3 Things to Look for in Tim Hortons' Earnings Next Week

Description

Tim Hortons (TSX: THI)(NYSE: THI), the Canadian institution and one of the largest publicly traded quick service restaurant chains in North America announces first-quarter results next week.

Started in 1964 by famed all-star hockey defenseman of the same name, Tim Hortons today has more than 4,300 restaurants, including nearly 3,800 in Canada and over 800 in the United States.

The stock is down 2% so far this year, but investors have done well of late — the stock gained 27% in 2013. The underlying business, however, has not performed well against a backdrop of weak economic growth and intense competition, both in Canada and in the U.S. In 2013, Tim Hortons missed, or barely achieved the lower end of guidance on key performance metrics, including same-store sales growth, new restaurant openings, and earnings per share.

Tim Hortons provided conservative guidance for 2014, namely:

- Earnings per share: $3.17 to $3.27
- Same-store sales growth: 1% to 3% in Canada, and 2% to 4% in the U.S.
- New restaurants: 140 to 160 in Canada, and 40 to 60 in the U.S.

When the company releases its first quarter results on May 7, here is what to look for.

Improved execution
For quick service restaurants, the key to success is, well, quick service. Tim Hortons has undertaken many initiatives to get customer through its restaurants more quickly, including easier to navigate digital menu boards featuring combo items, eliminating 24 menu items, and embracing technology — including offering mobile tap and scan payment options. And with the importance of the drive-thru to Tim's business, over 90% have been enhanced to get customers through more efficiently.

These improvements, if well executed, should eliminate bottlenecks at the most congested restaurants, and ultimately, drive same-store sales growth.

Same-store sales growth

In 2013, sales grew at restaurants open for at least 13 months by just 1.1% in Canada and 1.8% in the U.S. And the trend from the most recent quarter is not encouraging.

Same-store sales growth for Canadian restaurants was just 1.6% in the fourth quarter, down from 2.6% in the year earlier period. And despite the fact that much of its U.S. restaurants are still in their early growth phases, same-store sales growth also contracted slightly in the fourth quarter compared to the same period a year earlier.

Investors should pay close attention to same-store sales growth, and look for signs that some of the initiatives Tim Hortons is putting into place are yielding results.

Accessing new growth channels
It’s estimated that approximately 40% of the overall single-serve coffee market in Canada takes place in grocery stores. And Tim Hortons wants to tap into this market. In 2014, Tim Hortons will be rolling out two single-serve offerings in Canadian grocery stores – Tim Hortons and Tassimo-branded single-serve coffee cups.

Look for an update from management on how this new initiative is progressing over the next few quarters, and assurances that this strategy will be accretive to revenue, and not cannibalize in-store sales.

Foolish bottom line
Anyone who has purchased a coffee or a lunchtime sandwich lately knows the competition among quick service restaurants is fierce. **McDonald’s** (NYSE: MCD), **Starbucks** (NASDAQ: SBUX), and a whole host of new market entrants in the U.S. are constantly innovating and driving operational improvements. The competition is not standing still, so Tim Hortons must demonstrate to investors that it’s up to the challenge. With slow economic growth, gains will be achieved primarily at the expense of competitors.

Tim Hortons coffee may be inexpensive, but the same does not apply to its stock. Its trailing and forward price to earnings ratios of 21.5 and 18.6 respectively, are higher than their five-year averages, indicating a relatively expensive stock.

Investors should look for reassurances that Tim’s execution is improving, and that it will meet, if not exceed, the modest growth expectations it has set for itself in 2014. Until then, the only investment you should be making at Tim Hortons is in a cup of its coffee.

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Author

jklacey