Something's Brewing at Tim Hortons (and it's Not the Coffee)

Description

On the first day of the New Year, the Ontario government implemented a new law — one that would see the provincial minimum wage increase from $11.40 per hour to $14.00 per hour.

That's a 23% increase – overnight, mind you – and now many businesses that employ lower-wage workers, including Tim Hortons, Canada's iconic coffee chain, are scrambling to keep up.

Part of the problem facing Tim Hortons specifically is that the company's franchisees, who report to Tim Hortons' parent company, U.S.-based **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR) don't have the power to raise menu prices in their stores.

Facing a stiff jump in staffing costs – already one of the chain's biggest expenses prior to the new legislation and lacking the ability to raise prices in order to offset some of those costs – some franchisees have found themselves resorting to desperate measures.

One employee at a Windsor-based location said employees were no longer being paid for their breaks and were also being forced to pay for their own uniforms.

Another high-profile story this week saw a location that was owned and operated by the children of the company's original founder forcing eligible employees to begin paying for medical and dental employees while also forfeiting paid breaks.

Part of the problem is that 60% of Tim Hortons' franchisees belong to an organization that is dedicated to mitigating job losses for the chain's employees, so while the seemingly easiest solution might be to cut back on staffing, for some, this simply isn't a viable option.

Making matters worse for the local operators are claims by the small-business owners that Restaurant Brands International Inc.'s parent company, 3G Capital, is forcing franchises to pay steep prices for its some of its food ingredients, paper, and packaging supplies.

Perhaps that shouldn't come as too much of a surprise, as 3G Capital is a very large, Brazilian-based private equity firm renowned for being among the world's most aggressive firms in cutting costs and squeezing the most out of every single dollar.

Warren Buffett has famously partnered with 3G on several deals, including the takeover of Heinz, the world's largest ketchup maker.

What is Restaurant Brands International Inc. going to do about it?

Restaurant Brands International reported a strong quarter on Monday, beating analysts' expectations and downplaying the story north of the border with its Tim Hortons' franchisees.

Adjusted earnings were up 50% for the restaurant operator over one year ago, suggesting that while franchisees may not be happy with the way the company handles its business, the strategy may in fact be paying dividends for its shareholders.

Despite the positive results, Tim Hortons was a drag on performance, reporting its fifth straight quarter of flat or declining same-store sales.

Meanwhile, Restaurant Brands' two other major chains, Burger King and Popeyes, reported impressive growth of 12.3% and 6.8%, respectively.

Bottom line

It's no secret that Tim Hortons' franchisees are happy with the way the chain is currently being managed.

However, now that its parent company is being faced with noticeable under-performance on the part of the Canadian coffee chain, it may be time to find a different suitor for the iconic coffee brewer.

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