of the U.S. restaurant company through Burger King — and you get $11.9 billion or 83% of its market cap.

It's important to note that restaurant stocks are considered good investments because of their asset-light business models. One could hardly call Restaurant Brands asset light given its level of debt. Yet, investors as wise as Warren Buffett swoon over it, despite the leveraged state of its overall business.

I just don't get it.

You can buy **McDonald's**, whose long-term debt is just 23% of market cap, and you get a small piece of the world's biggest restaurant company, not to mention one of the most iconic brands in America.

Only Tim Hortons can come close to the Golden Arches iconic nature, and that's just here in Canada. Internationally, none of Restaurant Brands's three concepts can hold a candle to McDonald's.

The bottom line on QSR stock

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In late November, I'd argued that Restaurant Brands stock was not going to get any help from renovations at Burger King, because they would only shrink the gap in quality between its locations and McDonald's.

The bigger problem for Burger King is that McDonald's is spending $6 billion to renovate its U.S. locations sending the Whopper's franchisees back to square one, which isn't a good thing when same-store sales have been in a sequential free fall, dropping from 3.8% in Q1 2018 to 1% in the third quarter.

Meanwhile, McDonald's, which is working hard to increase its same-store sales, delivered 2.4% growth in the U.S. in the third quarter, a mediocre result for the Golden Arches, but still 140% better than Burger King's results.

It's not a fair fight.

Until Restaurant Brands takes decisive action to lower its debt, QSR stock will remain on my "do not buy" list.

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