

Brinker International

2Q Earnings: Can EAT maintain margins if mix headwinds worsen?

Reiterate Rating: UNDERPERFORM | PO: 44.00 USD | Price: 42.79 USD

Comp guidance hinges on stabilizing traffic/mix

Notwithstanding a negative mix shift at Chili's in 2Q and a soft start to F3Q, EAT reaffirmed expectations for mid-single-digit (MSD) company-owned same-store sales growth (SSSG) in F24. Negative mix in 2Q reflects the lapping of reduced discounting on 3-for-me, but also a higher-than-expected incidence of trade down (to wings) and lower attach (alcohol, appetizers). While EAT plans to recover some mix through new menu merchandising (de-emphasizing wings), we see risk of persistent negative mix trends should trade down behavior prove stickier than expected among Chili's most price-sensitive customers, especially as EAT pricing runs ahead of the industry.

Price/cost tailwind offset by investments to retain traffic

Investments in increased TV advertising are driving traffic share gains (EAT outperformed industry traffic by 2 ppts in 2Q) and EAT has been able to offset with commodity deflation (HSD (high-single digit) pricing, commodity deflation) to drive 150 bps restaurant margin expansion in 2Q. While the favorable price/cost dynamic should continue, the gap is narrower in 2H (MSD pricing, LSD (low-single digit) commodities inflation). Continued investments behind guest experience (R&M, rebuilding CRM to enable targeted advertising) continue to be an offset. We model RLMs stable q/q in 3Q and higher q/q in 4Q.

F24 EPS estimate raised on 2Q beat, price increases

We raise our 3Q co-owned SSSG estimate to 3.9% (vs 3.0% prior) to reflect incremental price increases at Chili's and Maggiano's. Flowing through higher pricing we raise our F24 co-owned SSSG to 5% (vs 4% prior) – in line with EAT's MSD comp guidance – but we see some risk if price elasticity is higher than we expect. Coupled with the 2Q beat (by \$0.04), higher 2H estimates move our F24 EPS estimate to \$3.60 (vs \$3.49).

Raise PO to \$44 on rolled forward estimates

Relative to the S&P 500, EAT's P/E multiple is 0.6x, in line with its 5-year historical average of 0.6x. We expect valuation to remain in line with the historical range, as upside to restaurant margins and EPS are limited by traffic/mix headwinds and investments to sustain traffic gains. Applying a 0.6x relative multiple (unchanged) to our \$4.23 12-month forward EPS (3QF25-2QF26), we arrive at our revised PO of \$44 (from \$43); our PO implies an absolute P/E of 10.4x (lower vs 10.8x prior on market multiple compression). We reiterate our Underperform rating.

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	3.09	2.85	3.60	3.94	4.58
GAAP EPS	2.58	2.29	3.43	3.94	4.58
EPS Change (YoY)	-1.0%	-7.8%	26.3%	9.4%	16.2%
Consensus EPS (Bloomberg)			3.54	3.85	4.37
DPS	0	0	0	0	0
Valuation (Jun)					
P/E	13.8x	15.0x	11.9x	10.9x	9.3x
EV / EBITDA*	10.5x	11.1x	9.2x	8.6x	8.1x
Free Cash Flow Yield*	5.4%	3.8%	10.5%	11.2%	12.8%

* For full definitions of *IQmethod*SM measures, see page 5.

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Timestamp: 01 February 2024 05:00AM EST

01 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	43.00	44.00
2024E Rev (m)	4,300.6	4,344.7
2025E Rev (m)	4,475.6	4,534.6
2026E Rev (m)	4,650.3	4,711.9
2024E EPS	3.49	3.60
2025E EPS	3.87	3.94
2026E EPS	4.51	4.58

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Stock Data

Price	42.79 USD
Price Objective	44.00 USD
Date Established	1-Feb-2024
Investment Opinion	C-3-9
52-Week Range	28.23 USD - 44.97 USD
Mkt Val (mn) / Shares Out (mn)	1,892 USD / 44.2
Free Float	97.5%
Average Daily Value (mn)	49.24 USD
BofA Ticker / Exchange	EAT / NYS
Bloomberg / Reuters	EAT US / EAT.N
ROE (2024E)	NA
Net Dbt to Eqty (Jun-2023A)	NA
ESGMeter TM	High

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

EAT – Brinker International
SSSG – same-store sales growth, or comparable sales, or “comps”
R&M – repair and maintenance
RLM – restaurant-level margins
CRM – customer relationship management

iQprofileSM Brinker International

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	7.9%	6.7%	10.2%	10.4%	10.5%
Return on Equity	NM	NM	NM	134.7%	59.0%
Operating Margin	4.2%	3.5%	5.3%	5.7%	5.9%
Free Cash Flow	102	71	199	212	243

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.8x	2.0x	2.4x	2.1x	2.0x
Asset Replacement Ratio	0.9x	1.1x	1.1x	0.9x	0.9x
Tax Rate	NM	NM	6.3%	12.0%	12.0%
Net Debt-to-Equity Ratio	NM	NM	NM	204.2%	48.5%
Interest Cover	3.5x	2.6x	3.5x	4.5x	5.6x

Income Statement Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,804	4,133	4,345	4,535	4,712
% Change	14.0%	8.7%	5.1%	4.4%	3.9%
Gross Profit	2,756	2,987	3,268	3,421	3,552
% Change	11.6%	8.4%	9.4%	4.7%	3.8%
EBITDA	358	340	411	438	466
% Change	-3.5%	-5.1%	21.0%	6.4%	6.5%
Net Interest & Other Income	(44)	(54)	(66)	(57)	(49)
Net Income (Adjusted)	141	127	162	177	202
% Change	-3.0%	-9.6%	27.3%	9.0%	14.4%

Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	118	103	154	177	202
Depreciation & Amortization	164	169	172	180	187
Change in Working Capital	(75)	(58)	43	7	5
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	45	43	14	14	14
Capital Expenditure	(150)	(185)	(185)	(165)	(165)
Free Cash Flow	102	71	199	212	243
% Change	-63.0%	-29.9%	178.6%	6.8%	14.4%
Share / Issue Repurchase	(101)	8	8	8	8
Cost of Dividends Paid	(1)	(1)	0	0	0
Change in Debt	76	(82)	(20)	(40)	(100)

Balance Sheet Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	14	15	202	381	532
Trade Receivables	66	61	64	67	69
Other Current Assets	121	107	108	112	116
Property, Plant & Equipment	817	808	821	807	785
Other Non-Current Assets	1,467	1,495	1,495	1,495	1,495
Total Assets	2,484	2,487	2,690	2,862	2,998
Short-Term Debt	53	0	0	0	0
Other Current Liabilities	558	536	583	596	608
Long-Term Debt	936	912	892	852	752
Other Non-Current Liabilities	1,205	1,183	1,183	1,183	1,183
Total Liabilities	2,753	2,631	2,658	2,631	2,543
Total Equity	(268)	(144)	32	231	455
Total Equity & Liabilities	2,484	2,487	2,690	2,862	2,998

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Restaurants

Company Description

Brinker International comprises two brands - casual diner Chili's Grill & Bar and polished casual chain Maggiano's Little Italy - Chili's domestic system is about 12x the size of Maggiano's when measured by sales (\$3.4BB vs 273MM in F21) and drives Brinker's results. The N. American Full Service segment (includes bar & grill and steak) is the largest among full service markets but also the most consolidated.

Investment Rationale

Because there are multiple large, scaled players in the Bar & Grill category, competitive intensity translates into lower average volumes, softer SSSG, and lower returns. Pre-COVID, Chili's 5-yr comp CAGR was 0.3%, with price accounting for more than all of that (avg annual price increase 1.3%). By the same token, the presence of other scaled operators means that Chili's ROI (15%) is lower. And given EAT's high operating & financial leverage, we see higher EPS risk in a slow growth environment.

Stock Data

Average Daily Volume 1,150,739

Exhibit 1: We estimate F24 EPS of \$3.60 and F25 EPS of \$3.94

EAT Income Statement, 2023-2025E

(\$ millions, FYE June)		2023	1Q24	2Q24	3Q24E	4Q24E	2024E	2025E
Company Restaurant Sales		4,093.2	1,002.0	1,063.7	1,113.2	1,123.0	4,301.9	4,490.9
Franchise & Other		40.0	10.5	10.4	10.7	11.1	42.7	43.8
Total Revenues		4,133.2	1,012.5	1,074.1	1,123.9	1,134.2	4,344.7	4,534.6
% Growth		8.7%	6.0%	5.4%	3.8%	5.5%	5.1%	4.4%
<u>Expenses</u>								
Cost of Sales		1,146.3	258.8	273.1	275.0	269.7	1,076.6	1,113.3
Restaurant Labor		1,389.3	348.1	356.1	380.9	383.7	1,468.9	1,566.6
Restaurant Expenses		1,097.5	290.8	294.7	310.4	315.1	1,211.0	1,236.2
D & A		168.5	41.9	41.3	44.1	44.6	171.9	179.6
G & A		154.5	42.4	43.2	45.0	45.4	175.9	181.4
Other (Gains) & Charges (Rest., Refranch., etc)		32.7	6.3	3.3			9.6	-
Operating Income		144.40	24.2	62.4	68.5	75.6	230.8	257.6
Interest Expense		54.9	17.0	16.7	16.6	16.5	66.8	57.4
Other		(1.3)	0.0	(0.1)	(0.6)	0.0	(0.7)	(0.7)
Total		4,042	1,005	1,028	1,071	1,075	4,180	4,334
Pretax Income		90.8	7.2	45.8	52.5	59.1	164.7	200.8
Taxes		(11.8)	0.0	3.7	3.2	3.5	10.4	24.1
Tax Rate		-13.0%	0.0%	8.1%	6.0%	6.0%	6.3%	12.0%
Adjusted Tax Rate			-5.9%	9.2%				
Net Income, reported		102.6	7.2	42.1	49.4	55.6	154.3	176.7
Pre-tax adjustments		24.9	4.7	3.3	-	-	8.0	-
Tax adjustments		(0.1)	0.7	(0.8)	-	-	(0.1)	-
Net Income before special items		\$127.4	\$12.6	\$44.6	\$49.4	\$55.6	\$162.2	\$176.7
Adjusted Net Income		127.4	12.6	44.6	49.4	55.6	162.2	176.7
% Growth		-9.6%					27.3%	9.0%
Adjusted EPS		\$2.85	\$0.28	\$0.99	\$1.10	\$1.24	\$3.60	\$3.94
% Growth		-7.9%	-148.2%	30.5%	-10.6%	-11.1%	26.6%	9.3%
Diluted Shares Outstanding		44.8	45.4	44.9	44.9	44.9	45.0	44.9
Actual Shares Outstanding		44.7	45.3	44.8	44.8	44.8	45.0	44.8

Source: BofA Global Research estimates, Company filings

BofA GLOBAL RESEARCH



Price objective basis & risk

Brinker International (EAT)

Brinker's relative valuation to the S&P is 0.6x, in line with its 5-year historical average (0.6x), which we view as the relevant time frame given higher leverage and slower growth vs the more distant past. We valuation to remain in line with the historical range as upside to restaurant margins and EPS are limited by traffic/mix headwinds and investments to sustain traffic gains. Applying a 0.6x relative multiple (unchanged) to our 12-month forward EPS (3QF25-2QF26: \$4.23), we arrive at our PO of \$44.

Upside risks are i) higher-than-expected demand from consumer trade-down into lower price point casual dining brands, which could drive Chili's sales volumes above our forecasts, ii) higher than forecasted debt pay down, which could expand Chili's relative multiple above our target valuation, iii) higher margins and returns at Chili's as a result of moderating commodities and wage inflation.

Downside risks are i) a significant slowdown in consumer spending could pressure EAT's topline growth, exacerbating the risk of company's high operating and financial leverage, ii) increased competitive intensity from casual dining peers, which would put downward pressure on Chili's average volumes and unit level returns.

Analyst Certification

I, Katherine Griffin, 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
BUY				
	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
	Portillo's Inc.	PTLO	PTLO 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
NEUTRAL				
	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
UNDERPERFORM				
	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

iQmethodSM 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 & 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

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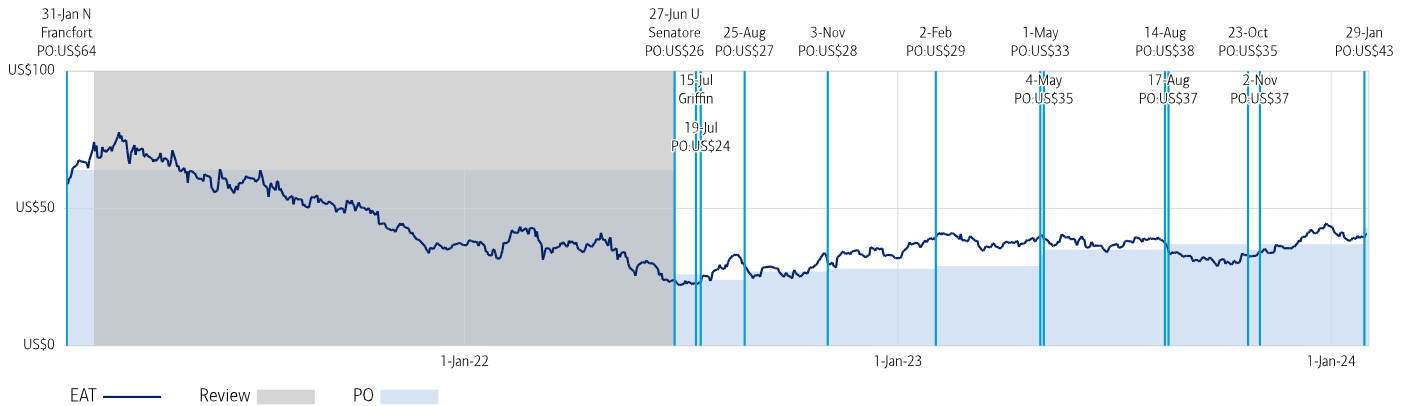
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Brinker Intl (EAT) Price Chart



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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	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 ^{R1}	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%

^{R1} 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 ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} 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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