The Surprising Reason Why Tim Horton's Shareholders Should Be Angry

Description

It's happy days for **Tim Horton's** (TSX: THI, NYSE: THI) investors. Shares of the Canadian icon are up almost 40% in the past year — nearing an all-time high. And the stock has been one of the best performers in the S&P/TSX Composite Index.

Is it time to pop the champagne? While it may seem counterintuitive, savvy shareholders are actually disappointed with the stock's good performance this year.

Good investing is counterintuitive
Picture yourself behind the controls of a small airplane. Suddenly a warning light goes off. You're losing airspeed and altitude. What do you do?

If you're like me, you pull back on the stick as hard as you can. Instinct compels you to point the nose upwards to pull the plane out of its dive. Congratulations, you're now a statistic.

Experienced pilots, in contrast, do the opposite. They push the stick *forward* and point the nose of the aircraft to the ground. As the plane descends it picks up airspeed and the wings start to generate lift. Slowly the pilot will pull back of the controls and level off. The crisis has been averted.

Everything about flying to counterintuitive. Going higher and faster is actually safer! Pilots are trained to resist their instincts.

The same applies to investing. We cheer when equities go up. When our neighbours start to invest in high flying tech stocks, we feel compelled to join them.

But savvy investors, like an experienced pilot, know not to trust their instincts. When the market rallies, you're just paying a higher fare for the same merchandise. And as Warren Buffett once said, you pay a high price for a cheery consensus.

What shareholders should *really* want
Tim Horton's is a wonderful business. The company has enormous brand loyalty and generates ample cash flow. Since going public in 2006, management has used that excess capital to repurchase over

25% of its outstanding shares.

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Over the next decade, I'd expect Tim's to buy back maybe another $3 billion to $5 billion in stock. My question for investors: What should long term shareholders hope for during that period?

The answer is counterintuitive: patient investors should wish for the stock to stagnant.

The idea is straightforward. If you are going to be a net buyer of stock in the future, you benefit when the price of shares fall. Afterall, the company is going to generate the same cash flows anyway. The less you have to pay for the stock, the higher your returns.

But this applies even if you have no intention of ever purchasing another share gain. That's because you are still accumulating a position in the company indirectly through the buyback.

In the case of Tim Horton's, the billions that the company will spend on buybacks will be more effective if the share price languishes. The firm gets to buy a bigger amount of stock for every dollar spent on repurchases. By the end of the decade, your ownership stake in a wonderful business will be higher and your returns will be better in the long run.

Why shareholders should be angry
Unfortunately, Tim's shares haven't languished. In fact, they have been one of the market's better performers.

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But if you're a long term investor (which I think most Foolish readers are) and you think Tim's is a wonderful business (which I think most will agree it is), then you'll agree that the company's recent outperformance is actually a bad thing. That applies to prospective *and* existing shareholders alike.

Foolish bottom line

Just like flying a plane, the type of thinking required to become a successful investor is counterintuitive.

I doubt many Tim Horton's shareholders will lose much sleep over the stock's appreciation. But the recent share price rally isn't something to celebrate. Savvy investors are actually quite disappointed.

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