Why Tim Hortons Inc. Should Rebuff Burger King Worldwide Inc.'s Takeover Offer

Description

Reports surfaced on Sunday night that **Burger King Worldwide Inc.** (NYSE: BKW) is in talks to buy **Tim Hortons Inc.** (TSX: THI)(NYSE: THI), and merge the two companies together to create a new Canadian holding company, effectively moving Burger King from its Miami base to being domiciled in Canada for tax purposes. The *Wall Street Journal* was the first to report these discussions.

From Burger King's perspective, the deal makes all sorts of sense. I'm not a corporate tax expert by any means, but the company has obviously done its homework and figured out there are some significant tax savings to be had by moving its headquarters to Canada. Also, it's set to acquire the strongest player in Canada's fast food sector, which has significant growth ahead of it in the United States. Seems like a good deal for Burger King, which is often left out of the discussion by investors when talking about some of sexier names in the sector.

But is it a good deal for Tim Hortons shareholders? We need to wait until all the information comes out before having a final opinion, but that this point I can't say I like the deal from the company's perspective.

In 2010, Burger King was taken private by a Brazilian private equity firm. In 2012, activist investor Bill Ackman forged a deal for the fast food chain to go public again. Since the new shares begun trading in 2012, they're up more than 70%.

Like most private equity deals, being bought out levered Burger King up with debt. Although the company has made decent progress with paying back its creditors, it still owes nearly $3 billion in debt, compared to just $1.5 billion in equity. Tim Hortons, which is approximately the same size, has just half that amount of debt.

Essentially, cash flows from Tim Hortons would go to paying off Burger King's debts. And that's not even factoring in the debt it would need to take on to make the acquisition in the first place, assuming it wouldn't be an all-stock deal.

Burger King is doing a nice job expanding its presence around the world, particularly in India and France. But back home, things don't look as bright. Recent same-store sales in the U.S. only rose 0.2%, and that's even as the company embarks on a quest to renovate many restaurants. Sure, it's doing better than **McDonalds Corporation** (NYSE: MCD), which recently saw negative same-store sales in the U.S., but it's losing ground to **The Wendy's Co** (NASDAQ: WEN), which reported same-store sales growth north of 3%.

What does all this mean? Tim Hortons is a leader in Canada. It pours 8 out of 10 cups of coffee served in this country. Canadians have identified Tim Hortons as one of the nation's top brands. It is one of the jewels of Canadian business, and investors were disappointed when it was first acquired by an American parent, Wendy's, back in 1995.

It’s obvious to see the deal from Burger King’s perspective, and not just from a tax standpoint either. It wants to buy quality, knowing that this kind of acquisition is a buy-and-hold-forever deal. But ultimately, Burger King isn’t the same kind of quality that Tim Hortons is. If I was a Tim Hortons shareholder, I’d want to own Tim Hortons, not Tim Hortons and Burger King.

That’s why I’d be opposed to the deal. Tim Hortons shareholders would just be better off without Burger King. If I owned the stock, I’d sell my shares in a merger. There’s no way I’d want to own the combined entity.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:WEN (The Wendy's Company)
2. NYSE:MCD (McDonald's Corporation)

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