Coffee Time – Canadian Institution or International Juggernaut?

Description

Tim Horton's (TSX:THI,NYSE:THI) reported its fourth quarter and full year results for 2012 this morning. A slight miss on Q4 earnings and lower than expected 2013 guidance have caused the stock to decline by 3.5% at midday. Management cited "competition" as one of the reasons for the disappointing results. In the coffee world, there is no more formidable competitor than **Starbucks (NASDAQ:SBUX).**

Arguments over which of these companies' brews a better cup of coffee have ended long term friendships, so we're going to avoid that one altogether. We Fools are known for investing, not tasting, therefore, let's pit these companies against each other and decide which might be the better stock to own. To do this, we're going to look at each from the three angles laid out below.

Growth

Round one focuses on each company's recent ability to demonstrate growth. The table below displays 4 metrics from the income statement and how they have changed over the past year.

	Revenue	EBITDA	Net Income	EPS
Tim Horton's	+9.4%	+7.8%	+5.2%	+10.2%
Starbucks	+12.1%	+15.0%	+11.9%	+10.2%

Source: Capital IQ

Almost a clean sweep for Starbucks. Tim Horton's share buyback program aided the exception, EPS. The number of shares outstanding fell by 4.2% over the past year at Tim Horton's, while theyincreased by 0.4% at Starbucks.

Profitability

Growth is great, but it must be supported by profits for long-term success. These four metrics give an idea of each company's ability to translate top line sales into bottom line profits.

	EBIT Margin	Ret on Assets	Ret on Capital	Ret on Equity
Tim Horton's	19.2%	16.7%	22.4%	34.8%
Starbucks	13.7%	14.3%	21.1%	28.8%

Source: Capital IQ

What Tim Horton's lacks in growth, relative to Starbucks, it makes up for in profitability. Tim Horton's management is clearly running a tight ship. And, there isn't even a full-time CEO in place.

Valuation

Perhaps the most important consideration of all for investors. Growth and profits will only translate into gains for shareholders if they are not already being reflected by the stock's valuation.

	Trailing P/E	Fwd P/E	P/S	P/FCF	Div Yield
Tim Horton's	18.9	16.9	2.4	23.5	2.1%
Starbucks	28.7	23.2	2.9	28.3	1.6%

Source: Capital IQ

Neither name can be considered absolutely cheap at current levels. Relatively speaking, investors seem keen to pay up for Starbucks past and, more importantly, potential growth. Currently Starbucks has more than 18,000 locations in 60 countries and is aiming to expand this number to more than 29,000 by 2021. 11,000 new locations is like building out 3 entire Tim Horton's (approx. 3,700 locations) across the globe.

The Foolish Bottom Line

Investors have elected for growth over profitability in valuing these two coffee shops. In my opinion, this is not wrong. Tim Horton's is slowly expanding into the U.S. but operating income from this division amounted to just 2.8% of the company's total in 2012. For the most part, Tim's is land locked here in Canada. Innovation within Tim's current foot print will be the primary growth driver. This can be hard. Only so many grilled Panini sandwiches can be pulled out of a hat.

With its impressive profit measures, recently increased dividend, and a $250 million share buyback program in place, Tim Horton's is beginning to resemble a cash cow. Cash cows do not garner the same multiples as companies with growth profiles, like Starbucks.

Over the past five years, Tim Horton's shares have gained 39.4% and Starbucks has climbed 189.7%. Given their respective profiles, an emerging cash cow and still relevant growth story, one might expect a similar shareholder return profile over the next five/ten years.

With that being said, I'm off to McDonald's for a coffee!

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Fool contributor Iain Butler does not own shares in any of the companies mentioned in this report at this time. David Gardner owns shares of Starbucks. Tom Gardner owns share of Starbucks.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:SBUX (Starbucks Corporation)

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