



Is Burger King Worldwide Inc Really After A Tax Break By Acquiring Tim Hortons Inc.?

Description

** This message was created and e-mailed directly to our **Take Stock** members **yesterday** before this morning's deal announcement was made. The advice, though slightly dated, and much of the information however remains relevant. **Take Stock** is the Motley Fool Canada's **free** investing newsletter. To have future editions delivered directly to you the minute they are ready, simply [click here now](#).*

Dear Fellow Fools,

In last week's edition of Take Stock I was lamenting about how "boring" the landscape has been this summer for corporate actions in the Canadian market. On cue, everything shifted yesterday afternoon when the Wall Street Journal broke the news that our beloved **Tim Hortons** (TSX: THI) is in talks to be acquired by U.S.-based (for now) **Burger King Worldwide** (NYSE: BKW). Both companies have confirmed the report, but at this point, that's about all we know.

What struck me right off the bat was that the press was labelling this deal as a so-called "tax inversion". Though Burger King is the potential acquirer, the combined entity's new headquarters would be located, and therefore taxed, here in Canada.

Tax inversions have grown in popularity of late. After all, it's a relatively easy strategy for companies to save millions of dollars and can give them a leg up on the competition. The thing is, Canada is not typically known as being a classic "low-tax" jurisdiction.

After taking a look at a couple of (readily available) numbers, this whole tax inversion labelling seems to be more of a way to fill space in a breaking report where details are scarce than an actuality.

According to Capital IQ, over the last twelve months (LTM), Burger King Worldwide paid tax at an effective rate of 26.5%. This compares to 27.5% in 2013 and 26.3% in 2012.

Tim Hortons, on the other hand, had an LTM effective tax rate of 27.7% and was charged 26.8% and 27.7% in 2013 and 2012 respectively.

I'm no tax expert, by any means, but do you see any material difference between these numbers?

Additionally, even if Burger King did face a tax rate of 40%, as I saw projected by one media outlet, it would have added about \$50 million (from \$97.4 million to \$147.2 million) to its total LTM tax bill. \$50 million is \$50 million, but mergers between companies that are worth in the neighborhood of \$10 *billion* do not take place so that the combined entity can save such a relatively modest sum.

The more likely rationale

Call me a simpleton but I don't think we have to look any further into a reason for this deal than a Tim Hortons drive-thru lineup at pretty much any time of the day. This is a fantastic company, with a prized brand, that gushes free cash as consistently as it changes up its pots of coffee. That's enough to get the acquisition juices of most in the financial world flowing.

Throw in the fact that Burger King Worldwide is 70% owned by a savvy private equity player and the company carries roughly twice the amount of debt on its balance sheet than its total equity and you can sort of see why the quality that Tim Hortons, the business, brings might be a nice fit in the eyes of the BK's majority owner.

That angle holds a whole lot less intrigue than one charged with the terms "tax inversion", which I might add is an increasingly hot button topic for the political types south of the border. However, I give it just as much of a shot of being right than the one that appears to *be* factually wrong.

What to do

Speculation aside, there's a decision on the table for many of you that own Tim Hortons shares. The stock currently sits about 20% higher than it did at last Friday's close (and is up 34% year-to-date) and by most metrics, certainly isn't cheap. Burger King and its private-equity owners aren't getting a bargain by any means.

Everybody's situation is different, and how a combined Tim Hortons/Burger King behemoth might perform going forward is anyone's guess. Based on today's move alone though, one prudent thing to do might be to remove at least a portion of your Tim Hortons position. The stock could obviously go higher, but there's a risk that a deal doesn't occur and this 20% jump vanishes before you know it.

Now that the news has leaked, and assuming there aren't other suitors for this Canadian icon (maybe **Valeant Pharmaceuticals** will swoop in? –just kidding, I think), the price BK pays is unlikely to be materially higher than today's level. Should the deal fizzle, so too will the shares, thus leaving you exposed to an unappealing risk/reward scenario for holding on – in my mind.

Bottom Line

We're going to hear a lot more about this deal in the coming weeks, and potentially years if it comes to fruition. In my mind, the things to keep front and centre right now are that a) don't believe everything you read in the media – they're looking for attention and if they can weave a political, potentially

polarizing theme into a story, they will; and b) consider lightening up your position in Tim Hortons – this move won't be right for all, and if you want to remain a long-term shareholder in the combined entity, ignore this suggestion. In my mind though, Timmies is likely to have made you a very nice return and what the future may hold just got a whole lot more uncertain.

Foolishly yours,

Iain Butler, CFA

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