



**BUFFALO  
WILD  
WINGS**



# SECTOR SPOTLIGHT

## RESTAURANTS & CONSUMER STAPLES

MAY 2, 2017

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**QA@HEDGEYE.COM**

*\*ANSWERED AT THE END OF THE CALL*

# HEDGEYE RESTAURANTS IDEAS LIST

## LONG LIST

<b>1) RRGB</b>	Red Robin Gourmet Burger
<b>2) SONC</b>	Sonic
<b>3) MCD</b>	McDonald's
<b>4) FRGI</b>	Fiesta Restaurant Group
<b>5) BWLD</b>	Buffalo Wild Wings

## TRADE TREND TAIL

✓	✓	✓
-	-	✓
✓	✓	✓
✓	✓	✓
✓	✓	✓

## SHORT LIST

<b>1) CMG</b>	Chipotle Mexican Grill
<b>2) DNKN</b>	Dunkin' Brands
<b>3) CAKE</b>	Cheesecake Factory
<b>4) CHUY</b>	Chuy's Holdings

## TRADE TREND TAIL

X	X	X
X	X	X
X	X	X
X	X	X

## LONG BENCH

<b>WING</b>	Wingstop
<b>RUTH</b>	Ruth's Hospitality Group

## SHORT BENCH

<b>SHAK</b>	Shake Shack
<b>YUM</b>	Yum! Brands
<b>DPZ</b>	Domino's
<b>EAT</b>	Brinker International
<b>SBUX</b>	Starbucks
<b>TXRH</b>	Texas Roadhouse
<b>DRI</b>	Darden Restaurants, Inc.
<b>GRUB</b>	GrubHub

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# HEDGEYE CONSUMER STAPLES IDEAS LIST

## LONG LIST

- 1) **WFM** Whole Foods Market
- 2) **COST** Costco Wholesale
- 3) **USFD** US Foods
- 4) **PF** Pinnacle Foods

## TRADE TREND TAIL

- | TRADE | TREND | TAIL |
|-------|-------|------|
| -     | ✓     | ✓    |
| -     | ✓     | ✓    |
| -     | ✓     | ✓    |
| -     | ✓     | ✓    |

## SHORT LIST

- 1) **HAIN** Hain Celestial
- 2) **UNFI** United Natural Foods

## TRADE TREND TAIL

- | TRADE | TREND | TAIL |
|-------|-------|------|
| X     | X     | X    |
| X     | X     | -    |

## LONG BENCH

- PEP** PepsiCo
- CAG** ConAgra Foods
- SJM** J.M. Smucker Co.
- TWNK** Hostess Brands
- LNCE** Snyder's-Lance
- PFGC** Performance Food Group

## SHORT BENCH

- NUS** Nu Skin
- KR** Kroger

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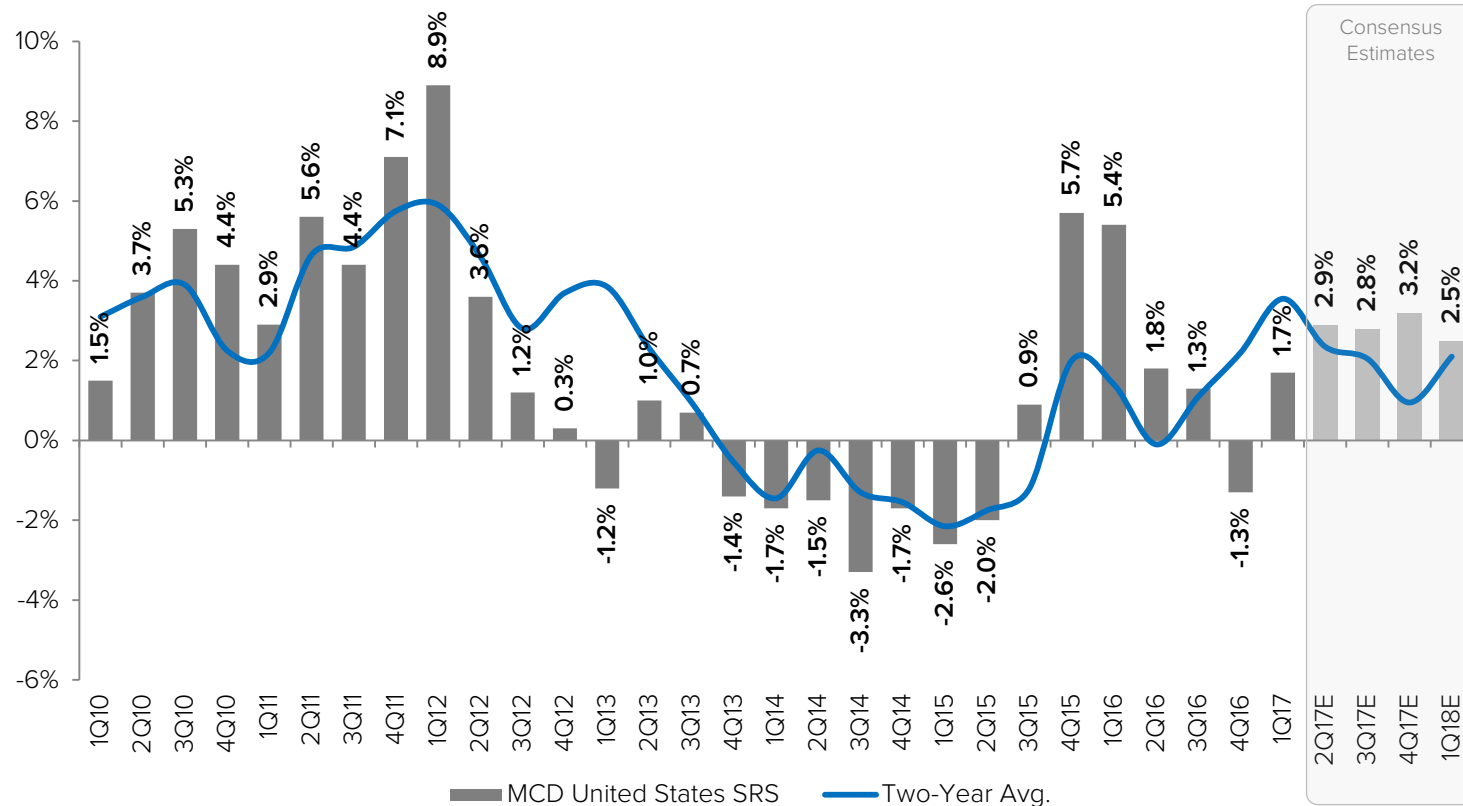


**BEST IDEA: LONG MCDONALD'S (MCD)**

# MCD UNITED STATES SRS

Before All-Day Breakfast

All-Day Breakfast



- On the Company's 1Q15 Earnings Call, management called out the sales results in the U.S. market as "disappointing."
- MCD's rebound can be attributed to the brand's All-Day Breakfast platform (formally introduced in October 2015), everyday value under the McPick 2 platform, and the introduction of Chicken McNuggets with no artificial preservatives.



# “MODERN, PROGRESSIVE BURGER COMPANY” (FROM APRIL 11, 2017 BLACK BOOK)

## Enhanced Menu Items

Coming in 2018

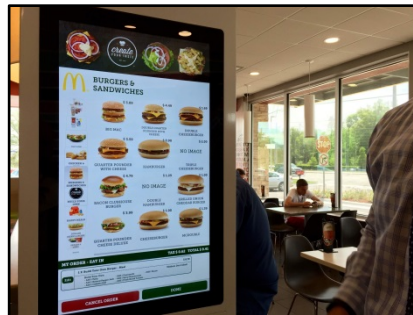
### New Fresh-Beef Quarter Pounder Burgers, Served Hot off the Grill

Just one more way we are RAISING THE BAR as part of our continued food journey

new **Signature Sriracha**  
Spicy meets saucy.



## Increased Convenience



## REDEFINING THE CUSTOMER EXPERIENCE

- MCD is bringing greater control, convenience and personalization to customers, in an effort to become the go-to destination, once gain.
- The Company recently announced that by mid-2018 it will serve fresh beef prepared when ordered in all Quarter Pounder burgers across the majority of its units, in an effort to increase transparency with consumers.
- Additionally, the brand is bringing greater personalization through the use of kiosks to place orders, allowing patrons the opportunity to place their order and skip the front counter, as the food is brought right to their table.



# REFINING QUALITY TO IMPROVE PERCEPTION (FROM APRIL 11, 2017 BLACK BOOK)

- MCD's new strategy focuses on connecting the brand with three customer groups:
  - Retaining existing customers
  - Regaining customers
  - Converting casual to committed customers
- MCD lost customers to other QSR competitors, as the brand failed to meet rising customer expectations. However, the brand has made an effort to right the ship...
  - In 2015, the Company announced a number of changes to how it serves and sources its food by offering All-Day Breakfast
  - Committing to only sourcing cage-free eggs by 2025
  - Committing to only serve chicken not treated with antibiotics important to human medicine (completed in 2016)
  - In 2016, the company removed artificial preservatives from several menu items, including Chicken McNuggets and eliminated high fructose corn syrup from the buns used on Big Macs, Quarter Pounders, hamburgers, cheeseburgers, Filet-O-Fish and McChicken sandwiches
- Most recently, the Company announced that by mid-2018 it will serve fresh beef, prepared when ordered, in all Quarter Pounder burgers across the majority of its restaurants

**At McDonald's, we're raising the bar on our continuing food journey.**

Over the last two years, we have accelerated the pace of changes to our menu that our guests can feel good about. We understand that now more than ever, people care about their food – where it comes from, what goes into it and how it is prepared.

**March 2015**  
Announced sourcing milk from cows not treated with rBST<sup>1</sup>  
Milk in our milk jugs and Go-GURT™ low fat yogurt is sourced from cows not treated with rBST, an artificial growth hormone

**May 2015**  
New process for searing beef patties  
Changed how quarter pound, hamburger and cheeseburger patties are seared on the grill, helping make burgers juicy

**August 2015**  
Buttermilk Crispy Chicken made with real buttermilk  
Introduced Buttermilk Crispy Chicken Sandwich made with 100% chicken breast filet, real buttermilk and a blend of spices including black pepper, garlic, and onion powder to premium sandwiches and salads

**June 2016**  
Refreshed McDonald's salad blend  
Added Tuscan red leaf lettuce and ribbon-cut carrot curls to the crispy romaine lettuce, baby kale and baby spinach blend added in June 2015

**August 2016**  
New buns  
Removed high fructose corn syrup from buns across the menu, including buns used on Big Macs, Quarter Pounders, hamburgers, cheeseburgers, McChicken sandwiches and Filet-O-Fish

**August 2016**  
New Chicken McNuggets with no artificial preservatives  
Announced Chicken McNuggets now have no artificial preservatives and still do not have artificial colors or flavors

**April 2015**  
Artisan Grilled Chicken with no artificial preservatives  
Introduced Artisan Grilled Chicken made with 100% chicken breast and no artificial preservatives, flav or colors, topped with vinaigrette dressing and made with simple pantry ingredients

**June 2015**  
Real butter on breakfast sandwiches  
Revitalized classic Egg McMuffin sandwich, switching from margarine to real butter<sup>2</sup>, and continuing to use a fresh-cracked Grade A egg on McMuffins

**September 2015**  
Sourcing 100% cage-free eggs  
Committed to sourcing 100% cage-free eggs by 2025 in the U.S. and Canada

**July 2016**  
Completes antibiotics chicken commitment  
Reached commitment to serve chicken not treated with antibiotics important to human medicine<sup>3</sup> nearly a year ahead of schedule

**August 2016**  
New omelet-style and scrambled eggs, pork sausage patty  
Removed artificial preservatives from breakfast pork sausage patty, omelet-style eggs and the scrambled eggs served on breakfast platters. These items still do not contain artificial colors or flavors

**Mid-2018**  
New Quarter Pounder burgers made with 100% fresh-beef patties  
Served hot off the grill, new fresh-beef patties for every Quarter Pounder burger will be cooked hot and juicy, right when you order – and like all McDonald's burgers, still with no fillers, preservatives or additives

**We can't wait to show you what's next.**

1. No significant difference shown between rBST treated and non-rBST treated cows.  
2. Quality of margarine and butter.  
3. Further to use a separate, third-party analysis that is not our best practices, as required by law.

© McDonald's USA

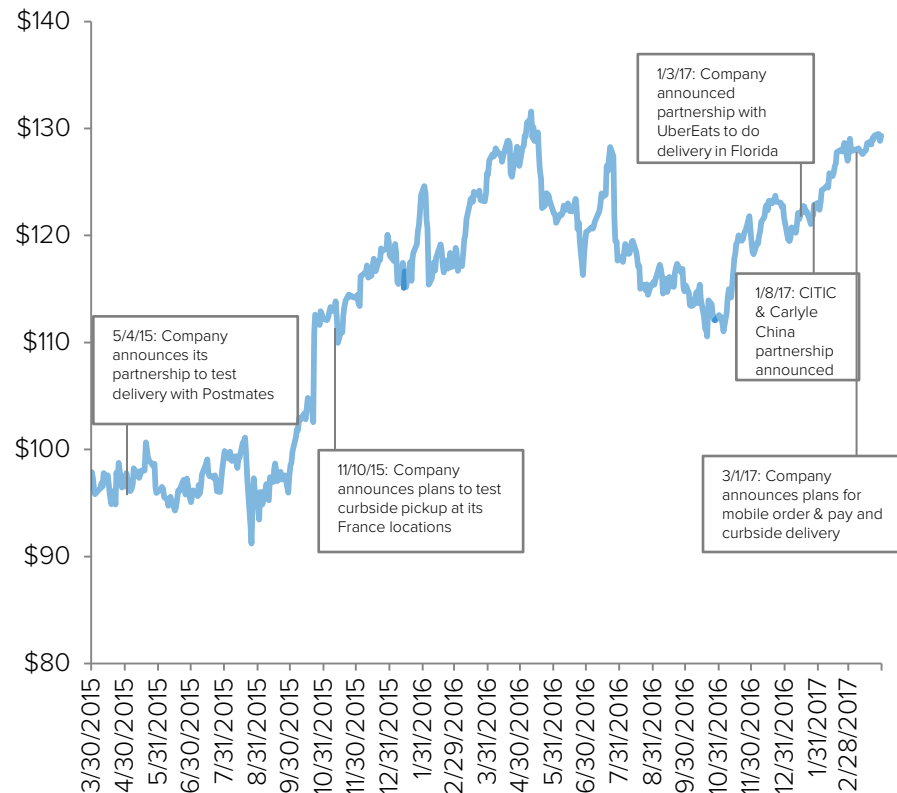
# “REDEFINING CONVENIENCE THROUGH DELIVERY”

(FROM APRIL 11, 2017 BLACK BOOK)

- Delivery is a \$100B market and is arguably the most significant disruption in the restaurants space in recent history. In the Company’s top 5 markets (US, France, UK, Germany, and Canada), nearly 75% of the population lives within three miles of a MCD restaurant and 85% live within five miles (this translates to one billion customers living 5-10 minutes from a MCD unit), so convenience and speed should be an advantage for MCD.
- The Company’s most developed delivery markets are in Asia and the Middle East, where the top restaurants generate up to 40% of sales from delivery.
- According to management, last year, delivery represented nearly \$1B in sales across both Company and franchise restaurants and now over 3,500 MCD units around the world provide delivery services.
- In select markets, MCD owns a delivery service model where they control all aspects of the delivery process, but the brand is also experimenting with different models, including partnering with third-parties for ordering and fulfillment.

**HEDGEYE** – Unfortunately, the third-party options that are available to the Company currently suggest that sales will come at lower margins (but are less capital intensive). While using third-parties allows MCD to get into the market quickly, it is not a sustainable long-term business model. Ultimately, to be successful in delivery, MCD will need to totally control their delivery network and take advantage of all of the important data that will come with such an expansive network.

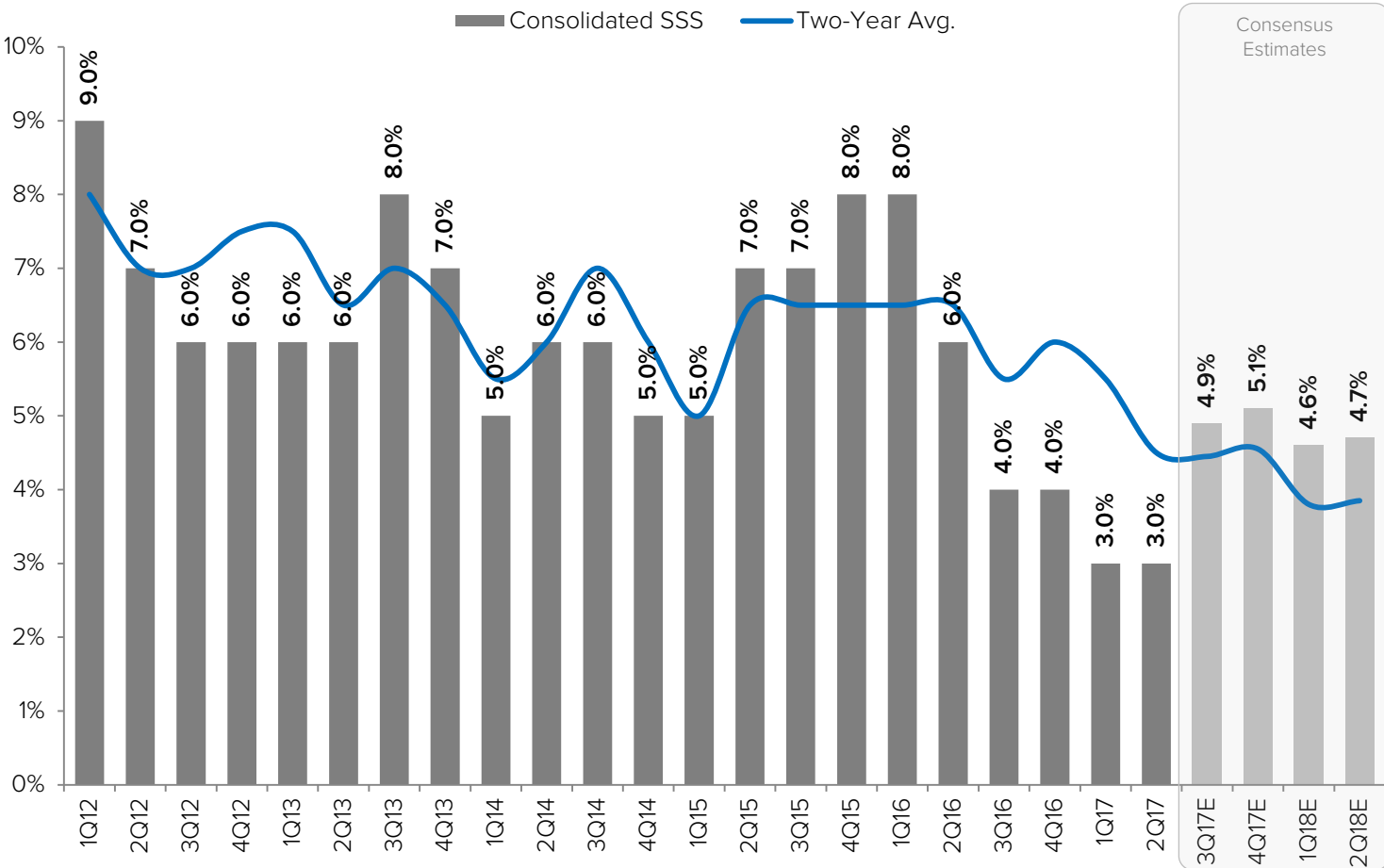
## MCD 2-Year Price Progression





**SHORT BENCH: STARBUCKS (SBUX)**

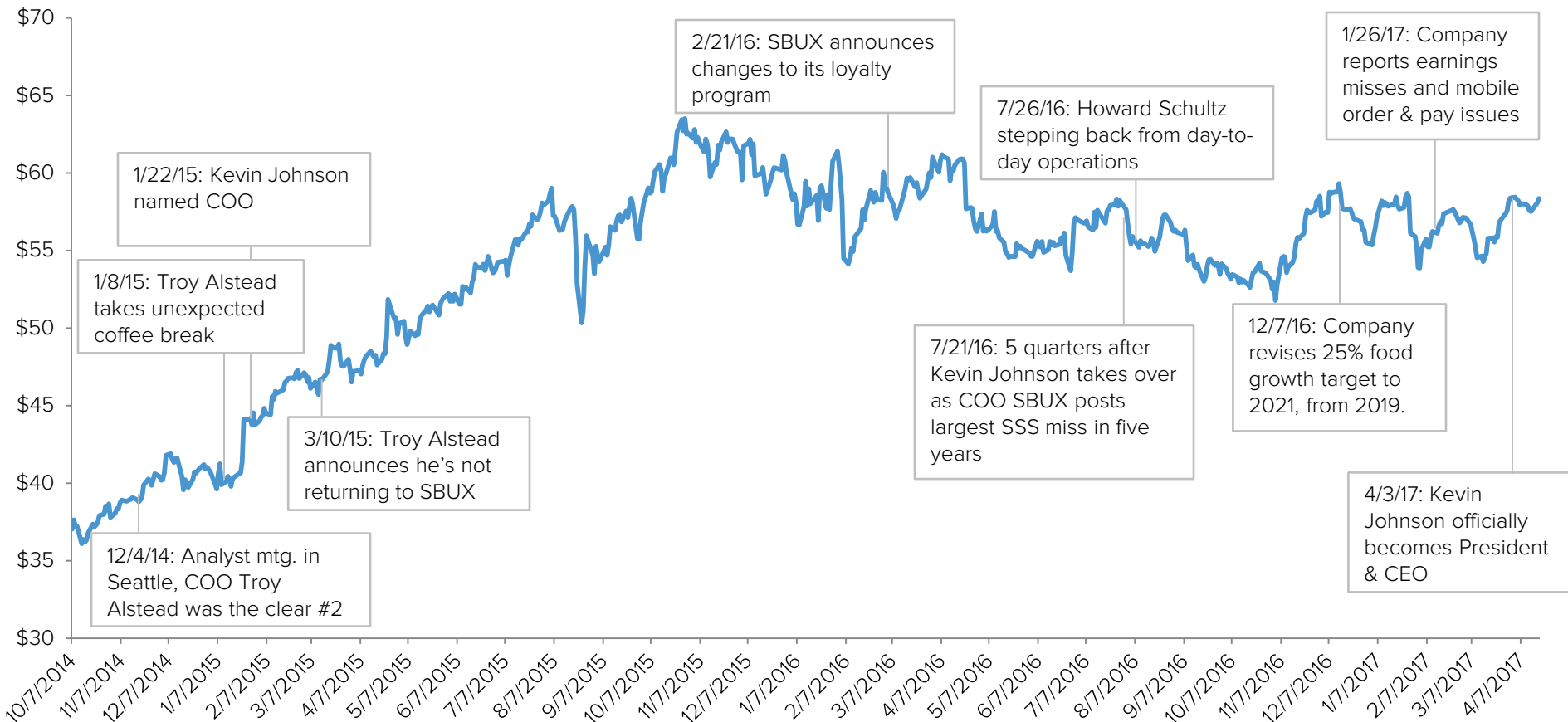
# SBUX CONSOLIDATED SSS



- Consolidated same-store stores continues to slow, showing a slowing topline across the business.
- Most recently, the Company reported SSS of +3%, well below Consensus +3.7%.

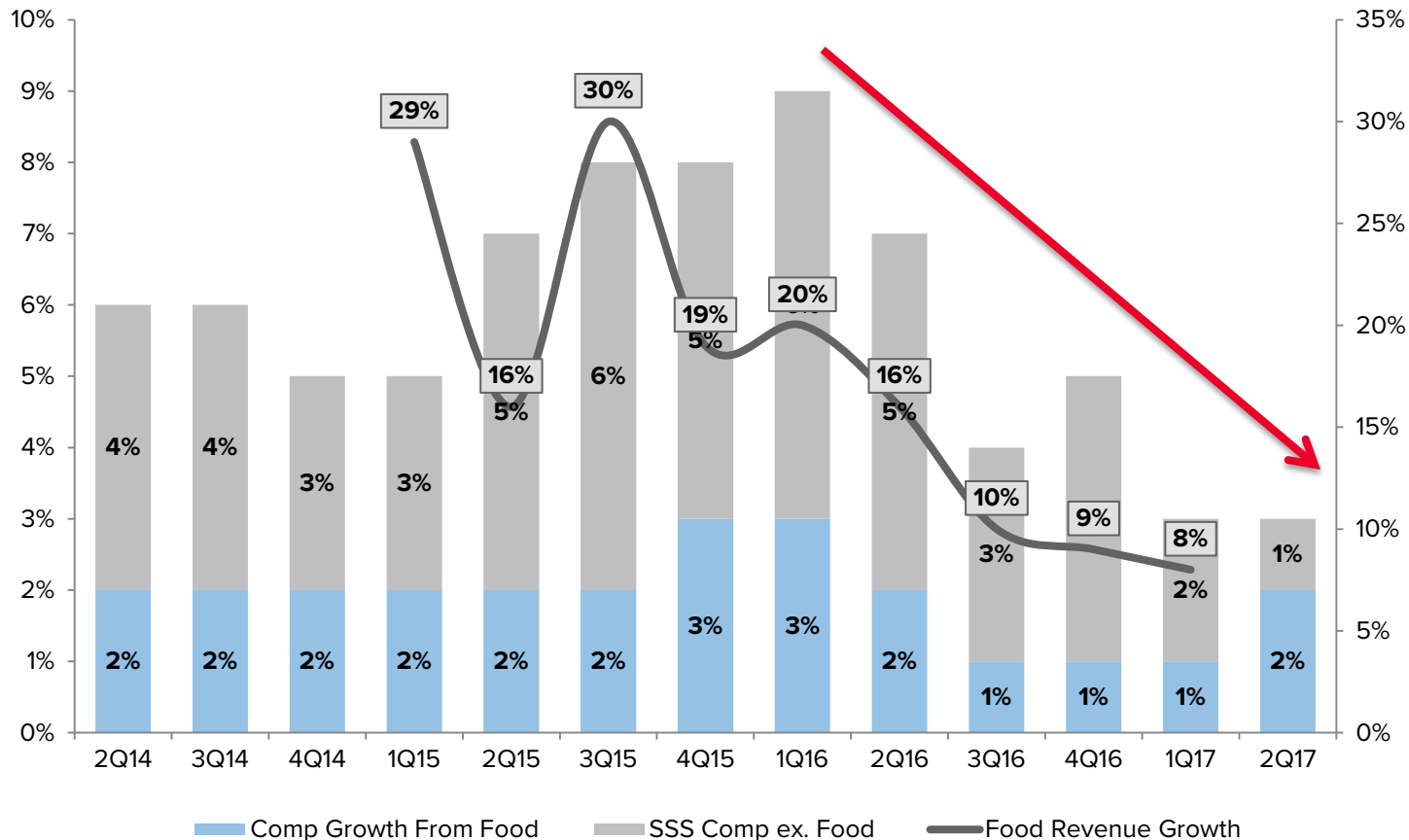
# NEW CEO POSES RISK FOR COMPANY

(From October 13, 2016 Black Book, updated)



# FOOD GROWTH CONTINUES TO SLOW...

(From October 13, 2016 Black Book, updated)



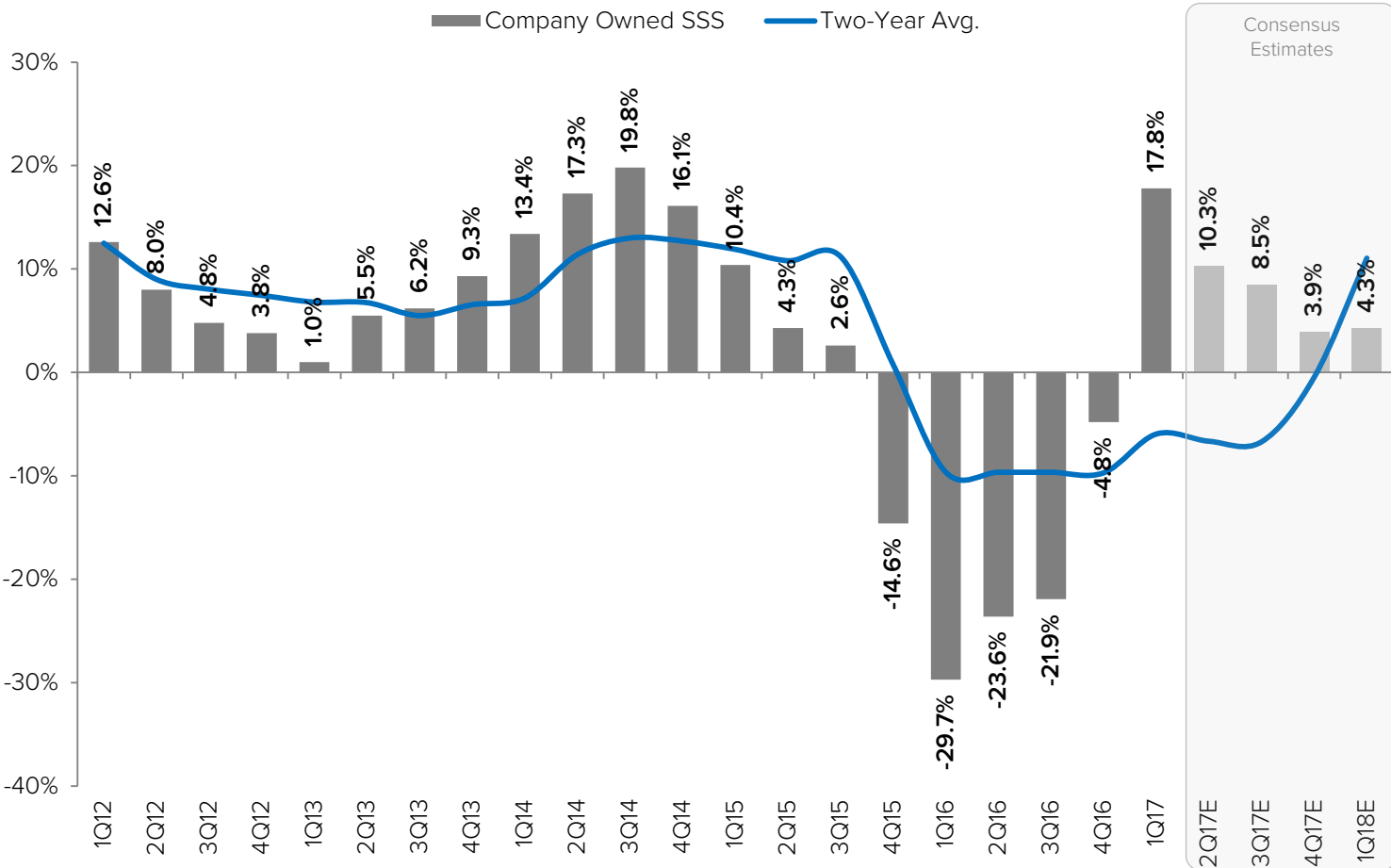
- 1Q15 was the first quarter SBUX began explicitly stating their food revenue growth, 2Q14 through 4Q14 were stated to be DD
- Food as a percent of the total comp has been in decline as well. Since hitting its peak of 40% in 1Q15, it fell to 25% in 3Q16, and struck a low of 20% in 4Q16.
- Food's percentage of the comp has surged to 67%, but it may not be for the right reasons.
- SBUX management continues to believe food is their new ahead, with goals of making food 25% of revenue in the next five years.





**BEST IDEA: SHORT CHIPOTLE (CMG)**

# CMG COMPANY-OWNED SSS



- The story line for the stock is centered around the progression of comp improvement. Bulls may be suggesting that CMG will beat Q1 comp expectations, but it is still not projecting a meaningful growth in the two year, as depicted in the previous chart. Comp growth and AUV growth, are critical to CMG regaining its best in class margin, but with so many more options than two years ago, do consumers truly miss Chipotle?

# COMPETITION BETTER THAN IT USED TO BE

*CMG 2016 10-K: “In recent years, competition has increased significantly from restaurant formats like ours that serve higher quality food, quickly and at a reasonable price. We believe that this competition has made it more challenging to maintain or increase the frequency of customer visits...”*

## Select Public Competition



## Select Private Players



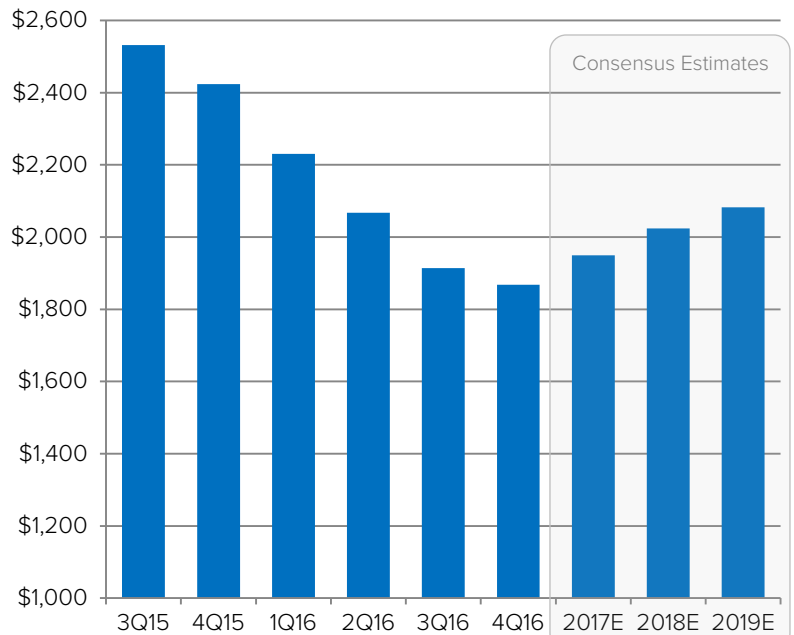
## COMPETITION IS STRONGER THAN IT WAS EVEN TWO YEARS AGO

The 30% of consumers that left chipotle in 1Q16, didn't just stop eating lunch/dinner, they went elsewhere, which gave them the time to realize how many other quality offerings there are across the country. Concepts such as sweetgreen and Dig Inn, although still small in numbers pack a punch when it comes to superior quality and value. Mexican competition hasn't given up either, private companies such as Dos Toros have also encroached on CMG's turf, nearly copying the menu completely. CMG is not the unicorn it used to be, and it is time it starts receiving a more realistic multiple for its lackluster potential.

# \$2.5M AUV IS A PIPE DREAM, THE \$\$\$ HAS GONE ELSEWHERE

*Lines are blurring between casual dining, fast casual and quick service, as price wars driven by deflation have represented a cloud over the space for the last two years. We don't believe the possibility of CMG getting back to a \$2.5M AUV is very high given competitive encroachment.*

## CMG Average Unit Volume (AUV)



- Mark Crumpacker was quoted in the AP in September 2016, saying people have started going to “places like McDonald’s” and “Chipotle knockoffs.”
- McDonald’s (MCD) starting to use fresh beef in their Quarter Pounders is a game changer for the QSR chain, that could materially elevate their ability to compete with the fast casual restaurants. As they build out this initiative it is conceivable to believe that they will start to make the rest of their beef products with fresh, never frozen beef.
- With behemoths such as MCD and more nimble chains getting more in tune with consumer preferences, it is very unlikely, CMG can recapture \$2.5M AUV’s.

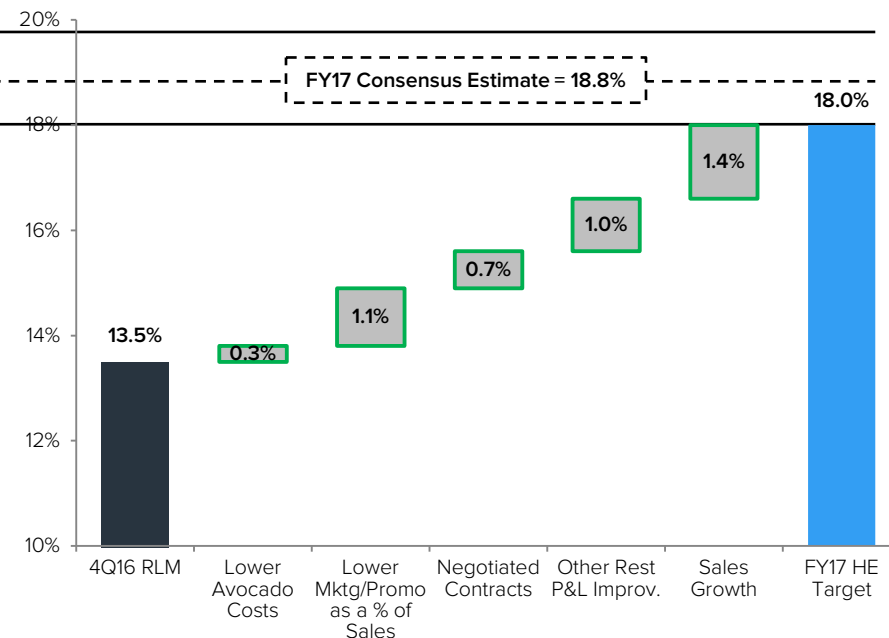
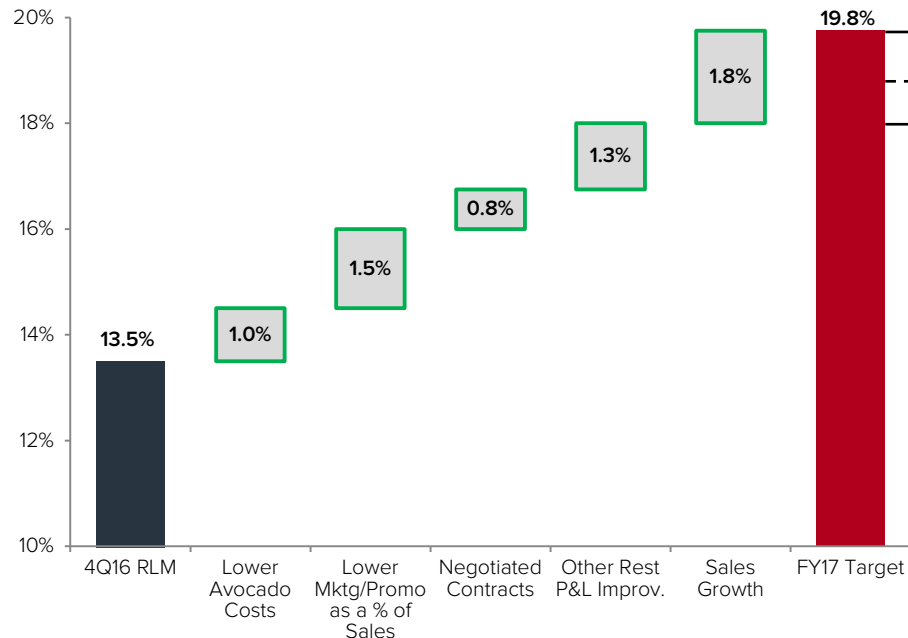


# DIFFERENT OPINIONS ON HOW THIS WILL UNFOLD

(FROM APRIL 11, 2017 BLACK BOOK)

## CMG Management

## Hedgeye



## CMG STARTING THE RACE FROM THE BACK

Getting back to their peak restaurant level margin (RLM) of 27.2% in FY14 will be difficult, especially with lower AUV's and structurally different costs that are attributable to food safety measures and incremental advertising that have been implemented.



**BUFFALO  
WILD  
WINGS.**

**BEST IDEA: LONG BUFFALO WILD WINGS (BWLD)**



# KEY POINTS STILL RING TRUE! (FROM OCTOBER 25, 2017 BLACK BOOK)

1

## **BATTLE WITH THE ACTIVIST IS ESCALATING**

Management has yet to budge in its battle with the activist and the war is heating up. On August 17, 2016, Marcato sent a detailed letter to BWLD's board of directors, followed by another letter on October 13<sup>th</sup>, in which they threatened legal action if The Board continued to ignore their requests for pertinent shareholder and Company information. It seems as if BWLD has poked the bear one too many times, and now the bear is forced to show its teeth, and The Board's initial reluctance could be viewed as them not working for the benefit of the shareholders and the overall business.

2

## **MANAGEMENT'S INABILITY TO LEAD IS APPARENT**

BWLD's lack of leadership is evident in the Company's lack of direction, as it has made irrational investments in other companies that have stalled. Additionally, the debacle that was the Analyst Day was another example of management's lack of leadership, as they failed to provide shareholders with a level of specificity necessary to maintain confidence in the business.

3

## **HISTORY WILL LIKELY REPEAT ITSELF | DRI CASE STUDY**

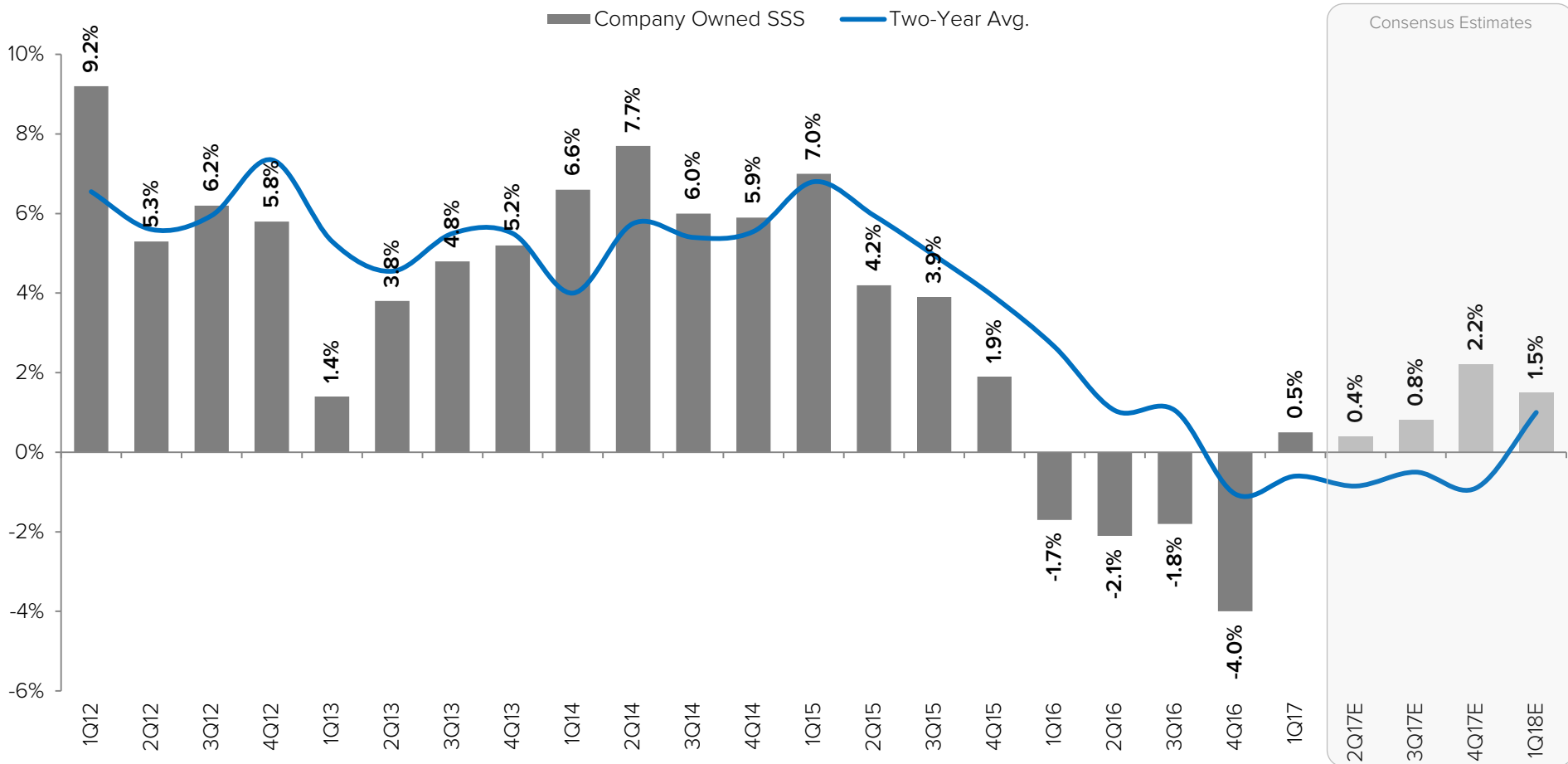
Like the Darden situation, the evidence against the current BWLD management team is substantial. The road to an activist victory is often not linear, there will be bumps along the way. We are confident we know how this is going to end!

4

## **A WIN-WIN SCENARIO ON THE LONG SIDE**

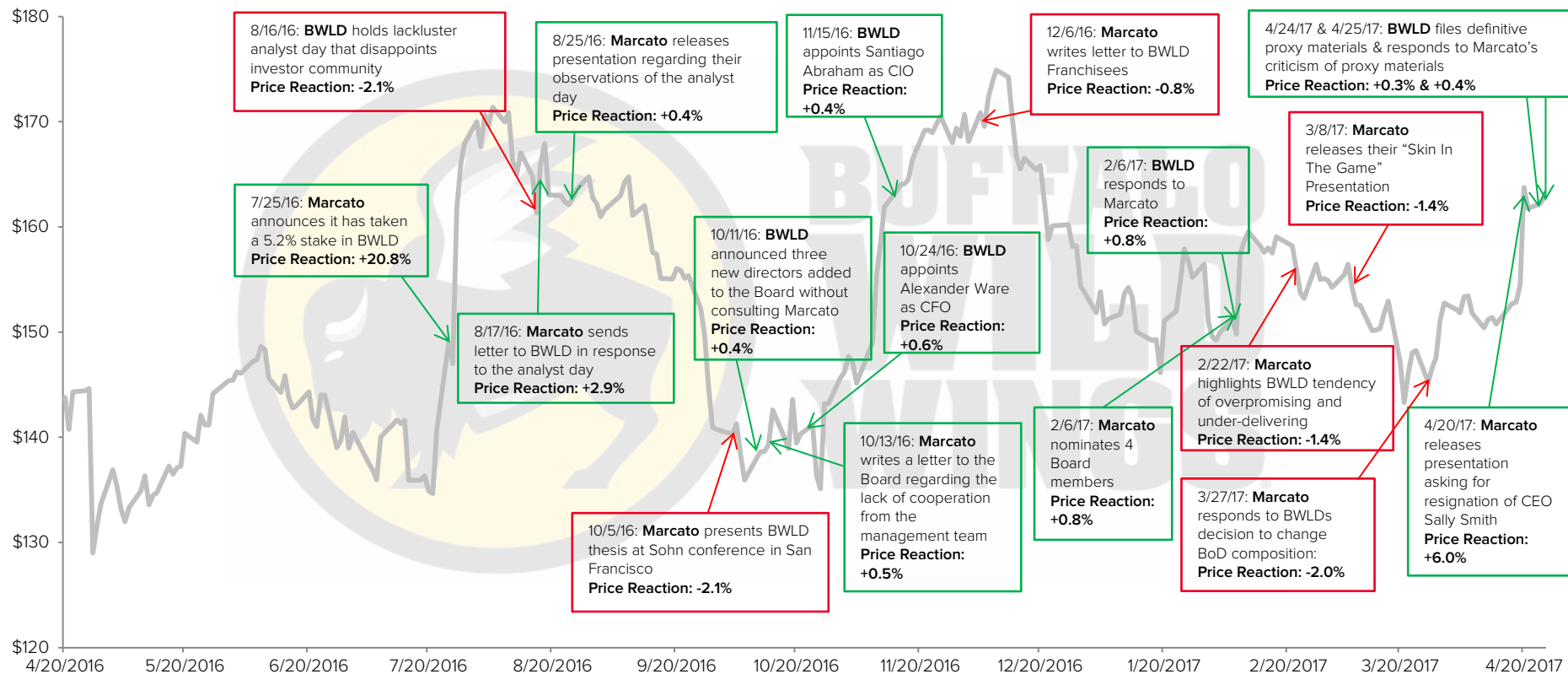
If the fundamentals turn, you win. If fundamentals get worse, Sally will ultimately lose her job, and the activist/shareholders win. As expressed in our ["Dear Sally" note](#), as the market perceives the activist gaining control, the stock price has traded higher, and the same can be expected if the fundamentals turn back on-course.

# BWLD COMPANY-OWNED SSS



# BWLD PRICE REACTION

## SIGNS OF ACTIVIST VICTORY OFTEN YIELD POSITIVE REACTION



(Percentage reaction based on first full trading day post announcement, except for 7/25/16, which incorporated five trading days due to significance of announcement)



## A CUT ABOVE

**BEST IDEA: LONG U.S. FOODS (USFD)**

January 19, 2017

# KEY POINTS

1

## **MARGIN EXPANSION THROUGH MULTIPLE AVENUES**

Pruning low margin distribution agreements and growing their private label sales have been two major initiatives to improve the profitability of the Company. Strategic national chain exits occurred from 2Q14 through 2Q16, while at the same time they have been growing the penetration of private brands which have expanded from 30% of sales in 2010 to 33% in 2016. These core initiatives, coupled with further penetration of customers' menus, and technological enhancements to improve USFD operations, as well as those of their customers, are meaningful contributors to the growth in profitability.

2

## **GROWTH WITH INDEPENDENTS AND HEALTHCARE SEGMENT**

One of USFD's biggest advantages is their positioning within the restaurant industry, dedicating themselves heavily to the independent and regional operators versus large/lower margin national chains. In addition to the profitability difference, the independents are faring better from a sales growth perspective than national chains, making it a stronger customer base. USFD's growth in the healthcare segment is also notable; with the recent signing of a deal with Brookdale Senior Living, they continue to expand in this channel.

3

## **DEBT BURDEN IMPROVING, ALLOWING FOR MORE M&A**

Pre-IPO net debt/EBITDA was 5.3x, USFD used all of their \$1.1 billion in IPO proceeds to lower their leverage, and have renegotiated many of their terms putting them in a much better financial position. As of the latest quarter they are down to a leverage multiple of 3.8x. Tuck in acquisitions are going to continue to be a major factor for both top line growth and profitability, of which they have done five in roughly the last year with a combined run rate of \$450-\$500 million in net sales. In our opinion a major deal looms in the industry, that will create a more formidable #2.

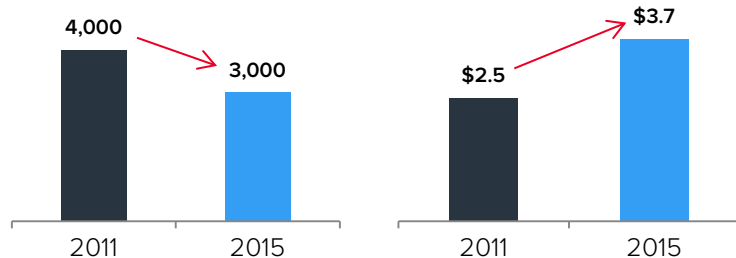
# E-COMMERCE & SUPPORT SERVICES

## “MADE EASY”...TO IMPROVE THE CUSTOMER EXPERIENCE

- The Company sees significant growth in e-commerce and the adoption of mobile technology by foodservice operators, and believes that investing in these capabilities will give them a competitive advantage.
  - Their e-commerce tools and mobile solutions make it easier for customers to conduct transactions with USFD, subsequently increasing customer adoption and loyalty.
  - USFD’s mobile and e-commerce platforms allow customers to easily place orders, track shipments, view product information, and verify orders once they are delivered.
- The Company is increasing sales force efficiency through e-commerce offerings.
  - Net sales dollars per sales associate increased by over 30% from 2012 to 2015 (\$4 million to \$5.4 million).
  - In fiscal 2015, \$15B in net sales were generated through USFD’s e-commerce platforms, representing 67% of total sales compared to 52% in fiscal 2011. Comparatively, e-commerce accounts for only 8% (2Q16) of Sysco’s sales.
  - Percent of sales from e-commerce to independent restaurants has risen from ~8% in 2011 to ~51% in 2016.
- Product Innovation: USFD supports their industry-leading product innovation with high-impact nationwide launches via Scoop.
  - Over 400 product launches
  - Majority of products featured are private label brands
  - \$1.2 billion in cumulative new sales
  - 3 Scoop launches per year (20-25 items per launch)
  - Over 50% customer trial, with a 7% prior customer retention rate

Number of Local Sellers

Average Route Size (\$M)






# PRECEDENT TRANSACTIONS / POSSIBLE TARGETS

## Recent USFD Deals

Company	Location / Date	Annual Sales (\$mm)	Strategic Rationale
 <b>DIERKS WAUKESHA</b> The Food Service Source®	Wisconsin / Dec. 2015	\$120	Share growth with independents
 <b>CARA DONNA</b> All The Ingredients For Your Success	Massachusetts / March 2016	\$107	Share growth with independents
 <b>Freshway FOODS</b>	Ohio / May 2016	\$130	Produce processing
 <b>JERACI FOODS</b> QUALITY FOODS FROM AROUND THE WORLD	New York / Sept. 2016	\$26	Share growth with independents
 <b>SAVE ON SEAFOOD</b>	Florida / Oct. 2016	\$80	Strengthen seafood sourcing

## Select Deals in the Space

Date	Target	Acquirer	Annual Sales (\$mm)
Feb. 2016	 <b>NORTH STAR SEAFOOD, LLC</b> FLORIDA'S FRESHEST SEAFOOD	 <b>Sysco</b>	\$128
June 2016	 <b>MT FOOD SERVICE</b>	 <b>thechef'sWAREHOUSE</b>	\$55
Sept. 2016	 <b>Kelley's</b> A Great Taste In Generation™	 <b>KEITH CO.</b>	NA
Oct. 2016	 <b>Kinnealey</b> QUALITY MEATS	 <b>PFG</b> Performance Food Group	\$70
Oct. 2016	 <b>Black River</b> PRODUCE	 <b>Reinhart</b> FoodService.	\$75

## Possible Targets

 **BIRITE** FOODSERVICE DISTRIBUTORS  
California  
Est. Sales: \$310mm

 **MERCHANTS FOODSERVICE**  
Mississippi  
Est. Sales: \$650mm

 **PFG** Performance Food Group

 **Cheney Brothers** C-B-I  
Florida  
Est. Sales: \$1.6bn

 **Shamrock Foods**  
ARIZONA  
Est. Sales: \$3bn

 **SAVAL** FOODSERVICE  
Maryland  
Est. Sales: \$125mm

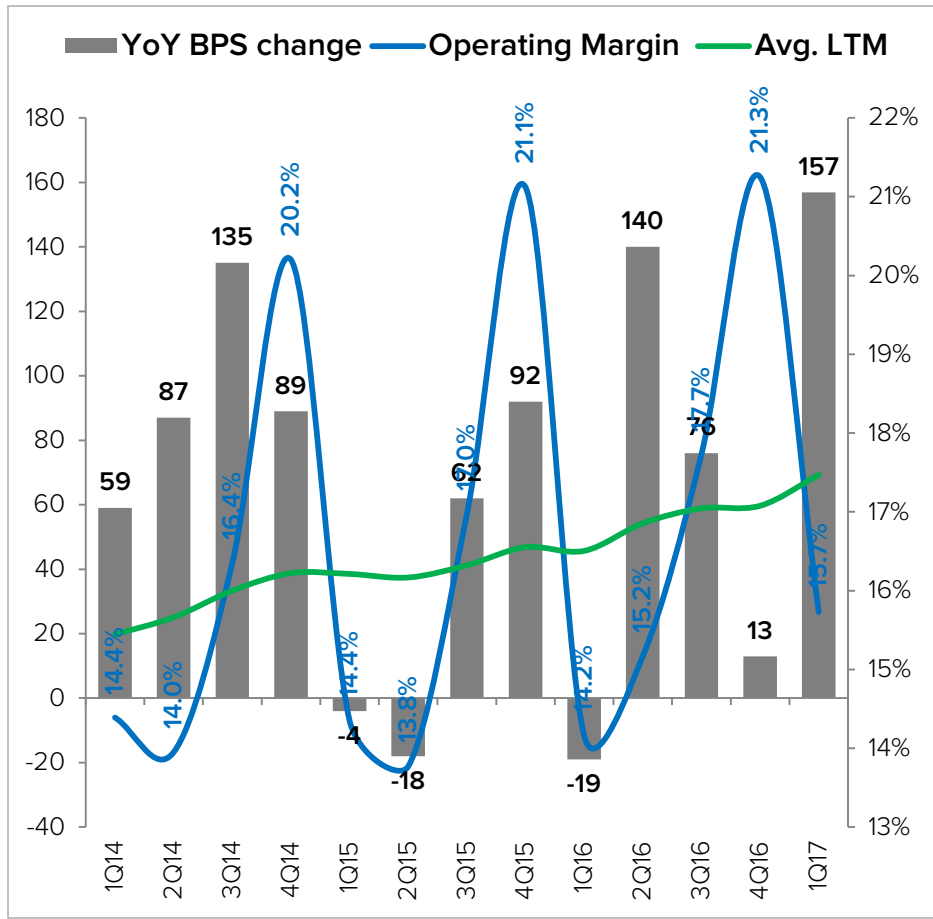
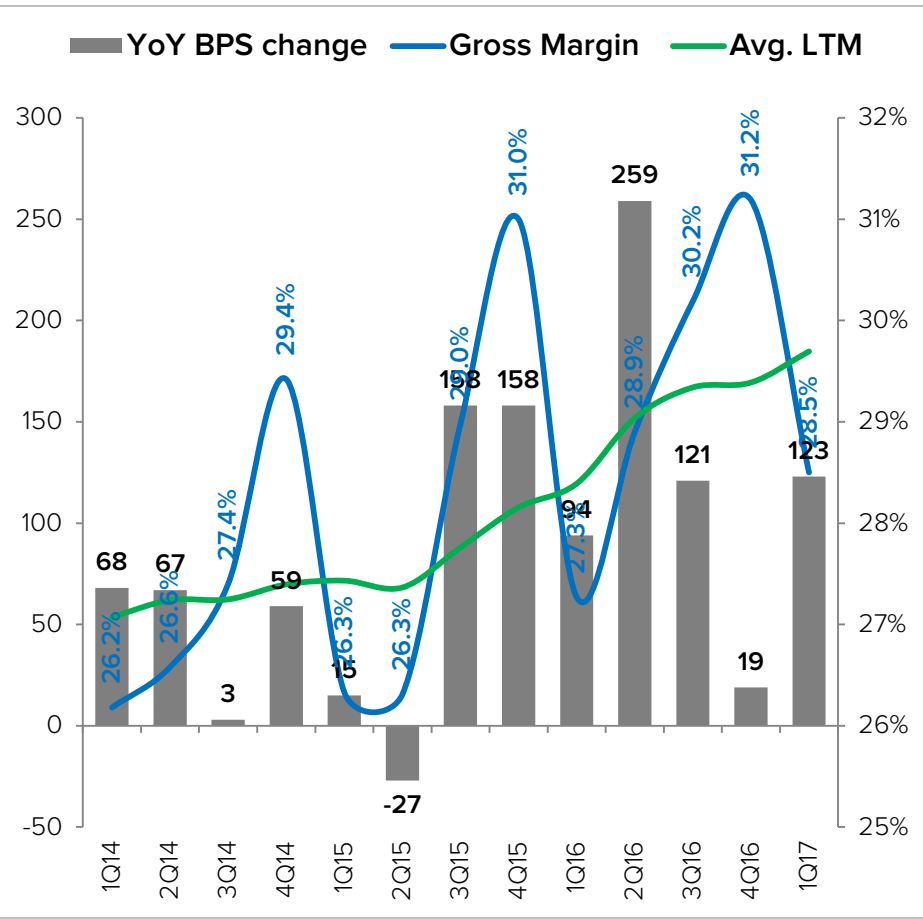
 **Labatt** FOOD SERVICE  
Texas  
Est. Sales: \$1bn

Virginia  
Est. Sales: \$16.7bn

 **FOOD SERVICES OF AMERICA**  
Arizona  
Est. Sales: \$2bn

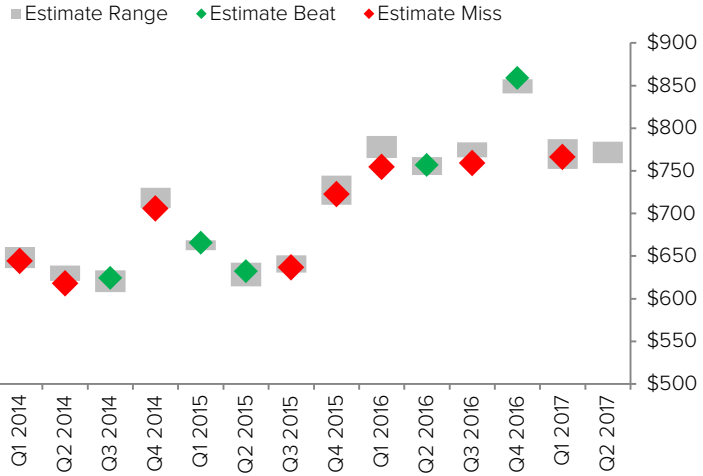
 **KEITH CO.**  
Texas  
Est. Sales: \$3bn

# PF: STRONG ADJ. GROSS/OPERATING MARGIN EXPANSION

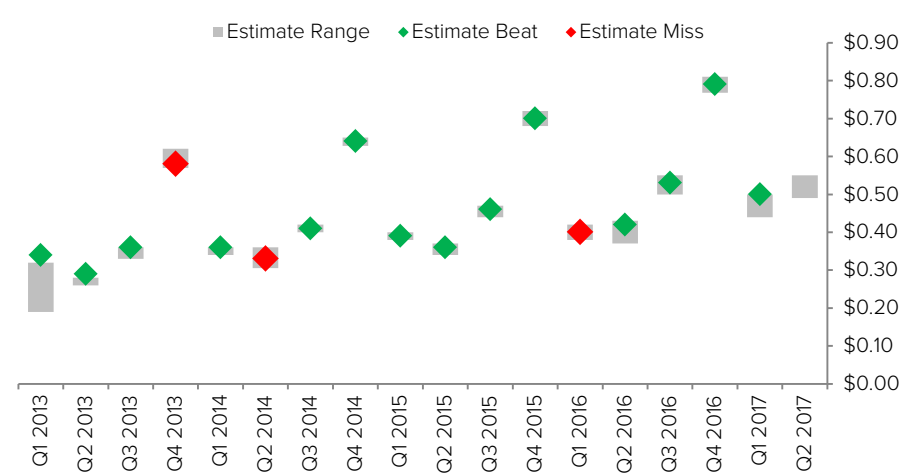


# PF: CONSENSUS EXPECTATIONS BEAT / MISS & PRICE IMPACT

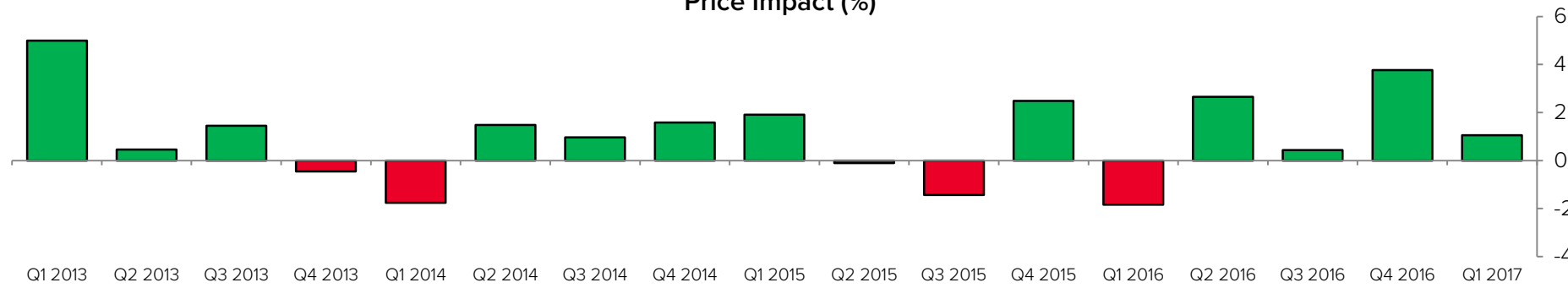
## Beat / Miss: Revenue



## Beat / Miss: EPS



## Price Impact (%)



FOR MORE INFORMATION, CONTACT US AT:

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