
BURGER KING
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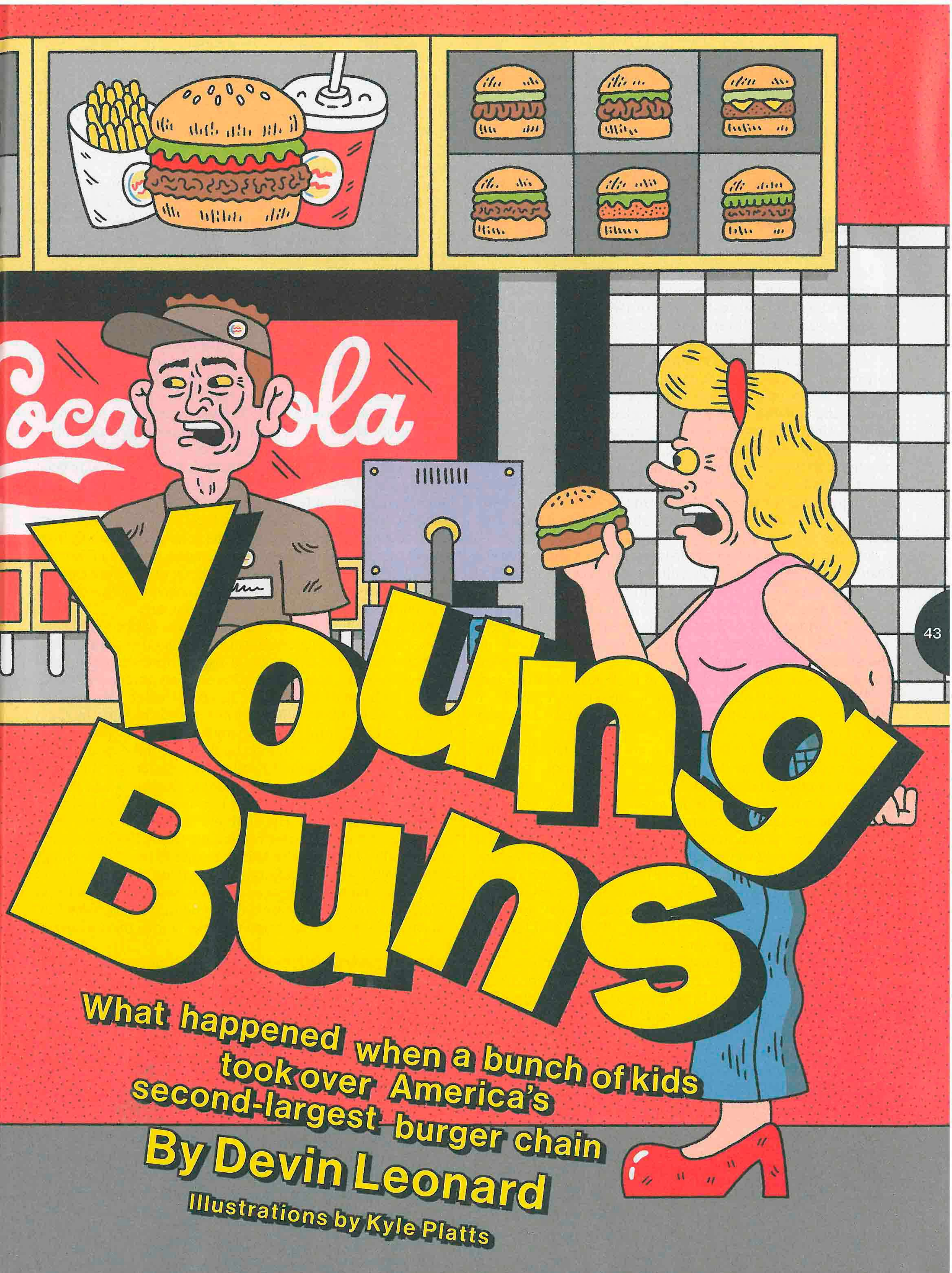


Young Buns

What happened when a bunch of kids took over America's second-largest burger chain

By Devin Leonard

Illustrations by Kyle Platts

Last summer a trim guy with wavy brown hair, high cheekbones, and a broad smile could be found making Whoppers, working the drive-through window, and scrubbing bathrooms at a Burger King in Miami. His name was Daniel Schwartz. He learned to make a Whopper in less than 35 seconds and blended in well with his fellow employees, except for the fact that Schwartz had a guy with a video camera trailing him. "I cleaned about 15 toilets in the past two days," he boasted at one point, as if he'd just completed a marathon.

Schwartz was justifiably pumped. That June he'd been named Burger King's chief executive officer, with a $700,000 annual salary and a potential cash bonus of twice that. There was another reason for Schwartz to be exuberant: He was only 32 and well on his way to becoming a star in the fast-food industry.

Making sure the fixtures in Burger King's restrooms gleam is only one of Schwartz's challenges. He's Burger King's 21st CEO since the company was founded in 1954. The chain has had six owners and suffered from years of neglect and strategic incoherence. Unlike his predecessors, Schwartz isn't just competing with McDonald's and Wendy's. He has to keep customers from straying to trendy newcomers such as Chipotle Mexican Grill and Panera Bread. Their sales in the U.S. last year grew 17 percent and 12 percent, respectively, according to Technomic, a food industry consultant. Sales were essentially flat for Burger King and its two primary rivals.

Schwartz looks much as he did when he was a student on the dean's list at Cornell University, all the way back in the Aughts. He had no experience in fast food before going to Burger King; he spent almost a decade on Wall Street after college. And he's surrounded himself with a similarly eager and fresh-faced inner circle. Josh Kobza, the chief financial officer, is 28. He and Schwartz are usually joined on conference calls by Alexandre Macedo, Burger King's ancient 36-year-old president for North American operations, and Sami Siddiqui, the head of investor relations, who's 29. Only one of the four saw a day of the Seventies.

Schwartz is an outlier in the corporate world. Matteo Tonello, managing director at the Conference Board, a nonprofit research organization that studies such things, says chief executives that young are a rarity outside of tech enclaves such as Silicon Valley. He says the average age of an incoming CEO at a company in the Standard & Poor's 500-stock index was 53 last year. Schwartz would be the second-youngest CEO on the Fortune 1000 (behind Mark Zuckerberg) if Burger King made that list, according to figures from BoardEx, a firm that analyzes data about corporate executives and directors. "The conventional wisdom is that you need an experienced candidate," Tonello says. "There's still a lot of skepticism toward younger ones."

These days, however, Burger King is behaving more like a startup than a typical burger chain. In 2010 it was purchased for $4 billion in a leveraged buyout by 3G Capital, the Brazilian private equity firm that also owns H.J. Heinz with Berkshire Hathaway and whose principals are among the controlling shareholders of Anheuser-Busch InBev. Jorge Paulo Lemann, 3G's 74-year-old billionaire co-founder, likes to enlist young executives and put them in top positions at the firm's companies. "Who says you have to be old to be good?" says William Ackman, the New York hedge fund manager who runs Pershing Square Capital Management, Burger King's largest investor after 3G.

Schwartz and his co-workers are apostles of 3G's ferocious approach to cost reduction. They talk about the need to instill everybody at Burger King with an "ownership mentality," meaning mainly that employees should husband the company's money as if it were their own. That's put an end to some cherished perks. After InBev swallowed Anheuser-Busch in 2008, the American brewery's executives were informed that they'd no longer get free cases of beer. In September, Bloomberg News reported that executives at Heinz, bought three months earlier by 3G and Berkshire Hathaway, had been commanded to turn in their mini-fridges.

Schwartz, who did not cooperate for this article, has overseen much chiseling. McDonald's owned 19 percent of its 35,429 restaurants worldwide in 2013. Wendy's owned 18 percent of its 6,557 outlets. Historically, Burger King operated much the same way: When 3G bought the chain in 2010 it owned 11 percent of its 12,174 restaurants around the world. Since then, Burger King has sold all but 52; it keeps the last few for training executives and testing products.

That's such a departure from the way its competitors operate that some people are questioning the company's strategy. "Unless you keep a certain percentage of stores, you don't really know how the business is operating," says Malcolm Knapp, a New York restaurant industry consultant. He contends that Burger King's management is interested primarily in siphoning cash out of the business. Howard Penney, managing director of Hedgeye Risk Management, a research firm in Stamford, Conn., is similarly skeptical of Schwartz's methods. "It's financial engineering," he says. Burger King disputes this, but such suspicions are reasonable. After unloading more than 1,200 restaurants, the company's corporate head count has fallen from 38,884 to 2,425 in 2013. Now its income flows almost entirely from royalty fees from franchisees, on average 4 percent of franchisees' monthly revenue. That's less money than before overall, but Burger King has become a cash machine. And 3G hasn't been shy about helping itself to some of that money.

At the same time, Burger King's business has been growing. Schwartz negotiated agreements with restaurant operators and financiers in Brazil, China, and Russia, where American hamburgers are still a novelty. They haven't just purchased restaurants from Burger King, they've also constructed new ones. As a result, the number of Burger Kings worldwide rose by 1,493 in 2013, to 13,667. And the company hasn't had to spend much money; its partners are putting up the bulk of the cash.

Wall Street has responded enthusiastically. Burger King went public again in June 2012 in an offering that put a $4.6 billion value on the company. As of early July, its market cap had risen to more than $9 billion. The doubters are in the minority now, and many in the investment community would like McDonald's and Wendy's to mimic the kids at Burger King. "These things are seemingly working at Burger King and causing questions to be asked about the strategy of others in fast food," says David Palmer, an analyst who covers the restaurant industry for RBC Capital Markets. "Like, why aren't you doing what they're doing?"

Schwartz grew up in Albertson, N.Y., an upper-middle-class Long Island suburb near the border of Queens. He went to the Wheatley School, where he played basketball and was an honors student. Carol Vogt, his history teacher there, thinks he'll make an accomplished fast-food company CEO. "He'll do fine if he's anything like he was when he was younger," she says. "He's a very hard worker." Schwartz made no secret of his big dreams. He summed them up with a quote from Shakespeare's *Twelfth Night* that he chose to go with his senior picture in the school's 1998 yearbook: "Some are born great, some achieve greatness, and some have greatness thrust upon them."

At Cornell he majored in management and applied economics. Friends say he was a bright if somewhat colorless guy who spent his time studying and working out. After college he worked as an analyst at Credit Suisse First Boston and did time at a

Schwartz (second from right) and co-workers celebrate Burger King's return to the stock market in 2012

hedge fund in Stamford. When he learned that 3G was opening an office in New York in 2005, he applied for a job, thinking it would be a good fit, according to a Burger King spokeswoman.

It was a prescient move for a 24-year-old. Schwartz started as an analyst and was soon promoted to the private equity group. He was involved in a campaign to win seats on the board of CSX, the American railroad company, with Children's Investment Fund, a charitably inclined British hedge fund. 3G made a profit, but the interlopers also endured a long, nasty courtroom battle with CSX. The documents that surfaced in the case reveal how much responsibility 3G was willing to give Schwartz despite his youth.

In 2010, Schwartz orchestrated 3G's purchase of Burger King, offering a 46 percent premium on the chain's stock price. That inspired some head-scratching. Burger King was a mess and had been for decades. James McLamore and David Edgerton had opened the first Burger King in Miami. They struggled to get by until they noticed crowds flocking to someone else's hamburger joint in Jacksonville, Fla. The other place was dirty; the door to the men's room was hanging by a single hinge. But the burgers were tasty—and huge.

McLamore would write in his surprisingly good autobiography, *The Burger King*, that the idea for the Whopper came to him later that afternoon as he got pleasantly buzzed on the drive back to Miami. "I had a small bottle of bourbon in the glove compartment and so I poured a little of it into a 7-Up I had just bought at the gas station," he wrote. All he could think about was the sandwich he'd just eaten and how he might clone it.

The Whopper made its debut in 1957. It was an immediate hit, and Burger King established itself as McDonald's doppelganger and its closest competitor. McLamore dreamed of being No. 1. It didn't happen. Pressured by his investors, he agreed to sell the company in 1967 to Pillsbury. He soon regretted it. Pillsbury had little interest in opening restaurants as rapidly as McDonald's. Burger King fell further and further behind. In 1988, Grand Metropolitan, a British conglomerate with interests in liquor, tobacco, and gambling, bought Pillsbury, and Burger King became even less of a priority. Nine years later, Grand Metropolitan merged with Guinness to create Diageo. The new company wanted to focus on Johnnie Walker, not Whoppers. In 2002 it sold Burger King in a leveraged buyout to Texas Pacific Group, Bain Capital, and Goldman Sachs for $1.5 billion. Franchisees welcomed TPG and its partners. They couldn't have been happier to escape from Diageo. "This is the first day of a new era for Burger King," proclaimed Julian Josephson, chairman of the chain's franchisee association, in a 2002 statement.

The good feelings didn't last. In 2009, Burger King put the $1 Double Cheese Burger on the menu. The item increased sales, which meant Burger King collected more in royalties. But franchisees abhorred it: They couldn't make money selling a big cheeseburger for a low price. The Burger King franchisee association sued the company to get the burger off the menu. "It was beyond toxic," says consultant Knapp of the chain's relationship with its franchisees at the time.

This was the moment when Schwartz and the rest of the 3G squad showed up with an offer to buy Burger King for $4 billion—$1.6 billion in equity, the rest in debt. TPG and its partners took it.

3G had a blueprint for making Burger King work. Once the deal closed in October 2010, the new owners raised double cheeseburger prices and settled the franchisee lawsuit. Meanwhile, Burger King's new CEO, Bernardo Hees, a 41-year-old former railroad company head, purged 375 people from the Miami headquarters and 275 more around the world, according to filings with the Securities and Exchange Commission. In

The company's corporate head count has fallen from 38,884 to 2,425 in 2013

COURTESY NYSE

By 2013, Burger King finished almost all its cost-cutting. It had to sell more burgers and fries

October, Schwartz, then Burger King's new deputy chief financial officer, showed up in Miami to perform more symphonic cutting. "Bernardo was the conductor," says Martin Franklin, a Burger King board member. "Daniel was the first violin."

According to Franklin, Schwartz played an integral role in rooting out what management considered to be heedless spending. The Burger King corporate jet was promptly sold. The 3G guys did away with the comfy offices that top executives and their secretaries had enjoyed, which people at Burger King called Mahogany Row. Executives now sit in a Spartan open-plan office. 3G discovered that the company's Europe, Middle East, and Africa division had been throwing an annual $1 million bash at a chateau beside an Italian lake. The party is over.

Some cuts appeared to be less about finding big savings than creating an oppressive cheapness. Employees were instructed to use Skype to make long-distance calls instead of running up a cell phone bill. They were urged to scan documents and e-mail them rather than use FedEx. They were ordered to turn in their personal printers and use large communal ones.

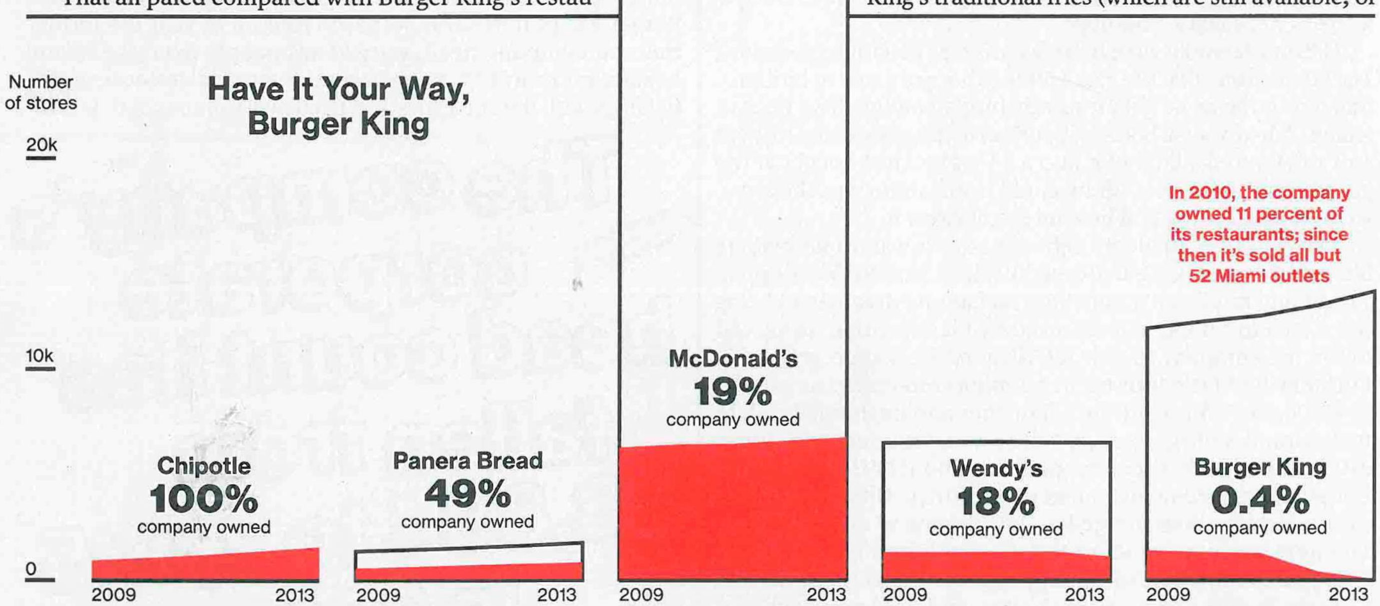
That all paled compared with Burger King's restaurant disposal initiative. The rationale was simple: Who was better qualified to operate a Burger King than an experienced franchisee? The plan would also relieve 3G from having to spend more than $400 million to remodel its restaurants, many of which still had old-style metal chairs and bright blue booths. The new owners would put up the money instead. (Burger King says it has contributed some cash to cover remodeling costs, though it won't provide a number.)

Early results under the new management were promising. In 2012 net income rose 34 percent, to $118 million. Same-store sales swung from a decline of 0.5 percent the previous year to a gain of 3.2 percent. Part of the reason was that Burger King introduced the largest number of new menu items in its history. There were salads, wraps, chicken strips, smoothies, and frappés. Meanwhile, Schwartz's deals with foreign restaurateurs were spawning hamburger joints globally and bringing in more royalty income.

Everything went so well that 3G was able to sell Burger King shares to the public. As part of the deal, 3G sold 30 percent of its stock to a group of investors led by Ackman for $1.5 billion, retaining the other 70 percent. The amount was about what 3G had put up in equity to buy Burger King. "They basically ended up owning the company for nothing," Knapp says.

In June 2013, Hees departed to run Heinz, and Schwartz became Burger King's CEO. He spent his first months toiling in Burger Kings and discovering what it was like for the chain's cooks and dishwashers. Brendan Berg, Burger King's senior director for global learning, was Schwartz's guide during his training. He remembers his boss struggling to keep up with orders for items from the expanded menu. "There's nothing like standing in the back of the house, and the lunch rush is upon you, and you have complicated sandwiches," Berg says. "We had three different barbecue sauces. Some burgers had raw onions. Some had red onions. We had sweet potato fries. We're standing there side by side, and he's saying, 'Brendan, this seems like a lot here.' "

After a few of these midday scrabbles, Schwartz thought it was time to simplify the menu with new products that were easier to assemble and didn't require a multiplicity of ingredients, such as Satisfries, which were introduced last September and have fewer calories and less fat than Burger King's traditional fries (which are still available, of



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Under the Heat Lamp, Or Hot Off the Grill?

Fast-food experience

Donald Thompson
McDonald's

1990
Electrical engineer

1998-99
Manager, San Diego

1999-2000
Regional vice president

2001-04
President, McDonald's USA, West

2004-05
Executive vice president for restaurant solutions, McDonald's USA

2005-06
Chief operating officer, McDonald's USA

2006-10
President, McDonald's USA

2010-12
President and chief operating officer

2012-present
CEO

Total years
24

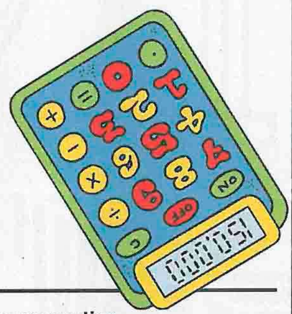
Daniel Schwartz
Burger King

2010
Executive vice president and deputy chief financial officer

2011
Chief financial officer

2013-present
CEO

Total years
3



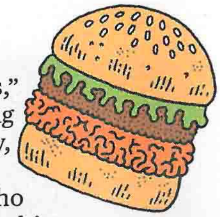
2013 publicly disclosed compensation

Donald Thompson	Daniel Schwartz
$9,496,664	**$4,770,787**

course). For customers in need of something more filling, there is the Bacon Cheddar Stuffed Burger.

Schwartz also shook up the management team, elevating people closer to his age to top positions. As a result, the average age of the Burger King executive team dipped from an already young 41 to 39. "It's a youthful, energetic team," says Franklin, the board member. "These are really intelligent guys." After surviving a few overwhelming lunches, it's not surprising that Schwartz looked for simpler products. But he needed to reinvent the menu for other reasons. By 2013, Burger King had completed almost all its cost-cutting. That meant it had to sell more burgers and fries to keep its numbers from weakening.

The U.S. in particular threatened to drag those numbers down. Annual sales at Burger King's restaurants in the country declined by 1 percent to $8.5 billion in 2013, according to Technomic. Schwartz also had to come up with new menu items—and unlike the $1 Double Cheese Burger, these would need to generate profits for his franchisees. Burger King doesn't break out their margins, but its largest franchisee, Carrols Restaurant Group, a Syracuse (N.Y.)-based publicly traded company that owned 538 outlets last year, does. In May 2012, Carrols purchased 278 restaurants from Burger King, which received $16 million in cash, a 29 percent stake in Carrols, and two seats on the board, one occupied by Schwartz. Last year, Carrols lost $13 million, because it borrowed so heavily to fund the remodeling plan it agreed to as part of the deal with Burger King. Paul Flanders, Carrols's chief financial officer, says the company hopes to refinance its junk-bond debt next year and cut its losses. He praises Schwartz and says Satisfries are helping. "Incrementally, we're selling more fries," Flanders says. "But it's not replacing the existing fries. People say one thing and eat another." In July, Carrols bought 21 more Burger Kings.



Meanwhile, Burger King has 140 people who spend all their time in the field coaching franchisees on how to boost profitability. On a recent morning, Leslye Johnson, an indefatigably cheerful Burger King coach, sat in the upstairs dining room of a Burger King in Midtown Manhattan with Kishana Scotchman, the restaurant's manager. Johnson produced an iPad and showed Scotchman scores of charts ranking her establishment on everything from hamburger sales, cleanliness, and service to the congeniality of her staff. Scotchman, a petite 29-year-old with long eyelashes, listened intently, jotting things down in a pink notebook.

Some nights were generating lousy results. Scotchman thought she knew why: She said one of her night managers was slacking off. "I try to look on the camera a lot to see what goes on at night," she said.

"Good, good," Johnson said, smiling. "What are you noticing at night?"

"He stays in the office."

"I'll come back over here and see what's going on," Johnson said. "Tell him he has a date with me."

Burger King's interventions are working. According to RBC, the company's same-store sales were up 2 percent for the first quarter of the year, while McDonald's increased only 0.5 percent. The franchisees, who made a lot of noise in the past when they were upset with Burger King's management, are also happy with Schwartz. "I don't focus on how much experience they have," says Tom Garrett, CEO of GPS Hospitality, which has bought 61 Burger Kings from the company since 2012. "They are extremely smart, which makes them very, very fast learners."

In late July, Burger King's stock had risen 15 percent; McDonald's was down 2 percent. Wendy's, meanwhile, was down 6 percent, despite the release of its much-discussed Pretzel Bacon Cheeseburger. Even a skeptic such as Hedgeye's Penney is impressed. "The stock has done better than I thought," he says.

Burger King's stock performance may not be based entirely on burger sales, however. The company's been talking publicly about refinancing its debt in coming months. This might enable the chain to do something nice for shareholders. Burger King won't say what that might be, though RBC's Palmer expects the company to pay a special dividend. He says there's "no question" that this has been driving the recent share appreciation. Of course, the biggest beneficiary would be 3G, Burger King's largest shareholder.

Schwartz spent most of June overseas, communing with foreign franchisees and investors. He didn't attend the Piper Jaffray Annual Consumer Conference at the New York Palace on Madison Avenue. There were a lot of middle-aged restaurant people in coats and ties, who run steakhouses, noodle places, and Cheesecake Factories. They faced a roomful of analysts who wanted to know about their menus and plans for expansion.

CFO Kobza was there. In his slim-cut suit and open-collar shirt, he looked like a Wall Street guy, and gave the impression of having been coached to smile as often as possible. He talked opaquely, but appetizingly, about the refinancing: "That could free up a decent amount of cash for us to potentially return to shareholders." He noted that Burger King had returned to France after a 15-year hiatus: "They still remember the Whopper," he said. "We walked through the airport with Burger King logos on our shirts. The security people asked us, 'Where's the Burger King?' " B

—*Additional reporting by Danielle Muoio*

THOMPSON: DANIEL ACKER/BLOOMBERG; SCHWARTZ: COURTESY BURGER KING