Facts about burger king holdings marketing essay

Burger King (BK) is the second largest fast food hamburger restaurant (FFHR) in the world with operations in 74 different countries. Its major competitors are McDonald's, Subway and Yum! Brands. BK was ranked among America's 1, 000 largest corporations by Fortune Magazine in 2008. Further, Burger King is listed among one of the Top 100 " Best Global Brands".

History

The history of the brand Burger King refers to 1959, when J, M and D. Edg purchased the firm from the original founders. Company was run as an independent entity for eight years, eventually expanding to over 250 locations in the United States, but in 1967 due to some reasons, baking giant Pillsbury repurchased Burger King. In 1978, when McDonald's executive Donald N. Smith came to renovate the company BKC was prominantly modificated in terms of its franchise agreements, strategy, menu, and restraunt look out. But Poor operating performance and ineffective leadership weight down the company during many years, even after Diageo, the global alcoholic beverages company baught Burger King in 1989. Eventually, Diageo damaged the company by neglecting the brand, and major franchises were driven out of business and its total value was significantly decreased. In 2002 Diageo divested itself of the money-losing business and sold Burger King to a group of investment firms lead by TPG Capital. After this acquisition, many positive changes started to happen to Burger King. One of the major issues was first public offering in 2006, which was highly succefful. But there were some spots on Burger King reputation. The case of unsauccessful Buck Double campaign, which promoted $1 burgers, provoking the lawsuits from franchisees, unhappy with selling at a price lower than production costs. Those events somehow were reflected on the BKC stock behavior. By the time the ordinary stock of Burger King was selling at $16 per share, another interesting and totally unexpected thing shocked the global business community.

‘ On September 2, 2010, a Brazailian company 3G Capital Management LLC. Announced decision to acquire all the stocks of Burger King for $24. 00 per share, or $3. 26 billion in aggregate including Burger King’s outstanding debt’. As the purpose of this report is to analyse the current state of the company and give recommendation upon this recent transaction, further in this paper we will answer whether it was good or bad acquisition.

Key People of Burger King

John Chidsey, Ex-CEO, currently is a Co-Chairman of the Board BK Inc. He joined Burger King Corporation as an Executive Vice President and the Chief Administrative and Financial Officer in March 2004. In fact, his effective leadership and strategic thought brought company to a quite successful level of performance. His wide range of responsibilities included monitoring franchise and company operations, finance, corporate strategic planning, and oversight of the annual budget, the information technology function, risk management, and corporate procurement, as well as the Franchise Financial Restructuring Program (FFRP). Mr. Chidsey obtained Doctor of Jurisprudence and MBA from Emory University. Therefore his academic background in law and business, overall professional skills and previous experience bring unprecedented value to the company. As from the recent news, John Chidsey is going to resign from the board and will be employed with BKC until the April 18, 2011.

Ben Wells – CFO and Treasurer of Burger King, who has more than 25 years of experience in financa. He repots directly to CEO and proves himself as a key member of the executive leadership team. Before joining BKC he held a position of vice president and corporate treasurer at Compaq Computer Corporation, when he successfully led the finance team in stabilizing finance and accounting operations. He also was employed by such famous corporation as British Petroleum and Hewlett Packard. Possessing degree in economics and business administration (University of Missouri, Texas A&M University, Canisius College), he is capabable for building a world-class treasury organization and developing capital structure and risk management programs for the global organization.

Alexander Behring – Co-Chairman of the Board BK Inc. and Managing Partner of " 3G Capital Management LLC". Experienced engineer and successful private equity manager, he is the one, who was behind the $4bn takeover of BKC. Becoming one of the inflluential investors of Brazil, he started and lead " America Latina Logistica", the biggest railroad and logistics corporation in Latin America. Mr. Behring holds MBA from Harvard Business School and Bachelor's Degree from Pontifícia Universidade Católica do Rio de Janeiro.

Bernardo Hees – new CEO of Burger King Inc., since September 2010. Previously, he was Chief Executive Officer of America Latina Logistica (ALL), as a successor of Alexander Behring, since January 2005 and served on its Board of Directors. B. Hees is an experienced executive with an impressive track record of enhancing performance, managing a team that drove strong gains in both revenues and profitability. He obtained MBA from the University of Warwick and passed Owners-Presidents Management program at Harvard Business School. According to his sound resume and reputation, he can be fairly considered as an excellent steward of the Burger King brand, inspired by the intention to take company to the next level of competition in the U. S. and worldwide.

Business Model of Burger King:

A business model is a plan implemented by a company to generate revenues and make profits from the operations it performs. (Investopedia, n. d.). Burger King uses the franchise business model to generate profits. Under the franchise arrangement, the franchisees invest in the equipment, signage, seating, and decor of the restaurant, while the company owns or leases the land and building. The company generates revenues mainly from three sources: sales at the company restaurants, royalties and franchise fees, and property income from certain franchise restaurants that lease or sub-lease property from the company (Datamonitor, 2010).

Resources of the Company

Reagrding the resources available for sustainable comptitive advantage, those resources are classified into tanbgible and intangible. As Burger King is a well-establiched global corporation, it has formulated very strong basis for its worldwide operations. In fact, despite of performing in the fast paced indutsry and facing the risk of once to become unclaimed due to unhealthy food provision, as consumers may change their preferences, BKC definitely creates a unique line of products. For instance, famous " Whopper" sandwich, Croissan'Wich, flame-broiled hamburgers and etc. Burger King proves itself as genuinly global company by localization of products versions by adding ingredients such as teriyaki or beetroot and fried egg to the

Whopper; beer in Germany, Italy and Spain; and halal or kosher products in the Middle East and Israel. They property counts for almost 12 000 restaurants worldwide, of which 60% is concentrated in US and Canada, and 40% is internationally spread.

Regards the intangible assets, highly quilified and experienced executive management team is a great value to Burger King, promising effective operations and high and stable earnings growth. While globally recognised brand Burger King is another powerful asset to corporation, as well as reputation and products assocated with it. And last, but not the list is the Knowledge, which mainly brought the Burger King fame for its products. They definitely possess unique production technology, which is constantly updated and successfully implemented.

Strategy Analysis

Business Strategy Analysis

From pdf

Business Strategy Analysis helps us evaluate the sustainability of the firm. BK strives to implement the following elements into its business strategy in order to grow.

Further drive sales growth: BK is attempting to increase sales growth by enhancing guest experience, expanding hours of operations and emphasizing on restaurant reimaging program. All this is expected to result in higher sales and traffic in these restaurants and yield strong cash on cash returns.

Enhance restaurant profitability: BK endeavours to enhance restaurant profitability by leveraging their fixed cost structure by introducing higher margin products and creating efficiencies through improved speed of service and equipment. Further, BK utilizes market based pricing model to achieve optimal pricing in the highly competitive market environment, thus making it a market follower.

Employ innovative marketing strategies and offer superior value and quality: BK employs innovative and creative marketing strategies to increase their restaurant traffic and comparable sales. BK's whooper has been one of the best known products in the fast food industry. In addition, BK has also launched AngryWooperTM sandwhich, BK Burger Shots and BK Breakfast ShotsTM in the U. S., the King DealsTM in Germany, the U. K. and Spain and the Come Como ReyTM (Eat Like a King) every day value menu in Mexico. Further, their advertisement campaigns have always created a buzz and improved their visibility in the market.

Expand our large international platform: Presently, BK is concentrated in the US and Canadian markets only, therefore they have a significant growth potential in international arena. BK has realized this and has developed a detailed global development plan to accelerate growth over the next few years. However, entering into international markets is tough because McDonalds already has its presence in almost all countries of the world. Further, BK fails to mention the strategy with which they plan to enter international markets. This maybe because they do not want to divulge their strategy to their competitors, or because they do not have a strategy which can provide them a competitive advantage over McDonalds.

Use proactive portfolio management to drive growth: BK intends to use proactive portfolio management to drive growth and optimize their Company restaurant portfolio and franchisee participation in new and existing markets, while maintaining our 90/10 franchise to Company restaurant ownership mix. Between April 2008 and May 2009, BK acquired 128 new restaurants in parts US and sold 39 Company restaurants to new and existing franchisee. In addition, they closed under-performing restaurants in UK and sold certain Company restaurants in Germany and Canada to their local franchisees.

Thus, the business strategy focuses on driving sales in existing markets and striving for presence in international market. However, almost all quick service restaurants that strive for greater profitability follow a similar strategy. If BK wishes to have a greater market presence, then it has to keep coming up with new, innovative, and creative products and marketing campaigns as these are the only ways by which they can differentiate their brand.

Further, we carried out the industry analysis (See Appendix X), and found that per se the industry has a good market potential. Moreover, as the global economic environment improves the industry would again be profitable as the consumers would again become price insensitive and companies coming up with new, innovative and affordable menus would have more power than the buyers and suppliers. In addition, the industry is forecast to increase by 19. 2 % till 2014 and there is a growing demand of fast-food in the emerging markets like India, China, and Indonesia etc. Therefore, the industry has good future prospects if tapped in an appropriate manner.

Based on the SWOT analysis (see Appendix X1), it can be discerned that the company understands that the only way to increase its profitability is through constant innovation and expansion into new international market; and given the brand reputation, the franchise mix and robust financial performance, we think the company has the capability to grow profitably in the future.

5. VALUATION

The value of any security is determined by its quality and profit potential. The economic environment and industry in which firm operates also have inevitable impact. Hence, we valued of BKC by incorporating these factors into the analysis of BKC's stock value.

It is well known that it is very subjective to valuate any company and its stock as the market is changing constantly and the market price heavily depends on people's expectations and feelings. The good example might be Burger King's market price that soared from $16. 77 to $13. 64 after the acquisition announcement http://www. wikinvest. com/stock/Burger_King_Holdings_(BKC)/WikiChart (Appendix H). Most analysts use various valuation models to calculate whether a stock is overvalued or undervalued. Those models are just generally accepted ways of assessing a company's stock and make a recommendation. Thus, analysts should not rely on the results of these models only but also take into consideration performance of existing competitors. Using " comparables", i. e. ratios of identical companies and their financial performance indicators, as an addition to the valuation analysis should give a better understanding of company health and what it stands for in the market. For that reason, we have implemented several valuation models, including Dividend Discount Model (DDM), Market premium (MP) and Residual Earnings Model (RE), and compared BKC's performance to its major competitor McDonald's using financial ratios. It should be noted that for the sake of comparison, we have taken the financial data available at the end of fiscal years for BKC and McDonald's i. e. June 30th, 2010 and December 31st, 2010, respectively. Further, the spot stock prices are taken as of June 30th, 2010.

5. 1 Performance

[I THINK PERFORMANCE SHOULD GO IN HERE]

5. 2 Dividend Discount Model

Starting from year 2006, when Burger King was first listed on the New-York Stock Exchange, the company has paid the fixed dividend of $0. 25[1]per share per year (Appendix A). Therefore, we do not expect any future dividend growth and assume zero growth for DDM valuation model. For simplicity, we use DDM-perpetuity and take required rate of return (k) as a discounting factor (r).

Therefore, V = D/r …… (1)

According to The Capital Asset Pricing Model (CAPM), required rate of return (k) is calculated as follows:

k = rf + B(rm – rf) ….. (2)

where, rf = risk-free rate,

B = beta,

(rm – rf) = market risk premium

We have used risk-free rate of 2. 92% from company report (Burger King Holdings, 2010, p. 87), company beta of 0. 80 was taken from on-line source (ADVFN, 2011) and market risk premium 6. 75% from Journal of Financial Economics, which is a bit outdated but we believe that this type of market is even riskier then it was 10 years ago (Fama, 1997, p. 172).

Substituting the values in equation 2, we get

k = 2. 92% + 0. 80*6. 75% = 8. 32%

As mentioned before, since r = k, substituting the value of r in equation 1, we get

V= 0. 25/0. 0832 = $3. 00 (The value of BKC's share)

However, as of June 30th, 2010 market share price of BKC was $16. 84/share (Wikinvest, 2011).

Further, in order to assess our valuation, we valued the share price of McDonald's share and got a valuation of $36. 28 (for calculations, see Appendix G). However, as of June 30th, 2010 the share price is $65. 87.

As, McDonald's is more popular brand than BK, and its stock price is twice as high as the valuation figure, whereas BK King is way behind McDonald's but its price is five times higher than the calculated value. To investigate the reliability of this result we calculate the market premium of the BK's share.

5. 3 Market Premium Model

The measure of stockholders' equity on the balance sheet typically does not reflect the intrinsic value of what the equity is worth (Penman, 2003). There is a definition of intrinsic value which states that it is " the actual value of a company or an asset based on an underlying perception of its true value including all aspects of the business, in terms of both tangible and intangible factors. This value may or may not be the same as the current market value" (Investopedia, 2011). For that reason it is meaningful to see what extra price, or premium, the market pays for a particular security.

In order to calculate market premium we use the formula (Penman, 2003):

Market Premium = Market Value of Equity – Book Value of Equity….. (3)

Calculating the market value of BKC as of June 30, 2010,

Market Value = Price per share*Shares Outstanding …. (4)

= $16. 84*135. 4m=$2, 280. 136m

The Book Value of BKC = Total Shareholders' Equity = $1, 128. 4m (Appendix C).

Therefore, Market Premium = $1, 151. 736m.

With Shares Outstanding = 135. 4m, the Book Value per Share (BVPS) = $8. 33 and Premium = $8. 51. Indeed, the premium constitutes 102% over the book value. As compared to McDonald's, with 1, 072m shares outstanding (Appendix D), McDonald's has a BVPS of $12. 25 and the premium of $53. 62, which is 438% higher than its book value.

Thus, we may conclude that market is ready to pay quadruple premium for MCD, which indicates a great brand awareness and customer loyalty; however, they are still ready to pay twice for BKC's shares, which is a good sign for the stock evaluation.

5. 4 Residual Earnings Model

The residual earnings model relies on book value, which represents shareholders' investments into the firm and measures value added to the investments. In other words, the book value of equity is taken and discounted back potential abnormal earnings are added to it. These earnings are returns to shareholders above their required rate of return. These earnings are important because otherwise the shareholders' would have no objective to invest into the company if it break-evens at the minimum rate of return (Penman, 2003).

Value = Book value + Premium …. (5)

or

Value of common equity (VE0) = B0 + RE1/re …… (6)

where, re = required rate of return,

RE = Residual Earnings for Equity

Now,

Residual Earnings = Comprehensive Earnings – (Required Return for Equity * Beginning-of-Period Book Value) ….. (7)

BK reported $165. 8 million of comprehensive income on June 30, 2010 (Appendix B) on book value of $974. 8 million. If BK's shareholders required a return of 8. 32% in June, 2010; then its 2010 residual earnings were:

Residual Earnings = $165. 8 – (8. 32%*$974. 8) = $84. 70 million

The very existence of the residual earnings gives us a sign that Burger King is a good investment to get extra return on invested funds.

Further, substitutiting the values in equation 7, we get:

Value of common equity (VE0) = $974. 8 + $84. 70/. 0832 = $1, 992. 83 million

VE0/share = $1, 992. 83/135. 4 = $14. 72

Assuming that RE remain unchanged (g= 0%), then the calculated the intrinsic value of BK's share of $14. 72 is close to market price of $16. 84. Obviously, market was aware of the existing premium and recognized it by setting market price at that level.

5. 5 Summary

The three valuation models have revealed Burger King's financial performance from different angles. For the reason that today's market is different from yesterday's, the DDM model is not really appropriate for security valuation, because contemporary market is mature and, as we have observed, dividends do not grow along with growing earnings as used to be in the past. However, this model was implemented just to see the consistency and get a better understanding of the value of the stock. The market premium model gave us a good sense of what market is ready to pay for the BK's share and McDonald's share. Further, the residual earnings model is said to be more reliable as compared to the other two models because it uses book value of the equity as well as market premium model. Overall, it can be seen that BK per se has performed well in the market; however it has been far behind its main competitor McDonald's.

6. RISKS

Burger King is exposed to a variety of risks (3G Capital, 2011). The most prominent and important risks come from internal characteristics of the firm and market-determined factors.

Internal characteristics of the firm include:

Business risk: This risk might arise as a result of decreasing demand due to changes in consumer preferences, possible suppliers' delays or adverse economic conditions. Also, the business model is based on franchising contracts, so franchisees' financial strengths and ability to manage increasing costs is also subject of risk.

Financial risk: BK has long-term and short-term debt outstanding, so it should have enough operating cash to meet these obligations. According to the notes to company's financial statements, BK uses derivative instruments, such as interest rate swaps and foreign currency forward contracts, which imply a higher risk exposure.

Legal risk: As every food company, BK is in charge of risk related to food safety and toys as promotional instruments in their restaurants, as well as any legal judgments and pressures from competitors.

Country risk / Exchange rate risk: BK is an international company, therefore fluctuations in foreign currencies and adverse government regulations create substantial risk exposure.

Reputation risk: Customers in FFHR industry are very sensitive to the reputation and brand awareness of the company.

Market-determined factors include:

Systematic risk: This is an unmanageable risk, which can arise as a result of recessions and wars.

Analyzing the risk associated with the functioning of the company, it can be discerned that BK acknowledges that there are some risks associated with the business. And therefore, has some measures such as following a market based pricing model, using trusted suppliers, etc. for overcoming these risks (Annual report, 2010). Further, BK is still vulnerable to the unknown risks such as exchange rate risks and systemic risks. However, these risks are faced by all companies. It is just a matter of the way in which they respond to these risks that determines how they fair in the market. As for BK, the impact of the systemic risk is has been high as compared to its competitor McDonald’s (Datamonitor, 2010). However, they have realized this and have tried to overcome these setbacks by implementing promotional, other price discounting actions, and closing non-profitable company restaurants. (Annual report, 2010)

7. CONCLUSION

Based on our analysis of company’s background, strategy and people, as well as industry analysis and financial performance valuation we discern that the financial performance of BK was stable and improving during last five year, and the valuation revealed that the market believes that Burger King’s stock is worth investing. Therefore, we can conclude that the company is financially healthy and hence the acquirer, 3G Capital, made a good decision. However, because the new management does not have any experience in the food industry and adding to this the current economic situation, Burger King might be in a vulnerable position right now. Further, in the industry analysis, on one hand, there was a threat of customers switching to the healthier options, which might imply a risky acquisition decision by 3G Capital. And on the other hand, there was a positive outlook towards the quick service restaurant industry, which is expected to grow at a rate of 3% per year. Analyzing the annual report of BK, we realized that BK is aware of these issues and has been trying to improve them by introducing healthier meals and innovative marketing campaigns. Moreover, the strategy of the company is very ambiguous. The strategies and goals of BK are very generalist and unclear how the management is going to achieve these. However, the new management might set a new and a sound strategy and provide necessary resources for achieving it. In conclusion, in light of the business strategy and the comparison of the performance of the company with its competitiors , we think that the BK’s acquisition was hugely overvalued. However, because of the stable financial performance and positive industry outlook it was a good acquisition and if the new management is able to tap the potential in the existing and new markets in a appropriate manner then the company's growth potential is huge.

[PLEASE FEEL FREE TO ADD/AMEND SOMETHING IN CONCLUSION]

APPENDIX A

Consolidated Statement of Income – Burger King

Source: Burger King Holding, Inc. Form 10-K, 2010

APPENDIX B

Consolidated Statement of Stockholders' Equity – Burger King

Source: Burger King Holding, Inc. Form 10-K, 2010

APPENDIX C

Consolidated Balance Sheet – Burger King

Source: Burger King Holding, Inc. Form 10-K, 2010

APPENDIX D

Consolidated Statement of Income -McDonald's

Source: McDonald's Corporation, Form 10-K, 2010

APPENDIX E

Consolidated Statement of Stockholders’ Equity -McDonald’s

Source: McDonald’s Corporation, Form 10-K, 2010

APPENDIX F

Consolidated Balance Sheet -McDonald’s

Source: McDonald’s Corporation, Form 10-K, 2010

APPENDIX G

Dividend Discount Model – McDonald’s

For valuation of McDonald’s share, we have used the same risk-free rate of 2. 92% and market risk premium of 6. 75%, company beta of 0. 49 was taken from the same on-line source (ADVFN, 2011).

Substituting the values in equation 2, we get

k = 2. 92%+ 0. 49*6. 75% = 6. 23%.

The dividend per share was virtually stable; therefore we took the figure of $2. 26 per share, as of 2010.

As, r = k, substituting the value of r in equation 1, we get

V = 2. 26/0. 0623 = $36. 28

Therefore, as of June 30th, 2010 market share price of MCD was valued using the DDM model as $36. 28, whereas the spot share price was $65. 87 per share.

It should be noted that for the valuations using the DDM model, we take the same risk-free rate and market risk premium, because companies are competing in the same industry, however beta is different because MCD is more stable than BKC which is why the risk of volatility is lower.

McDonald’s price history

Source: Morningstar investment research, 2011

APPENDIX H

Price History -Burger King

Source: Wikinvest, 2011

Industry Analysis: Using the Porter’s Five Forces Model (Datamonitor, Industry analysis)

Porter’s five forces model helps in analysing the profit potential of an industry which would eventually help in determining a firm’s chances of generating long-term profits. (book)

Bargaining power of buyers: The economic recession has strengthened the buyer power as the industry players try to secure price sensitive consumers using competitive pricing strategies. However, due to the sheer convenience of having fast-food makes fast-food more important to the consumer than a simple source of food. Therefore, the buyer power is assessed to be moderate.

Bargaining power of suppliers: For a fast food company to make profits, it is vital that the company has reliable suppliers that offer food of marketable quality and at a low margin. However, a large number of these suppliers serve other kinds of foodservice and cost service customers, thereby decreasing their dependence on fast food players. Therefore, the supplier power is considered to be moderate.

Threat of new entrants: As large capital reserves are not required for setting up a single, independent fast food outlet, the entry into the global fast food market is easy. However, to build a global brand requires precise market knowledge, an excellent management team, and an admirable brand reputation, therefore the threat from new entrants is assessed to be moderate.

Threat of substitute products: The substitutes for fast-food include other forms of profit foodservice and also food retail (ready meals or ingredients for home cooking). However, these are considered to be unhealthy and take time in preparing, whereas convenience and availability are considered to be the main drivers for choosing fast-food. Therefore, the threat of substitutes is assessed to be moderate.

Rivalry among existing firms: Rivalry in the fast-food industry is considered to be intense as the fast food markets can be very concentrated. The burger segment is close to being a Burger-King/ McDonald’s duopoly. Further, prices especially of value meals and brand power form the greatest sources of competition in the fast-food market.

SWOT Analysis:

The SWOT analysis helps us determine a company’s strengths and weaknesses, and then helps us evaluate whether the company has the ability to effectively exploit its opportunities and overcome its threats.

Adapted from (Datamonitor, 2010)

Strong market position and brand equity

BK enjoys a strong market position and possesses an established brand reputation. This has enabled it to gain economies of scale, increase its bargaining power, and enter international markets. (Datamonitor, 2010)

High franchise mix

The company has franchise stores and company restaurants in the ratio of 90-10. This restaurant ownership mix provides BK with a strategic advantage as the capital required to grow and maintain the BK system is funded primarily by franchisees, while the Company restaurants give it a sizeable base to demonstrate credibility. (pdf)

Innovative marketing campaigns and advertising to provide greater visibility

BK uses innovative marketing, advertising and sponsorships to drive sales and generate restaurant traffic. The main target market of BK is the 18-35 year old male with a love of fast food. (Datamotiner, BKcase study). Therefore, its advertisements are made to appeal to this segment. Further, BK’s advertisements campaigns such as “ Whopper Sacrifice” campaign and

“ Cheat on beef” campaign help the company gain better visibility which helps it to have an impact on the revenue generating capacity.

Weaknesses

Declining comparable sales growth

BK saw a decline in its comparable sales growth in 2009. This was mainly because of continued adverse macroeconomic conditions, higher unemployment, more customers eating at home, and heavy discounting by other restaurant chains. This only means that the management has to focus on various product offerings that cater to the value conscious customers during times of poor economic conditions.

Concentrated operations-in terms of geographic presence and dependence on selected distributors increases business risks

Although BKC operates in 74 countries, its operations are heavily concentrated in the US. Approximately 61% of its restaurants are located in the US. US and Canada account for about 68. 7% of the total revenues, whereas BKC’s competitor McDonald’s generates only 35% of its total revenues from US. Concentrated operations increase the business risk of the company and impact its results of operations and thus its financial condition.

Opportunities

Expansion in existing and new markets

BKC should focus on expanding into existing and new markets and the company has taken steps to expand into international markets. 2009 saw a

28% rise in new restaurants in international markets. The company also entered two new in