



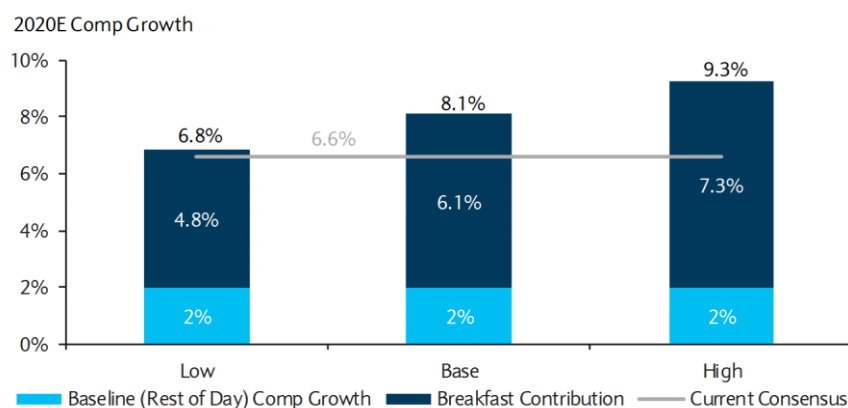
## U.S. Restaurants

# Wendy's Breakfast V4.0...Geolocation Suggests Skepticism 'Overcooked'

At its October 2019 Investor Day, Wendy's management offered detailed plans on the re-launch of breakfast nationwide (likely by the end of March 2020). In this report, our Investment Sciences team used geolocation data to examine the ~300 Wendy's restaurants that currently offer breakfast and assess the potential for the rollout.

- **We estimate breakfast could support 7-9pp comp growth for the system in 2020.** Such is predicated on a full-year 13-18% traffic lift, mitigated by a ~25% lower average check in the breakfast daypart (Fig. 4) and an end of 1Q20 launch.
- **MCD will likely 'defend' its industry leading breakfast share at 25%+ of sales.** That said, even our bull case suggests Wendy's would have a lower share of combined breakfast customers than it currently has rest of the day, and would be below the threshold where it makes sense for MCD to make an aggressive response.
- **WEN guidance appears reasonable, with our cautious view still above consensus.** While many investors are prudently skeptical, and breakfast consensus difficult to assess thus far, we believe WEN breakfast guidance (8-10% run rate) is reasonable.
- **Prior WEN breakfast launches failed due to:** 1) lack of franchise engagement / support; 2) lack of brand momentum; 3) regional rollout allows for easy competitive response; 4) complex operation with large investment in equipment / labor; 5) complex offering with large SKU requirement / slow speed. **We believe these issues have been addressed within the 2020 rollout, and we're bullish on WEN shares.**

**FIGURE 1**  
Even Our Cautious (Low End) Geolocation-Based Estimate for the Comp Contribution from Wendy's New Breakfast Launch Supports 2020 Comp Above Consensus



Source: Complementics, Barclays Research

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## INDUSTRY UPDATE

## U.S. Restaurants

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## How Many People Are Likely to Eat Breakfast from Wendy's?

With Wendy's planning to re-launch breakfast nationwide (likely by the end of March), we formed what we believe a reasonable estimate of how many customers the platform is likely to attract.

Our starting point is the limited number of Wendy's (WEN/OW) restaurants that already offer breakfast (~300 of Wendy's ~6,200 US restaurants). We then compare that breakfast traffic to its closest competitors - McDonald's (MCD/OW) & Burger King (QSR/OW) – to estimate a reasonable contribution from the breakfast daypart.

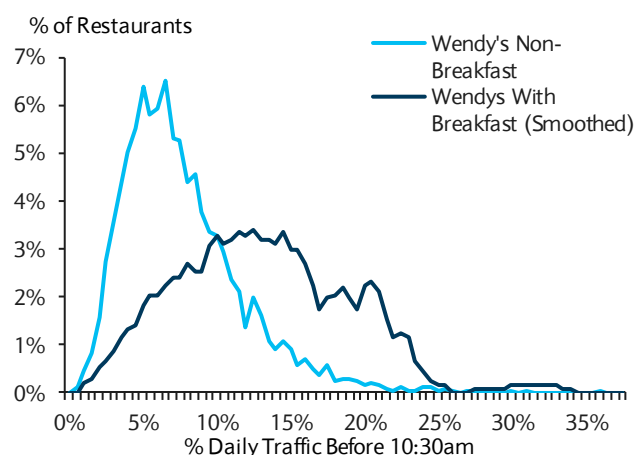
For Wendy's, we used the store locator on its ordering website to identify which restaurants currently offer breakfast. We then use geolocation data to estimate breakfast traffic for Wendy's, McDonald's & Burger King (see [Data Science Methods: Making Geolocation Data Work](#), October 15, 2019 for general information about our methods).<sup>1</sup>

For each restaurant, we estimate the percent of daily traffic during core breakfast hours (we assume 5:00am to 10:30am).

- At Wendy's restaurants currently selling breakfast, we estimate traffic during this timeframe represents ~13% of overall daily traffic. We also estimate that restaurants not selling breakfast average ~7% of daily traffic before 10:30am, of which ~2% is a combination of noise / employees working before opening hours, and ~5% is traffic at restaurants that open before 10:30am for lunch.
- Using the same timeframe, we estimate McDonald's breakfast contributes 21%+ of overall daily traffic & Burger King breakfast contributes ~16% of overall daily traffic, with both corroborated by these competitors in past public commentary. This increases our confidence in the reasonableness of our geolocation estimates.

FIGURE 2

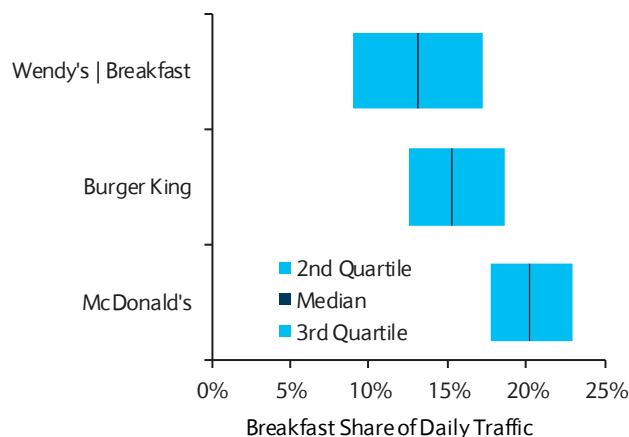
Wendy's That Serve Breakfast See A Much Larger Share of Traffic Before 10:30am



Source: Complementics, Barclays Research

FIGURE 3

At Wendy's Currently Offering Breakfast, Traffic Share is Lower than MCD, But Close to in-line with BK



Note Source: Complementics, Barclays Research

The most notable feature of the current Wendy's breakfast traffic is the relative similarity to Burger King, while both are clearly well below McDonald's.

<sup>1</sup> We only use traffic for standalone restaurant locations, excluding those in malls, airports and other large buildings where there is too much ambiguity surrounding attribution of traffic. That leads to us using 4,674 Wendy's locations (of which 190 serve breakfast), 10,945 McDonald's locations & 5,509 Burger King locations.

**We use three scenarios to estimate the impact to Wendy's 2020 comp growth from a nationwide breakfast launch:**

**(1) Base:** Assume Wendy's breakfast traffic share matches Burger King:

- Wendy's is generating its current breakfast traffic at a level slightly below Burger King but without the significant benefit of national advertising, creating upside to a nationwide launch with national advertising.
- Traffic observed in Wendy's restaurants with breakfast is a combination of its old and new breakfast offering, and therefore not apples-to-apples, with our belief that the new offering will have stronger / more consistent results.
- Wendy's mean in our data is lower. But because it is a noisy statistical process, and Wendy's has only select stores with breakfast, there is a ~80% chance that Wendy's breakfast traffic actually resembles Burger King.

**(2) Low:** Assume all Wendy's restaurants see the same breakfast traffic share as the current ~300 restaurants that offer it. Why we think this is a reasonable downside:

- Even if Wendy's did not benefit from the items in the base case above – national ad support, new menu items, reduced statistical error - the brand has generated this share of breakfast traffic with the existing offering.

**(3) High:** Assume Wendy's breakfast traffic share achieved a level between Burger King and McDonald's. Why we think that's a reasonable upside:

- If the new menu is very successful, it would likely exceed Burger King sales mix, though still not reach the mix at McDonald's for many years, if ever.

**In all cases, we make the following assumptions:**

- Breakfast average check is ~75% of the rest of the day average check, so the assumed traffic growth needs to be haircut in estimating the comp benefit.
- Pre-10:30am traffic for core / non-breakfast menu items needs to be backed out of the assumed breakfast traffic gain in order to avoid double-counting.
- Pre-opening employee traffic should be backed out because it will instead be captured in the new (earlier) pre-opening hours (where it is captured for McDonalds, Burger King & Wendy's already serving breakfast).
- The core / non-breakfast comp continues to grow at Wendy's historical comp levels.
- Traffic in the core / non-breakfast dayparts are unaffected by the addition of customers at breakfast (no customers move a Wendy's visit from lunch / dinner to breakfast). This assumption has the greatest risk, though with the average Wendy's customer visiting only ~5.5x / year, relative to McDonald's at ~25x / year (both Wendy's management estimates), cannibalization would be modest.

*"We have not seen cannibalization in our restaurants where we've brought in breakfast... we believe this is incremental to our business overall, and that's what makes it so financially powerful." – Kurt Kane, Wendy's US President & Chief Commercial Officer*

FIGURE 4

**We Anticipate Wendy's Comp Growth of 9-13% If Breakfast Had Been Added At The Start of 2020...We Expect it by End of March, but Assume End of April For Estimates**

	Low	Base	High
Logic	Wendy's limited-location breakfast expanded to all stores	Performs similar to Burger King breakfast	Performance between BK and MCD breakfast
Raw Breakfast Traffic	13.4%	15.9%	18.2%
Less: People Who Already Eat at Wendy's Before 10:30am	-1.7%	-1.7%	-1.7%
Less: Employee Traffic Before 10:30am	-2.1%	-2.1%	-2.1%
Equals Annualized Breakfast Traffic Gain	9.6%	12.1%	14.4%
Reduced by: Breakfast Check Percent Relative to Rest of Day Check	75%	75%	75%
Full-Year Equivalent Comp Contribution from the Breakfast Launch	7.2%	9.1%	10.8%
Reduced by Percent Of 2020 Revenue Year Left After Launch	67%	67%	67%
2020 Comp Contribution from Breakfast	4.8%	6.1%	7.3%
Plus: Baseline Rest of Day Comp Growth	2.0%	2.0%	2.0%
<b>2020E Total Comp Growth</b>	<b>6.8%</b>	<b>8.1%</b>	<b>9.3%</b>
Current Consensus (Consensus Metrics)	6.6%	6.6%	6.6%
Barclays Restaurant Team Estimate	8.1%	8.1%	8.1%

Note: Assumes breakfast is launched by end of April 2020. Source: Complementics, Barclays Research

## How We Account for McDonald's Competitive Response

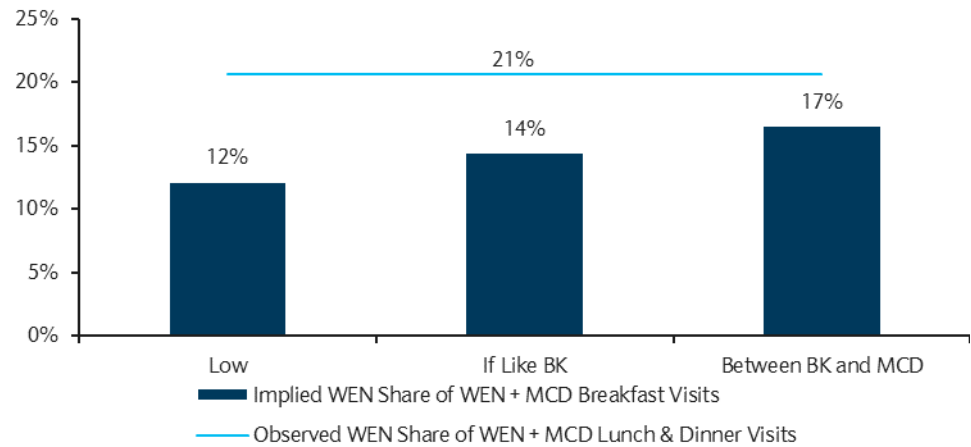
*"There is also a [franchisee] feeling which is we pioneered breakfast, we own breakfast... There is a real strong [franchisee] feeling that we're going to defend it and we're going to make sure that we don't let someone in that creates a long lasting problem."* – Chris Kempczinski, MCD CEO

It would be naïve to assume that McDonald's & other quick-service breakfast market participants will not respond to Wendy's breakfast launch in an effort to protect their market share.

One factor that needs to be considered is the pro forma market share implied by our model. Our measurement of traffic suggests that Wendy's has about a ~20% market share of visits to both Wendy's & McDonalds (i.e., McDonald's currently receives 4x as many visits as WEN in non-breakfast dayparts). Viewed differently, this is not surprising given MCD has ~2x as many stores and ~2x the AUV of WEN with a similar average check, and therefore a 4:1 ratio of market share visits (80% MCD / 20% WEN). Currently McDonald's holds the vast majority of the share at breakfast, but our comp growth estimates imply pro forma market share for Wendy's of 12-17%. Given this market share is lower than WEN's share of lunch & dinner, we believe our estimates are already consistent with absorbing some competitive response from McDonalds and other quick-service breakfast players and could ultimately be conservative. Importantly, we do not believe Wendy's will be able to achieve a breakfast mix anywhere close to McDonald's over the next many years, as McDonald's has been dominant in the daypart for 50+ years, and therefore has a large first-mover advantage on a variety of fronts (i.e., real estate, marketing, habitual behavior / loyalty).

FIGURE 5

**All Of Our Breakfast Case Assumptions Imply Wendy's Will Have a Lower Share of Traffic vs McDonald's At Breakfast Than They Already Capture at Lunch or Dinner Times**



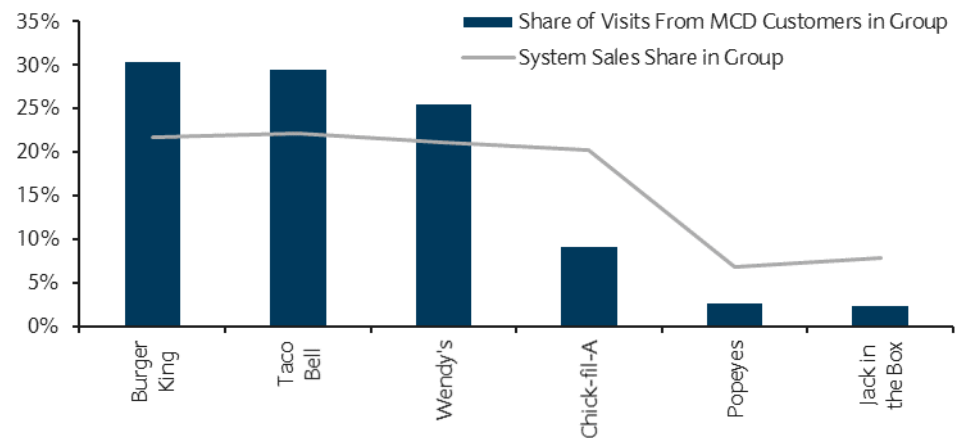
Source: Complementics, Barclays Research

Another way to look at it is the cost to McDonald's of defending that market share, and whether it would consider it worthwhile if, ultimately, it is unable to push Wendy's out of the breakfast daypart entirely. Given past (unsuccessful) attempts at breakfast and the spotlight given to this effort at its most recent 2019 Investor Day, we believe Wendy's management is determined to make this rollout a near- & long-term success.

One option is for McDonald's to offer free coffee to breakfast customers (or a comparable / similar discount offering). This type of response is very costly given the relative scale of McDonald's market share: McDonald's would be giving free product to many customers who were unlikely to ever leave, in order to retain a much smaller number of customers who might consider leaving. And with McDonald's having 2x the number of US restaurants relative to Wendy's, the McDonald's franchisees at the one-half of restaurants that are not located near a Wendy's would not be happy with the unnecessary discounted offering.

FIGURE 6

**Customer Overlap Between Select Quick-Service Chains Shows McDonald's / Wendy's Overlap Higher Than Sales Suggest, But Still Lower Than With Burger King and Taco Bell**



Source: Complementics, Barclays Research

An analysis of the revenue loss of free coffee suggests it would generate an immediate net gain only if an undefended Wendy's breakfast would claim more than 12% of McDonald's

breakfast traffic. Our estimate is that even the high case for Wendy's would only put ~8% of McDonald's breakfast traffic at risk of departing (and likely less, as Wendy's will almost surely attract customers from other quick-service brands as well). The downside potential of this strategy to McDonald's is compounded by the fact that Wendy's is not actually McDonalds' most significant competitor, in either system sales or our view of customer overlap (Figure 6). Therefore, taking the most aggressive strategy has the potential to draw more customers (and thus secondary responses) from even competitors more significant than Wendy's.

**Bottom line, while we believe McDonald's will respond in some way to Wendy's, we don't anticipate they will deploy a scorched earth strategy with broad-based discounts.**

## Share Price Implications

We remain bullish on the shares of Wendy's at current levels. And such was accentuated by takeaways from its 2019 Investor Day, which offered lots to be excited about. See below for excerpts from our note entitled "Growth Initiatives Refined... Getting Better with Age" (*link attached*) post the 10/11/19 Investor Day. In addition, we include a link to our Wendy's note, "Mgmt Meetings...Top 5 Takeaways; "System Pretty Darn Excited"" (*link attached*) post the 11/18/19 non-deal roadshow we hosted with management.

"The focus all about their national breakfast launch, int'l unit growth & digital sales growth. To be fair, we were excited about these opportunities when presented in years past. But importantly, we believe franchisees / management better positioned to execute this time around. Not surprisingly, these all require investments. Investor patience is essential as near-term growth tempered before reaping rewards of outsized growth beyond 2020. Long-term annual guidance culminates in high single-digit EBITDA growth. While such is similar to guidance in years past, we believe more credible this time around, with benefit from breakfast & int'l growth."

2019, 2020 & LT Guidance; 3Q19 comps were 4.4%, above sub-3% consensus. And all 2019 guidance was reiterated, with sales at the high end of ranges. As for 2020, guidance culminates in EBITDA of \$425-435m, up ~5% y-y, below consensus at \$465m, with the headwind a \$30m+ investment in breakfast ads. System sales growth of 13% is supported by ~3% unit & high-single-digital comp growth, led by breakfast. Long term (2021-2024), guidance culminates in high-single-digit EBITDA growth, supported by 4-5% system sales growth, including ~3% unit & 1-2% comp growth.'

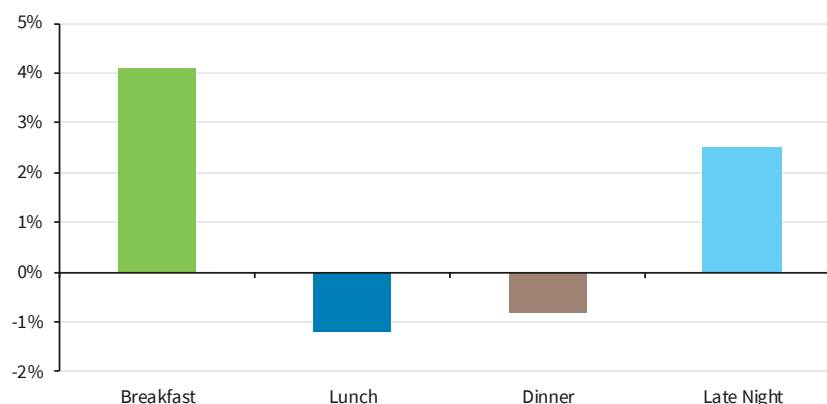
**Breakfast launch;** target 10% sales mix, supported by ~\$20m initial investment in '19 & \$30m+ contribution of breakfast royalty into ad fund in '20, fading in '21 & '22.'

Investor skepticism around Wendy's announced nationwide breakfast launch on 9/9/19 was palpable, as evidenced by the ~10% drop in the shares (vs. the S&P 500 Flat) the next day. To its credit, management did acknowledge missteps in its previous attempts to enter the breakfast daypart, noting the lack of widespread franchisee buy-in, high operational complexity, labor intensity, out-of-control food costs, and fragmented local ad plans. Additionally, the prior launch of breakfast did not 'have scale behind it' as the initiative was launched from a regional perspective.

This time around, the research and planning process was far more structured and deliberate with full engagement from the franchise community every step of the way. Ultimately, management believes the new breakfast rollout, expected to commence in 1Q20, will be operationally simple to execute (18 SKUs vs. the prior 45) without any incremental equipment upgrades and minimal staffing requirements, while supporting the initiative with

‘full national media power’. In terms of the rationale for pursuing breakfast in the first place, third-party research (NPD Crest) suggests quick-service breakfast is the most attractive daypart, with growth of +4.1%, relative to lunch at -1.2%, dinner at -0.8%, & late night at +2.5%.

FIGURE 7

**Total Quick-Service Traffic Growth by Daypart**

Source: Company Reports, The NPD Group / CREST® Total Day. PC5YA – YE May '19

As for breakfast specifics, the plan is to introduce a ‘craveable yet efficient’ menu consisting of mostly sandwich items (i.e., croissants, biscuits, ‘Baconator’) that are operationally comparable to the core burger & chicken sandwich platforms. And in a nod to the potential for coffee to drive habitual morning traffic, Wendy’s ‘went to school’ in designing a truly differentiated offering (the ‘Frosty-ccino’) that leverages in-house brand equities rather than relying on an external supplier. In terms of testing, the company introduced the new menu lineup within the existing ~300 units that already featured breakfast and the subsequent effect was ‘an immediate sales impact’ with minimal operational complexity, manageable food costs, and a ‘great customer response’. Test results were in line with their internal models / forecasts, while being achieved with little media support or customer outreach.

Looking ahead, management expects breakfast sales will eventually grow to ‘at least 10%’ of the daily sales mix, while resulting in minimal cannibalization to the existing lunch & dinner business. In terms of sequencing, Wendy’s aims to ‘maximize the upside’ of breakfast during the first year post-rollout. From a financial standpoint, management already invested ~\$20m in 2019 for startup costs (i.e., small wares, menu boards & recruiting / training). In 2020, breakfast will be further supported by a ‘fully national and incremental media approach’ via the reinvestment of breakfast royalties (~4% of gross breakfast sales) in addition to ongoing marketing fund contributions (~3.5% of gross breakfast sales). Our back-of-the-envelope math implies a total incremental royalty reinvestment of \$30m+. This is predicated on breakfast reaching a 7% mix (midpoint of 6-8% in 2020 guidance) on total US system sales of \$11b+ (\$12.25b global system sales at the midpoint of 2020 guidance less \$1b+ in international system sales), which ultimately implies \$700m+ in 2020 breakfast sales (yielding \$30m+ when applying the 4% royalty rate). And beyond 2020, Wendy’s will continue a similar approach, though the incremental royalty support will fade over time as breakfast sales become accretive to profitability and free cash. In terms of the bottom line, the plan is for breakfast will be profitable in 2021.”



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**McDonald's Corp.** (MCD, 22-Jan-2020, USD 211.44), Overweight/Neutral, A/CD/CE/D/J/K/L/M/N

**Restaurant Brands International** (QSR, 22-Jan-2020, USD 65.13), Overweight/Neutral, A/CE/D/J/L

**The Wendy's Company** (WEN, 22-Jan-2020, USD 21.99), Overweight/Neutral, CE/J

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McDonald's Corp. (MCD)	Performance Food Group Co. (PFGC)	Restaurant Brands International (QSR)

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## IMPORTANT DISCLOSURES CONTINUED

## McDonald's Corp. (MCD / MCD)

USD 211.44 (22-Jan-2020)

Stock Rating

OVERWEIGHT

Industry View

NEUTRAL

## Rating and Price Target Chart - USD (as of 22-Jan-2020)

Currency=USD



Publication Date	Closing Price	Rating	Adjusted Price Target
09-Jan-2020	205.91		233.00
22-Oct-2019	199.27		225.00
26-Jul-2019	215.58		230.00
30-Apr-2019	197.57		220.00
19-Dec-2018	179.16		208.00
23-Oct-2018	177.15		198.00
26-Jul-2018	156.14		194.00
30-Apr-2018	167.44		204.00
30-Jan-2018	172.48		200.00
16-Jan-2018	173.68		205.00
08-Dec-2017	173.15		193.00
18-Oct-2017	165.77		182.00
25-Jul-2017	159.07		173.00
30-May-2017	149.93		164.00
25-Apr-2017	141.70		155.00

On 23-Jan-2017, prior to any intra-day change that may have been published, the rating for this security was Overweight, and the adjusted price target was 139.00.

Source: Bloomberg, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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**Valuation Methodology:** Our price target is \$233, or ~17.5x our 2021 EBITDA forecast of ~\$11.6b.

MCD has historically traded within a 3-year EV/EBITDA range of 13-18x with an average of ~16x.

**Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target:** Competition, specifically related to price, service, location, personnel and quality of food, is the most significant risk faced by companies in the restaurant industry. If there were a significant change in the competitive landscape from current levels, our earnings forecast, rating and price target would have to be reconsidered. Other risks that would require us to review our investment thesis include food safety, including the effects of food borne illness, changes in interest rates, foreign currency exchange rates, commodity prices and government regulation surrounding the restaurant industry.

## IMPORTANT DISCLOSURES CONTINUED

## Restaurant Brands International (QSR / QSR)

USD 65.13 (22-Jan-2020)

Stock Rating

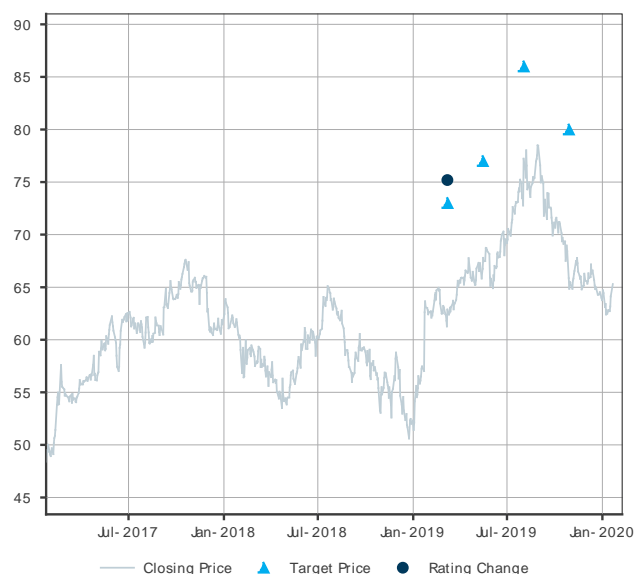
OVERWEIGHT

Industry View

NEUTRAL

## Rating and Price Target Chart - USD (as of 22-Jan-2020)

Currency=USD



Publication Date	Closing Price	Rating	Adjusted Price Target
28-Oct-2019	68.45		80.00
02-Aug-2019	77.22		86.00
15-May-2019	66.76		77.00
08-Mar-2019	62.87	Overweight	73.00

Source: Bloomberg, Barclays Research

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Source: IDC, Barclays Research

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**Valuation Methodology:** Our price target is \$80, or ~18.5x our 2021 EBITDA forecast of ~\$2.6b.

QSR has historically traded within a 3-year EV/EBITDA range of 15-20x with an average of ~18x.

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## IMPORTANT DISCLOSURES CONTINUED

## The Wendy's Company (WEN / WEN)

USD 21.99 (22-Jan-2020)

Stock Rating

OVERWEIGHT

Industry View

NEUTRAL

## Rating and Price Target Chart - USD (as of 22-Jan-2020)

Currency=USD



On 23-Jan-2017, prior to any intra-day change that may have been published, the rating for this security was Overweight, and the adjusted price target was 15.00.

Source: Bloomberg, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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**J:** Barclays Bank PLC and/or an affiliate is a liquidity provider and/or trades regularly in the securities by The Wendy's Company and/or in any related derivatives.

**Valuation Methodology:** Our price target is \$26, or ~16.5x our 2021 EBITDA forecast of ~\$480m.

WEN has historically traded within a 3-year EV/EBITDA range of 13-17x with an average of ~15x.

**Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target:** Competition, specifically related to price, service, location, personnel, and quality of food, is the most significant risk faced by companies in the restaurant industry. If there were a significant change in the competitive landscape from current levels, our earnings forecasts, stock rating, and price target would have to be reconsidered. Other risks that would require us to review our investment thesis are food safety, including the effects of food-borne illness; changes in economic, market, and other conditions; government regulation related to the restaurant industry; growth plans; international operations; disposition of restaurants; and fluctuations in interest rates, foreign currency exchange rates, and commodity prices.

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