



## THE BIG WINNER (AND LOSER) STOCKS IN THE RESTAURANT INDUSTRY

### CONVERSATION WITH JONATHAN MAZE

August 30, 2018

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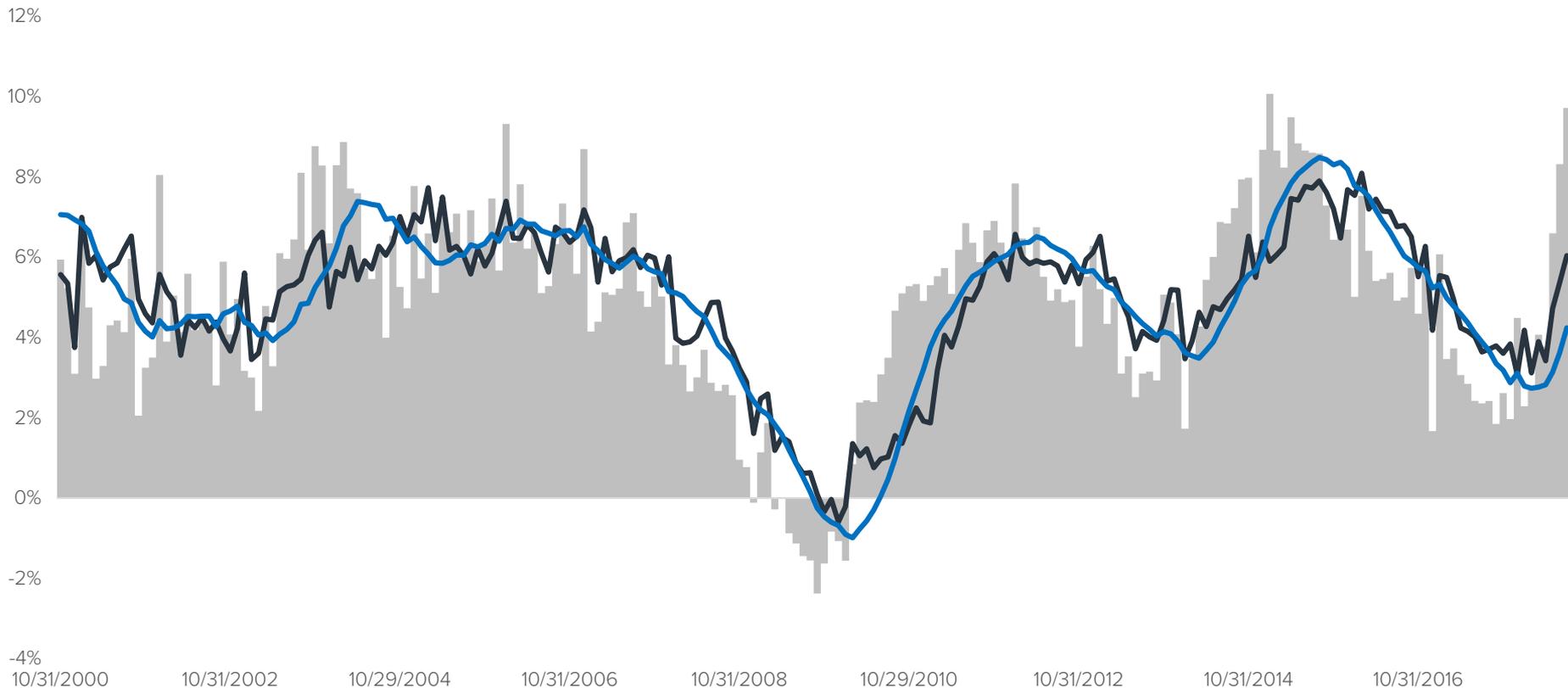
# WHY ISN'T RESTAURANT TRAFFIC STRONGER?



# RETAIL SALES: FOODSERVICE AND DRINKING PLACES

Retail Sales: Food Service & Drinking Places (SA)

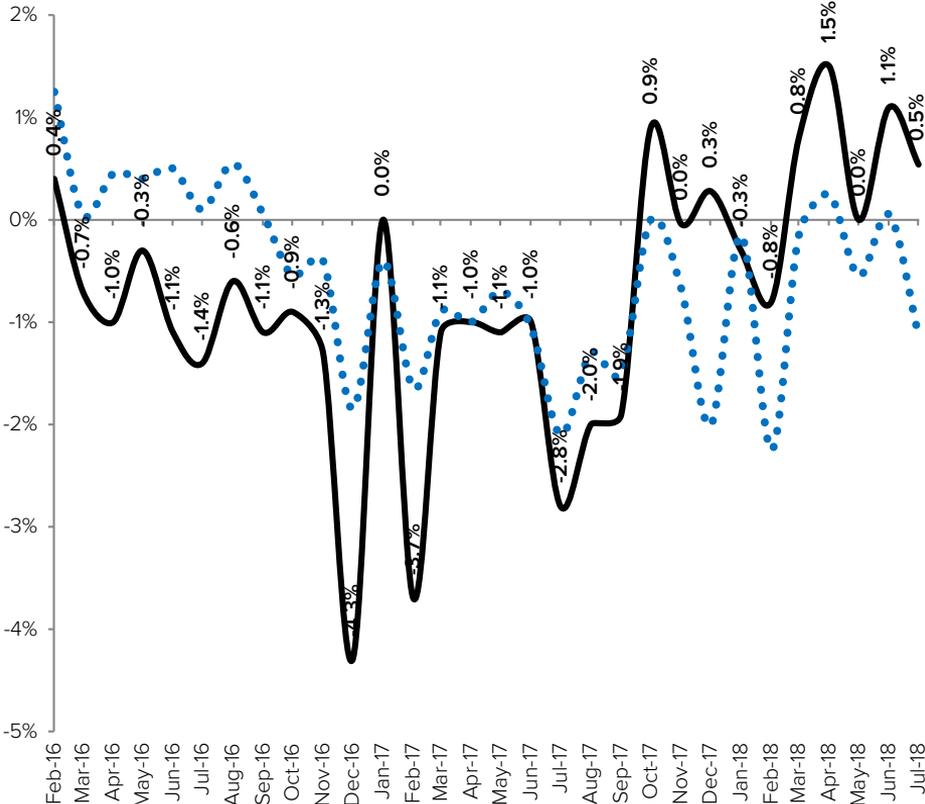
YoY % Change   2-Yr Avg.   LTM Average



# BLACK BOX COMPARABLE SALES AND TRAFFIC

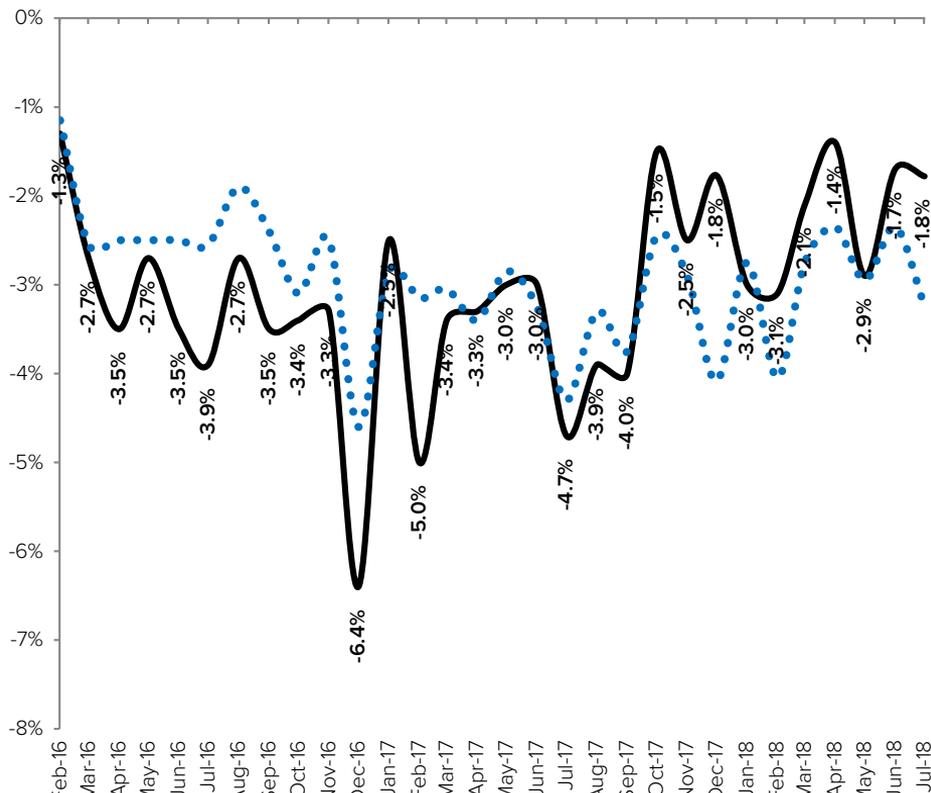
## Black Box Comparable Sales

— Same-Restaurant Sales    ●●●● 2-Year Average

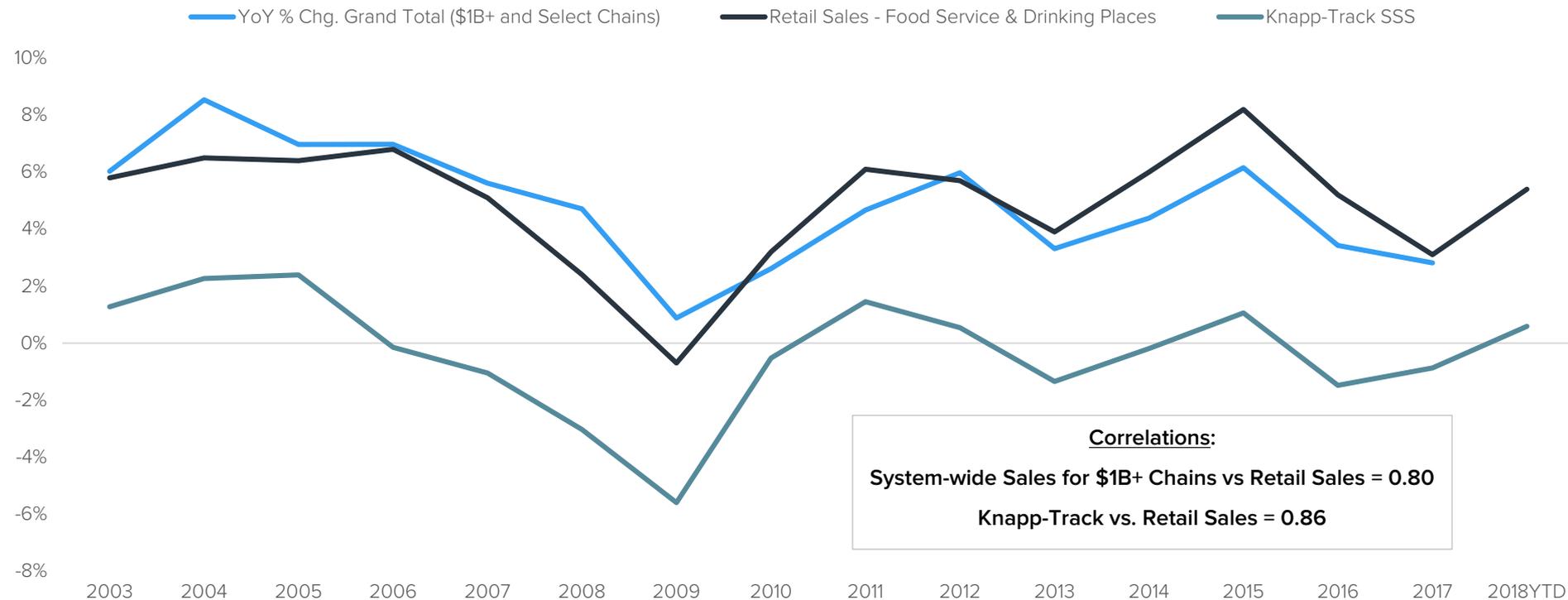


## Black Box Comparable Traffic

— Same-Restaurant Traffic    ●●●● 2-Year Average



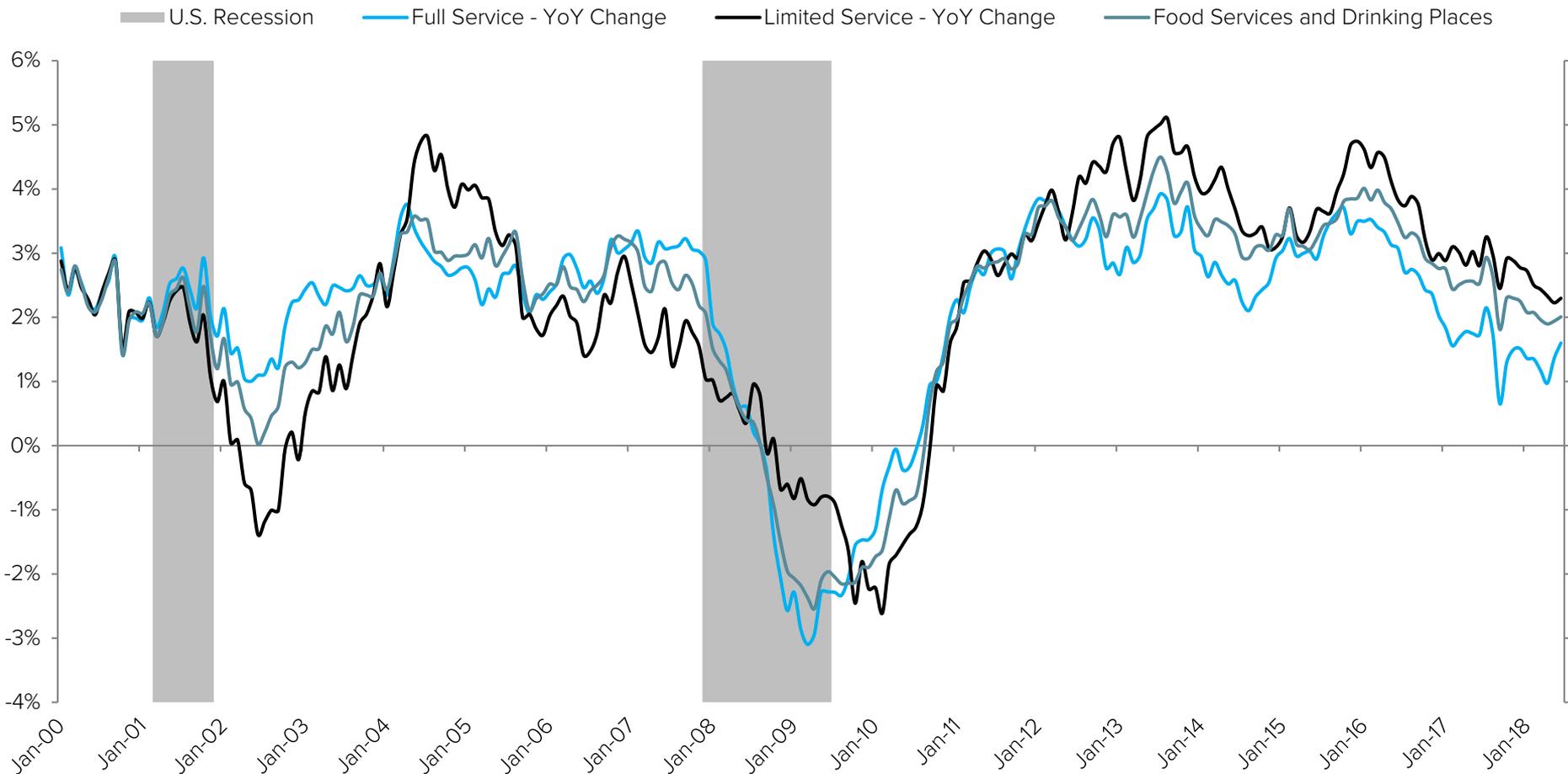
# CHAINS HAVE HISTORICALLY LED THE CHARGE!



## AND RECENT KNAPP-TRACK/BLACK BOX DATA INDICATES THAT THAT TREND REMAINS!

The \$1B+ and select chains included in this analysis represent roughly \$230B in system-wide sales. According to The NPD Group, Independent restaurant units declined by 3% in 2017 to 346K, which still represents over half of the total commercial restaurant units, which currently stands at roughly 647K (a 2% decline in total). Biggest winners in unit growth were fast casual concepts, which increased 4% to ~25K units. Independents have less resources and capital to withstand tougher times which makes the prospect of slowing GDP growth, lapping of the tax reform bump and widespread labor shortage/inflation a particularly difficult outlook for independents.

# RESTAURANT EMPLOYMENT GROWTH

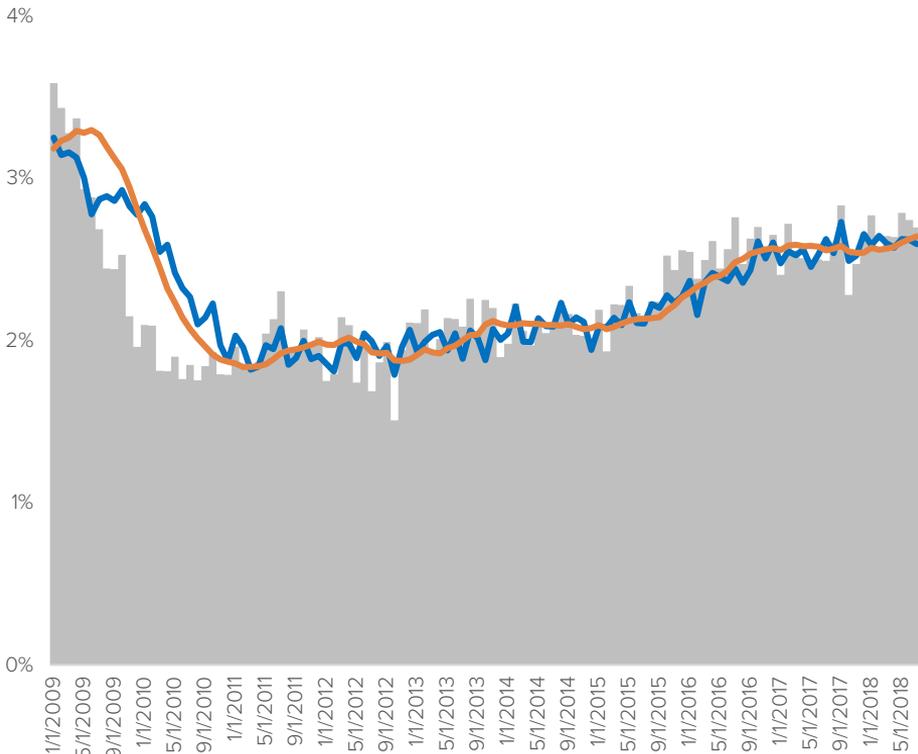


# WAGE INCREASES ARE A BLESSING AND A CURSE

## Total Private Sector

Average Hourly Earnings Growth

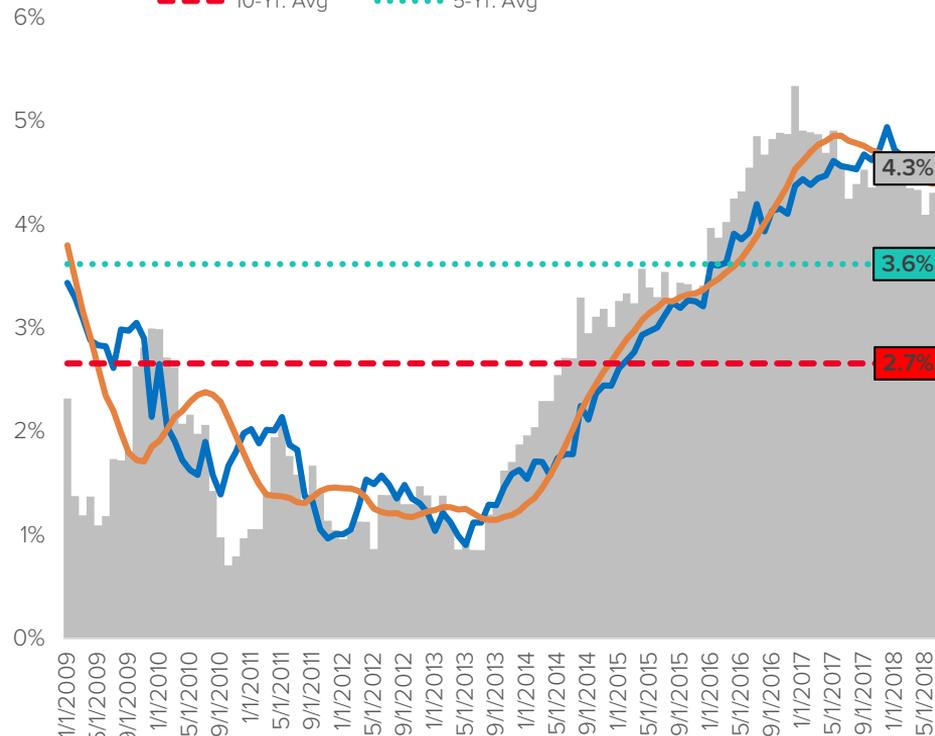
YoY % Growth 2-Yr. Avg LTM Avg.



## Restaurants & Other Drinking Places

Average Hourly Earnings Growth

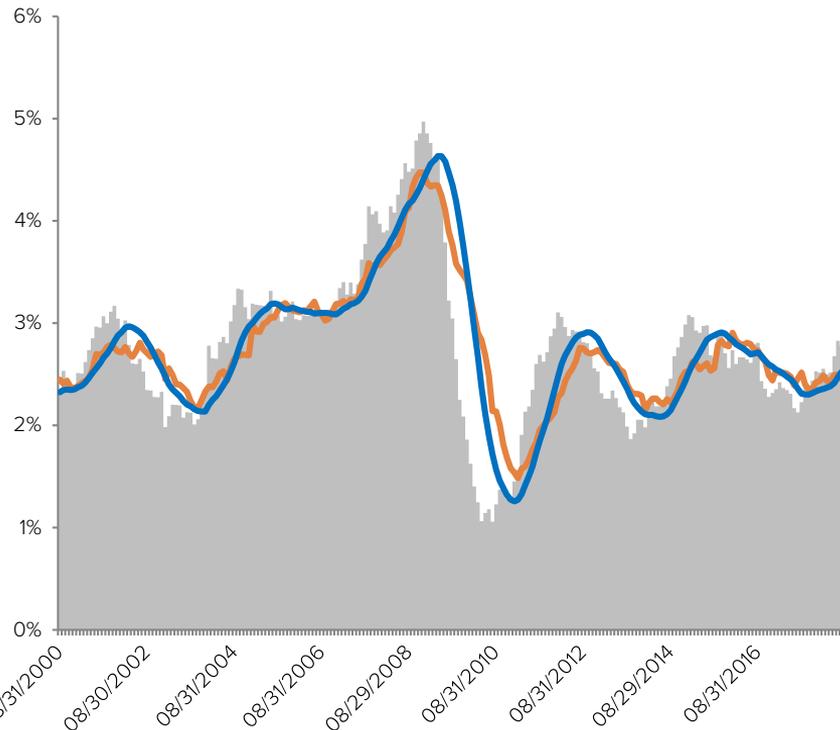
YoY % Growth 2-Yr. Avg LTM Avg.  
10-Yr. Avg 5-Yr. Avg



# RESTAURANTS CONTINUE TO PRICE AGGRESSIVELY

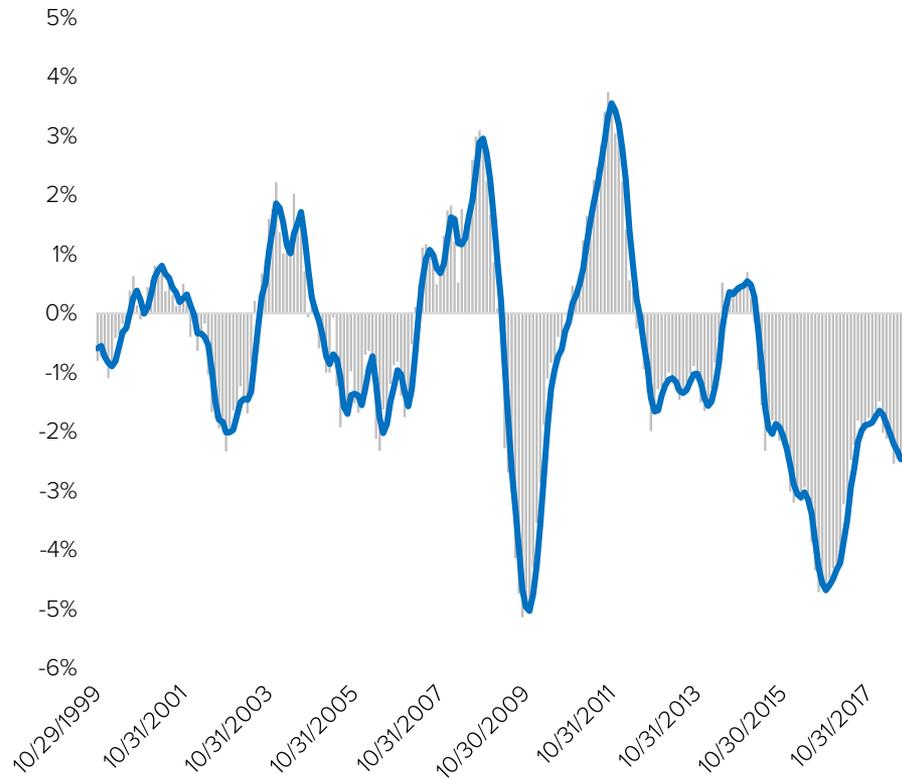
## CPI – Food Away From Home (FAFH)

YoY % Change    2-Yr Avg.    LTM Average



## FAH vs. FAFH Inflation Differential

FAH vs FAFH inflation Differential    3-Month Average



# DELIVERY IS CHANGING THE RESTAURANT INDUSTRY

**DRI** – “We are still very attracted to the large party delivery catering in Olive Garden where our average order is over \$300. That makes a lot more sense for us to market and pursue than running around delivering \$10 entrees at this point in time. So for us, it's a wait-and-see. We're very engaged in the process with all the third-party delivery companies. And we're very engaged with our own activity around that. So it's -- to us, it's so let's see how this thing develops.”

**YUMC** – “In November 2017, we launched KFC Delivery Prime, which offers our members unlimited free delivery for 30 days at the subscription fee of CNY 18. This program is limited to orders placed through our brand app or website only. Thus, it helped drive traffic to our own channels. We believe our digital and delivery capabilities provide a strong foundation for future growth.”

**DIN** – “In fact, 24% of Americans order to go or delivery 2 times each week, resulting in 44% of all restaurant dining occasions being enjoyed off-premise.”

**WING** - “We conducted our initial delivery test in Las Vegas during the second quarter of 2017. The results of this initial test were very positive. Delivery in that market has sustained a 10% sales lift, and most of the sales are incremental.”



**EAT** – “We also recognize the increasing importance of delivery to our guests. We've learned a lot over the last 10 years since we've developed our own delivery model with Maggiano's. We've driven year-over-year growth every year since we started. And now we're taking the Maggiano's knowledge as well as work we're doing with multiple third-party vendors, like Amazon, who can leverage our shared Olo platform to develop the most efficient model that delivers a great off-premise Chili's experience. And just like with to-go, once we get the model right, we'll aggressively drive that daypart.”

**MCD** – “Delivery orders tend to surpass average check size by 1.5x to 2x. And with high customer satisfaction, we are seeing solid repeat business from those who try it. During the fourth quarter, delivery gained traction and emerged as a meaningful contributor to our comparable sales in several of our largest markets.”

**TXRH** – “We are not chasing delivery”

**RRGB** – “we still see no evidence that growth and delivery is having a significant impact on dine-in frequency and, as such, are comfortable in the incremental profitability of these sales.”

**CAKE** – “We deployed point-of-sale integration with our main delivery provider, which is driving operational improvements and efficiencies in the restaurants while enhancing the guest delivery experience.”

**JACK** – “We're now delivering Jack in the Box food from nearly 63% of our system. And we're expecting additional restaurants to begin offering delivery over the course of the year. We continue to see an incremental sales lift in markets where delivery is offered.”

**BLMN** – “In 240 of our restaurants, as you know, we are doing it ourselves. And we have really focused on them to get this exactly right, because the volumes are such that you've got to make sure that you nail the in-store and also the delivery expectations on timing. We feel like we're getting really good at that and so we anticipate rolling it -- starting rolling it into more the back half of the year. But those will be our own delivery system. We are opportunistically working with other third-party delivery. But we do think there's a role for those, but that would exist in a hybrid system.”

**BLMN** – “Over time, off-premise has the potential to reach 25% of total restaurant sales. We currently have 240 restaurants that offer delivery and are fine-tuning the staffing and operations to ensure that the off-premise experience exceeds expectations.”

**WEN** – “The economics have proven to be worthwhile as early reads indicate that delivery orders are highly incremental, especially in the evening daypart and result in higher average checks, both of which are positives for our restaurant economic model.”

**ZOES** – “The longer term for potential delivery opportunities in the dinner day part where recent customer research confirms our incremental sales growth opportunity at dinner. Already in 2018, we have finished designing, developing and deploying new in-store software in a small set of restaurants to help our teams execute delivery.”

# WHO IS RESPONSIBLE WHEN THERE ARE ISSUES?

If one of the following issues occurred when using a Food On Demand app, who do you feel is primarily responsible?



## Restaurant

At Fault



91%

Food  
Packaged  
Poorly



86%

Poor  
Presentation  
Of Food



82%

Order  
Was  
Inaccurate



## Delivery Service

At Fault



85%

Poor  
Service  
From Driver



69%

Delivery  
Not Within  
Estimated Time



## Customers Divided

Food Temperature  
Was Not Correct



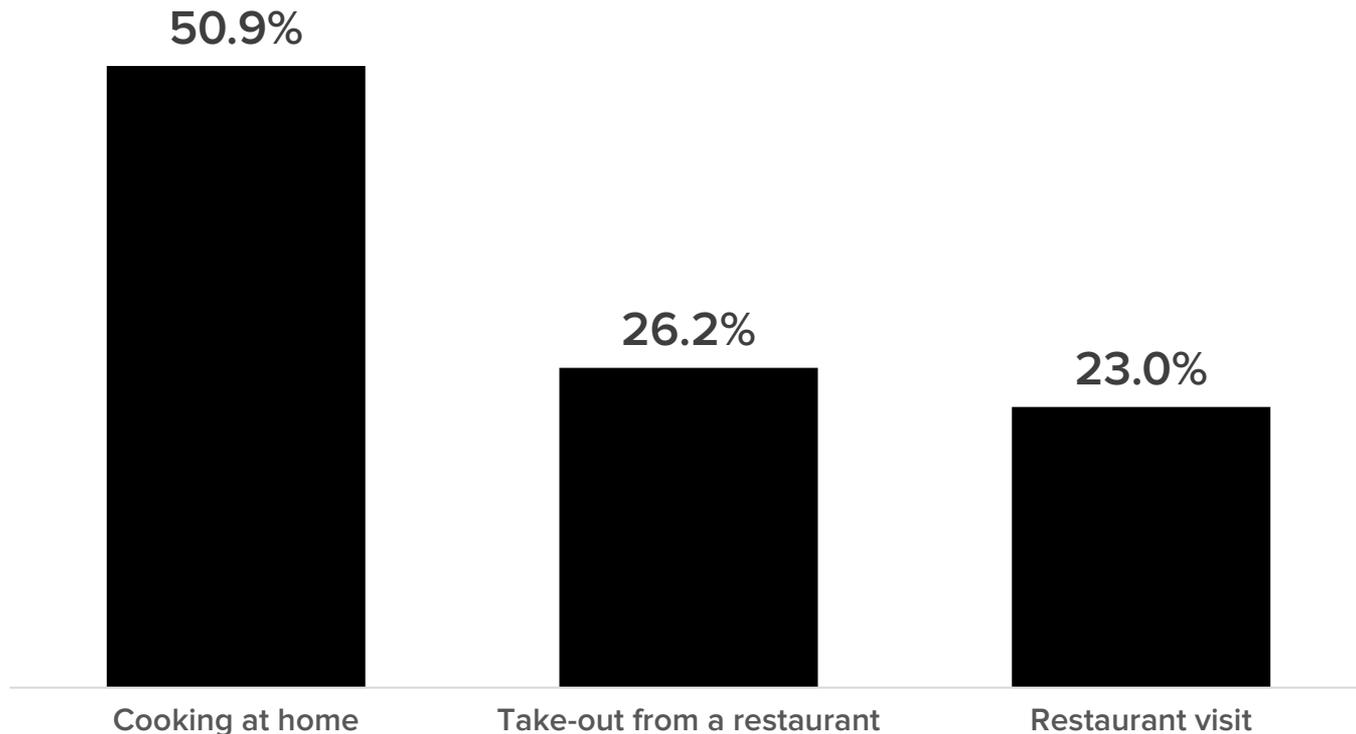
38%  
Restaurant  
At Fault

46%  
Delivery  
Service  
At Fault

- Restaurants have expressed concerns that all negative feedback falls back on them and not on the 3<sup>rd</sup> party delivery service.
- This survey should alleviate some of that concern, as customers for the most part understand which party is responsible for each component of the order.
- Food temperature, which is critical, is still a battle ground for who receives the blame. However, it is worth noting that only 6.6% of survey respondents indicated the food was not the correct temperature.

# WHAT IS THE INCREMENTALITY OF DELIVERY?

When you placed this most recent order, did it replace visiting a restaurant in person, cooking at home, or ordering take-out from a restaurant?



- The survey supports the fact that delivery orders are more often than not incremental for the restaurant, with ~51% of delivery orders replacing cooking at home occasions.
- Interestingly, only 23% of people said that delivery was replacing a dine-in occasion.

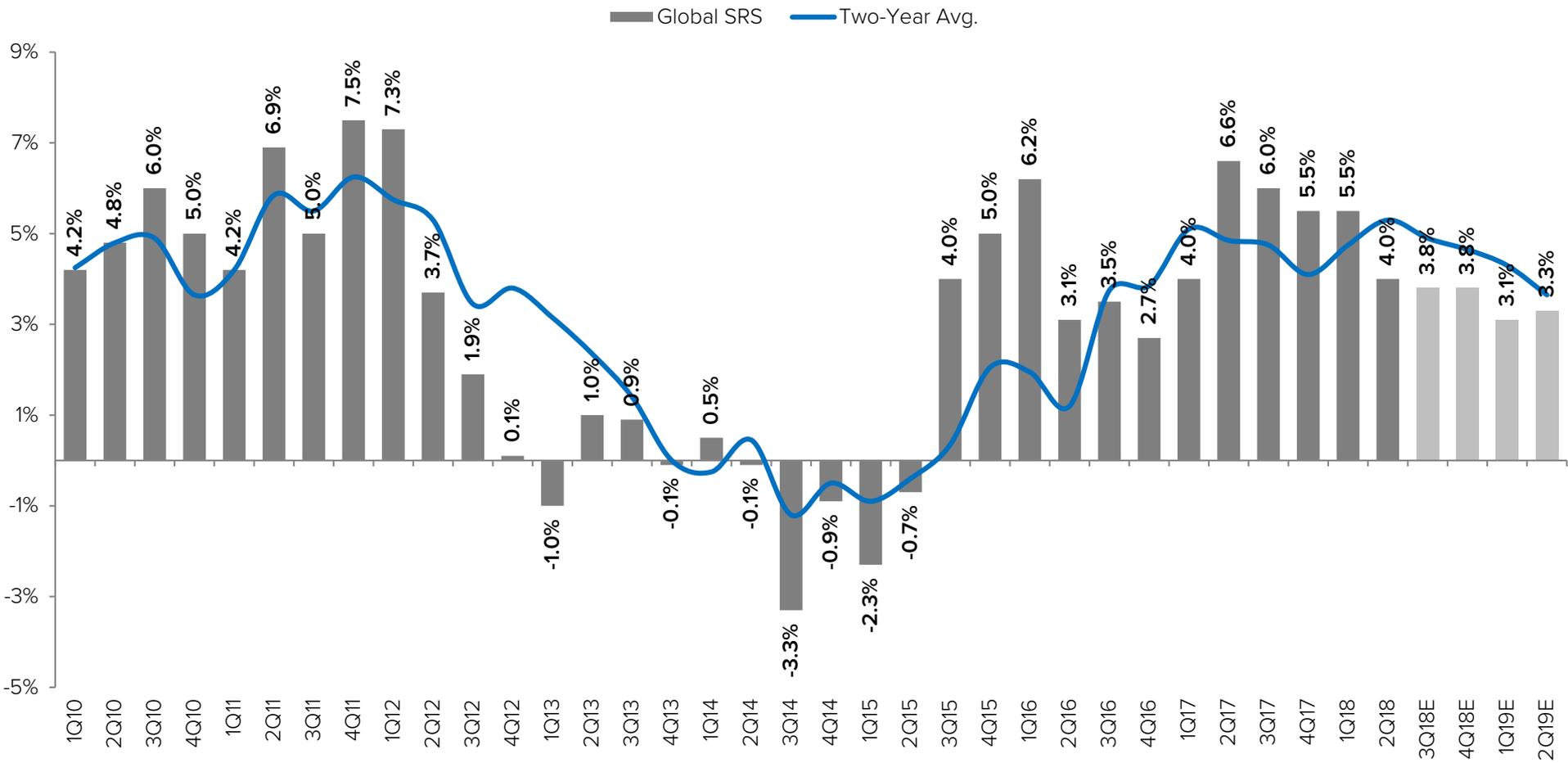


IS HISTORY ABOUT TO REPEAT ITSELF?

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

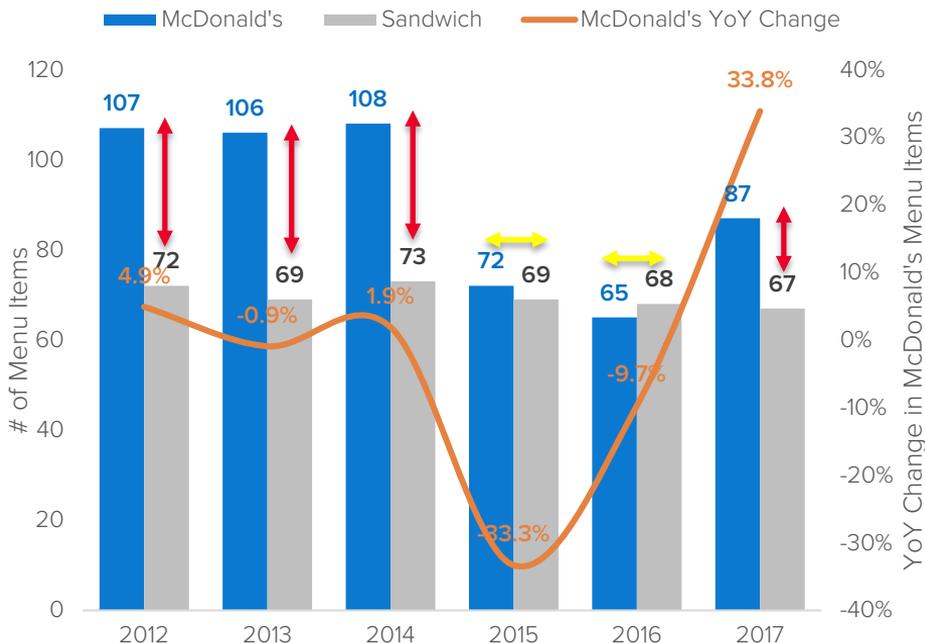
Originally Presented on May 17, 2018

# MCD: GLOBAL SAME-STORE SALES

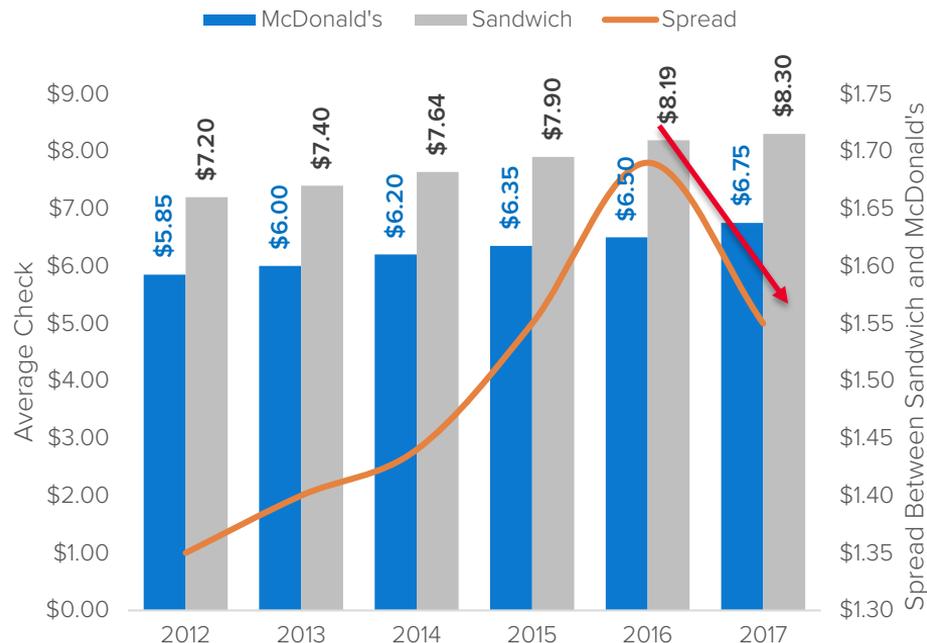


# MCD: MENU TRENDS REVERTING BACK TO OLD HABITS

## Menu Size Trends



## Average Check Trends = Gap Narrowing

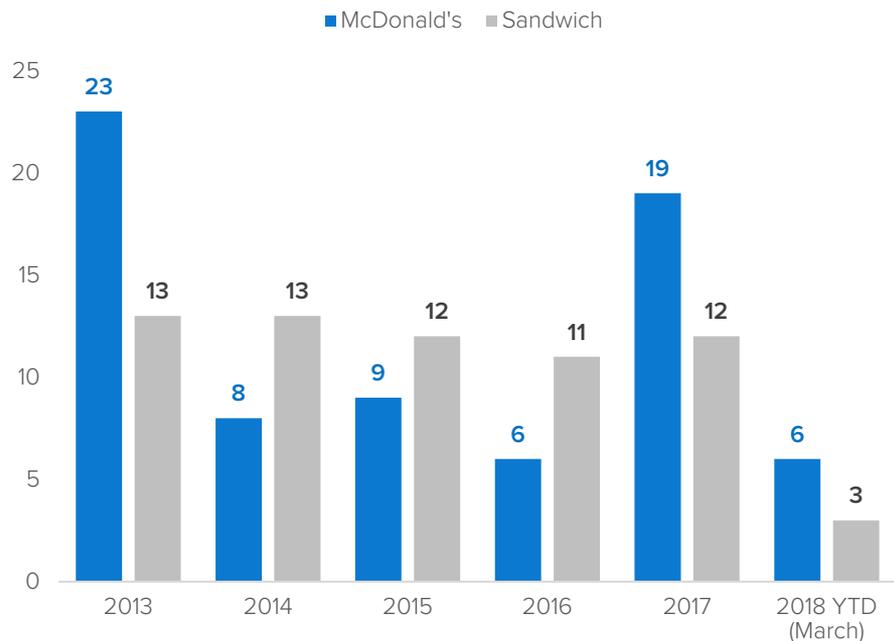


## MCD'S VALUE ADVANTAGE IS DWINDLING

Approximately 25% of MCD's customers are value conscious low/middle income consumers. Although MCD beats the segment average on value, their spread vs. the competition took a notable hit in 2017, dropping from \$1.69 to \$1.55. The value conscious consumers seem to be headed elsewhere, most likely Burger King! Taco Bell also has ~20 items on their dollar menu.

# MCD: TOO MANY PROMOTIONS COMPLICATE THE PROCESS

## Total New Product Promotions



## Complexity Slowing Down the Drive-Thru

Chain	Time (Seconds)		% Change YoY
	2016	2017	
<b>McDonald's</b>	<b>208.2</b>	<b>239.0</b>	<b>14.8%</b>
KFC	203.9	231.0	13.3%
Arby's	225.3	244.4	8.5%
Wendy's	169.1	180.1	6.5%
Hardee's	273.7	287.9	5.2%
Carl's Jr.	268.9	270.2	0.5%
Panera Bread	267.9	262.7	-1.9%
Chick-fil-A	257.6	251.0	-2.6%
Taco Bell	220.1	212.7	-3.4%
Dunkin' Donuts	181.0	173.9	-4.0%
Burger King	201.2	189.5	-5.8%
Starbucks	299.8	266.7	-11.0%
<b>Average</b>	<b>231.4</b>	<b>234.1</b>	<b>1.2%</b>

## ON PACE FOR 24 NEW PRODUCT PROMOTIONS THIS YEAR!

You would think that coming off a year where their drive-thru times increased by nearly 15%, MCD would strive to simplify the process within the four-walls to speed things up. But they are doing the exact opposite by adding menu items, new cooking processes, and promotions that will further strain the kitchen and restaurant staff.

# MCD: INTERNAL COMPLEXITY

**CHANGE IN MARKETING SPEND** - It remains to be seen what the impact is from a streamlined marketing structure. MCD has reduced its advertising co-ops from around 200 down to just over 50. Also, there has been a shift to a more national marketing (now that they have a national value platform) approach in co-op marketing spend which will offset smaller increase in national ad budget.

**VALUE PROMOTION IS SLOW IN THE UPTAKE** - It could take 3-6 months to assess whether huge positioning around \$1 \$2 \$3 platform pays off, but we remain skeptical.

## **OPERATIONAL COMPLEXITY IS GROWING:**

1. Customized, made-to-order fresh beef items
2. McCafé extensions
3. Breakfast served all day (requires grill space)
4. A high level of menu innovation
5. New digital/delivery channels

**Speed comes a close second to value in terms of brand equity for McDonald's. Specifically, for MCD, Menu complexities are particularly challenging as it relates to the drive-thru where 75% of sales originate. Its drive-thru times are already challenged and could slow further.**

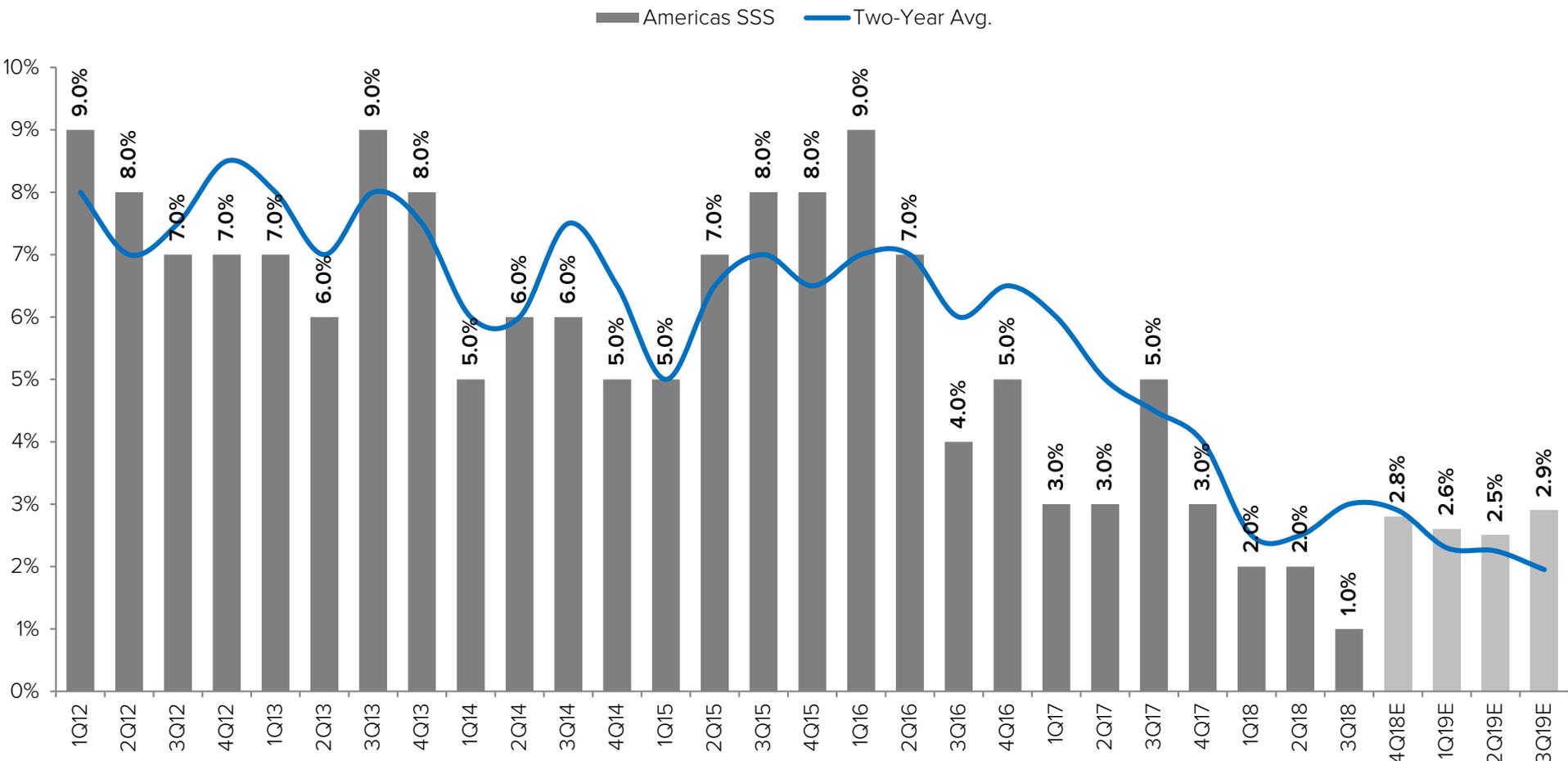


# COMPLEXITY KILLS GROWTH

## **REITERATING OUR SHORT CALL ON STARBUCKS (SBUX)**

Originally Presented on April 23, 2018

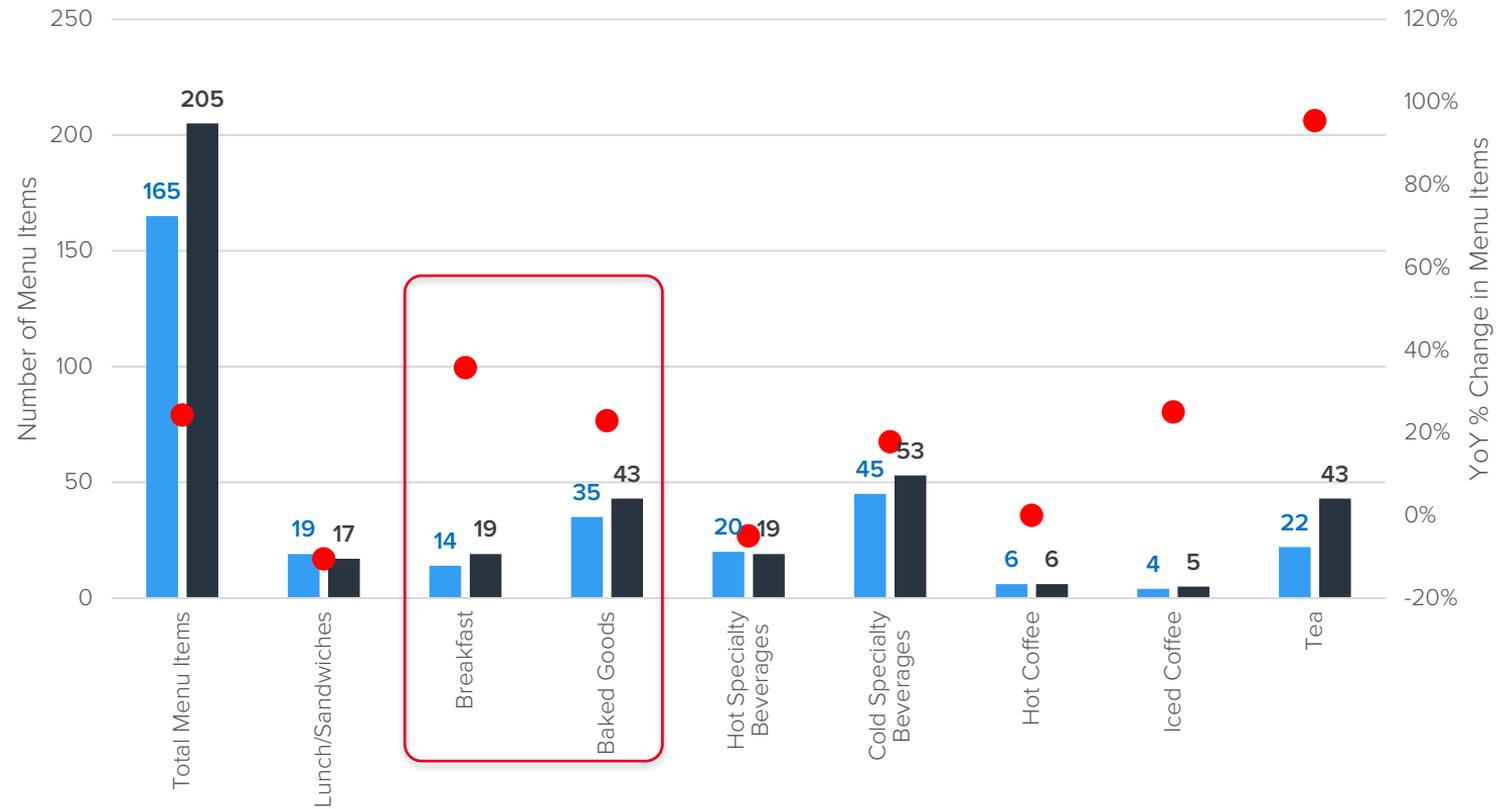
# SBUX: AMERICAS SAME-STORE SALES



# SBUX: MENU COMPOSITION HAS CHANGED AS THEY INCREASE FOCUS ON FOOD

## SBUX Menu Trend

■ 2015 ■ 2017 ● YoY Growth

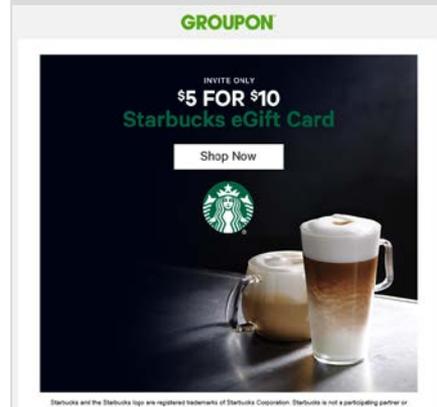
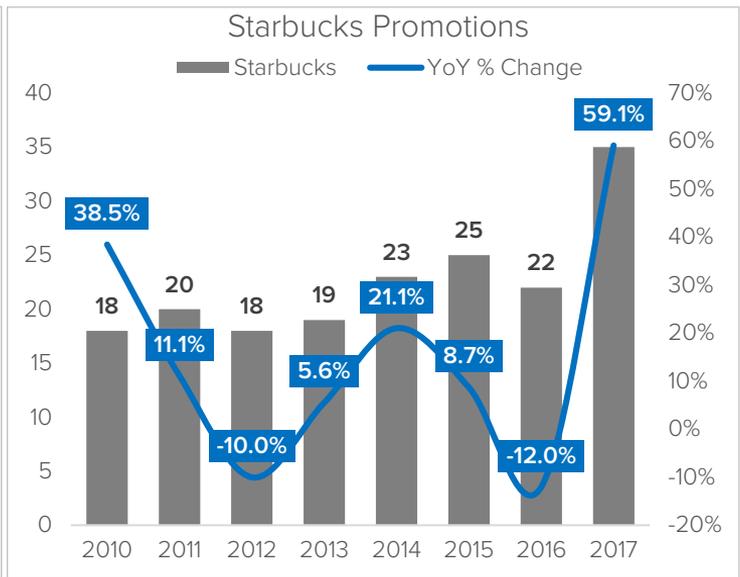
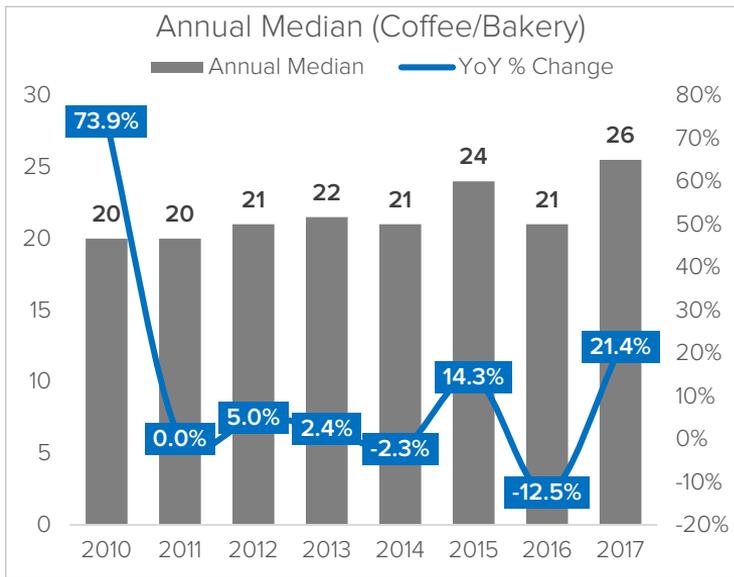


- SBUX has increased Breakfast and Baked Goods items by ~36% and ~23%, respectively, from 2015 to 2017.
- The number of Lunch/Sandwiches SBUX has declined 10.5% due to complexity. They need this daypart to drive food sales to their 25% of revenue target.
- Notably, they have also significantly increased their Tea segment as they broaden their drink offering beyond coffee.

# SBUX: PROMOTIONS DON'T LEAD TO SUSTAINABLE GROWTH

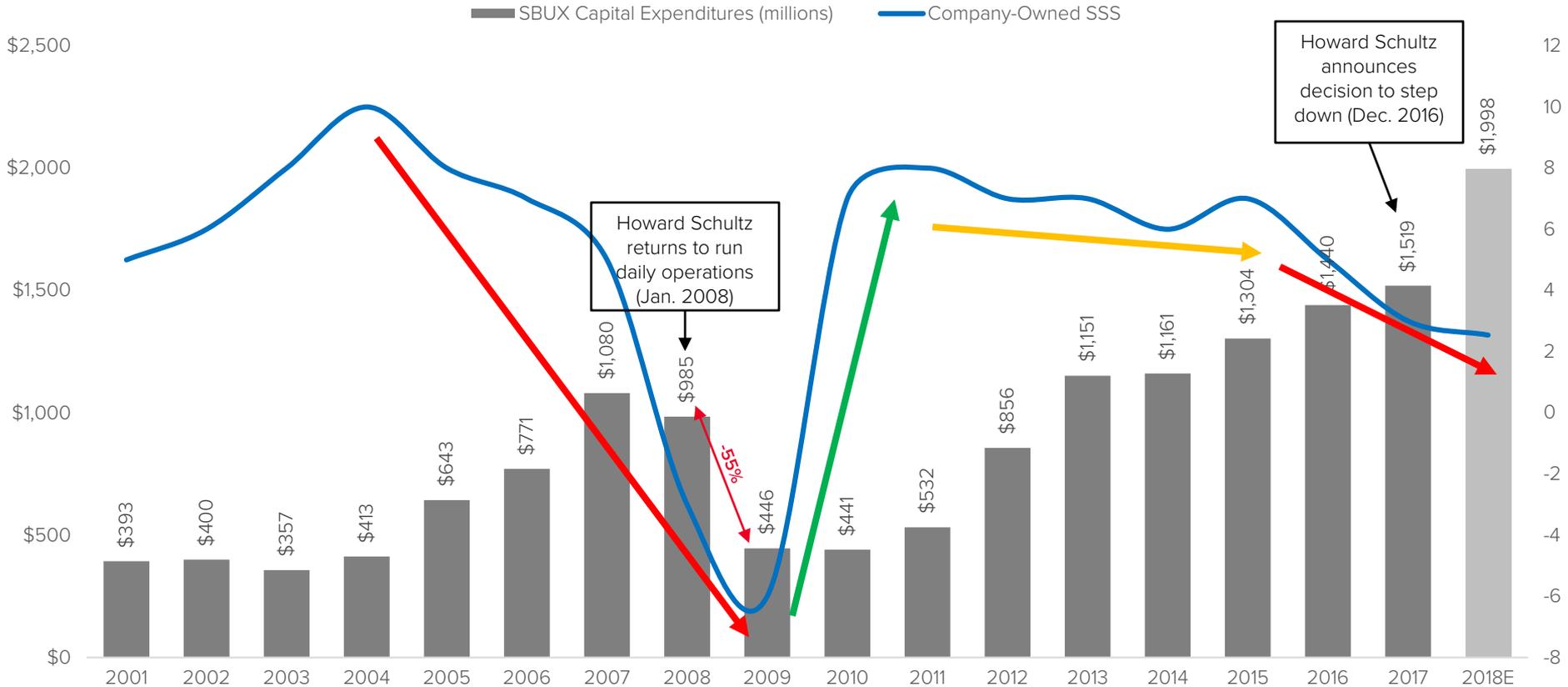
Annual Promotions (Coffee/Bakery)									
Concept (Coffee/Bakery)	2010	2011	2012	2013	2014	2015	2016	2017	2018YTD
<b>Dunkin Donuts</b>	<b>22</b>	<b>20</b>	<b>24</b>	<b>24</b>	<b>41</b>	<b>23</b>	<b>18</b>	<b>23</b>	<b>10</b>
Krispy Kreme	-	-	-	-	17	25	20	15	3
Tim Horton's	-	-	-	-	19	23	25	28	2
<b>Starbucks</b>	<b>18</b>	<b>20</b>	<b>18</b>	<b>19</b>	<b>23</b>	<b>25</b>	<b>22</b>	<b>35</b>	<b>8</b>
<i>YoY % Change</i>	<i>38.5%</i>	<i>11.1%</i>	<i>-10.0%</i>	<i>5.6%</i>	<i>21.1%</i>	<i>8.7%</i>	<i>-12.0%</i>	<i>59.1%</i>	
<b>Annual Median</b>	<b>20</b>	<b>20</b>	<b>21</b>	<b>22</b>	<b>21</b>	<b>24</b>	<b>21</b>	<b>26</b>	<b>6</b>
<i>YoY % Change</i>	<i>73.9%</i>	<i>0.0%</i>	<i>5.0%</i>	<i>2.4%</i>	<i>-2.3%</i>	<i>14.3%</i>	<i>-12.5%</i>	<i>21.4%</i>	

- 2017 was the year of promotions and the push for value across the restaurant space.
- The \$5 for \$10 Groupon (seen below) displays desperation in hopes of reaching the low end of their 3% to 5% LT SSS guidance.



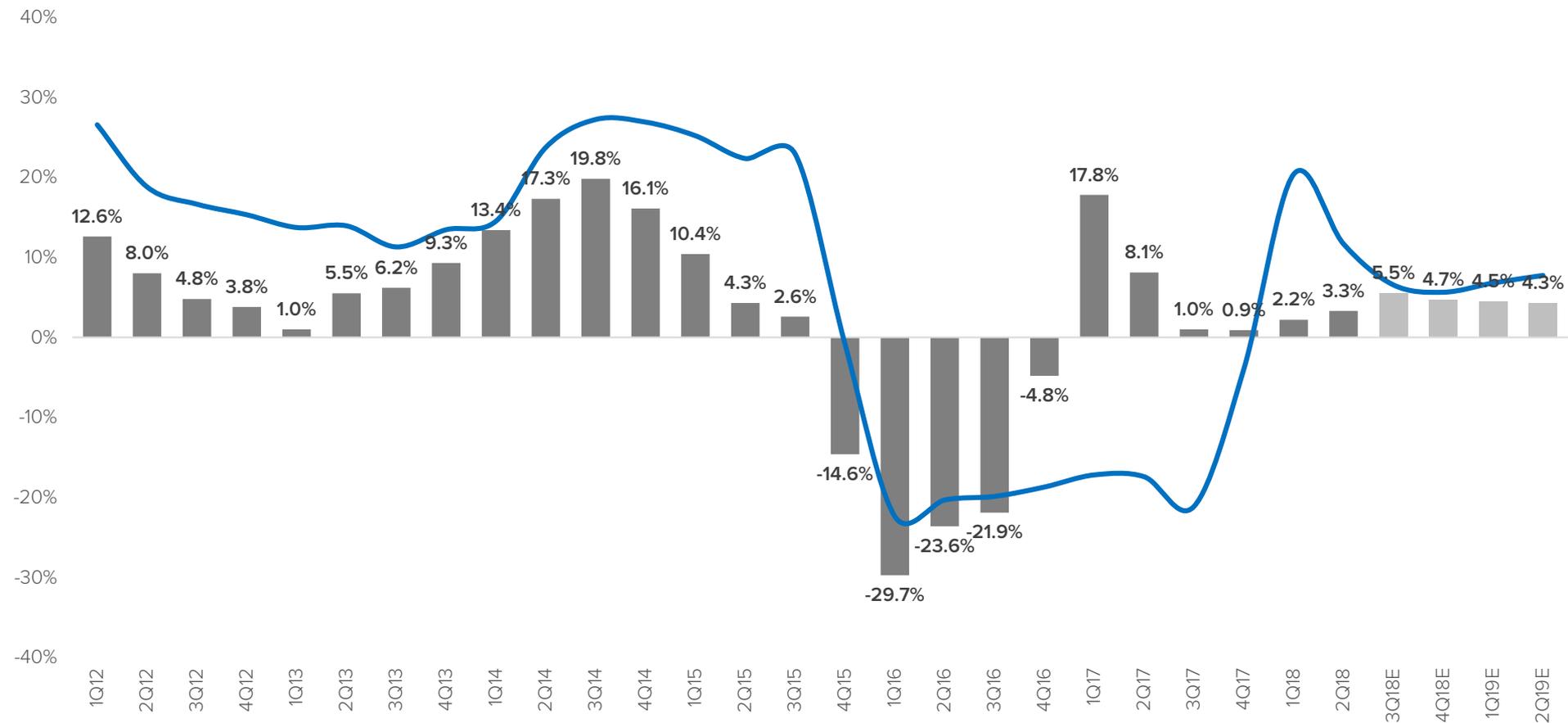
# SBUX SSS SHOWING DETERIORATION IN RETURNS

## SBUX Capital Spending Trends vs. Same-store sales



# CMG: SAME-STORE SALES

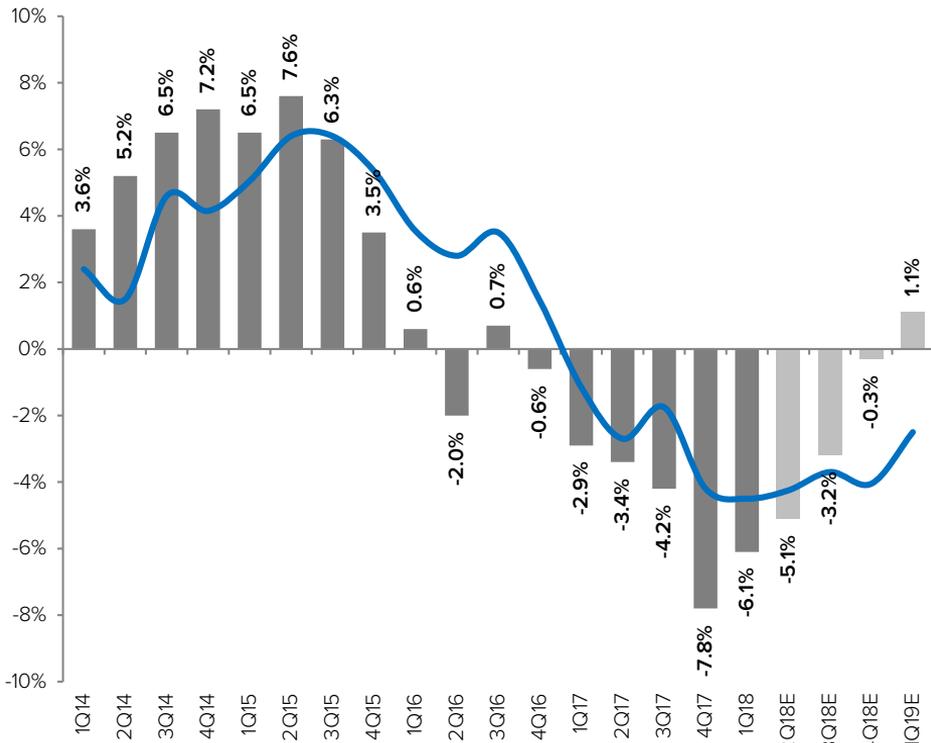
Same-Store Sales Compound Growth



# PLAY: SAME-STORE SALES

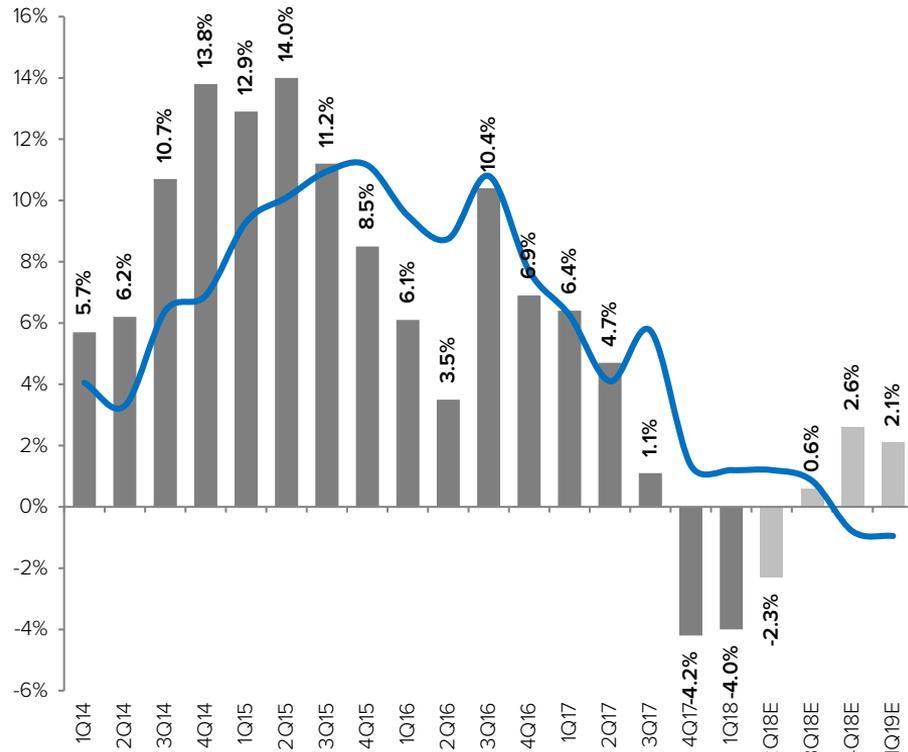
## PLAY: Food & Beverage SSS

Food & Beverage SSS Two-Year Avg.

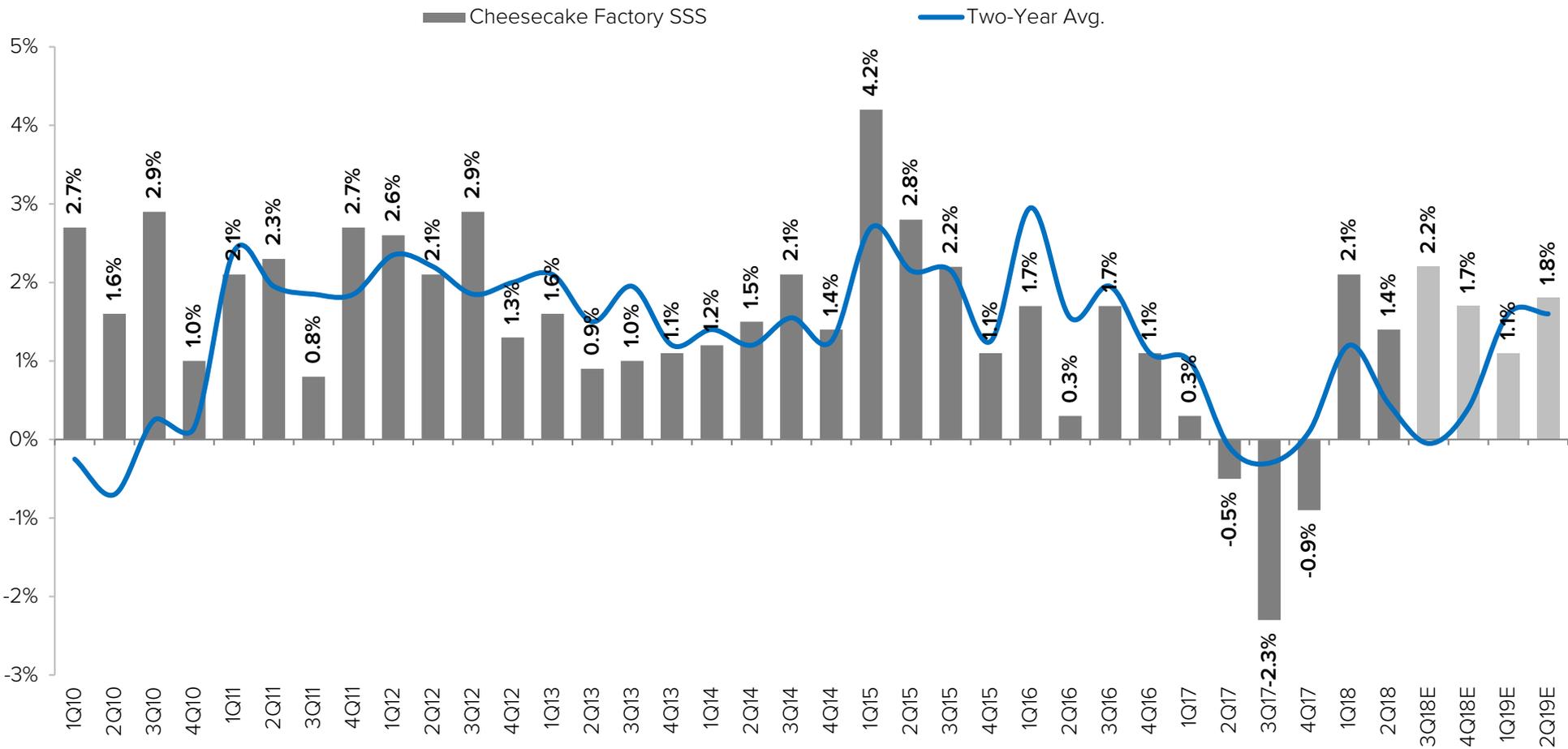


## PLAY: Amusement & Other SSS

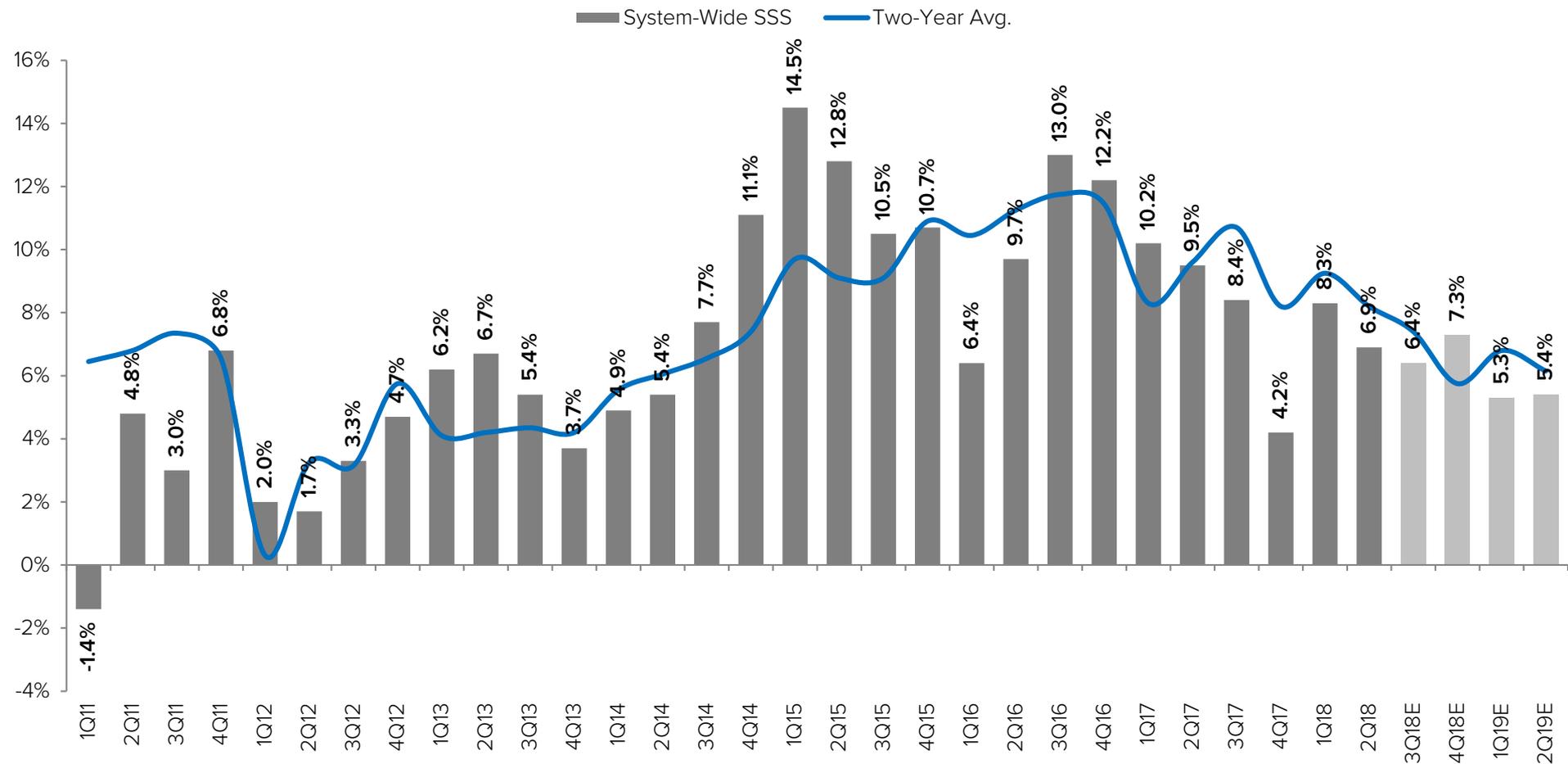
Amusement & Other SSS Two-Year Avg.



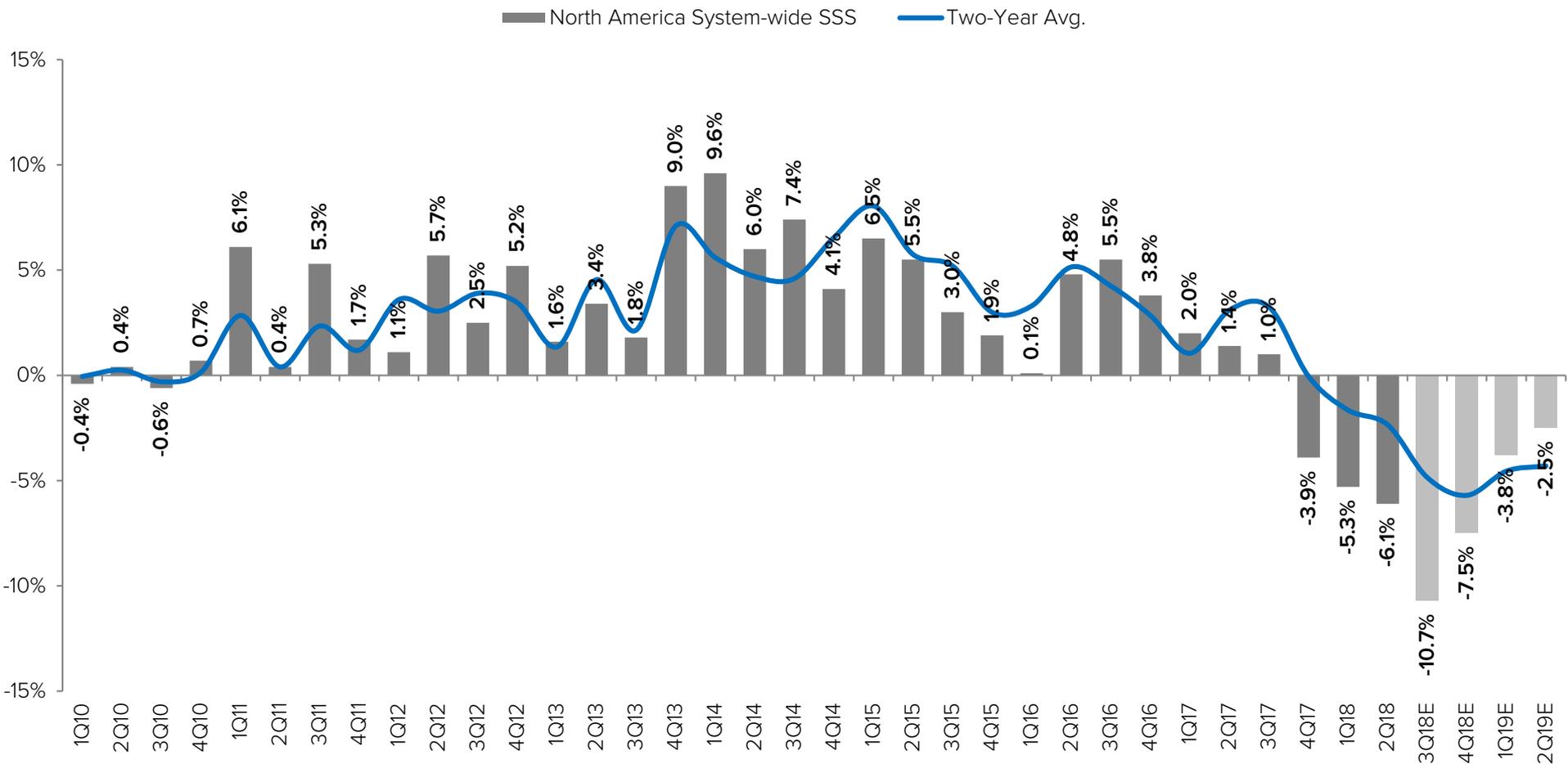
# CAKE: CHEESECAKE FACTORY SSS



# DPZ: SYSTEM-WIDE SSS



# PZZA: NORTH AMERICA SYSTEM-WIDE SAME-STORE SALES



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