Tim Hortons: Strengths, Weaknesses, Opportunities, Threats

Description

A good way to size up a company and its market position is by conducting a SWOT analysis, looking at its internal strengths and weaknesses and external opportunities and threats.

Today, I'll break down everything you need to know about **Tim Hortons** (TSX:THI)(NYSE:THI), the Canadian coffee and donut juggernaut, into delectable bite-sized portions.

Strengths

- **Strong market share:** It has a 27% share of dollars and 42% share of traffic in the Canadian Quick Service Restaurants category, more than next 15 chains *combined*.
- **Iconic brand:** Tim Hortons ranks No. 1 on the *Canadian Business* Top 40 Brands list, and was included as one of the 100 brands that APCO Insight found to be "Most Loved" globally. In fact, Tim Hortons ranks higher on the emotional attachment list than competitors **Starbucks** and **McDonald's**.
- **Financial discipline:** Steadily increasing dividends are awarded every quarter like clockwork, starting with $0.07 every quarter in 2006 to $0.32 in the first quarter of 2014.
- **Steady financial indicators:** Free cash flow over the past 12 months has totaled $378 million and was $356 million in fiscal 2013. This easily covered the $160 million and $156 million in dividend payments that were made during these periods and helps provide further evidence of the strength of the Tim Hortons franchise.
- **Investment in stores:** Tim Hortons opened 261 locations in 2013, improved drive-thrus at more than 1,400 locations in Canada, and gave more than 300 restaurants in Canada and the U.S. "a more modern, contemporary look."
- **Well-established but still growing:** The company's 2014 financial outlook includes a total of 215 to 255 restaurant openings in Canada, the U.S., and the Gulf Cooperation Council, including 140 to 160 locations in Canada and 40 to 60 full-serve restaurants in the U.S.

Weaknesses

- **Declining profitability for franchisees and store owners:** A highly publicized class-action lawsuit has drawn attention to allegations that Tim Hortons was requiring franchisees to sell new lunch menu items at a loss.

- **U.S. expansion has been sluggish:** Tim Hortons has only a 2.7% market share in the highly saturated American market according to Technomic. After 36 closings in New England in 2011, Tim Hortons is coming back aggressively with plans to open 300 stores in the next four years, but it is uncertain now whether that strategy will be successful.
- **Same-store-sales red flags:** Yearly same-store-sales growth in both Canada and U.S. has declined every year from 2011 to 2013. In 2013 in both Canada and the U.S., Tim Hortons missed its same-store-sales growth targets. A "persistently challenged economic environment of [the] quick service restaurant industry" was blamed.

Opportunities

- **Innovation:** Tim Hortons is already testing new ways to stay competitive. These include K-Cup home coffee prodicts, new coffee blends, mobile payments, and express lines for improved service.
- **"Brunch and Brinner":** All-day breakfast options are growing in popularity, and with many 24-hour locations, Tim Hortons could benefit from a steady traffic of people seeking breakfast later in the day.
- **Healthier options:** Though Tim Hortons is best known for its coffee and donuts, many of its lunch options are healthier than those of competing fast-food establishments. More marketing emphasis on healthy offerings and a little improvement in the nutritional makeup of its soups and baked goods offerings could go a long way in making customers opt for Tims over McDonald's.

Threats

- **Competition:** This is a crowded market! The number of Tims restaurants in Canada has jumped over 12% in past five years, though customer traffic has only increased 1%-2%. McDonald's is remodeling many of its Canadian outlets. Tim Hortons was scheduled to have nearly 10% of 3,300 restaurants refurbished at end of 2013, but this is both fewer in absolute terms and a slower pace than McDonald's Canada. Starbucks has been gaining ground, using a Canada-only brew called True North and singing the praises of maple with a new Maple Macchiato.
- **Hard times:** Lingering effects of a slow economic recovery mean fewer consumers eating outside the home. Operating income has been under pressure, and now Tim Hortons has to rely on lower prices to stay competitive, cutting into profits.
- **Investor pressure:** Highfields Capital Management (which owns 4% of shares) and Scout Capital Management (owns 5% of shares) oppose the expansion in America as returns have been lower than anticipated and the highly competitive U.S. fast-food market is just about saturated.

So what?

I really *want* to be in Tim Hortons' corner. It has refused to buckle in the face of an economic recession, making it a clear force to be reckoned with. But the fact is that new CEO Marc Caira's aggressive plan to expand into the U.S. is far from ideal. The best businesses are those that fulfill an *unmet* need. The United States has a sufficient ruckus in that industry with Dunkin Donuts, Starbucks, McDonald's, Panera, and more.

It has been a reliable stock in the past, and I hope it stays that way as it transitions into its new five-year plan. But the company's expectations for U.S. growth seem unrealistic and may end up costing it more than it bargained for.

There was a time when this stock would have been a sure bet, but now it looks too much like a gamble. Were Tims to change its tactics and expand to different regions with more promise, or differentiate its services and products in the U.S. so that they no longer overlap with every other fast food joint, I would happily recommend this stock to buy and keep for the long run.

CATEGORY

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