

## First Watch

## 4Q23 Earnings: Ongoing margin tailwinds, long growth runway

Reiterate Rating: BUY | PO: 31.00 USD | Price: 24.58 USD

## Solid trends ex-weather; new markets speak to portability

While January SSSG was dogged by poor weather and difficult comparisons (negative MSD traffic QTD), improvement in February and FWRG's expectations that 1Q SSSG should be "better than flat" suggest that F24's SSSG guide (1-3%) is likely to be conservative, at least at the low end. FWRG's plan to enter New England – a market from which other restaurants have shied away because of high costs and slower growth – reflects the brand's portability across geographies and the exceptional unit level returns. FWRG's success in Philadelphia – characterized by similar cost structures and traditional diner breakfast occasions as New England – augurs well.

## Inflation still elevated but tech helps offset

Inflation expectations for commodities (2-4%) and labor (5-7%) remain elevated vs the industry's pre-COVID rates, when inflation tended to run LSD for food and MSD for labor. We expect FWRG to be very deliberate in its pricing actions as it seeks to remain broadly accessible (per person average ~\$15); in the absence of additional pricing, F24 carryover pricing of ~3% will likely lag overall input cost inflation modestly. That said, 4Q results were very encouraging as 240 bps of RLM expansion exceeded what we would expect under normal circumstances (5.7% price likely just covered net inflation). We expect labor scheduling to serve as a continued tailwind, amplified by other tech like Kitchen Display Systems, pay-at-the-table and digital waitlists.

## 1Q lower on weather impact, F24 up on margins

We lower 1Q SSSG (from 4.0% to 1.0%) to reflect the QTD drag from adverse weather, only partly offset by improved margins from tech efficiencies. Our 1Q EBITDA declines from \$30.3mm to \$23.3mm and EPS from \$0.19 to \$0.11. We expect demand to recover meaningfully through the year and raise our F24 adj. EBITDA forecast to \$110.3mm (vs \$104.2mm prior, guidance of \$106-112mm) and EPS of \$0.55 (vs \$0.51 prior).

## Raise PO on rolled fwd ests, multiple expansion; Reit. Buy

We believe FWRG should trade at a premium consistent with its faster growth and higher returns. We apply a conservative 15x multiple, up from 14x (high growth peers currently trade at an average of 17.4x, up from 14x prior) to our forward estimate 12-months from now (F25: \$134mm) to arrive at our \$31 PO (vs \$28 prior).

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.22	0.49	0.55	0.76	0.97
EPS Change (YoY)	NA	122.7%	12.2%	38.2%	27.6%
Consensus EPS (Bloomberg)			0.45	0.58	0.69
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	111.7x	50.2x	44.7x	32.3x	25.3x
EV / EBITDA*	28.7x	20.6x	18.2x	15.0x	13.3x
Free Cash Flow Yield*	0%	-1.9%	3.6%	0.2%	-0.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 06 March 2024 05:00AM EST

06 March 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	28.00	31.00
2024E Rev (m)	1,057.8	1,059.8
2025E Rev (m)	1,225.3	1,226.2
2024E EPS	0.51	0.55
2025E EPS	0.73	0.76
2026E EPS	0.94	0.97

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## Stock Data

Price	24.58 USD
Price Objective	31.00 USD
Date Established	6-Mar-2024
Investment Opinion	C-1-9
52-Week Range	14.34 USD - 25.88 USD
Mkt Val (mn) / Shares Out (mn)	1,473 USD / 59.9
Free Float	41.4%
Average Daily Value (mn)	8.25 USD
BofA Ticker / Exchange	FWRG / NAS
Bloomberg / Reuters	FWRG US / FWRG.OQ
ROE (2024E)	6.0%
Net Dbt to Eqty (Dec-2023A)	13.4%
ESGMeter™	NLA

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

## Glossary

FWRG – First Watch

SSSG – same-store sales growth, also referred to as comparable sales or 'comp(s)'

# iQprofile<sup>SM</sup> First Watch

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	0.9%	2.7%	3.4%	4.2%	4.4%
Return on Equity	1.3%	4.7%	6.0%	7.9%	8.8%
Operating Margin	2.3%	4.6%	5.2%	6.2%	6.4%
Free Cash Flow	0	(28)	54	3	(4)

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	9.6x	3.8x	5.3x	2.9x	2.5x
Asset Replacement Ratio	1.8x	3.0x	2.9x	2.9x	2.9x
Tax Rate	46.3%	29.6%	27.0%	27.0%	27.0%
Net Debt-to-Equity Ratio	9.7%	13.4%	0.6%	-9.1%	-18.4%
Interest Cover	3.0x	5.1x	6.1x	8.1x	9.4x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	730	892	1,060	1,226	1,405
% Change	21.5%	22.1%	18.9%	15.7%	14.6%
Gross Profit	140	190	230	271	306
% Change	13.6%	36.3%	20.8%	18.0%	12.8%
EBITDA	70	97	110	134	151
% Change	7.6%	39.4%	13.3%	21.6%	12.7%
Net Interest & Other Income	(5)	(5)	(8)	(8)	(8)
<b>Net Income (Adjusted)</b>	<b>7</b>	<b>25</b>	<b>35</b>	<b>49</b>	<b>59</b>
% Change	NM	285.5%	36.7%	42.2%	20.5%

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	7	25	35	49	59
Depreciation & Amortization	35	42	46	49	53
Change in Working Capital	(10)	(7)	24	(45)	(61)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	32	36	80	90	98
Capital Expenditure	(63)	(123)	(131)	(141)	(153)
<b>Free Cash Flow</b>	<b>0</b>	<b>-28</b>	<b>54</b>	<b>3</b>	<b>-4</b>
% Change	NM	NM	NM	-95.3%	NM
Share / Issue Repurchase	1	6	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	(3)	22	21	63	78

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	50	50	124	190	264
Trade Receivables	6	6	4	4	5
Other Current Assets	11	16	13	14	17
Property, Plant & Equipment	195	263	349	441	542
Other Non-Current Assets	842	933	866	868	864
<b>Total Assets</b>	<b>1,104</b>	<b>1,267</b>	<b>1,356</b>	<b>1,517</b>	<b>1,692</b>
Short-Term Debt	6	6	5	5	5
Other Current Liabilities	92	109	103	121	138
Long-Term Debt	95	120	123	126	129
Other Non-Current Liabilities	387	471	529	620	714
<b>Total Liabilities</b>	<b>580</b>	<b>706</b>	<b>760</b>	<b>871</b>	<b>986</b>
<b>Total Equity</b>	<b>523</b>	<b>562</b>	<b>597</b>	<b>647</b>	<b>706</b>
<b>Total Equity &amp; Liabilities</b>	<b>1,103</b>	<b>1,268</b>	<b>1,356</b>	<b>1,518</b>	<b>1,693</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Restaurants

## Company Description

First Watch is a daytime restaurant concept with a single operating shift (7:00am-2:30pm) serving made-to-order breakfast, brunch and lunch. First Watch has over 400 restaurants (mostly company-owned) with locations across the United States. The company has a continuously evolving menu with five seasonal menus per year and a full service specialty Brunch/Lunch offering.

## Investment Rationale

Our Buy rating is based on secular tailwinds from a fast growing breakfast daypart, additional benefits associated with the breakfast daypart (ex. lower staff turnover and higher returns), and upside, in our view, to First Watch's same store sales and AUV outlook.

## Stock Data

Average Daily Volume

335,527

**Exhibit 1: We forecast EBITDA of \$110.3mm in F24 and \$134.1mm in F25**

FWRG Income Statement, F23-F25E

\$000 except per share amounts	2023	1Q24E	2Q24E	3Q24E	4Q24E	2024E	1Q25E	2Q25E	3Q25E	4Q25E	2025E
<b>Net Sales</b>	877,092	234,797	262,996	271,371	277,802	1,046,965	279,937	306,377	309,438	316,973	1,212,725
<b>Franchise Revenue</b>	14,459	2,958	3,277	3,184	3,417	12,836	2,660	3,318	3,646	3,896	13,521
<b>Total Revenue</b>	<b>891,551</b>	<b>237,755</b>	<b>266,273</b>	<b>274,554</b>	<b>281,218</b>	<b>1,059,801</b>	<b>282,597</b>	<b>309,695</b>	<b>313,084</b>	<b>320,869</b>	<b>1,226,245</b>
y/y growth	22.1%	12%	23%	25%	15%	19%	19%	16%	14%	14%	16%
Cost of Sales	197,374	52,116	58,214	61,134	63,484	234,948	62,695	68,429	70,329	73,070	274,523
Labor and other related expenses	294,010	80,519	86,386	89,771	95,063	351,739	91,791	98,480	101,442	107,421	399,134
Other restaurant operating expenses	134,477	36,169	38,267	40,192	41,014	155,642	43,553	45,025	46,288	47,265	182,132
Restaurant occupancy expenses	68,400	18,420	19,636	21,322	21,264	80,642	20,815	22,188	24,094	24,028	91,126
Preopening Expenses	7,173	1,170	1,549	2,563	1,945	7,226	1,395	1,804	2,922	2,219	8,340
<b>Company Operated Costs</b>	<b>701,434</b>	<b>188,393</b>	<b>204,052</b>	<b>214,982</b>	<b>222,769</b>	<b>830,197</b>	<b>220,249</b>	<b>235,927</b>	<b>245,075</b>	<b>254,003</b>	<b>955,254</b>
General and administrative expenses	103,121	27,306	31,062	31,033	34,254	123,655	32,081	35,659	34,871	38,515	141,125
Depreciation & Amortization	41,223	10,280	11,513	11,871	12,159	45,823	11,371	12,461	12,598	12,911	49,341
Impairment & Asset Disposals	1,359	151	368	232	852	1,602	179	428	264	972	1,843
Transaction & Conversion Expenses	3,147	253	1,744	546	604	3,147	253	1,744	546	604	3,147
<b>Total Operating Expenses</b>	<b>850,284</b>	<b>226,383</b>	<b>248,739</b>	<b>258,664</b>	<b>270,638</b>	<b>1,004,424</b>	<b>264,134</b>	<b>286,219</b>	<b>293,354</b>	<b>307,004</b>	<b>1,150,711</b>
<b>Income from Operations</b>	41,267	11,372	17,534	15,890	10,580	55,377	18,464	23,476	19,730	13,865	75,535
<b>EBITDA</b>	<b>85,361</b>	<b>21,850</b>	<b>29,321</b>	<b>28,108</b>	<b>23,154</b>	<b>102,433</b>	<b>30,052</b>	<b>36,238</b>	<b>32,710</b>	<b>27,232</b>	<b>126,232</b>
<b>Adjusted EBITDA</b>	<b>\$97,335</b>	<b>\$23,347</b>	<b>\$31,446</b>	<b>\$29,872</b>	<b>\$25,624</b>	<b>\$110,289</b>	<b>\$31,549</b>	<b>\$38,363</b>	<b>\$34,474</b>	<b>\$29,702</b>	<b>\$134,088</b>
% of Revenue	10.9%	9.8%	11.8%	10.9%	9.1%	10.4%	11.2%	12.4%	11.0%	9.3%	10.9%
% Growth	39.4%	-14.8%	21.8%	38.1%	14.0%	13.3%	35.1%	22.0%	15.4%	15.9%	21.6%
Interest expense	(8,063)	(2,002)	(2,333)	(2,352)	(2,372)	(9,059)	(2,052)	(2,391)	(2,410)	(2,430)	(9,283)
Other Income	2,871	198	274	347	414	1,233	217	301	382	456	1,356
<b>Earnings Before Taxes</b>	\$36,075	\$9,568	\$15,475	\$13,885	\$8,623	\$47,551	\$16,628	\$21,386	\$17,702	\$11,892	\$67,608
Income Taxes	(10,690)	(2,583)	(4,178)	(3,749)	(2,328)	(12,839)	(4,490)	(5,774)	(4,779)	(3,211)	(18,254)
	30%					27%					
<b>Net Income (Loss)</b>	<b>\$25,385</b>	<b>\$6,984</b>	<b>\$11,297</b>	<b>\$10,136</b>	<b>\$6,295</b>	<b>\$34,712</b>	<b>\$12,139</b>	<b>\$15,612</b>	<b>\$12,922</b>	<b>\$8,681</b>	<b>\$49,354</b>
GAAP EPS	\$0.42	\$0.11	\$0.18	\$0.16	\$0.10	\$0.55	\$0.19	\$0.24	\$0.20	\$0.13	\$0.76
Adjusted EPS	\$0.49	\$0.11	\$0.18	\$0.16	\$0.10	\$0.55	\$0.19	\$0.24	\$0.20	\$0.13	\$0.76
Avg Diluted S/O	61,198	62,189	62,689	63,189	63,689	62,939	64,189	64,689	65,189	65,689	64,939

Source: Company reports, BofA Global Research estimates

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## Price objective basis & risk

### First Watch (FWRG)

We believe FWRG should trade a premium consistent with its faster growth and higher returns. FWRG currently trades in line with its peer group of restaurants and retailers with similar above-market growth rates. We believe a valuation in line with other high growth peers is justified owing to FWRG's faster than average topline growth, extended growth runway, as the brand goes national, and higher incremental returns, with restaurant level ROIs of about 40% or 2x other full service restaurants. We apply a 15x multiple to our forward EBITDA estimates (F25, \$134mm) to arrive at our \$31 PO. This target multiple is conservative relative to high growth peers' average of 17x.

Downside risks: higher-than-expected cannibalization of existing restaurants due to new store openings, staffing challenges and/or higher-than-expected wage inflation, higher-than-expected occupancy costs as First Watch ramps-up new stores at a faster rate.

Upside risks: higher-than-expected AUVs of new units, faster-than-expected SSS growth, lower labor and G&A costs.

## Analyst Certification

I, Sara Senatore, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Restaurants Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Chipotle Mexican Grill	CMG	CMG US	Sara Senatore
	Darden Restaurants	DRI	DRI US	Sara Senatore
	Domino's Pizza	DPZ	DPZ US	Sara Senatore
	Dutch Bros	BROS	BROS US	Sara Senatore
	First Watch	FWRG	FWRG US	Sara Senatore
	Jack in the Box	JACK	JACK US	Sara Senatore
	Krispy Kreme	DNUT	DNUT US	Sara Senatore
	Papa Johns International	PZZA	PZZA US	Sara Senatore
	Starbucks	SBUX	SBUX US	Sara Senatore
	Sweetgreen	SG	SG US	Katherine Griffin
	Texas Roadhouse	TXRH	TXRH US	Sara Senatore
	Wingstop Inc	WING	WING US	Sara Senatore
<b>NEUTRAL</b>				
	Bloomin Brands	BLMN	BLMN US	Sara Senatore
	McDonald's	MCD	MCD US	Sara Senatore
	Shake Shack	SHAK	SHAK.US	Sara Senatore
	The Cheesecake Factory	CAKE	CAKE US	Katherine Griffin
	Yum Brands Inc	YUM	YUM US	Sara Senatore
<b>UNDERPERFORM</b>				
	Brinker International	EAT	EAT US	Katherine Griffin
	Cracker Barrel	CBRL	CBRL US	Katherine Griffin
	Restaurant Brands International	YQSR	QSR CN	Sara Senatore
	Restaurant Brands International Inc.	QSR	QSR US	Sara Senatore
	Wendy's Co	WEN	WEN US	Sara Senatore
<b>RSTR</b>				
	Portillo's Inc.	PTLO	PTLO US	Sara Senatore

## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethod<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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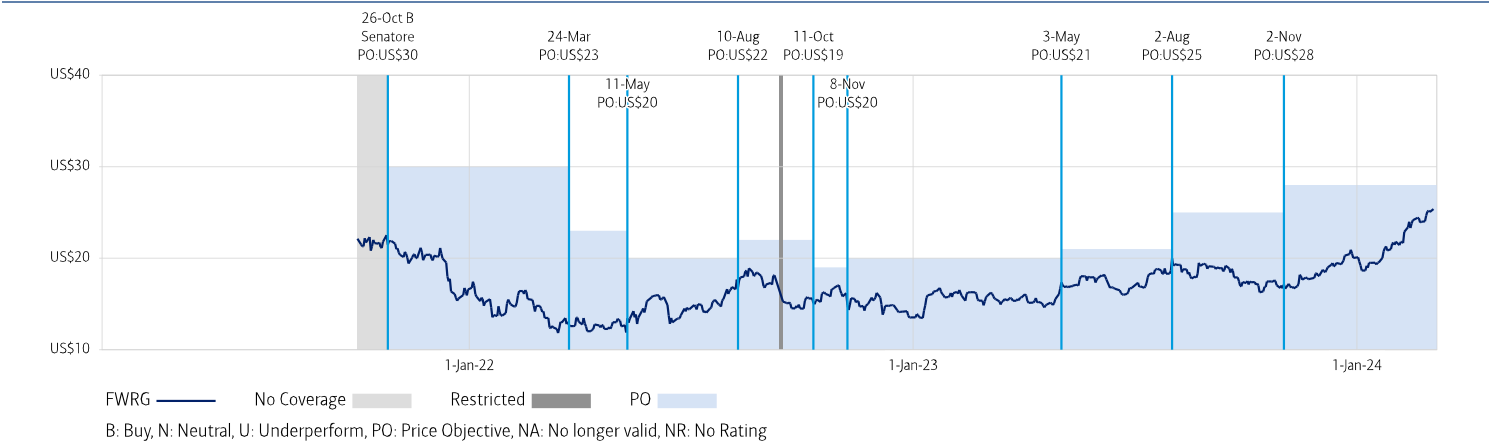
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# Disclosures

## Important Disclosures

### First Watch (FWRG) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Restaurants Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	21	58.33%	Buy	10	47.62%
Hold	10	27.78%	Hold	3	30.00%
Sell	5	13.89%	Sell	4	80.00%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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