Investors can taste more of Tims
Wendy's completes spin-off tomorrow

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Investors who missed out on a sizeable amount of one of Canada's most-hyped IPOs in history are going to get another chance soon.

Wendy's International Inc. will complete its spin-off of Tim Hortons Inc. tomorrow afternoon, transferring nearly 160 million shares over to its shareholders. On Monday morning, those shares are likely to start flying across the border into the hands of Canadian investors like so many Timbits.

And while the spin-off was expected to depress the stock, Standard & Poor's announced Tuesday night that Tims will be included in the S&P/TSX Composite Index, a surprising move that pushed the stock up 5% yesterday. A place in the index means higher demand for the stock, since index funds across the country will want a piece of a more liquid Tims with a market cap in excess of $5-billion.

"More people in Canada will own it, and I think have to own it because we've lost a lot of Canadian stocks," to foreign buyers said David Hartley, an analyst at Blackmont Capital. "Scarcity value is high on this one."

Tim Hortons makes an intriguing investment opportunity. The company is churning out 7% same-store sales growth in Canada and 9% in the U.S., well above most competitors in the food service industry. It has a clean balance sheet with a manageable debt level. It's planning to add about 1,500 new restaurants to consolidate its dominant position in Canada and grow in the United States. It has started to add breakfast sandwiches to the menu, which analysts say are already a big hit. And it has a proven management team with a strong track record.

On top of that, it's a cash flow machine. Mr. Hartley estimates that Tims could churn out $200-million in free cash flow in the short-term. That could open the door for a dividend increase similar to rival McDonald's Corp., which hiked its quarterly payout almost 50% yesterday. The company could also buy back more stock on top of the $200-million repurchase program announced last month.

"I really like Tim Hortons," said Peter Holden, an analyst with Veritas Investment Research, who thinks the stock has an intrinsic value of $37 a share. "I think it's a solid, stable, low-risk, well-run company." He doesn't believe it will ever reach the blue-chip status of a Microsoft Corp. or Royal Bank of Canada because of the volatility of the food service business, but thinks it will "be as prevalent in portfolios as any other retail stock in Canada."

Mr. Holden is also not concerned that too many U.S. investors will rush to sell the shares on Monday, since they have no reason to sell at a loss, and the inclusion of Tims in the TSX Composite will increase the Canadian demand. The company's stock buyback plan will also lessen the impact, he wrote.

All the same, a lot of people on Bay Street aren't buying the Tim Hortons hype.

Part of the reason is the stock's performance to date. After a predictable run-up when it first started trading in late March, the stock sank back to the high 20-dollar range, where it has stayed ever since. It closed yesterday at $28.98.

"I'm not positive at these prices. I think it's a better investment at the 25-dollar level," said Steve MacMillan, VP of investments at KBSH Capital Management. "I think most investors overestimate the growth potential."

One of his biggest concerns is in the U.S. market, where Tims hasn't duplicated its phenomenal success in Canada. The acquisition of more than 40 Bess Eaton Donut outlets in New England has been especially disappointing. The company closed several under-performing outlets last year, though results have improved outside of New England. The U.S. opportunity is key to the company's future, since the market is roughly 10 times larger than Canada.

"I don't think something called a 'breakfast sandwich' is going to turn their U.S. operations around," said Bruce Hartman, a portfolio manager with Blackmont Capital.

Mr. Hartman is also not convinced that the company's Canadian expansion, which will focus on Western Canada and Quebec, will reap the same kind of rewards as the older restaurants. "I'm not sure you can replicate that when you're opening stores in Kelowna or Campbell River [British Columbia]."

There are other issues that could affect the stock price as well. Tims may have higher costs because it can no longer piggyback on Wendy's. It also cannot make any changes to its corporate structure in the short-term -- such as an income trust conversion -- as a condition of its tax-free spin-off from Wendy's, Mr. MacMillan said. Many U.S. investors may also prefer to keep their Tim Hortons stock and dump Wendy's instead, which could keep many shares out of the hands of Canadian retail investors.

But the biggest question going forward is growth.

"I don't see great growth prospects for it," said Greg Eckel, a fund manager at Morgan Meighen & Associates. "It took 20 years for them to gain momentum in Canada. It's a Canadian icon, let's face it, and a good retailer. I'm just wondering if the real growth is over and we're looking at a more mature business."