

# FINAL TRANSCRIPT

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**THI.TO - Q2 2009 Tim Hortons Inc. Earnings Conference Call**

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**Don Schroeder**  
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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by and welcome to the Tim Hortons 2009 Second Quarter Earnings Conference Call. (Operator Instructions). As a reminder this conference is being recorded.

It is now my pleasure to turn the conference over to Scott Bonikowsky, Vice President of Investor Relations at Tim Hortons. Please proceed, sir.

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**Scott Bonikowsky** - *Tim Hortons Inc. - VP, IR*

Thanks, Julia, and good morning, everyone. Welcome to our 2009 second quarter conference call. Before we start I would remind you that, as usual, we have a presentation supporting today's discussion. This and other earnings material released earlier today is available on our Investor Relations website, as usual, at [timhortons-invest.com](http://timhortons-invest.com) by clicking on the Investment Presentations tab. This material will be available for a period of one year.

Both Don Schroeder, our President and CEO, and Cynthia Devine, our Chief Financial Officer, join me on the call this morning and after their remarks we will be pleased to take your questions.

Before we begin, please note that we may provide forward-looking statements this morning within the meaning of the Private Securities Litigation Reform Act of 1995 and this includes discussions about future performance based on our current expectations

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and information. Various risks and uncertainties could cause the Company's results to differ materially from those expressed in our forward-looking statements, which speak only as the date and time made. We do not intend to update our forward-looking statements after today except as required by applicable law.

More detailed information about the risks and uncertainties affecting our future performance is included in our 2008 end report on Form 10-K and this is filed on February the 26th of this year. This is available also on our website under Regulatory Filings tab, other public securities filings and in our Safe Harbor statement, which are also located on the website.

All Tim Hortons, I would remind you, our results are presented in accordance with US GAAP and reported in Canadian dollars unless we otherwise note and it is now my pleasure to turn the call over to Don Schroeder, President and CEO of Tim Hortons. Don?

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**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Thanks, Scott, and good morning, everyone. Tim Hortons once again demonstrated the strength and resilience of our business this quarter as we overcame anticipated challenges and generated positive sales and earnings growth.

We headed into the quarter fully aware that we faced continued economic weakness both in the US and in Canada. From a sales perspective we also knew we had a strong comparable period from 2008 with minimal levels of prior year pricing in the system compared to the same quarter of 2008 and other factors that would be offset to earnings this quarter, including spending on the proposed public Company reorganization.

Against this backdrop we grew operating income 3.7% and experienced same-store sales growth of 1.7% in Canada and 3.3% in the US. Our operating income growth includes the impact of CAD2.7 million in spending on the proposed public Company reorganization. I believe that our underlying performance is a testament to the strength of our brand, the loyalty of our customers and the soundness of our business model.

In the second quarter, system-wide sales grew 5% on a constant currency basis supported by 218 net restaurant openings since the same period last year. Additionally, 25 restaurants were opened in the second quarter, 15 of which were in Canada and 10 in the US. And we had a very active quarter of menu innovation and marketing programs that contributed to our overall sales performance.

Previously we have indicated that traffic had been under some pressure, particularly around the snacking day parts. We believe this stemmed from the high frequency we typically experienced from our loyal customers, 40% of whom typically visit us four or more times a week, and the pressures they were under to rationalize discretionary dollars due to the state of the economy.

Our team focused on creating traffic catalysts, including introducing chicken-wrap snackers, promoting iced cappuccino and in Canada by launching iced coffee with the support of a national free sample day. I am pleased to report that product, promotional and operational activities led to traffic growth. And average check was up slightly with minimal price increases remaining from the prior year offsetting changes in product mix.

I am also very pleased to say that, despite the ongoing cost pressures our franchisees continue to face, they have been very disciplined and diligent in not raising prices, thereby helping our customers cope with these difficult economic times. We will continue to evaluate pricing as we normally do following our disciplined processes and, while we may in fact have to take some pricing on a regional basis to offset cost pressures, I am proud of our franchisees' efforts to support our customers during the economic challenges of the past year.

We were delighted with the response of our customers to our free iced coffee sample day in Canada featuring our product that is well entrenched in the US but relatively new to the Canadian market. This promotion followed a successful free sample



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promotion in early April of the chicken-wrap snacker in the US markets and a buy one get one free promotion in the Canadian market.

In Canada, the macroeconomic situation remained difficult in the second quarter, particularly in regions with a significant manufacturing base, so we were pleased with 1.7% same-store sales growth. We experienced sales momentum in the Canadian business as same-store sales strengthened in each consecutive month of the quarter and continued to strengthen by the end of the quarter.

As I mentioned earlier, Canadian sales performance was driven by growth in transactions and average check was slightly higher, supported by minimal prior year pricing remaining in the system, which helped overcome the negative 0.4% timing impact of the Easter holiday reversing in the quarter.

I would like to note that many expressed the view that competitive activity in the quarter in which a competitor gave away free coffee in the Canadian market for two weeks would likely have a major detrimental impact on our sales performance. The fact is that we actually grew transactions over the two weeks of this competitive activity demonstrating the tremendous loyalty of our customers and the entrenchment of our competitive position in Canada.

Moving to the US segment, our US business experienced its second consecutive quarter of robust same-store sales delivering 3.3% year-over-year growth. Several factors came together this quarter to help our US segment deliver a really solid performance, both from a sales and earnings' perspective.

Continued traction of our menu initiatives and promotional programs played a role in sales growth. For example, we reinforced our commitment to providing value to our customers by promoting the sausage-on-a-biscuit product offered at an attractive price point. This program, first successfully promoted earlier in the year, was well received by our customers. We also promoted iced cappuccino and breakfast sandwiches.

Cold Stone Creamery in co-branded locations had a significant positive impact on same-store sales this quarter. At quarter end we had 39 co-branded Tim Hortons and Cold Stone Creamery locations. We also announced that three existing Cold Stone Creamery stores in Manhattan will be co-branded to include Tim Hortons in August, including their flagship location in Time Square.

Customer response to the co-branding program has exceeded our expectations. We are seeing customer traffic in snacking and evening day-parts typically not as busy in our US restaurants, particularly in developing markets. We are seeing new product trial and new customers leading to higher average unit volumes.

The initiative is also resulting in better leverage of the box economics for our franchisees. So the brands are co-existing very nicely together. Our store owners are benefiting from higher sales volume and better store level efficiencies while the Company benefits from additional rents and royalties and lower relief.

I expect that we might further opportunistically broaden our testing in the US somewhat beyond the initial 50 Tim Hortons locations we had originally targeted. I would note that we also introduced the Cold Stone Creamery test in the six Ontario locations and we are expanding to another six sites in other Canadian markets.

I've made it clear previously that it is not business as usual in our US business. In addition to the many menu and promotional programs we have recently introduced and the Cold Stone Creamery co-branding initiative, we have also made other adjustments to our development approach to the US market in the past year. We are actively pursuing new restaurant development in our core and developing markets, but we are taking some capital out of the development process by reducing our square footage to better match customer needs and to optimize restaurant efficiencies in developing stages.



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We are also complementing our core growth strategy by expanding our footprint and penetration in a capital efficient manner with non-standard restaurants and strategic partnerships. In the opening of 12 locations subsequent to the quarter in New York City including 10 in Manhattan and two in Brooklyn clearly fits this approach. The New York City locations, which give us an immediate and notable footprint in down town Manhattan in such high traffic locations as Grand Central Station, Broadway, Madison Square Gardens and Time Square, help us build out our footprint and create brand awareness through non-standard formats.

And while from an operations standpoint we are still moving through transition, we are pleased with the traffic we are experiencing and with the huge positive welcome that New Yorkers gave us to their City. I also believe this announcement created secondary benefits in giving us broad attention and great brand recognition across other parts of the US.

So overall we expected a more challenging quarter but we were generally pleased with the quarter we delivered given those anticipated challenges.

And with that, I'll turn it over to Cynthia.

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**Cynthia Devine** - *Tim Hortons Inc. - CFO*

Thanks, Don, and good morning, everyone. We appreciate you joining us today and I'll get right to it by expanding on our performance this quarter starting with the top-line results.

Turning to slides 13 and 14 we outlined revenue details for the quarter. On a constant-currency basis system wide sales increased 5% and on unadjusted basis 6.3%. Our second quarter revenues grew 8.9% to about CAD556 million.

Foreign exchange translation continued to play a role in both revenues and costs this quarter. The impact of translating our US business results into Canadian dollars for reporting purposes increased revenues by about 1.4%.

The main factors leading to the total revenue growth this quarter included system-wide sales growth, which drove rents, royalties and higher distribution sales. The higher distribution sales were also the result of new products managed through the supply chain including the expansion into the grocery channel as well as higher underlying commodity costs.

Contributions to sales from higher coffee and other commodity costs are also reflected in higher costs of sales. This will have an impact on margins as we generally operate on a fixed-penny profit basis with products managed through our supply chains.

In the second quarter we made continued progress towards converting Company operated restaurants to owner operated restaurants. We now have only 20 Company stores in our system including only five in the US. This process has long-term benefits but acts as an offset to revenue growth, which it did this quarter.

We also had lower revenues from FIN 46R restaurants this quarter and lower franchisees fees, which I'll outline in a few minutes.

Rents and royalties grew 7.3% this quarter, relatively consistent with our system-wide sales growth of 6.3% unadjusted for currency.

Franchise fees were down this quarter by 9.3%. Remember that franchise fees are a relatively minor component of our business model and move around a bit quarter-to-quarter based on the timing of openings, resales and replacement restaurants. Last quarter, for example, they were up 13.9%. The year-over-year decline this quarter was mostly due to fewer new store openings, particularly non-standard units as well as lower resales and fewer renovations. These factors were partially offset by the timing of revenue recognition in our US franchise incentive program.



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Now turning to the cost side of the business, please refer to slide 15 where we provide a summary of our cost structure for the second quarter. As noted with revenues, foreign exchange translation also played a role in several cost-line items this quarter offsetting much of the positive impact it had on revenue. Because currency movement was again so meaningful this quarter, we have footnoted the currency impact on a percentage change for each line-item and this is also noted on slide 15.

So, starting with cost of sales, we saw an increase of 12% this quarter. This increase is mostly due to new products managed through our supply chain, higher commodity costs, which I noted earlier, and continued system-wide sales growth.

Foreign exchange translation added about 1.4% to our cost-of-sales increase this quarter. Lower cost of sales from our Company operated restaurants and our FIN 46R restaurants acted as a partial offset to these cost drivers this quarter.

And now, moving to operating expenses, we had an increase of 8.8% this quarter compared to the same period last year. Similar to other quarters, the number of new units in the system was the largest contributing factor to the growth and operating expense of this quarter followed by percentage rent increases on our variable rent contracts. Foreign currency translation contributed a further 2% to the operating expense growth this quarter.

In the second quarter franchise fee costs were down at 1.5% year-over-year due to same factors which resulted in the decline in franchise fee revenue.

We experienced a decline in G&A expenses year-over-year. Remember that the comparable period in 2008 had a CAD3.1 million impact from a management restructuring charge. We anticipated that reversal this quarter but we also had G&A spending of approximately CAD2.7 million this year on professional advisory and filing fees for the proposed public Company reorganization that we didn't have last year. Currency changes caused about 2% growth in G&A this quarter offset by other factors.

Year-over-year equity income comparison this quarter were also affected by events in 2008 that didn't recur. In the second quarter of 2008, certain joint ventures benefited from items that did not recur this quarter. The combination of this factor and certain underlying commodity cost increases, which were absorbed by our bakery joint venture and not passed on to our franchisees, led to an equity income decline of 13.1% this quarter.

So I'm now going to move to a discussion on our earnings performance. You can find additional information on our earnings this quarter on slide 16 of the presentation.

Operating income was CAD121.9 million, an increase of 3.7% compared to the second quarter of last year. Increased rents and royalties and system-wide sales growth, increased distribution revenues and improvements in the US business drove most of the increase. Remember that the G&A spending of CAD2.7 million on the proposed public Company reorganization reduced our rate of earnings' growth in the quarter and was not included in our operating income growth target communicated earlier this year.

Net income attributable to Tim Hortons also grew by 3.7%, consistent with our operating income growth, to CAD77.8 million as our net interest expense and our effective tax rate were essentially flat year-over-year.

And finally, diluted earnings-per-share attributable to Tim Hortons were CAD0.43 per share compared to CAD0.41 per-share in the second quarter of 2008, an increase of 5.6%.

We had 1.8% fewer shares outstanding in the quarter compared to last year.

I'm going to move to the segment information, which you can find on page 17 of the slide presentation. Our Canadian segment operating income was up slightly at CAD131 million, an increase of about 0.5%. Lower new store openings and the timing of resales and renovations contributed to the more moderated growth in the quarter.



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Operating margin was also impacted by higher commodity costs, which reduced our distribution income growth and equity income at our joint venture bakery, as not all the commodity cost increases were passed on to our franchisees.

In our US segment we had operating income of 3.1 million, which was a \$3.3 million improvement from the second quarter of 2008. As we mentioned in our earnings announcement, several factors came together for what was a solid quarter from both a sales and earnings' perspective. Strong menu and promotional program and significant contributions from the co-branded Cold Stone Creamery locations resulted in very healthy same-store sales growth given the operating conditions, which continued to be challenging. In fact, some industry data pointed to a very challenging sales climate in the US, particularly in June when our business had good sales performance.

US system-wide sales growth, a 1.2 million positive impact from the 2008 restaurant closure and impairment charges in Southern New England market, lower G&A expenses and contributions from vertical integration located in the US all contributed to the improved earnings performance, a significant improvement from the slight loss in the same quarter of 2008.

Now turning to our outlook for the balance of the year, our current expectations, based on our performance to date and the outlook for the remainder of the year is that we will meet our previously announced operating income target excluding the CAD6 to CAD7 million impact of the proposed public company reorganization I detailed earlier.

Our operating income growth target is 11% to 13% or 6% to 8% excluding the impact of the asset impairment and related restaurant closure costs taken in the fourth quarter of 2008. As it relates to our US segment, at 2009 target of breakeven operating income we currently expect that we may exceed that target given our year-to-date performance to the end of the second quarter and our outlook for the balance of the year.

Our year-to-date Canadian same-store sales performance of 2.5% growth is slightly below our targeted range of 3% to 5% growth but our expectation is that we will catch that up over the balance of the year and be within the range on a full-year basis.

In terms of our US business, same-store sales year-to-date are tracking at 3.3% growth and based on our performance to the end of the second quarter, we expect we may exceed our targeted same-store sales growth of zero to 2% growth.

On slide 19 and 20 of the presentation you will find information regarding our balance sheet and cash flow highlights. As you can see, we continue to have a strong balance sheet and financial strength and flexibility.

We continue to self-fund our business growth through operations and have only about CAD395 million in long-term debt and capital leases.

At the end of the second quarter, we had about CAD142 million on hand in cash and cash equivalent. Our cash balance is a little higher than usual due to the deferral of the share repurchase program, which we announced earlier this year due to the work on the proposed public Company reorganization.

Capital expenditures in the quarter totaled CAD33.1 million. Depreciation and amortization for the quarter was CAD25.1 million.

For the wrap up I thought it would be important to provide an update on our proposed reorganization as a Canadian Public Company. We filed an amended Form S-4 registration statement on July 27th with the SEC that describes this transaction in more detail. This transaction remains subject to various conditions including stockholder approval. Registration statement provides comprehensive information on the proposed transaction. I strongly would encourage you to read the document, which details the benefits as well as the implications and risks.



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We are pleased with our progress on this important initiative and plan to have a special meeting of stockholders during the third quarter of this year. We included important information in our Earnings Release this morning on where to access the information about the proposed transactions.

So with that I'll turn it back over to Scott.

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**Scott Bonikowsky** - *Tim Hortons Inc. - VP, IR*

Thanks, Cynthia. We'll now begin our Q and A session, operator. We request that, as always, that you try to stay to a limit of one question each but I know you generally won't stick to that but I would encourage you to try. After your questions we'd welcome you to get back into the queue for any additional follow up that you might have and with that, operator, I'm going to turn it over to you to start.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Our first question comes from the line of Irene Nattel. Please proceed.

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**Irene Nattel** - *RBC Capital Markets - Analyst*

Scott, I'll keep it to one question on same-store sales with two parts if that's okay? First of all, in the US obviously very strong performance year-to-date and I was wondering if you could provide some more color on what you're seeing on a regional basis and I really -- what I mean here is what's happening in some of your more mature, well developed markets versus some of your more emerging markets?

And the second question, or second part of the question, speaks to your guidance for same-store sales for Canada. Obviously as you've noted you're behind the low end of your target range for this year and I'm wondering whether you're confident that you're going to reach it has to do with planned price increases that you've alluded to perhaps or the promotional or what you saw in terms of same-store sales building as you went through the quarter?

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**Cynthia Devine** - *Tim Hortons Inc. - CFO*

Hi, Irene. Thanks for your question. I'll start with the first one. With respect to the US regional performance, I would say we're pretty pleased across all regions in the US. We saw momentum in -- really across the board and we're pretty happy with it and even in some of the more challenged markets where the economy has certainly been hit pretty hard with job losses, we were pleased with the traction that the brand is having there and, as we mentioned previously, the Cold Stone Creamery test has really contributed to those same-store sales results.

With respect to our outlook for Canada we've looked at our balance of year calendar. We know what we're lapping. If you'll recall in the third quarter of last year, we felt the consumer was under a significant amount of pressure, given the rise in gas prices, and felt that that provided some pressure on our consumer and hopefully if gas prices remain where they are today that's significantly lower than where they were the same period last year. And so the combination of all those factors give us confidence at this time that we hope to be back within that range on a full-year basis.

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**Irene Nattel** - RBC Capital Markets - Analyst

Thanks, Cynthia, and just back to the US, if we were to exclude the impact of the Cold Stone units, would we still be seeing or the co-branding Cold Stone units, would we still be seeing strong same store sales performance in the US?

**Cynthia Devine** - Tim Hortons Inc. - CFO

Our same store sales with our without the Cold Stone were positive.

**Irene Nattel** - RBC Capital Markets - Analyst

That's great thank you.

**Scott Bonikowsky** - Tim Hortons Inc. - VP, IR

Thanks for your three part question, Irene.

**Operator**

Michael Van Aelst.

**Michael Van Aelst** - TD Newcrest - Analyst

Yes I'll keep it to one plus a bit of a clarity on the first one. The -- just as per Irene's questions, the price increases that you alluded to possibly in Canada in the second half of the year, is there anything that has been announced and why is it -- why are you talking about doing it on a regional basis rather than on a national basis?

**Don Schroeder** - Tim Hortons Inc. - President, CEO

Well, regionally is the way we've always done it in terms of establishing any price increase across the country because there are differences with the various regions across Canada. Every year we have done it that way. We have pricing committees in each of the regions of the country and in the US and so this year, as usual, we have been meeting on an ongoing basis with those committees just looking at the cost pressures facing our stores and also recognizing the challenges facing our customers, so we've been looking at it even more closely this year due to the combination of those two factors. So nothing has been announced at this point but I can tell you that we are meeting with the various pricing committees on an ongoing basis.

**Michael Van Aelst** - TD Newcrest - Analyst

And the price increase that you would be taking, would that be to alleviate some of the costs that the franchisees are feeling like, for example, on coffee or is it also to alleviate some of the margin pressure in your bakeries.

**Don Schroeder** - Tim Hortons Inc. - President, CEO

Well, again, when you say the costs you will be taking, again, we have not announced any price increase at this particular time. We will continue to look at it but we look with our store owners at every aspect of their base business on line-by-line basis, coffee, labor, everything, just to make sure that we take price at the appropriate time.



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**Michael Van Aelst** - TD Newcrest - Analyst

Okay and just a question on your G&A costs, it seemed like when you adjust for the non-recurring items it was up in Q1 year-over-year but it was down in Q2. Is this sustainable? Is there -- can you kind of direct us to where some of those savings are coming from?

**Cynthia Devine** - Tim Hortons Inc. - CFO

Some of the savings would I say they're sustainable, some of the savings are items that relate to equity compensation as well as in some other employee type costs and, at this point in time, it's hard to say whether those are sustainable. I would think that probably next year you wouldn't see the same sort of results in that area but, again, that's a limited component of it.

G&A varies quarter-to-quarter and on a yearly basis we've always said our goal is really to keep our G&A spending in line with our top line revenue growth and that's a commitment that the Company still believes in.

**Operator**

Jim Durran.

**Jim Durran** - National Bank Financial - Analyst

Yes I was just wondering with respect to New York City, I mean do you deem that a change in your location strategy for the US or was that more of a one off?

**Don Schroeder** - Tim Hortons Inc. - President, CEO

Yes that was a unique opportunity that we were presented with to get into a unique market. The quality of the locations and the experience of the organization and someone that understood uniqueness of New York City and that market, so, is it different? Yes but it was, again, a unique opportunity that presented itself to us and so we took advantage of it.

**Jim Durran** - National Bank Financial - Analyst

And with respect to Cold Stone, I mean you haven't provided much detail in terms of the arrangement you have with them. Can you give some idea as to how it does affect your income statement?

**Cynthia Devine** - Tim Hortons Inc. - CFO

With respect to it we haven't outlined specifically the economic terms of the Cold Stone deal, you're correct. But with respect to our P&L overall it looks very similar to a regular sale that would go through a Tim Horton's restaurant in terms of a royalty component or a rental component, so it's not significantly different than our existing business.

**Jim Durran** - National Bank Financial - Analyst

And, as far as the six store test we've got in Canada where are we on that and how long do you think you'll deem it a test?

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**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

For the six stores in -- there are six stores in Ontario that are open. We are opening six other stores across the country and I -- most of them are open and they will all be open this month but it's, again, just to give us the opportunity to review the impact of Cold Stone sales across the entire country so that we can evaluate whether or not we should pursue the idea of adding that to our menu.

**Jim Durran** - *National Bank Financial - Analyst*

And how do you find the Cold Stone product offering impacting your transaction time in your stores?

**Cynthia Devine** - *Tim Hortons Inc. - CFO*

With respect to transaction time, I mean I think some of the things that Don has already pointed out with respect to the day parts it is very complementary from a day part standpoint with the traffic patterns being that ice cream is more of a snack, a late afternoon snack or an evening snack point. But no doubt and the reason we're testing it so thoroughly is to put it into high traffic stores to see what it does to that and obviously, as you bring a lot of people in for ice cream at the same time as the Tim Hortons piece of it, you need to make sure that you're managing the queue and understanding the various customer needs and that's part of it. That's the great reason that we're having a test is to work through some of those.

**Jim Durran** - *National Bank Financial - Analyst*

And what have you found if most people come into the store to get it or is there a reasonable amount of drive through traffic?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Well, at this stage I would say most of the traffic is coming into the store and that's one of the things that we have to work through. For the most part, Cold Stone does not have drive through so this is something new so it's -- the good news from our standpoint is that our customers come to us so often that we will be able to help them and understand the process so that our core customer looking for his large double, double is not going to have to wait to get his product. And so there's some education on our side and some education for our customers so that they understand how the two can work hand in hand.

**Operator**

David Hartley.

**David Hartley** - *BMO Capital Markets - Analyst*

Just with regard to system sales growth I believe in the 5% range and your total revenue growth was 9%, I guess even higher through factor of currency, so that spread between them, could you kind of break down the importance of your sales to the supermarket channel, increased distribution of new products and other things and what kind of factor the Cold Stone played in that increased distribution?



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**Cynthia Devine** - *Tim Hortons Inc. - CFO*

With respect to so if you take our system-wide sales growth on an unadjusted basis at 6.3% that's more comparable to what you should be comparing total revenues because total revenues have obviously currency built into them. So that 8.9% is more comparable to the 6.3.

In terms of what drives the difference between those two, it really is for the most part related to the warehouse sales component that I broke out and what you're seeing with the warehouse sales is a combination of things.

It's not only new products that are going through the system and expansion of our coffee offering into the retail grocery channel but in addition to that, as we pointed out, it is commodity cost increases, particularly as it relates to coffee. When you take our cost of coffee in the first half of this year versus last year, there's been an increase in that and that, again, it drives higher sales but it also drives higher costs to sales and so we pointed out that most of these items that have gone through sales you're seeing an offset when you go to the cost to sales line, which is up 12%. So that is the biggest driver of that.

**David Hartley** - *BMO Capital Markets - Analyst*

And just to follow up on that, so because you refrain from taking price increases to offset these at retail I guess that's why kind of see a lot of differential so I suspect that this was the biggest factor in that spread, if you will, for the quarter?

**Cynthia Devine** - *Tim Hortons Inc. - CFO*

I'm not sure what the prices at retail, at store level have to do with that actually because, again, those would be our store owner sales and not necessarily sales going through the warehouse. What it would do, as Don pointed out, increase in commodity costs obviously would affect our store owner's profitability and that piece of it would obviously be a factor that, again as we work through with the store owners on various aspects of their business.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay understood, thank you very much.

**Operator**

Winston Lee.

**Winston Lee** - *Credit Suisse - Analyst*

Just on Cold Stone, just elaborating a bit more, I mean it seems to be something that's catching on quite quickly. You've brought it up to Canada. I've actually tried it. I think it's very good, by the way but a lot of calories. But what's the average ticket on Cold Stone versus Tim Hortons ex Cold Stone?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Yes the average ticket on Cold Stone is higher than Tim Hortons for sure. It's an indulgent luxury I guess.

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**Cynthia Devine** - *Tim Hortons Inc. - CFO*

And it's typically something you come into with a family, you come in with a group and so we're seeing that it's not as much single people coming in and getting an ice cream. You're bringing kids and family and friends and whatnot so you definitely see an increase there in average there.

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

And it's not a product that people would buy every day. Our core customer is the average ticket is lower but they come, again, as I said before 40% of our customers come four more times a week. We're not likely to see a Cold Stone customer more than once every couple of weeks or maybe once a month but, as Cynthia says, the family comes and it's just a real treat.

**Winston Lee** - *Credit Suisse - Analyst*

So it's something that's stimulated traffic in the day part but it's also been in the higher average ticket and it's something that has the potential to roll up. Are you still kind of evaluating it and you don't have much of it in drive thrus at this stage and what I am wondering is going forward, and is -- are you finding so far that the Canadian consumers love it different than the US or is it just on Cold Stone or is there no difference so far? I know it's early days in both but -- from what you see.

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

It's very early days in the Canadian market and that's why with the test we want to get through a full season. You know, we just for the most part in Canada it's only been there for really less than two months. We haven't completed one full cycle yet for the stores that began the test in the US so there's still a lot of learning there for us to do and I can tell you, again, it exceeds our expectations and our store owners are pleased. Our -- the people at Gala that operate Cold Stone are also very pleased with it to date but it's still a test.

**Winston Lee** - *Credit Suisse - Analyst*

Okay and my last question on Cold Stone if I could is I understand it's a very low capital intensive endeavor and I guess Canada would be very similar to the US and that is also low capital intensity. There isn't any difference in the amount of capital that you put into a standard unit in Canada versus the US as it relates to Cold Stone. Is that correct?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Well, there is a capital cost certainly attached to doing this. What we have found, as we work through it in Canada and the US, is that a very easy retrofit from a timing standpoint. We can go into the store at 11 o'clock at night, take out one of the picture windows, take one of the coffee units out, put in the Cold Stone unit and have the construction completed by five AM the next morning and be in business two days later. But there is a capital cost attached to that. The good news is when you do the retrofit it looks like it's been there from day one, so the design people have done an outstanding unit to blend the two brands together.

**Winston Lee** - *Credit Suisse - Analyst*

Great thank you very much.

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**Operator**

Perry Caicco.

**Perry Caicco** - CIBC World Markets - Analyst

Thanks. I have 27 questions.

**Cynthia Devine** - Tim Hortons Inc. - CFO

Eight parts to each.

**Perry Caicco** - CIBC World Markets - Analyst

Actually I just want to talk a bit about the US if we could. You know, as you're expecting consecutive quarter pretty decent same store sales results and outside of the Cold Stone Creamery units are you getting any indications that this is -- and this is a bad word to use -- but that this is some kind of a break through for our? I mean, are there indications such as coffee penetration or foot traffic or maybe consistency across the week and across day part that suggest that maybe you've turned the corner here?

**Don Schroeder** - Tim Hortons Inc. - President, CEO

Well, there's no question it's a great early sign but two quarters do not make a break through. We are very positive. It's a great sign but we'll continue to work through and with the plan with David Clanachan and his team in the US so, again, we're very positive but to say it is absolutely a break through might be a little premature.

**Perry Caicco** - CIBC World Markets - Analyst

And is there any impact from the Cold Stone Creamery units in the US on your coffee penetration in those stores?

**Cynthia Devine** - Tim Hortons Inc. - CFO

There overall I mean it's been a very positive impact and what we're seeing is it's not as much hot coffee but you would think that there is probably a little bit of cannibalization as you get into the warmer periods between iced coffee, iced cappuccino and then possibly a cold offering from Cold Stone. But, again, I mean overall we're so pleased with the positive contribution that it's had in the business. That's -- you know, that was something that we anticipated and don't see it as a big factor at this time.

**Perry Caicco** - CIBC World Markets - Analyst

And how are your newer US markets doing? I mean, specifically maybe do you think you could chat a bit about Rochester?

**Cynthia Devine** - Tim Hortons Inc. - CFO

Yes Rochester is we're very pleased with our progress in Rochester. We've been there for a number of years now and feel that the brand is really resonating with the consumer and there are very pleased with the performance in that with the brand in that market.

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**Perry Caicco** - CIBC World Markets - Analyst

That's good. Thank you.

**Operator**

Irene Nattel.

**Irene Nattel** - RBC Capital Markets - Analyst

Thanks. Don't think we're quite finished beating the US. Just looking at the financial contribution, again, a very, very nice reversal so far this year. How sustainable do you think that is and what are the key factors behind that reversal above and beyond the elimination of that CAD1.2 million of losses associated with the units that you closed last year?

**Cynthia Devine** - Tim Hortons Inc. - CFO

I mean we're very pleased with the improvement in the US business and we said it was really a combination of things that came together. It was the system wide sales growth that we had; definitely there was a contribution from the closure of those restaurants, as you indicated. There were favorability from a G&A standpoint and contributions from the vertical integration that is located in the US so it really was a coming together of many positive trends within the business.

**Irene Nattel** - RBC Capital Markets - Analyst

Okay let me ask the question a different way, Cynthia. Are there any of those trends that contributed that you think will not recur later on this year?

**Cynthia Devine** - Tim Hortons Inc. - CFO

I think overall what we're saying with respect to the US business is, given where we currently are to date in our expectations for the balance of the year, that we do -- you know, we expect to exceed our previous target of breakeven performance in the US, so that's probably in terms of our commentary on the US outlook, that's probably I think a good measure of how we feel about it.

**Irene Nattel** - RBC Capital Markets - Analyst

Okay and not to belabor the point but as we look forward a year or two years, three years, how should we think about the evolution of profitability in the US? What are the key factors that are going to take it from whatever number you want, zero or CAD5 million, to something more meaningful?

**Cynthia Devine** - Tim Hortons Inc. - CFO

I mean I think it's consistent with what we've always said, Irene. The US, the structure in the US is fundamentally built and ready for volume, so it's a continue to grow same store sales in that market is the most critical thing that we can do to improve the profitability for our franchisees and help the Company as well and so that's the continued focus on it. And to build out in existing markets that we're in, we still think there's lots of opportunity there, so I -- I mean, I think those fundamentals of the business haven't changed in terms of the long-term success there.

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**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Right. As I said before, it's not business as usual in the US and David Clanachan and his team have been challenged to think outside the box, new ways to grow the business and to speed up the process to profitability in the US and I think what we did in New York is an example of that. The Cold Stone piece I think is a great potential step forward. What it does is allow good cash flow into the stores while we build the traditional Tim Hortons segment of the business, so I think that's what you can look forward to seeing as we go forward.

**Irene Nattel** - *RBC Capital Markets - Analyst*

That's great. Thank you.

**Operator**

Keith Howlett.

**Keith Howlett** - *Desjardins Securities - Analyst*

Yes I was wondering on the Cold Stone Creamery tests that have been open the longest in the US, if you can speak us to how the week-to-week trend is? I mean, do you find a lot of big initial trial and then a tail off or do you find it building week-to-week?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

I think that depends on the market that you're in, if it's a smaller town and that the novelty obviously you know, same as we would get with the opening of a Tim Hortons. There's some initial trial and then in the normal course that's going to tail off and then build back up again, so it really varies from market to market but it's consistent with what Cold Stone has seen in the development of their full store so and very positive from all aspects in our mind.

**Keith Howlett** - *Desjardins Securities - Analyst*

And then just in terms of the mix of the Cold Stone business, is it -- I know they have some take home ice cream cakes or whatever. Is it predominantly the eat in the store business or is there a significant take home business there?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Well, it's predominantly an eat in type of treat but there certainly is a market there for the take home. There's a freezer in each one of the stores and we're going to test the idea of just having a freezer in some of the stores where you can't put a full Cold Stone so it gives the customer the opportunity to have access to those take home products.

**Keith Howlett** - *Desjardins Securities - Analyst*

And then just finally, in the New England market how is -- how are the residual stores in the sort of Rhode Island, Connecticut business doing post the closure of the other stores and after the introduction of Cold Stone? How is that all sorting out?



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**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Well, we're continuing to work with those stores to build traffic and to get that customer base, so we had hoped to see some of the traffic from the stores that were closed moving over there so we continued to monitor all of that, just to see where we're going. But it's, again, it's been less than a year since we had the store closures but, again, the US team is focused on that and working with those store owners.

**Keith Howlett** - *Desjardins Securities - Analyst*

Thanks very much.

**Operator**

We do have a follow-up question from David Hartley.

**David Hartley** - *BMO Capital Markets - Analyst*

Just on the promotional expenses and environment in the quarter, I am just curious to know how successful your promotions worked in terms of driving profitability and not just growth on the top line. Was that a bit of a drain in the quarter? Could you give us some color on how you thought that went?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Well, we had the iced coffee, the sample day there was extremely successful. I think it was successful beyond our expectations in terms of the trial and, as we've indicated, the result in the quarter was that we did drive transactions, which was one of the goals there. We had a very successful day with respect to the buy one, get one free on the snackers, so would you say it's a drain? I would say no it was a very positive thing. It was also -- you know, it was a buy one, get one free, a little bit of a thank you to our loyal customers and whatever so it was received very well and I think it achieved exactly what we hoped it would and, as they say, the iced coffee, the results on that day were beyond our expectations.

**David Hartley** - *BMO Capital Markets - Analyst*

So if we look into the next quarter and actually beyond the next quarter when we think about ice at Cold Stone but in the next quarter when we think about some of the promotional initiatives that you would have in place, would you be looking or do you have any plans to do something similar or do you think there will be positive carry forward from the previous initiatives that drove trial that now will drive kind of continue purchase?

**Don Schroeder** - *Tim Hortons Inc. - President, CEO*

Well, we have a very strong calendar we believe for the balance of this year, which will hopefully will produce the same types of results that we saw in the first quarter but we always focus on just that price value proposition with something on the menu to remind our customers about the price value proposition that we stand for every day. It's not about discounting but about providing those quality products at a reasonable price quickly and in a friendly environment every day.

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**David Hartley** - BMO Capital Markets - Analyst

Fair enough. And then finally, on the Cold Stone, I mean as you look into Q4 and Q1, which are traditionally colder months here in Canada in particular in many of your markets in the US, I suspect you won't have the same contribution from Cold Stone or are their other products that Cold Stone does sell quite well in those months that I am not thinking about?

**Don Schroeder** - Tim Hortons Inc. - President, CEO

Well, again, we're still in the first year of the test but when we opened the Cold Stone in the off season of the first stores in the US were all open in the off season and still had very good sales so.

**David Hartley** - BMO Capital Markets - Analyst

Okay thank you.

**Operator**

And we have a follow-up question from the line of Michael Van Aelst.

**Michael Van Aelst** - TD Newcrest - Analyst

It should be an easy one. When I look at the segmented operating income, which line would I find your public reorg costs and last year's restructuring costs? Is it Canada, US or Corporate?

**Cynthia Devine** - Tim Hortons Inc. - CFO

Really in Corporate unallocated.

**Michael Van Aelst** - TD Newcrest - Analyst

All in Corporate unallocated?

**Cynthia Devine** - Tim Hortons Inc. - CFO

Yes for the most part.

**Michael Van Aelst** - TD Newcrest - Analyst

Thank you.

**Operator**

And there are no further questions at this time. I'll turn the call back to you.



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**Scott Bonikowsky** - *Tim Hortons Inc. - VP, IR*

Okay thanks, Julia. And with that, everybody, thanks for joining the call this morning. We appreciate your time, as always. If you have any follow-up questions feel free to give me a call at 905-339-6186. Appreciate it very much and have a great day.

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**Operator**

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines. Have a great day, everyone.

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