

# Restaurant Brands NZ

## Fried Chicken on Post Lock-Down Menu; Upgrade to NEUTRAL

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### NEUTRAL

Fried chicken is a consumer favourite, regardless of the economic backdrop; we upgrade Restaurant Brands (RBD) to NEUTRAL from UNDERPERFORM. Trading at 23x two year forward PE ratio, RBD remains at elevated multiples but with a solid track record, exposure to a defensive retail category against an uncertain backdrop, and growth options. We view the risk/reward as balanced. Through the global financial crisis (GFC) RBD's core brand, KFC, achieved robust same store sales growth, while quick service food generally outperformed other retail categories. RBD will likely experience a strong recovery in sales as New Zealand exits lock-down, in our opinion, and expect sales to be generally more robust amid slower retail activity. We have made significant near-term earnings changes to reflect trading disruption and have lowered our target price to NZ\$10.90 from NZ\$11.20.

NZX Code	RBD	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$11.00	NPAT* (NZ\$m)	42.2	17.5	40.8	60.0	EV/EBITDA	16.9	22.3	14.5	11.5
Target price	NZ\$10.90	EPS* (NZc)	34.1	8.2	27.3	43.7	EV/EBIT	26.9	n/a	26.8	17.9
Risk rating	Medium	EPS growth* (%)	2.9	-76.0	n/a	60.1	PE	32.2	n/a	40.3	25.2
Issued shares	124.4m	DPS (NZc)	0.0	0.0	0.0	0.0	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$1,368m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	0.0	0.0
Avg daily turnover	58.1k (NZ\$582k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	0.0

#### Pent up 'lock-down' demand

RBD will be one of the key beneficiaries from a move to Alert Level Three from Four, in our opinion, as the drive through and delivery channels resume activity. We suspect pent up demand through the lock-down will drive a surge in sales following the shift to a lower level, with ongoing sales activity supported by RBD's strong digital marketing presence. Weekly New Zealand sales data through March (ahead of lock-down) illustrates robust activity at takeout operators, despite strong social distancing messaging.

#### Fried chicken a consumer staple?

Trading at quick service restaurant (QSR) operators is typically defensive through an economic downturn. The impact of lock-down policies is a known unknown, with the next key question around the severity of potential economic downturn to follow. Looking to the GFC as the most recent example, RBD reported robust same store sales (SSS) growth through the period at its New Zealand KFC operations (+4% to +9% through 2008 to 2011), highlighting the defensive nature of its core brand.

#### Balance sheet passes health check; California settlement delayed

RBD's balance sheet is in a strong position heading into COVID-19, having restructured its lending facilities in early 2020. RBD secured total debt facilities of NZ\$370m (majority undrawn), across multiple tranches with maturities of three to four years. On our revised forecasts, we estimate FY20E net debt to EBITDA of 1.9x for the core business. In December 2019 RBD entered into an agreement to acquire a 70 store KFC franchisee operator in Southern California for ~NZ\$110m. When adjusting for the acquisition, and using 12 month rolling EBITDA, net debt to EBITDA lifts to 2.2x. The acquisition was due to settle in March 2020, however, COVID-19 has led to delays and we now expect settlement to occur in June.

**Restaurant Brands NZ Ltd (RBD)**

Priced as at 16 Apr 2020 (NZ\$)

**11.00**
**12-month target price (NZ\$)\***
**10.90**

Expected share price return

-0.9%

Net dividend yield

0.0%

Estimated 12-month return

-0.9%

**Spot valuations (NZ\$)**

1. DCF

10.00

2. Sum of the parts

10.00

3. n/a

n/a

**Key WACC assumptions**

Risk free rate

2.00%

Equity beta

1.02

WACC

8.1%

Terminal growth

1.5%

**DCF valuation summary (NZ\$m)**

Total firm value

1,502

(Net debt)/cash

(241)

Less: Capitalised operating leases

0

Value of equity

1,260

**Profit and Loss Account (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
Sales revenue	766.3	826.4	825.3	984.7	1,059.6
<b>Normalised EBITDA</b>	<b>97.9</b>	<b>89.7</b>	<b>69.8</b>	<b>110.6</b>	<b>139.3</b>
Depreciation and amortisation	(34.7)	(33.4)	(41.5)	(50.6)	(49.7)
<b>Normalised EBIT</b>	<b>63.2</b>	<b>56.2</b>	<b>28.2</b>	<b>60.0</b>	<b>89.7</b>
Net interest	(5.6)	(6.8)	(23.9)	(24.5)	(27.6)
Associate income	0	0	0	0	0
Tax	(16.7)	(13.7)	(4.0)	(13.6)	(21.8)
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>40.8</b>	<b>42.2</b>	<b>17.5</b>	<b>40.8</b>	<b>60.0</b>
Abnormals/other	(5.4)	0	5.3	5.0	4.3
<b>Reported NPAT</b>	<b>35.5</b>	<b>35.7</b>	<b>22.8</b>	<b>45.9</b>	<b>64.3</b>
Normalised EPS (cps)	33.2	34.1	8.2	27.3	43.7
DPS (cps)	28.0	0	0	0	0

**Growth Rates**

	2018A	2019A	2020A	2021A	2022A
Revenue (%)	48.1	7.8	-0.1	19.3	7.6
EBITDA (%)	43.3	-8.4	-22.2	58.5	26.0
EBIT (%)	44.1	-11.0	-49.8	>100	49.6
Normalised NPAT (%)	33.6	3.4	-58.5	>100	47.0
Normalised EPS (%)	17.1	2.9	-76.0	>100	60.1
Ordinary DPS (%)	21.7	-100.0	n/a	n/a	n/a

**Cash Flow (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
<b>EBITDA</b>	<b>97.9</b>	<b>89.7</b>	<b>69.8</b>	<b>110.6</b>	<b>139.3</b>
Working capital change	(8.7)	4.6	13.0	5.0	2.4
Interest & tax paid	(21.4)	(23.0)	(27.9)	(38.1)	(49.4)
Other	0	0	0	0	0
<b>Operating cash flow</b>	<b>67.8</b>	<b>71.3</b>	<b>54.8</b>	<b>77.5</b>	<b>92.3</b>
Capital expenditure	(31.1)	(36.9)	(48.0)	(43.0)	(41.1)
(Acquisitions)/divestments	(143.4)	10.2	(108.9)	(2.8)	(3.3)
Other	1.2	(0.0)	0	0	0
<b>Funding available/(required)</b>	<b>(105.6)</b>	<b>44.5</b>	<b>(102.0)</b>	<b>31.8</b>	<b>47.9</b>
Dividends paid	(23.7)	(17.7)	0	0	0
Equity raised/(returned)	0	0	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(129.3)</b>	<b>26.8</b>	<b>(119.3)</b>	<b>12.8</b>	<b>28.1</b>

**Balance Sheet (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
Working capital	(13.7)	(13.8)	(26.8)	(31.9)	(34.3)
Fixed assets	157.2	153.4	290.0	284.1	277.9
Intangibles	246.3	249.1	246.4	243.7	240.8
Right of use asset	0	0	0	0	0
Other assets	17.9	20.4	41.9	41.9	41.9
<b>Total funds employed</b>	<b>407.7</b>	<b>409.1</b>	<b>551.5</b>	<b>537.8</b>	<b>526.4</b>
Net debt/(cash)	156.7	130.8	238.6	225.8	197.7
Lease liability	0	0	0	0	0
Other liabilities	49.4	53.6	33.3	33.3	33.3
Shareholder's funds	201.6	224.7	180.8	153.8	144.7
Minority interests	0	0	0	0	0
<b>Total funding sources</b>	<b>407.7</b>	<b>409.1</b>	<b>452.7</b>	<b>412.9</b>	<b>375.6</b>

\* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

**Valuation Ratios**

	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	14.6	16.9	22.3	14.5	11.5
EV/EBIT (x)	22.7	26.9	55.0	26.8	17.9
PE (x)	33.1	32.2	>100x	40.3	25.2
Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Free cash flow yield (%)	2.7	2.5	0.5	2.5	3.7
Net dividend yield (%)	2.5	0.0	0.0	0.0	0.0
Gross dividend yield (%)	3.5	0.0	0.0	0.0	0.0

**Capital Structure**

	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	11.3	8.3	1.2	2.4	3.2
Interest cover EBITDA (x)	17.5	13.2	2.9	4.5	5.0
Net debt/ND+E (%)	43.7	36.8	56.9	59.5	57.7
Net debt/EBITDA (x)	1.6	1.5	3.4	2.0	1.4

**Key Ratios**

	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	13.9	12.2	2.7	5.8	8.8
Return on equity (%)	20.3	15.9	9.7	26.5	41.5
Return on funds employed (%)	17.6	11.9	6.2	11.6	18.8
EBITDA margin (%)	12.8	10.8	8.5	11.2	13.2
EBIT margin (%)	8.2	6.8	3.4	6.1	8.5
Capex to sales (%)	4.1	4.5	5.8	4.4	3.9
Capex to depreciation (%)	105	122	124	90	88
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	84	0	0	0	0

**Operating Performance**

	2018A	2019A	2020E	2021E	2022E
<b>Store numbers</b>					
KFC - NZ	94	94	102	104	107
Other NZ	55	48	47	45	43
<b>Total New Zealand</b>	<b>149</b>	<b>142</b>	<b>149</b>	<b>149</b>	<b>150</b>
KFC - Australia	61	61	62	66	71
Hawaii	82	80	74	73	74
California	0	0	0	70	70

**Divisional EBITDA (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
KFC - NZ	66.5	70.4	50.2	67.6	81.5
Other NZ	5.2	2.9	-1.4	2.5	3.4
KFC - Australia	22.0	29.1	22.1	28.0	33.4
Hawaii	24.1	23.7	16.0	25.3	30.9
California	0.0	0.0	3.8	14.5	18.5
Other	4.8	3.1	0.0	0.0	0.0
<b>Total store EBITDA</b>	<b>122.6</b>	<b>129.2</b>	<b>90.8</b>	<b>137.8</b>	<b>167.5</b>

## Assessing the COVID-19 impact

COVID-19 and the corresponding social distancing policies are having varied impacts across RBD's portfolio. To date, only the New Zealand portfolio has seen operations come to a halt, with dine in the only channel impacted in other markets. We note dine in does not represent a significant portion of total sales. In this report we explore:

- The demand impact through various levels of enforced social distancing
- Addressability of the cost base
- Balance sheet health check

### Target price lowered; Upgrade to NEUTRAL

We have lowered our target price to NZ\$10.90 from NZ\$11.20, and upgrade our rating to NEUTRAL from UNDERPERFORM. RBD has traded -21% lower year to date. We expect RBD's trading activity to experience both a fast recovery once lock-down type policies are lifted, as well as being more defensive in a wider economic slowdown. Trading at a 22x 24 month forward PE ratio, current multiples represent a significant discount to its recent trading average, but remains reasonably elevated for what is a franchisee operator, in our opinion. However, RBD has a strong track record within its core brands, operates in a sector more likely to see a near-term recovery, and offers an aggressive medium-term growth profile. We, therefore, view the risk reward as fair and see any short-term weakness as opportunities to add defensive retail exposure.

### Earnings revisions and valuation

We have made material negative revisions to our near-term forecasts to reflect store closures and subsequent recovery outlook. Our key assumptions include:

- New Zealand brands experience four weeks of no sales (lock-down), a further four weeks of sales at 50% (enforced social distancing with no dine in), before recovering to ~90% of usual activity for an extended period.
- In Australia and Hawaii we assume eight weeks of sales at 75% (enforced social distancing), before entering an extended period of ~90% of usual activity.
- We assume fixed cost relief (namely labour and rent) in line with sales through the eight weeks of peak disruption.
- We expect RBD to experience reasonably strong sales recovery, with takeout typically performing well against an uncertain economic backdrop. We, therefore, forecast RBD to achieve full sales recovery by FY22.

In addition, we have pushed the settlement of the California acquisition out three months to June 2020 (previously March). Although we note there could be further delays.

**Figure 1. Earnings revisions summary (NZ\$m)**

	FY20E			FY21E			FY22E		
	Old	New	chg %	Old	New	chg %	Old	New	chg %
Total Revenue	996.2	825.3	-17.2%	1,082.2	984.7	-9.0%	1,134.2	1,059.6	-6.6%
<b>Store EBITDA</b>	<b>154.8</b>	<b>90.8</b>	<b>-41.4%</b>	<b>169.8</b>	<b>137.8</b>	<b>-18.9%</b>	<b>181.4</b>	<b>167.5</b>	<b>-7.6%</b>
Total EBITDA	132.7	69.8	-47.4%	141.8	110.6	-22.0%	152.6	139.3	-8.7%
Normalised Profit	62.9	17.5	-72.1%	63.0	40.8	-35.2%	69.6	60.0	-13.8%
Underlying EPS	44.9	8.2	-81.8%	45.2	27.3	-39.6%	51.5	43.7	-15.1%
DPS	-	-	-	-	-	-	-	-	-

Source: Forsyth Barr analysis

### Trading in line with peers despite offering attractive growth opportunities

RBD has traded at a premium to our view of fundamental value for an extended period. However, following the significant pull back it is now trading in line with key international QSR peers (Figure 2) despite offering more attractive earnings growth (Figure 4).

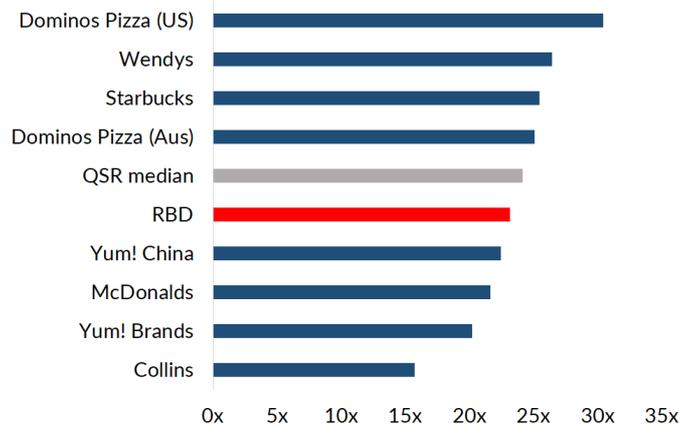
Whilst at a two year forward PE ratio of ~23x, it is by no means cheap, RBD offers investors 1) exposure to a defensive retail category against a backdrop of heightened economic uncertainty, 2) a management team with a strong track record, and 3) a significant array of growth opportunities. We view the risk reward as balanced.

**Figure 2. Two year forward PE ratio at similar levels to peers**



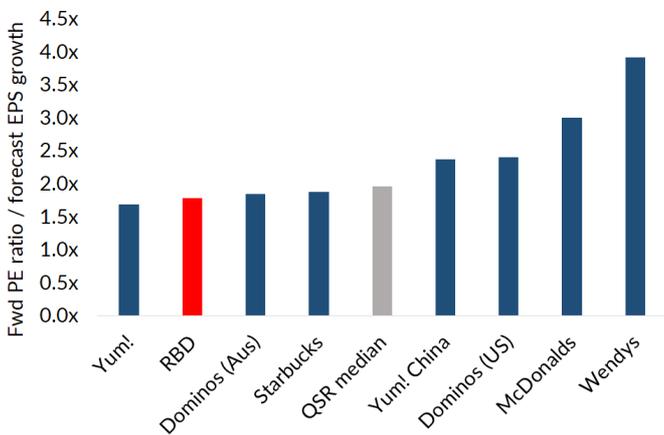
Source: Bloomberg, Forsyth Barr analysis

**Figure 3. Two year forward PE ratio**



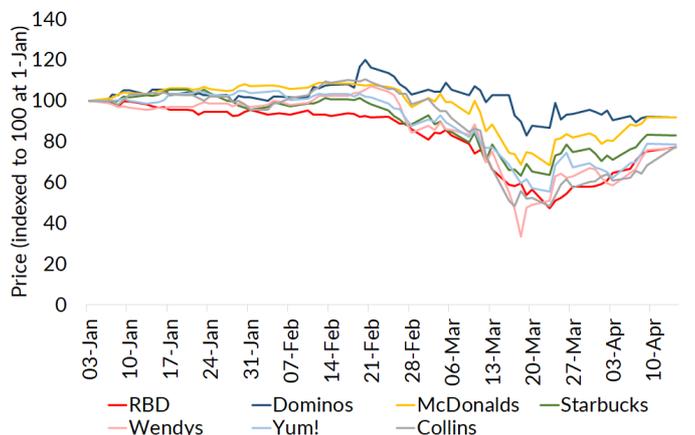
Source: Bloomberg, Forsyth Barr analysis

**Figure 4. PE / Growth**



Source: Bloomberg, Forsyth Barr analysis, PEG = 2yr forward PE / consensus 3yr EPS CAGR

**Figure 5. Year to date price change**



Source: Bloomberg, Forsyth Barr analysis

## Defensive demand profile

Trading at quick service restaurant (QSR) operators, such as RBD, is likely to be more defensive through the various levels of social distancing policies and the expected economic slowdown, in our opinion.

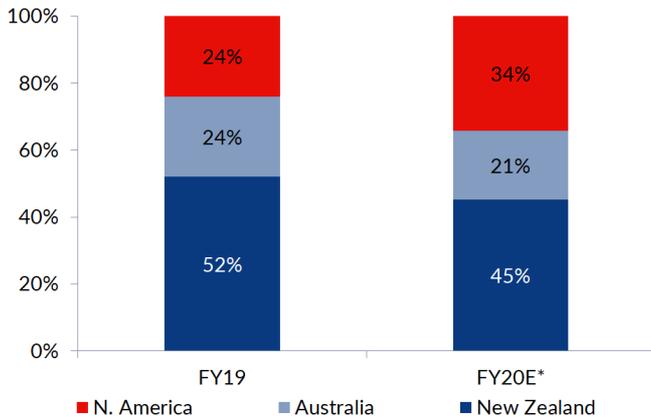
In the lead up to COVID-19 and as the messaging around social distancing grew, QSR trading appears to have held up well (Figure 7), likely supported by its alternative eating options such as takeout, drive through, and delivery. We expect to see a similar trend as countries exit lock-down phases, with consumers likely to remain wary of congregating in groups for an extended period. We view RBD as particularly well positioned for this theme given its brand portfolio, with KFC and Taco Bell stores generally well suited for drive through traffic, often situated on driving thoroughfares.

### Impact varied by geography – Lock-down applied in different ways

The response to COVID-19, and corresponding social distancing policies such as lock-downs, vary by geography. New Zealand appears to have adopted a stricter approach, to date, than other markets in which RBD operates.

- **New Zealand** – All stores in New Zealand are closed through the duration of Alert Level Four.
  - In Alert Level Three, dine in operations will remain closed, with drive through and online delivery becoming available. Face to face transactions can occur at Alert Level Two and lower.
- **Australia** – All dine in operations are closed, however, stores can still offer takeout, drive through, and online delivery.
- **Hawaii** – Similar to Australia, all dine in operations are closed with other channels open.

With dine in not a significant portion of total sales, and most markets allowing other channels to remain open, the negative impact on operations through any extended period of enforced social distancing (similar to New Zealand's Alert Level Three) is limited in our opinion. In addition, anecdotal evidence suggests a reasonable spike in demand at QSRs in the days ahead of lock-down, which we suspect will repeat once lock-down policies are lifted or relaxed.

**Figure 6. Revenue by region (FY20E based on prior forecasts)**


Source: Company reports, Forsyth Barr analysis, \* assumes pro-forma California contribution

**Figure 7. Weekly NZ retail spend (YoY % change)**

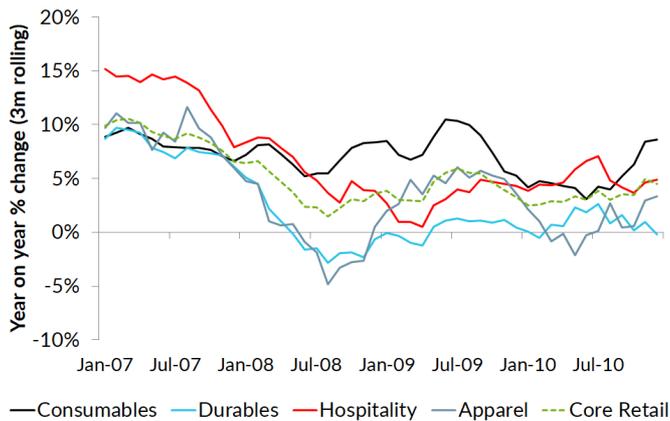
	16-Feb	23-Feb	1-Mar	8-Mar	15-Mar	22-Mar	29-Mar
Grocery	5%	6%	12%	10%	14%	52%	31%
Pharmacy	9%	7%	16%	33%	36%	81%	26%
Non-food retail	1%	1%	0%	0%	2%	-2%	-28%
QSR	4%	4%	4%	5%	4%	-8%	-61%
Restaurants	1%	3%	0%	0%	1%	-27%	-87%
Accom.	-5%	0%	-4%	-6%	-8%	-37%	-78%
<b>Total (ex. Fuel)</b>	<b>2%</b>	<b>3%</b>	<b>4%</b>	<b>3%</b>	<b>5%</b>	<b>9%</b>	<b>-26%</b>

Source: Paymark, Forsyth Barr analysis

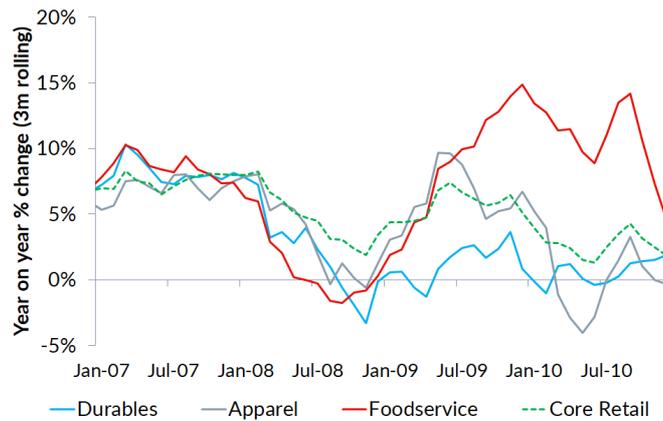
### Fried chicken still a favourite through tough economic times

Out the other side of COVID-19, the key question for retailers is the length of recovery. We expect New Zealand and other markets will experience an extended period of economic slowdown. Foodservice, in particular QSR, has historically been more defensive in periods of economic stress. Figures 8 and 9, illustrate New Zealand and Australian retail category growth through the Global Financial Crisis (GFC), with food service (hospitality) sales growth generally outpacing other retail categories.

RBD reported robust same store sales (SSS) growth through the GFC at its New Zealand KFC operations. Whilst Pizza Hut reported negative SSS, we understand there are also competitive factors influencing those results, with the Dominos chain taking market share.

**Figure 8. NZ retail category performance through the GFC**


Source: Stats NZ, Forsyth Barr analysis

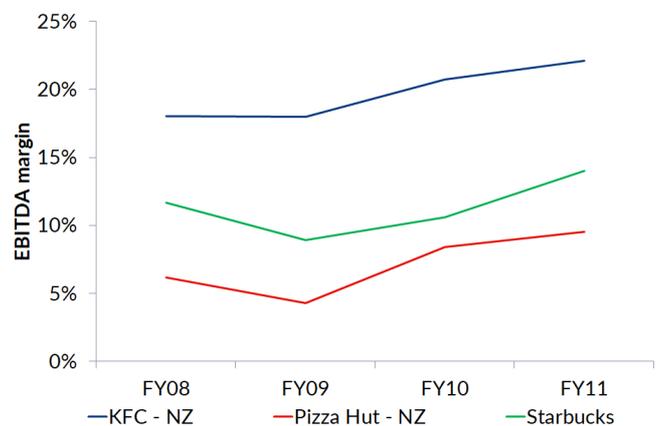
**Figure 9. Aus retail category performance through the GFC**


Source: ABS, Forsyth Barr analysis

**Figure 10. Same store sale growth through the GFC**

	2008	2009	2010	2011
McDonalds	6%	-3%	3%	12%
Yum! - US	2%	-5%	1%	-1%
KFC - NZ	8%	4%	9%	4%
KFC - US	-3%	-1%	-3%	1%
Taco Bell - US	10%	-1%	3%	-1%
Pizza Hut - US	4%	-10%	11%	2%
Pizza Hut - NZ	-7%	-7%	4%	-4%
Dominos - International	7%	6%	4%	7%

Source: Company reports, Forsyth Barr analysis

**Figure 11. RBD store EBITDA margins through the GFC**


Source: Forsyth Barr analysis

**Modelling the demand impact**

We have modelled the earnings impact on the basis of time spent in three levels of lock-down policy.

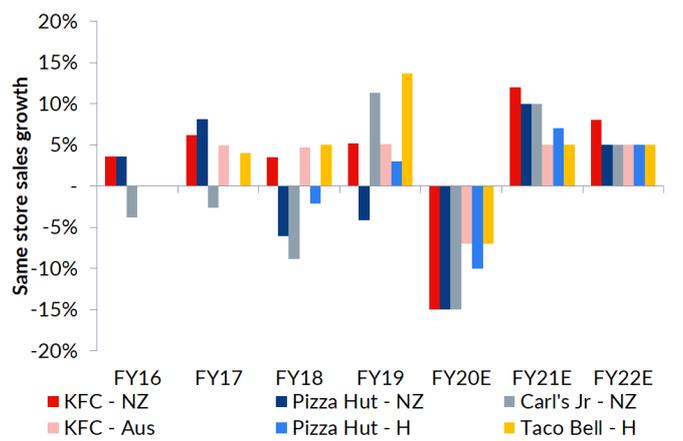
- A complete lock-down – No sales activity takes place (Alert Level Four in New Zealand). We also assume some level of fixed cost relief through the duration of time spent in this level.
- Enforced social distancing – Dine in channel is closed, however, takeout, drive through, and delivery open (similar to Alert Level Three). We continue to assume some level of fixed cost relief is available through the duration of time spent in this level.
- Subdued activity – Social distancing messaging limits customer traffic and some caution exists around dine in (similar to Alert Levels Two/One). Fixed cost relief subsides.

We expect RBD's three key markets will experience differing degrees of time at each level, with only New Zealand seeing a full lock-down. The disruption expected is summarised below:

- New Zealand – Four weeks of Alert Level Four down before heading into a further four weeks of Alert Level Three. We then assume a slow recovery to normal levels over a ~44 week period.
- Australia and Hawaii – Australia and Hawaii experience enforced social distancing, with only dine in operations restricted for a period of eight weeks. Similar to New Zealand, we then assume a slow recovery to normal levels over a ~44 week period.

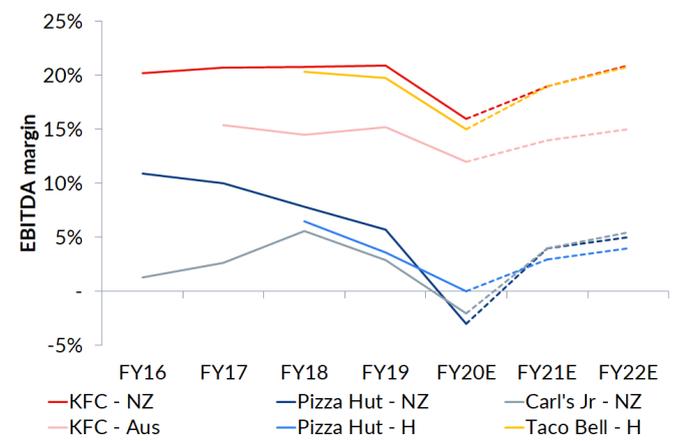
We note dine in does not represent a significant portion of total sales and therefore we expect the biggest degree of sales recovery to occur when moving from Alert Level Four to Three. We expect activity to slowly resume to more normal levels following further easing of social distancing policies/messaging. However, consumers are likely to remain wary of food and crowds for some time and we, therefore, assume it takes a further year for sales to fully recover.

**Figure 12. Same store sales**



Source: Forsyth Barr analysis

**Figure 13. EBITDA margin**



Source: Forsyth Barr analysis

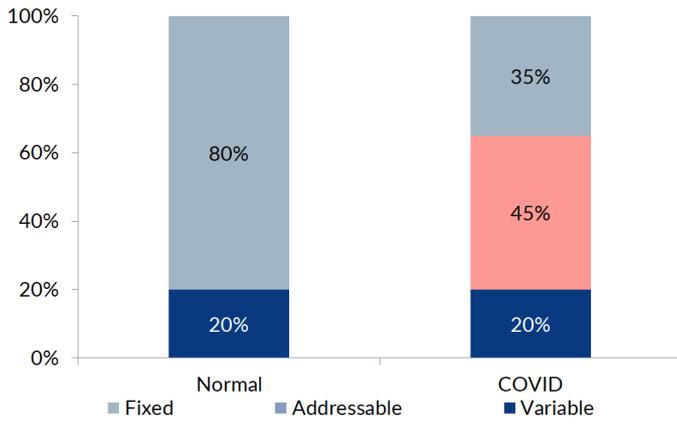
**RBD recovery assumptions**

Whilst we expect sales to recover quickly, we do not assume a complete recovery within 12 months, forecasting sales and margins to remain at lower levels through FY21E. This is underpinned by our assumption that consumers will remain cautious for an extended period, translating to lower foot traffic for dine in. Acknowledging this represents a relatively small portion of total earnings

## Addressability of the cost base

Pre-COVID-19 RBD generated EBITDA of NZ\$8.2m/month (NZ\$9.2m/month including California on a pro-forma basis). We estimate RBD's fixed cost base is ~80% of total operating costs or ~NZ\$5.5m/month, its largest fixed costs being labour and rent. However, this is a non-normal situation and unprecedented levels of support are being provided by governments in the form of wage subsidies. In addition, many landlords are negotiating a level of rent relief. We suspect through the period of peak disruption, RBD's fixed cost base falls to ~35% (NZ\$2.5m/month).

**Figure 14. Est. of cost flexibility during COVID-19**



Source: Forsyth Barr analysis

**Figure 15. Estimated cash burn per month (NZ\$m)**

	Normal	COVID-19 scenario
Fixed opex	24	11
Cash interest	1	1
Capex	4	3
Total	28	15
<b>per share</b>	<b>0.23</b>	<b>0.12</b>

Source: Forsyth Barr analysis

### RBD commits to paying New Zealand staff, receives Government wage support

RBD has committed to paying its New Zealand staff (only market in which all operations are closed) 100% of average earnings over the four weeks leading into COVID shut down. In order to support that commitment, RBD has received Government wage support covering a period of 12 weeks, consistent with the relief package. The amount received, NZ\$22m, is the equivalent of c. 80% of the estimated New Zealand wage expense for the period.

In other markets, RBD has the ability to stand down staff, who are then eligible for wage relief packages.

### Largely domestic supply chain

Border restrictions and trade disruptions should have limited to no impact on RBD's supply chain with products generally sourced in market.

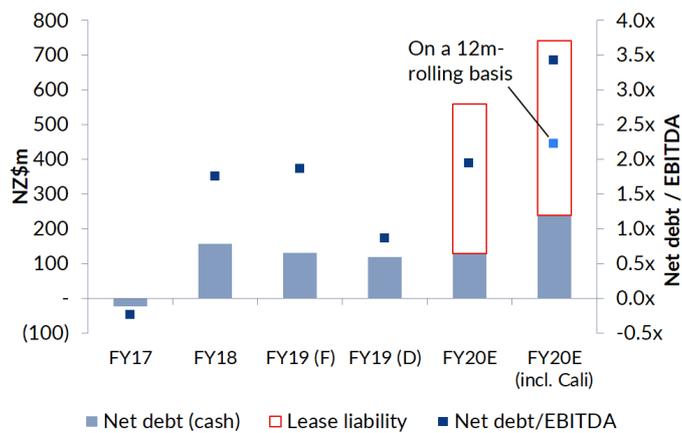
### Balance sheet health check

RBD's balance sheet was in a robust position, heading into COVID-19 having recently renegotiated its lending facilities. RBD now has ~NZ\$370m total bank debt facilities, with a maturity profile of three plus years, as such we see limited refinancing risk.

### Plenty of available liquidity ahead of acquisition

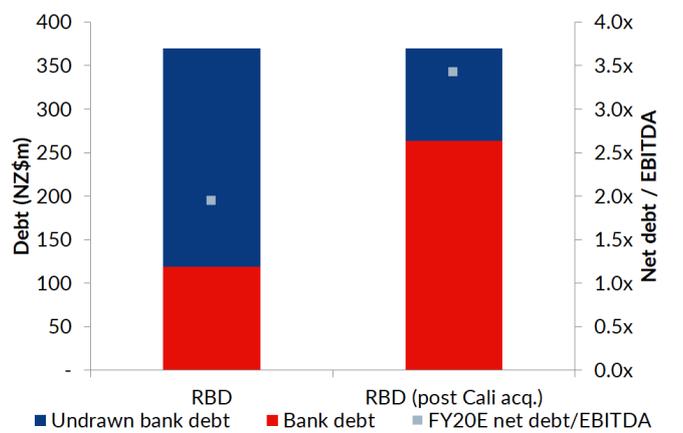
RBD's significant funding headroom, the majority of which is undrawn, was negotiated ahead of its California acquisition which is yet to settle. Should the acquisition settle tomorrow, RBD's capital position comes under significantly more pressure. Under our current earnings scenario, we estimate RBD's net debt/EBITDA ratio increases to 1.9x, however, if the acquisition goes ahead the rolling 12-month net debt / EBITDA lifts to 2.2x.

**Figure 16. Gearing history**



Source: Forsyth Barr analysis

**Figure 17. Bank debt availability**



Source: Forsyth Barr analysis

**California running behind schedule**

In December 2019, RBD announced the acquisition of a 70 store beachhead in Southern California for US\$70m (~NZ\$110m). The acquisition which was due to settle by March 2020 appears to have been delayed, in part due to the impacts of COVID-19. Yum! Brands approval, a condition of the sale, remains outstanding.

We continue to view the acquisition as likely to complete, although now assume settlement by June 2020. The delay in settlement is favourable for RBD, limiting the exposure to the financial impact of social distancing in California. In addition, we understand the acquisition was an asset based sale, with RBD not liable for any build up of debt during this period.

**Capex lever available to preserve capital**

RBD does not currently pay a dividend given its growth mandate, with capex deferral its key capital preservation lever.

RBD has a significant amount of planned capex. Although we view the company as having sufficient capital headroom, we suspect a large portion of its non-essential capex will be deferred due to construction constraints and as a result of elevated uncertainty, with room to further delay growth projects should it be required.

RBD's aggressive growth plans include additional KFC and Taco Bell store rollouts in New Zealand and Australia as well as further refurbishment work. We suspect store rollouts could be delayed amid uncertainty. In Hawaii, RBD has a pipeline of Taco Bell refurbishment projects. Given lengthy time-frames for consent application and approval, we view these projects as less likely to be deferred.

## Investment Summary

Restaurant Brands (RBD) is a well-run corporate franchisee, focussed on fast food. Recent earnings growth has been driven by KFC which continues to have positive momentum. Early signs from Taco Bell are encouraging in Hawaii, while Pizza Hut is under pressure and needs work. Carls Jr continues to underperform but is no longer a growth priority for capital investment. We like the investment attributes of RBD, with above-WACC returns and a supportive industry backdrop and a material array of growth options. As the global market heads into a period of slower economic growth following COVID-19, we view the category exposure as more defensive. Our rating is NEUTRAL.

### Business quality

- **Business expansion:** RBD's expansion into Australia (KFC) and Hawaii (Taco Bell and Pizza Hut) through acquisition presents growth opportunities but also risks. We see Australia as a more natural fit but are more cautious on Hawaii.

### Earnings and cashflow outlook

- **Marketing and new products:** Marketing, product innovation and promotional appeal is key to keep the brands fresh and relevant to customers. It is important not to stand still in the quick services business.
- **Store rollout:** There is store rollout opportunity for KFC NZ (~15 stores) and in Australia for KFC through store rollout or bolt-on acquisitions. Hawaii also presents opportunities, albeit this will likely take time.
- **Input costs:** This is dominated by food and labour. RBD's main flexibility to respond to higher input costs is through the product mix of its sales. Customer purchases can be influenced by targeted promotions.

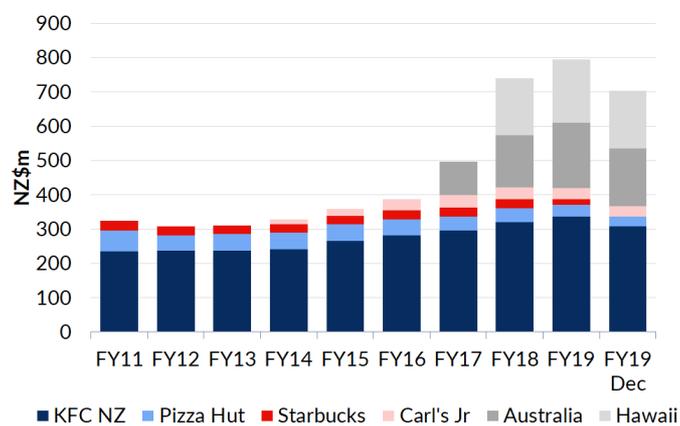
### Financial structure

- **Balance sheet and dividends:** FY19 net debt was down NZ\$28m with no interim dividend and continued to fall in 1H20. Gearing is down from 44% to 35%. RBD has announced it has ceased dividend payments to retain funding for growth.

### Risk factors

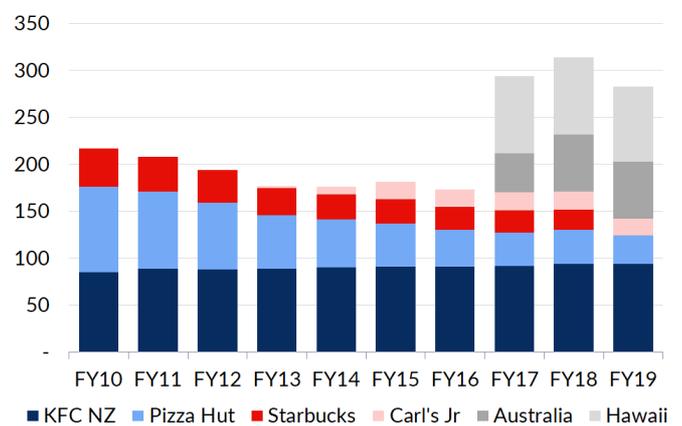
- **Corporate franchisee:** A relationship breakdown with its franchisor, particularly for KFC (its major earnings driver).
- **Fast food operator:** Any change in consumer preference away from fast food or change in government regulation or taxes on fast food.
- **Minimum wage:** Any increase can weigh on profitability, if RBD cannot offset this through price changes and/or menu mix. RBD has pricing power in its key KFC brand and labour productivity can help offset cost pressure.

**Figure 18. Divisional revenue breakdown**



Source: Company reports, Forsyth Barr analysis

**Figure 19. Store footprint**



Source: Company reports, Forsyth Barr analysis

**Figure 20. Price performance**


Source: Forsyth Barr analysis

**Figure 21. Substantial shareholders**

Shareholder	Latest Holding
Global Valar S.L.	75.0%

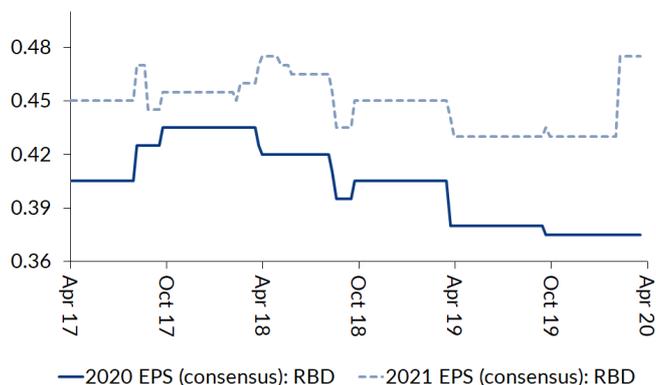
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 22. International valuation comparisons**

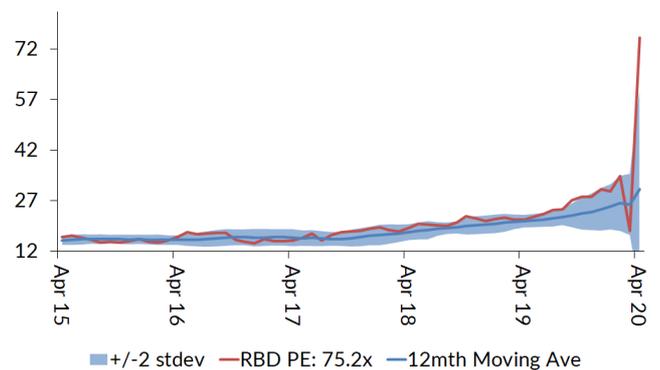
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>Restaurant Brands NZ</b>	<b>RBD NZ</b>	<b>NZ\$11.00</b>	<b>NZ\$1,368</b>	<b>&gt;50x</b>	<b>40.3x</b>	<b>21.5x</b>	<b>13.6x</b>	<b>53.1x</b>	<b>25.0x</b>	<b>0.0%</b>
Briscoe Group *	BGP NZ	NZ\$2.46	NZ\$547	9.0x	8.7x	3.9x	3.8x	5.0x	4.8x	9.3%
Kathmandu Holdings *	KMD NZ	NZ\$0.75	NZ\$221	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Michael Hill Intl *	MHJ NZ	A\$0.25	A\$95	18.7x	20.4x	3.7x	4.0x	10.8x	11.4x	16.1%
The Warehouse Group *	WHS NZ	NZ\$2.02	NZ\$701	9.2x	7.8x	4.4x	3.9x	6.8x	5.8x	9.7%
DOMINO'S PIZZA ENTERPRISES L	DMP AT	A\$53.40	A\$4,605	27.9x	24.6x	15.9x	14.2x	22.4x	20.0x	2.9%
MCDONALD'S CORP	MCD US	US\$153.40	US\$114,273	18.4x	16.9x	14.5x	13.7x	17.5x	16.3x	3.5%
STARBUCKS CORP	SBUX US	US\$62.72	US\$73,744	21.4x	18.2x	15.0x	13.2x	19.3x	16.4x	3.0%
WENDY'S CO/THE	WEN US	US\$13.25	US\$2,979	21.5x	17.4x	14.8x	13.7x	21.2x	19.3x	3.9%
YUM! BRANDS INC	YUM US	US\$64.61	US\$19,295	16.5x	14.4x	14.2x	13.3x	15.0x	13.7x	3.2%
DOMINO'S PIZZA INC	DPZ US	US\$336.33	US\$13,144	30.6x	27.2x	22.6x	20.9x	24.6x	22.7x	1.0%
COLLINS FOODS	CKF AT	A\$4.78	A\$557	10.9x	9.5x	8.8x	7.9x	13.0x	11.3x	5.3%
<b>Compc Average:</b>				<b>18.4x</b>	<b>16.5x</b>	<b>11.8x</b>	<b>10.9x</b>	<b>15.6x</b>	<b>14.2x</b>	<b>5.8%</b>
<b>RBD Relative:</b>				<b>n/a</b>	<b>144%</b>	<b>82%</b>	<b>25%</b>	<b>241%</b>	<b>76%</b>	<b>-100%</b>

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (RBD) companies fiscal year end

**Figure 23. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 24. One year forward PE (x)**


Source: Forsyth Barr analysis

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<b>42.0%</b>	<b>42.0%</b>	<b>16.0%</b>

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