After the Hype: Should Investors Embrace the New Tim Hortons Inc?

Description

It has been a couple of weeks since **Tim Hortons Inc.** (TSX: THI)(NYSE: THI) celebrated its 50th birthday, then followed it up by announcing a merger between itself and the 3G Capital-owned Burger King.

The initial excitement is passing and now we are left to ponder with cool heads what the future holds for the post-merger Tim Hortons. And what will be left for investors?

On paper this deal is being touted as a tax break for Burger King, leaving the more expensive American tax zone in favor of a cheaper Canadian tax code. For Tim Hortons, not much has been offered in terms of future benefits aside from aspirations of growing its U.S. footprint though Burger King's expertise. That's much the same rational we heard back when **Wendy's Corp** took control of Tim Hortons. In all, Tim Hortons has spent $650 million to grow its presence south of the border.

The axe is about to fall

If 3G Capital remains consistent in its post-acquisition strategy, heavy cost-cutting will emerge in the form of corporate store sell-offs, shifting costs to franchisees, cuts to advertising, and could even affect programs like Timbits hockey. This is the complete opposite of the business model Tim Hortons has applied in the past, which favours reinvestment and brand loyalty.

3G Capital is better known for collecting successful companies it can "flip" rather than building a brand to new heights. That's been the case with the acquisitions of Burger King, Heinz, and Anheuser-Busch InBev, where core operations were sacrificed for a quick boost to margins.

Another trend we are seeing more and more is companies such as Burger King shifting its own internal costs onto franchisees. By either selling off corporate stores or shifting renovation costs onto store owners, the work gets done but stays off the corporation's books.

Unfortunately for Tim Hortons and long-term investors, 50 years of steady grass roots growth could be at risk of evaporating.

Wendy’s all over again?

If all of this seems familiar, it is, as Tim Hortons has already gone down the burger chain merger path before with Wendy’s. The first time around, Tim Hortons was saddled to a company with little growth and it was the only part of the merger company that grew at all. Now Tim Hortons has hooked its ship to another poorly performing anchor, as Burger King posted negative sales growth of 0.5% in 2013.

A kick in the dividend

Another major shift that current investors will experience if they choose to take stock over cash is the sudden burden of debt being taken on. Tim Hortons has always been more modest when it came to carrying debt, with about $1.3 billion before the merger news. This strategy has allowed it to reward investors by boosting its dividend by 25% in the past five years, and had a yield of 2.2%.

The new entity will be burdened with $11.8 billion worth of debt when preferred shares are considered, meaning that investors will be at the bottom of the priority list, behind 3G Capital and its debt repayment schedules, fueled by Tim Hortons cash. Nothing is finalized yet, but some are predicting that the new merged stock’s dividend will only yield around 1%.

Now current investors of Tim Hortons are left with a choice — take the cash and run or stick around and hope it plays out well? Here’s my 10-year prediction on the state of the newly merged 3G owned company.

- Year 1: not much change
- Year 2: corporate stores are sold, advertising and product development gets reduced
- Year 3: following the cuts, huge net gains are posted, spiking the stock
- Year 4: more cuts followed by another stock price surge; Warren Buffett initiates exit strategy
- Year 5: cuts begin to take a toll on customer satisfaction and franchisees, stock plateaus
- Year 6: cuts to advertising and community programs begin
- Year 7: previous round of cuts boost stock price, 3G begins exit plans
- Year 8: secondary competitors begin to take market share from Tim Hortons
- Year 9: rumours of a sell-off emerge, stock surges
- Year 10: 3G Capital sells Tim-King at a premium, Tim Hortons begins rebuilding its brand

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:WEN (The Wendy's Company)

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