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Burger King's \$1 deal may boost profits

BY ELAINE WALKER

Alexis Parrish treated herself to two \$1 double cheeseburgers for lunch Thursday at a Miami Burger King.

But Parrish, a 20-year-old art student, didn't buy any soda or fries because she was looking to conserve both cash and calories.

"This is a good promotion," said Parrish, a Lauderhill resident, who just started a retail job after more than six months out of work. "I used to pay over \$2 for the same thing."

Burger King is pulling out all the stops with an aggressive \$1 double cheeseburger promotion launched earlier this month as a way to help combat falling sales.

Burger King on Thursday blamed high unemployment for its disappointing first-quarter performance, which didn't meet analysts expectations. The company earnings dropped 6 percent to \$46.6 million or 34 cents per share, compared to \$49.8 million or 36 cents per share during the same period last year.

For the quarter, Burger King's revenue also sank 5 percent to \$636.9 million. Sales at stores open more than a year, considered the best measure of a retailer's health, declined 2.9 percent worldwide and 4.6 percent in North America.

Chief Executive John Chidsey told analysts he is encouraged by the early results of the double cheeseburger promotion regarding its ability to boost sales and traffic.

"I remain cautiously optimistic, but I also remain realistic," Chidsey said. "This is the worst consumer environment we have seen. Unemployment continues to worsen and competitive pressures remain fierce, so it could be some time before we see meaningful sustainable improvements."

While Chidsey declined to provide any specifics of the promotion's performance since the Oct. 19 national launch, executives said results were in line with the test. During the 18-month test, Burger King claims the \$1 double cheeseburger represented between 5 percent and 10 percent of restaurant sales.

Although the sales had a negative impact on gross profit margin, Burger King says restaurants saw an increased gross profit dollars because consumers added on high profit items like sodas and french fries.

"The key for us is to outrun the impact on margins with traffic increases, which is what we have done in the test," said Mike Kappitt, senior vice president of business intelligence for Burger King. "We're also benefiting in that most consumers when they come in are not just buying the \$1 double cheeseburger."

Eric Godlewski was another Miami Burger King customer who didn't fit the bill. He purchased one double cheeseburger Thursday for lunch and nothing else. "I could eat two or three of these, but this should do it," said Godlewski of Miami. "I normally don't come here that often."

Burger King franchisees argue that Burger King is using the promotion to boost sales to satisfy Wall Street investors at the expense of franchisees' profits. Franchisees twice this summer voted down the launch of the \$1 double cheeseburger, but then Burger King went ahead with it anyhow.

The move by Burger King comes after McDonald's, at the end of last year, stopped selling the double cheeseburger for \$1 because of profit margin concerns. McDonald's replaced it with a new value-engineered product, the McDouble, with one less slice of cheese and a smaller hamburger patty.

Based on numbers Burger King provided to franchisees, the company projects that the double cheeseburger will lead to a 5-percent increase in restaurant sales. That will translate into an increased bottom line profit of \$365 per restaurant based on \$105,000 in sales, according to the analysis.

But financial models run by one Illinois franchisee and circulated among franchisees across the country suggest that those numbers are too optimistic and won't drive enough sales to offset the margin pressure. The franchisee models suggest that the bottom line impact for restaurants would be a loss of between \$489 and \$930 depending on the percentage of total sales generated by the value menu.

Stifel Nicolaus restaurant analyst Steve West agrees with franchisees that it's a dangerous move for Burger King.

"They're going to pressure margins and lower their average check," said West, who last month downgraded Burger King's stock to a "hold" rating. "If you don't get enough sales, you're shooting yourself in the foot. History has shown that this doesn't work."

Other analysts say that promotions have become the cost of doing business in an economic climate that has seen consumers cut back on eating out.

"I think the benefits outweigh the costs right now," said Tom Forte, restaurant analyst with Telsey Advisory Group. "What's the alternative? Not discounting and losing traffic to the competition."