Street chokes on Hortons' listing
U.S. firm on S&P/TSX

Carrie Tait; with files from Peter Koven
Financial Post

Thursday, September 28, 2006

When Tim Hortons Inc. was cut loose as its own company in March, Bay Street rejoiced. When that same doughnut shop was tapped to be included in the Standard & Poors/TSX index yesterday, those same Bay Street types spit out their morning coffee in disgust.

"The Street is massively pissed off," one fund manager said. "Oh so very pissed off."

Why? Because no matter how many Canadian street corners are furnished with a Tim Hortons, it is incorporated in Delaware, making it a U.S. company. And U.S. companies aren't allowed in the S&P/TSX index.

The rules were bent for Tim Hortons because the index committee did not want the company to be an index orphan. But tossing a U.S. company into the Canadian index has a lengthy list of nasty implications, fund managers said.

Take the short-sellers, for example. Tim Hortons is being spun out of Wendy's International Inc., a process that is near completion. Because a wave of Tim Hortons stock is poised to hit the market, its stock was "wildly" expected to drop, one fund manager said.

But now that Tim Hortons will be in the Canadian index, the stock shot up because many funds are mandated to own all the companies in the index. As a result, those who were betting it would drop were caught off guard yesterday.

The stock gained $1.45, or 5% yesterday to close at $28.98. Short-sellers rarely attract pity, but in this case the fund manager said it is warranted.

"People took an investment position based on the TSX following its own rules," the fund manager said.

Canadian fund managers whose performance is measured against the performance of the S&P/TSX index may also find themselves in a pinch.

Canadian equity funds, for example, are prohibited from owning companies outside of Canada. Yet, at the same time, they are benchmarked against the Canadian index, which will include Tim Hortons -- a company they can't own.

"The question becomes whether it's fair to be judged against an index with Tims included," said Patrick Kim, a fund manager at KBSH Capital Management.

Tony North, S&P's director of index operations in Canada, said the index committee used its discretion to bend the rules because Tim Hortons wouldn't meet the criteria to be included in any of the U.S. S&P indices and the rules say it isn't allowed in the Canadian index because it is incorporated in Delaware.

"If it's not going in either of those indices, it's not going anywhere else," Mr. North said.

"You create a situation where the company is orphaned."

Not everyone on the Street thinks rescuing a company from being excluded from the indices is a good enough reason to put a U.S. company into the Canadian index.

"The whole notion of the S&P stepping in to protect the company from being orphaned is really not their business," the fund manager said.

"That's not what they are there to do. They are there to make orderly markets, not interfere with the forces of supply and demand of American companies, which, for better or worse, Tim Hortons is."

That the index committee sidestepped its own rules is also bothering Bay Street investors.

"If the rules don't need to be followed, then effectively there are no rules," said Peter Holden, an analyst at Veritas Investment Research, in a note yesterday.

"The TSX 60 can be anything S&P says it is and investors need to remember that when looking at potential investments."

Tim Hortons trades on both the TSX and the New York Stock Exchange. And while it may be incorporated in Delaware with its headquarters in Oakville, Ont., it is still largely a foreign concept in the U.S. At the end of June, it had 288 stores in the United States, compared with 2,597 in Canada.

"The company is viewed as being as Canadian as you can get," S&P's Mr. North said. "I don't think the idea of it being iconic was part of" the decision to add it to the Canadian index.