How the Burger King deal could change Tim Hortons

Merger will help expansion plans but could also change coffee chain's more free-wheeling habits

Canadians aren't likely to lose their beloved double-doubles or the Timbits that prove so perplexing to our American neighbours. But the planned acquisition of Canada's Tim Hortons by the U.S.-based Burger King will undoubtedly bring changes.

Tim Hortons agreed Tuesday to be bought by 3G Capital, the investment firm that owns Burger King. The Miami-based burger chain said the new combined company would be based at the current headquarters of Tim Hortons in Oakville, Ont.

The $94-a-share deal has been unanimously approved by the boards of both companies, but is still subject to a shareholder vote. Regulators in the U.S. and Canada will also likely want a say.

If completed, the deal would automatically give the merged entity more clout simply by making it the world's third-largest quick-service restaurant. The new company would have combined global sales of $23 billion and have 18,000 locations in 98 countries.

But beyond the dollars, what's at stake for the Canadian icon?

"Tim's won't die because of foreign ownership, they'll die because foreign ownership will bring forth ... death by a thousand cuts," says Alan Middleton, executive director of York University's Schulich Executive Education Centre.

The companies said Tuesday that Daniel Schwartz, CEO of Burger King, would become CEO of the new company. Current Tim Hortons CEO Marc Caira would become a director of the new company, as well as its vice-chairman. In a joint press release the two entities reassured customers that they'd continue to operate "as standalone brands," promising to preserve existing "iconic brands."

But such early day promises don't always last.

The majority owner of Burger King, 3G Capital, is a "ravenous" global investment firm based in Brazil, says Middleton, and it is one that tends to push for quicker profits than, say, Warren Buffett's Berkshire Hathaway or other leading acquisition firms.

On the other hand, Barry Schwartz, an investment manager at Baskin Financial in Toronto, says that 3G Capital's cost-cutting ways and focus on tight capital expenditures could be highly beneficial for Tim Hortons.

"3G has been extremely successful converting strong brands and making them even stronger," says Schwartz. "We think this is a huge, huge win for Tim Hortons' shareholders."

Ketchup cutters

Canadians might remember the private equity firm 3G from another recent purchase.

In 2013, 3G and Warren Buffett's Berkshire Hathaway, bought Heinz. That led to hundreds of residents of the small southern Ontario town of Leamington, known as the tomato capital of Canada, losing their jobs as the company sought to cut costs.

While back-office cuts are unlikely to matter to the customer at the counter, that focus on profits might eventually change the way Tim Hortons operates, perhaps leading them to test fewer new items.

"Tim's success is because of successful trial and error," said Middleton. "The fact that they have constantly so many [new items] is part of what keeps the Tim's franchise fresh in people's minds, because it's never exactly the same Tim's year to year."

One of the latest ventures of the chain, which celebrated its 50th year, is made-to-order paninis for the lunch-time crowd, a growing segment.

The coffee chain's experiments aren't always successful, though. A five-year partnership to sell Cold Stone ice cream in some of its stores ended earlier this year.

The latest addition to the Tim Hortons menu is its dark roast coffee, a bid to expand its reach in the lucrative coffee market.
It's too early to know whether that item will succeed. Tim Hortons already boasts selling eight out of 10 cups of coffee consumed in Canada, though McDonald's is slowly eating away at that huge lead.

Overall, the deal is expected to be a big win for Tim Hortons, particularly in its faltering attempts to expand globally.

Burger King, with its more than 13,000 locations in nearly 100 countries and territories, has tremendous reach and expertise around the world.

That translates into on-the-ground help such as location mapping, knowledge of regional competition and networks of local suppliers.

More importantly, though, the burger empire has the capital needed by the Canadian icon to market itself to consumers in the U.S. and abroad who are unfamiliar with the brand.

Burger King's know-how may be most crucial in the highly-competitive American market where Tim Hortons has struggled since entering in 1984 in New York state.

"The coffee shop segment is crowded and you've got two huge players that have very good, very strong customer loyalty [in the U.S.]," said David Henkes, vice-president of Chicago-based food industry consultancy Technomic.

"Tim Hortons has sort of tried to figure out how to be that No. 3 player," but it's been a struggle in part because Americans don't understand "the brand heritage of Tim Hortons," says Henkes.

An aggressive plan

Despite questions over its saturation of the Canadian market and its struggles in the U.S., Tim Hortons new chief executive Marc Caira outlined an "aggressive" plan in February to grow both here and abroad.

By 2018, the company plans to open 500 restaurants in Canada, with about half of them added this year alone. The company currently has more than 1,300 stores.

In the U.S., it hopes to expand its 850-strong network of stores with 300 more by 2018.

The company also has 38 restaurants in the Persian Gulf, where it's seen some success. There it hopes to add about 220 locations in the same time period.

Schwartz sees the Tim Hortons-Burger King deal as a "huge win" not only for the Canadian restaurant, but also for Canadian taxpayers in the long term.

The new merged company would be headquartered in Canada, where the corporate tax rates are substantially lower. The basic U.S. rate stands around 35 per cent, while Canada's is about 10 points lower, depending on the province.

"It would create a large world-class company based in Canada, paying taxes in Canada, increase the exposure of the Toronto stock market and potentially lead to more tax inversions of U.S. and foreign companies coming into Canada," said Schwartz. Tax inversions are the relocation of a company's headquarters to a country with lower taxes.

But ultimately, will it make any difference for the average Canadian?

No, says Middleton, not unless cost-cutting measures change the nature of Timmies.

"Canadians are very loyal, they don't change buying habits as fast as Americans, they're not as price seeking as Americans. They're more patient," said Middleton.

But if 3G takes it a step too far, they could find themselves faced with a profit-line that looks more like an inverted hockey stick, a sudden downward move, as Canadians say, "This is no longer my Tim's."