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Cara Operations: Purchase of St-Hubert and Value Creation

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We're creating this Big Chicken solution for all of Canada.
– Bill Gregson, CEO, Cara Operations[5]

Bill Gregson, CEO of Cara Operations since 2013, tends to think big. The company had been taken private eleven years earlier, but in 2015, he took it public once again and began actively looking for ways to grow the business.

On March 31, 2016, he announced that Cara had entered into an agreement to acquire 100% of Groupe St-Hubert Inc. ("St-Hubert"), for $537 million. The company already owned Swiss Chalet, a restaurant chain with outlets throughout Canada. While its activities were similar to those of St-Hubert, Swiss Chalet had closed its 61 outlets in Quebec in the early 2000s.

Groupe St-Hubert Inc. was one of Quebec's largest restaurant chains, with 120 outlets in Quebec along with manufacturing plants and distribution centres. With this acquisition, Cara would be able to expand its restaurant network and expand into St-Hubert's retail food business.

Cara's management announced that leveraging the combined businesses would achieve an estimated $10 million of annual run-rate synergies within three years in areas such as purchasing, associating Cara and St-Hubert brands at shared points of sale, and reducing supplementary costs in other retail operations. The full deployment of Cara-branded products through St-Hubert's pan-Canadian food production and distribution network should generate benefits beyond the first three years.

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[1] Translation from the French by Debbie Blythe of case #9 40 2017 009 "Cara Opérations : achat de St-Hubert et création de valeur."

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[5] Joe Castaldo, "Cara Operations CEO Bill Gregson on taking over a family business", *Canadian Business*, June 9, 2016 (accessed June 14, 2017).

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The acquisition of Quebec's iconic rotisserie chicken chain opened many doors for Cara. The integration of St-Hubert's activities and the maximization of the advantages thus created presented it with a formidable challenge, however. Its leadership team would have to carefully consider the strategic development options now available to them.

Cara Operations Ltd.

Now headquartered in Vaughan, Ontario, Canadian restaurant giant Cara Operations was founded in Ontario in the early 1850s by the Phelan family, still a major shareholder. The company's history paralleled that of Canada as a nation. In the 19th century, it pioneered the sale of newspapers, cigars, and candy to passengers on steamboats and the Canadian railway network. It gradually diversified, selling snacks and light refreshments. In 1954, it opened its first establishment devoted to chicken, Swiss Chalet, in Toronto.[1] In 1978, Cara introduced Swiss Chalet to Quebec under the French name Chalet Suisse, but strong competition doomed this expansion and the brand was withdrawn from Quebec in 2004.[2]

Since the 1970s, Cara has made numerous acquisitions that have propelled it to the forefront of its industry. In 2013, it purchased one of its biggest competitors, Prime Restaurants, for $71 million,[3] adding more than 150 points of sale to its network. In an extremely competitive environment, Cara also seized the opportunity to purchase New York Fries, a Canadian fast-food chain with 120 outlets in Canada and 36 outside of North America, mostly in the Middle East and China, for an estimated $30 to $50 million[4] (see Exhibit 1).

Listed on the Toronto Stock Exchange in 2015, Cara is owned mainly by the Phelan family and Fairfax Financial Holdings, a financial services holding company. Fairfax is "a holding company whose corporate objective is to build long-term shareholder value by achieving a high rate of compound growth in book value per share over the long term."[5] Since 1985, this value has grown at an annual rate of 19%. Fairfax owns several insurance and reinsurance companies around the world along with a few companies unrelated to insurance, such as Cara. In 2016, Cara and St-Hubert accounted for 22% of Fairfax's US$9.2 billion in revenue, or US$2.0 billion. Fairfax holds 57% of Cara's voting rights.[6]

Following its relisting on the TSE, Cara aimed to boost total sales from $1.7 to $3 billion while increasing its operating margin from 6.6 to 8% within seven years.[7] With a 14% average annual growth rate of revenue since 2010, this posed a real challenge for the company (see Exhibit 2).

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1 Cara, Our history, https://www.cara.com/fre/history.php (accessed August 10, 2016).

2 Marie-Eve Fournier, "Que sont-ils devenus?", *La Presse+*, December 26, 2015 (accessed August 10, 2016).

3 Hollie Shaw, "Cara, Fairfax's Prime Restaurants to merge", *Financial Post*, October 31, 2013 (accessed August 10, 2016).

4 Jonathan Ratner, "Want some New York Fries with your Swiss Chalet?" *Financial Post*, September 2, 2015 (accessed August 10, 2016).

5 Fairfax Holdings, 2016 Annual Report.

6 Ibid.

7 Dominique Beauchamp, "Cara fait un peu d'ombre à MTY en Bourse", *Les Affaires*, November 12, 2015 (accessed August 10, 2016).

Before acquiring St-Hubert, Cara already owned many of Canada's most recognizable restaurant chains, including Swiss Chalet, Milestones, Montana's, Kelsey's, Harvey's, East Side Mario's, Fionn MacCool's, Prime Pubs, Bier Markt, Landing Group, Casey's, and New York Fries.[1] With its flagship restaurant Swiss Chalet, the Ontario-based company operates primarily in Canada's full-service and fast-service restaurant sectors. Every chain is given the independence needed to manage its brand as it sees fit. Cara provides them with marketing support and selects pre-approved suppliers of raw materials.

In terms of marketing support, Cara offers services tailored to its various brands such as the bulk buying of TV advertising space. In addition, each brand has a dedicated marketing team that determines its positioning strategy, prices, promotions, and advertising based on its specific characteristics.

Ensuring its restaurant chains and franchisees are supplied with enough high-quality raw materials, including food products, beverages, and other supplies and services, is one of Cara's major responsibilities. Cara itself does not produce, supply, or sell raw materials to the restaurants in its network. Instead, it takes advantage of its size and bulk purchasing power to negotiate advantageous prices with suppliers and distributors. If the various brands and franchisees had to negotiate individually with suppliers, their prices would be much higher. In addition, to avoid becoming over-reliant on specific suppliers, Cara diversifies its supply chain. This helps to keep prices low and increase flexibility so it can deal with any problems the market might throw at it.

Finally, Cara negotiates contracts with a wide range of suppliers in the areas of telecommunications, maintenance, insurance, financing, human resources, and leasing to help its franchisees keep management and operating expenses as low as possible.

Cara operates some 1,000 restaurants employing over 50,000 people in Canada and the United States, mainly in the form of franchises.[2] In the past five years, Cara has expanded its franchise system to reduce risk, grow quickly, and minimize overall operating costs. At last count, 88%[3] of the company's restaurants were franchise operations, compared to an industry average of 36%.

Cara still lags behind its two largest competitors, Tim Hortons/Burger King ($6.9 billion in sales) and McDonald's ($4.3 billion) (see Exhibit 3). However, compared to its full-service competitors, Cara has a 7.1%[4] market share, while its closest competitor, Boston Pizza, has just 4.1%[5] (see Exhibit 4).

[1] Cara franchising opportunities, http://carafranchising.com (accessed August 10, 2016)

[2] Danielle Boudreau, "Made in Canada Quiz: How much do you know about Cara Operations?" *Yahoo Finance*, April 8, 2016 (accessed August 10, 2016).

[3] Jean-Philippe Cipriani, "St-Hubert, une proie des plus appétissantes", *L'Actualité*, March 31, 2016 (accessed August 10, 2016).

[4] Cara, Acquisition of Group St-Hubert by Cara, March 2016.

[5] Andrew Alvarez, IBISWORLD, Industry report 72211CA Full-Service Restaurants in Canada, May 2016.

St-Hubert restaurants

Sixty-five years after Hélène and René Léger opened the first St-Hubert rotisserie at 6355 Saint-Hubert Street in Montreal, St-Hubert had become the #1 full-service restaurant operator in Quebec. In 1952, the innovative couple pioneered free home delivery in Canada, their fleet of yellow Volkswagen beetles painted with its signature colours eventually becoming a distinctive symbol of the company. In the 1960s, its creative television and radio spots (and catchy jingle) made St-Hubert a staple of Quebec culture. In 1965, the company began selling its BBQ sauce (its recipe a carefully guarded secret) in supermarkets throughout Quebec.[1]

Fifteen years after the opening of its first restaurant, the company had firmly established itself in Quebec with five rotisseries, including one take-out counter. Another pivotal moment occurred in 1967, when the first St-Hubert franchise opened in the Quebec City area. In 1991, Jean-Pierre Léger, son of the founding couple, became the new CEO. The following decade was an eventful time, with the launch of new concepts, including a kid's menu and terraces – and its fair share of financial difficulties, including a $3.8 million loss in 1991[2] and a failed attempt to expand into Ontario and the U.S. During the 2000s, the company consolidated its presence in Quebec with the opening of new outlets (by the end of 2016, 108 of St-Hubert's 117 restaurants were franchised)[3] and increased efforts to build brand loyalty through technological innovation (a more user-friendly website to simplify the on-line ordering process) and eco-awareness (the use of recyclable and/or compostable packaging for delivery orders and completely eliminating Styrofoam from all packaging).

In the new millennium, the company entered a turbulent period with many changes to its senior management team. In 2010, St-Hubert announced that it would again launch an expansion into the U.S. and Canadian markets. Fierce competition in its sector along with unfavourable economic conditions quickly forced it to abandon that attempt, however. As it refocused its geographic market, the company saw a quick succession of three CEOs between 2013 and 2015.[4] Following its purchase by Cara, 2017 would thus be a transition year for St-Hubert.

By the end of 2016, the St-Hubert Group had 10,000 employees in 117 restaurants (primarily full service), including 108 in Quebec.[5] Its activities were similar to those of Ontario-based Swiss Chalet, its main Canadian competitor. In the eyes of Quebecers, St-Hubert was a cultural icon and an economic jewel. In a 2015 survey, it ranked fifteenth among 249 national and international businesses as Quebecers' most admired company.[6] Its business concept incorporates four service offerings tailored to meet the needs of different clienteles with a range of prices and service levels: St-Hubert restaurants, St-Hub resto-bars, St-Hubert Express, and St-Hubert groceries (see

1 St-Hubert, History, http://www.st-hubert.com/entreprise/historique/annees-2010.en.html (accessed August 10, 2016).

2 Frédéricke Chong, "La petite histoire des rôtisseries St-Hubert", ICI Radio-Canada, March 31, 2016 (accessed August 10, 2016)

3 Cara, op. cit.

4 La presse canadienne, "Pierre Rivard nouveau PDG du groupe St-Hubert", ICI Radio-Canada, September 17, 2016 (accessed August 10, 2016).

5 Renaud Turenne, "Cara met la main sur le groupe St-Hubert", Canoe.ca Argent, March 31, 2016 (accessed August 10, 2016).

6 Ginette Poulin, "Palmarès 2015 des entreprises les plus admirées des Québécois", *HRIMag*, March 19, 2015 (accessed August 18, 2016).

Exhibit 5). The company thus has two main focuses: a restaurant network with three complementary offerings and a food manufacturing and distribution program.

St-Hubert is a vertically integrated company. A single organization handles all marketing and promotional activities for all St-Hubert restaurants and other Group brands.[1] The firm's procurement department looks after all purchasing needs of the Group's restaurants, manufacturing plants, and retail operations, reselling the products purchased to the members of its network. The procurement department also ensures that all health and hygiene standards are met by the various establishments.

The company's real estate portfolio consists of twenty-eight owned properties including two manufacturing plants (responsible for producing St-Hubert salads, meat pies, and ribs sold in grocery stores) and two distribution centres. The manufacture and distribution of these products enables fans of the company's products to enjoy them in their own home as well as in restaurants. Of the company's total sales in 2015, $403 M came from restaurant operations and $225 M came from food operations, including sales to national grocery chains such as Sobeys, Metro, and Loblaws. St-Hubert's distribution activities are the envy of its competitors. Earnings before interest, taxes, depreciation, and amortization (EBITDA) are estimated to be $45 M. In Canada, St-Hubert is a leader in placing restaurant brands in retail grocery stores; in 2015, such sales were in excess of $100 million (of the $225 million in food operations).[2]

Canada's restaurant industry

Cara and St-Hubert operate primarily in the Canadian restaurant industry – specifically, in the full-service restaurant sector, where customers are seated at tables, order, and pay after they've eaten. Companies in this sector are often categorized according to the type of food they serve: European, Asian, Canadian, Mexican, steak, pizza, seafood, or "other," a category including all other types of food (see Exhibit 6). Canadian restaurants serve food that is typically North American (hamburgers, chicken, poutine, fries, salads, and sandwiches). In 2015, Restaurants Canada reported that commercial restaurant sales in Canada had grown by 2.0% to $60 billion.[3]

Over the past decade, social spending habits have changed dramatically,[4] and technology has changed the way we eat. Healthy eating and gastronomic options are all the rage. Many fast-food restaurants (Five Guys, Shake Shack in the U.S.) have adapted to this trend by offering higher quality, more nutritious options. To compete with these new players, full-service restaurants have also begun to improve the quality of their menu items. But since higher quality means higher prices, these options are not available to all consumers.

[1] St-Hubert, Administration, http://www.st-hubert.com/emploi/administration/emploi-administration.en.html (accessed April 1, 2017).

[2] Cara, Acquisition of Group St-Hubert by Cara, March 2016.

[3] François Pageau, "Palmarès des restaurants de chaîne", *HRIMag*, September 6, 2016 (accessed March 15, 2017).

[4] Alvarez, op. cit.

Canada's full- and fast-service restaurant industry has entered the maturity stage.[1] In many areas, the restaurant market is almost saturated. Moreover, this sector is divided among several high-earning companies (see Exhibits 3 and 4). These large firms play side by side with many small companies, often Mom and Pop-type businesses with a single point of sale. In 2013, Canada's two largest industry players, Cara and Prime Restaurants, joined forces and pooled resources to achieve economies of scale and boost their profit margin.

Most full- and fast-service restaurants adopt a franchise model. With this model, the franchisee is responsible for capitalizing the company and assuming most of the operational risk for the benefit of the parent company, which, in turn, devotes time and resources to promoting the expansion of its operations. In 2016, the number of franchise restaurants grew in Quebec, while the number of independents fell. In Canada, St-Hubert ranked thirteenth among the top 100 restaurant franchises, which generated a total of $30 billion in sales in 2015 for a 50% share of Canada's restaurant market.[2] Analysts predict that, in the coming years, sales and clientele for this type of restaurant will increase due to their capacity for innovation, access to financing, efficient management tools, and brand awareness throughout the country.

Increases in income and population size are insufficient to support a significant increase in the number of eating establishments, so full-service restaurants and other types of food business, including fast food places, face stiff competition. Food quality, brand image, adaptability, and cost control are at the heart of the operational and strategic concerns of many companies.

Between now and 2021, sales are expected to grow by an average of just 1.7% annually (see Exhibit 7). This is because Canadians are devoting a shrinking percentage of their budget to eating out. According to Statistics Canada, in 2003, the average Canadian spent 30%[3] of their food budget on restaurant meals. By 2013, this percentage had shrunk to 27.9%.[4]

Canada's food processing and distribution industry

According to Quebec's ministry of agriculture, fisheries, and food (MAPAQ), processed food results from the skilful combination of raw ingredients by players in the food processing industry.[5] These raw ingredients come from Quebec's agricultural, fishing, and aquaculture sectors. The resulting products are distributed throughout Quebec, other Canadian provinces, and 160 countries around the world.

The meat processing sector accounts for almost 25% of shipments of processed food products (see Exhibit 8). Between 2011 and 2016, three-quarters of those shipments came from some twenty establishments belonging to groups such as Olymel, Exceldor, and Cargill. St-Hubert's food processing and distribution activities are situated in this niche.

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[1] Ibid.

[2] Pageau, op. cit.

[3] MAPAQ, *Bottin statistique de l'alimentation 2015* (accessed August 10, 2016).

[4] Statistics Canada, "Household spending on food", *The Daily*, February 21, 2013 (accessed August 10, 2016).

[5] MAPAQ, "Portrait du secteur de la transformation et de la distribution alimentaires" (accessed March 15, 2017).

In Quebec, food and beverage processing is the largest employer in the manufacturing sector, accounting for 64,000 jobs. Quebec's food processing sector accounts for almost 25% of all Canadian activity. At the end of 2016, Quebec was home to 2,000 bio-food processing establishments and manufacturing facilities[1] with total shipments of $27.5 billion.

Companies in the bio-food chain of this industry strive to constantly improve the quality of their products. Cost reduction and supply chain optimization are the primary challenges they face. All major players adopt improved management and food risk management practices.

Strategic options

In late 2016, after his final meeting with the financial press in downtown Toronto, Bill Gregson studied the financial statements of St-Hubert and Cara Operations (see Exhibits 9 and 10), wondering how his company could create maximum long-term value following the acquisition of Quebec's iconic chicken rotisserie chain.

Gregson had five options to present to his board of directors: 1) allow St-Hubert to operate as an independent division at the national level, 2) use St-Hubert to introduce Cara-branded products to Quebec, 3) have Cara and St-Hubert combine locations, 4) adopt St-Hubert's procurement process for Cara brands, or 5) simply cut costs by implementing Cara's best practices and know-how.

2017-11-16

[1] Stéphane Lacharité, BioClips – Actualité bioalimentaire, MAPAQ, Vol. 25, No. 7 (accessed March 15, 2017).

Exhibit 1
Cara Operations purchases Prime Restaurants and New York Fries

Prime Restaurants[1]	New York Fries[3]
In 2011, when Cara announced its plan to acquire Prime Restaurants, that company had 155 restaurants, including 139 franchisees. The brands managed by Prime Restaurants were East Side Mario's, Casey's, Pat and Mario's Fionn MacCool's, and Bier Markt. In 2011, Prime Restaurants had income from operations of $35 M.[2]	When it was acquired by Cara in 2015, New York Fries was a Canadian fast-food company specialized in French fries, poutine, and hot dogs. The company had 120 restaurants in Canada and 36 others abroad. Since it was a private company, it was difficult to obtain information about its finances before the acquisition.

Exhibit 2
Financial Performance of Cara Operations

Cara Operations – financial performance*

Year	Revenue ($ million)	Change (%)	Operating profit	Change (%)
2011	1274.9	5.5	50.6	11.0
2012	1318.4	3.4	55.1	8.9
2013	1371.9	4.1	73.3	33.0
2014	1714.0	24.9	78.2	6.7
2015	2475.0	44.4	81.9	4.7

*estimate

Source: IBISWORLD / Cara Operations

Exhibit 3
2014 Sales of Canada's Top Ten Restaurant Management Companies[1]

Restaurant management company	2014 sales ($ M)
Tim Hortons / Burger King	6,958
McDonald's	4,331
Cara	1,786,
Subway	1,406
Starbucks	1,356
MTY Food	1,056
Boston Pizza	1,012
YUM	990
A&W	986
Wendy's	656
Industry total	50,419

Exhibit 5
St-Hubert's Service Offerings[1]

St-Hubert restaurants Target all types of customers who frequent the business (families with children, couples, singles, professionals, and seniors). Family restaurants par excellence offering most St-Hubert menu items. Prices are highest and service is good.	**St-Hub Resto-bar** Music, subdued lighting, and a hip decor offer customers a place to kick back with friends, relax, and have fun while enjoying St-Hubert products. Prices are still highest and service is good.
St-Hubert Express For customers in a hurry willing to accept a lower standard of service for the various St-Hubert menu items at lower prices.	**St-Hubert in your grocery aisle** Specializes in the production and distribution of St-Hubert products to grocery stores and the company's partners.

Exhibit 7
Data and Economic Forecast for Canada's Full-Service Restaurant Industry[1]

Year	Revenue ($M)	Establishments	Companies	Jobs	Consumption expenditures ($G)
2007	24,651.9	35,024	30,155	412,525	10,041.6
2008	24,980.3	36,861	31,648	427,842	10,007.2
2009	25,145.1	36,921	31,693	425,198	9,847.0
2010	24,779.6	37,179	32,023	419,591	10,036.3
2011	24,794.0	35,927	30,956	425,779	10,263.5
2012	25,638.7	37,645	32,472	443,947	10,413.2
2013	26,252.1	40,602	34,968	460,726	10,590.4
2014	26,460.7	41,364	35,861	470,894	10,875.7
2015	26,437.7	41,932	36,260	485,161	11,225.9
2016	27,024.9	42,583	36,575	495,232	11,562.7
2017	27,645.8	43,169	36,977	505,567	12,099.4
2018	28,091.8	43,900	37,438	514,714	12,432.4
2019	28,489.8	44,745	38,107	523,402	12,729.5
2020	28,818.7	45,437	38,584	530,871	13,051.2
2021	29,315.0	46,174	39,124	540,102	13,397.4

Exhibit 10
Earnings Statement – St-Hubert[1]

Sogelec Inc. (St-Hubert Inc.).
Consolidated retained earnings, in Canadian dollars

	2015
Sales*	**278,877,117**
Earnings before the following items	**210,309,006**
Inventory recognized as expenses	166,646,525
Stock-based compensation	475,126
Net change in defined benefit asset	676,000
Financial expenses	2,281,179
Severance	285,294
Reversal of non-recurring professional fees	-500,000
Franchise and restaurant branch closure costs	
Gain on disposal and write-off of assets held for sale	-168,333
Loss on disposal and write-off of property, plant and equipment	4,471
Depreciation of property, plant and equipment	9,606,959
Amortization of intangible assets	4,726,288
Earnings before income tax	**26,275,697**
Income taxes	**7,337,915**
Net earnings	**18,937,782**

*Sales (Sogelec)	2015
Food Processing and distribution	147,792,643
Franchise network procurement	69,976,876
Restaurant branches	35,023,099
Rent and royalties	22,716,009
Other	3,368,490
	278,877,117

SOMAIYA VIDYAVIHAR UNIVERSITY

Semester: Jan – Mar 24		
Maximum Marks: 50 **Examination: ETE Exam** **Date: 28/3/2024** **Duration: 3 Hours**		
Programme code: 01 **Programme: MBA Minor Strategy and Consulting**	**Class: SY**	**Semester/Trimester: VI**
College: K. J. Somaiya Institute of Management	**Name of the department/Section/Center:** **General Management**	
Course Code: 217P01M613	**Name of the Course: Corporate Strategy**	

Instructions:

1. Section-A is based on the attached case study "Cara Operations". The relevant exhibits of the case have been provided. All questions of Section-A (Question Number 1 to 4) are compulsory.
2. Section-B has three questions (Question number 5 to 7). Answer any two questions from this section.
3. Suggested word length is 250-300 words for each question.

Question No.		Max. Marks
	Section-A	
1	Given the expectations of Fairfax Holdings and the market conditions of Canadian restaurant industry, what is the strategic challenge facing Cara?	8
2	What are the key differences in how Cara and St-Hubert manage their operations and affiliates?	8
3	What specific challenges are facing Cara regarding the integration of St-Hubert?	8
4	Evaluate the five options proposed by Gregson. Which one would you propose and why?	10
	Section-B	
5	Discuss hybrid vs matrix organization with benefits and potential challenges for each of them.	8
6	What is the significance of Corporate Governance in today's Indian business environment? What are some of the critical issues to be addressed under Corporate Governance?	8
7	Innovative Electronics is a start-up with 5 staff. As a new venture, it is still based firmly on the vision and values of its founder, Akash, and its 7S elements are in alignment. It sells into one market, and uses off-the-shelf IT and accounting systems. As time goes on, the business grows employing 30 staff, and diversifying into different markets. New customer requirements demand new skills in marketing, technology, product development, and financial management. Akash calls you as a consultant to help him understand the alignment issues. You find that the developing sales strategy no longer aligns with the small-business skill set. The rapid influx of new staff members, along with changes in technology, means that some staff don't have the necessary systems skills. Many are unclear on the organization's values and sense of purpose. Using McKinsey 7S framework, what elements of the 7S would you like to focus on? What specific recommendations would you have for the Human Resource function to ensure organizational alignment.	8