

Restaurants Industry

Casual Dining: Exceptions that prove the rule

Industry Overview

A slow growth industry, more cyclical industry

The casual dining restaurant (CDR) segment generated ~\$70 bb in sales in 2022, on a CAGR of just 2% since 2007 and a little over 1% since 2017. Unit count accounted for ~1/3 of total growth since 2007 (in 2022 there were ~21K CDRs) but unit count has declined since 2017; despite the exit of capacity from the market, traffic has been persistently negative. During the Global Financial Crisis (GFC), casual diners Same Store Sales Growth (SSSG) fell farther than QSR's, though less steeply than for Fine Dining.

But averages obscure wide variations among segments

The varied menu category accounts for ~40% of CDR sales but while large, it grows slowly – flat over five years – and well behind Steak's leading 5% CAGR. In that same vein, while steakhouse SSSG declines were of similar magnitude to those of the Italian and Varied Menu categories, the steakhouse demand has consistently outpaced that of other categories since. As fast casual has siphoned off convenience occasions, consumers are proving more selective in their use of full-service restaurants, seeking out strong value (markups are lowest on beef), and food or experiences they're unable to replicate at home or at a fast casual.

Dominant market share mitigates cyclicalities

In an industry where scale is the only sustainable competitive advantage, Olive Garden stands out for its dominance -- it is 6.5x as large as the next biggest Italian CDR, Carraba's. Its practice of reinvesting its low-cost advantages has translated into an average of ~1 ppt of market share gain annually for 15 years. In contrast, other chains have mostly held share and independents have shrunk. In the steak category, Texas Roadhouse and LongHorn Steakhouse have gained share at the expense of most other chains and independents. All three saw same store sales declines less precipitous than those of casual dining overall during the GFC. Among the varied menu restaurants, however, the presence of multiple large chains – and the absence of relative scale advantages – dictated that GFC SSSG declines were equally steep across concepts.

... and sustains supra-competitive returns

We attribute the role of share in lessening the impact of macroeconomic declines to two factors: the first is that in periods of economic strain, consumers seek certainty in their dining choices, a guarantee of a good experience that the best operators can provide; the second is that dominant scale translates into higher margins, affording large chains the ability to reinvest in price, value, service and quality when restaurants with slimmer margins are forced to cut back. An analysis of unit level returns against relative share suggests most casual diners are generating returns in-line with expectations; the steak category is an exception where Texas Roadhouse appears to be underearning and Outback's (BLMN) returns are somewhat higher than expected.

We favor industry leaders in single-cuisine categories

The sustained advantage provided by scale – when continuously reinvested in the business underpins our Buy Ratings on Darden and Texas Roadhouse.

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Equity
United States
Restaurants

Sara Senatore
Research Analyst
BofAS
+1 646 743 2110
sara.senatore@bofa.com

Katherine Griffin
Research Analyst
BofAS
+1 646 855 2849
katherine.griffin@bofa.com

Jessica Owusu Afari
Research Analyst
BofAS
+1 646 617 9040
jessica.owusu-afari@bofa.com

QSR: quick-service restaurant

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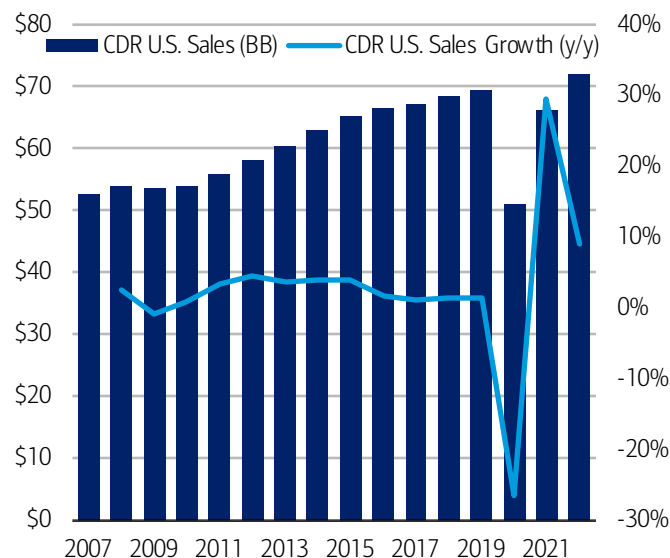
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Exhibit 1: The casual dining restaurant (CDR) segment generated ~\$70 bb in sales in 2022, on a CAGR of just 2% since 2007 and a little over 1% since 2017

U.S. casual dining restaurant sales by year vs. y/y growth

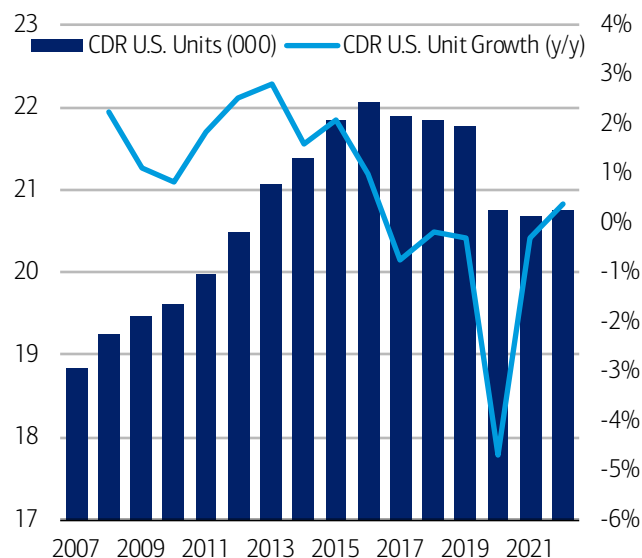


Source: Technomic

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Exhibit 2: There were ~21K casual dining restaurants in the US in 2022; unit count has accounted for ~1/3 of total growth since 2007, but has been negative since 2017

U.S. casual dining restaurant unit count by year vs. y/y growth



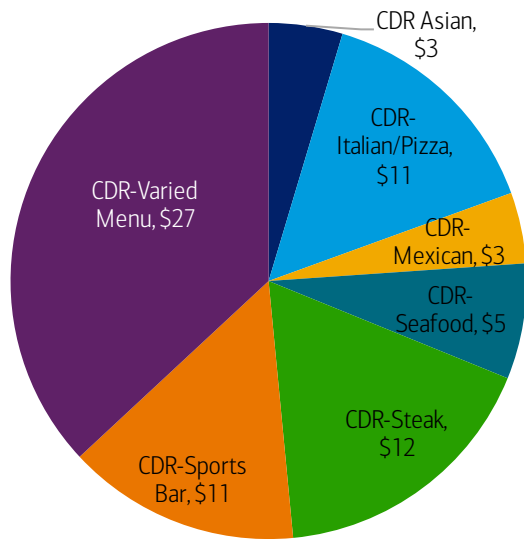
Source: Technomic

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But averages obscure wide variations among segments

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Exhibit 3: The varied menu category accounts for ~40% of CDR sales
2022 Sales by Casual Dining Category (\$BB)

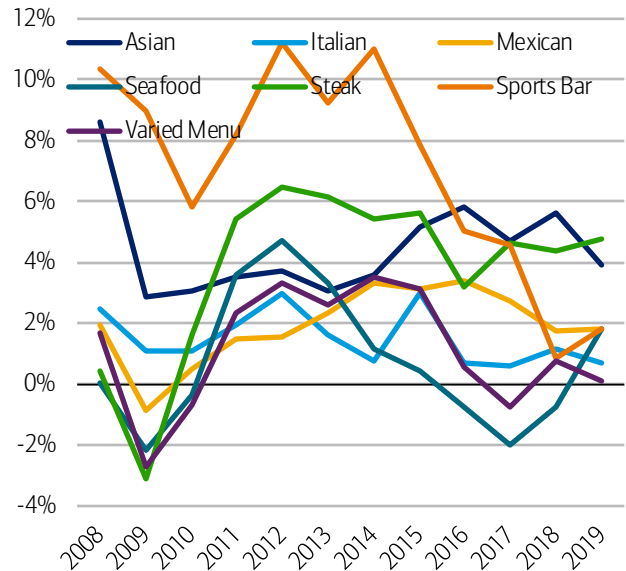


Source: Technomic

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Exhibit 4: But while large, varied menu is the second slowest growing category – flat over five years – just ahead of the Seafood category (-1% 5-yr CAGR) – and well behind Steak's leading 5% CAGR

Sales growth by CDR category 2008-2019

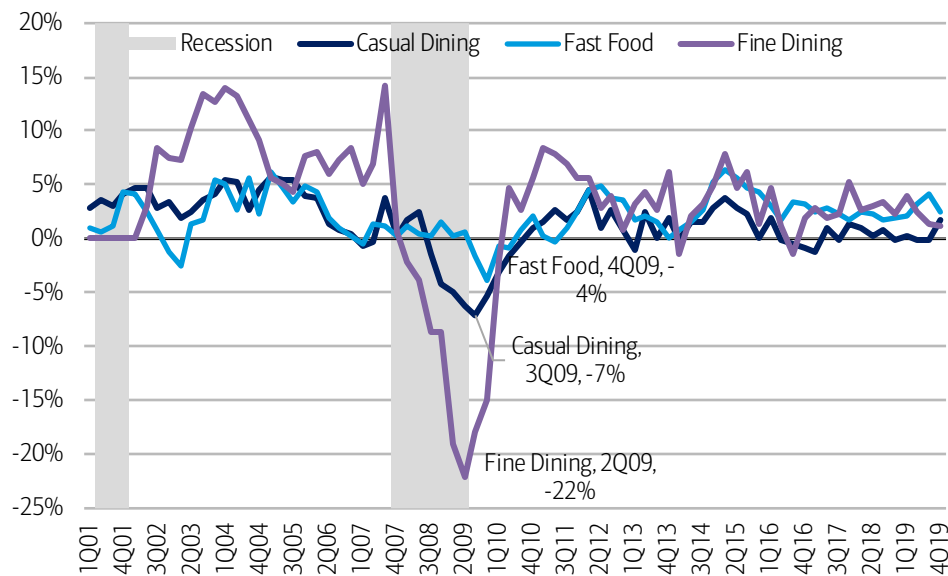


Source: Technomic

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Exhibit 5: Same Store Sales Declines were inversely correlated with price point during the Global Financial Crisis, but fine dining has outpaced other segments since, benefitting from consolidation and the relative strength of higher income consumers

SSSG by segment 2001-2019

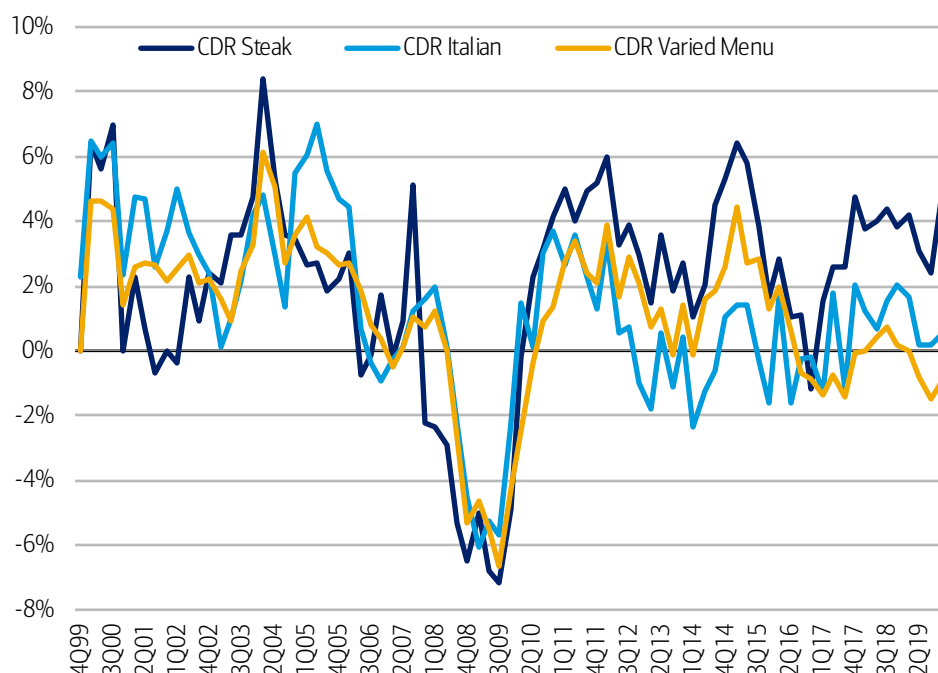


Source: Company reports

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Exhibit 6: During the GFC, SSSG declined similarly for the Steak, Italian, and Varied Menu CDR segments but over the next 10 years, steakhouses consistently outpaced

Average public company Same Store Sales Growth by Casual Dining cuisine



Source: Company reports, BofA Global Research estimates

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Exhibit 7: Among full service restaurants (casual dining, polished casual, fine dining), concepts with higher price points – fine dining, polished casual – tend to appeal to higher income cohorts; First Watch is an exception as higher income consumers gravitate to its breakfast/brunch offering

Estimated Household Income by brand

Brand	Avg HHI by brand	Median HHI by brand
Fleming's	\$121	\$83
The Capital Grille	\$113	\$80
First Watch	\$94	\$69
Carrabba's	\$87	\$65
Maggiano's	\$88	\$65
Bonefish Grill	\$83	\$64
Dave & Buster's	\$85	\$64
Red Robin's Gourmet Burgers	\$81	\$62
Cheesecake Factory	\$86	\$62
TGI Friday's	\$78	\$59
IHOP	\$78	\$58
Applebee's	\$77	\$58
BJ's	\$75	\$55
LongHorn Steakhouse	\$72	\$54
Olive Garden	\$68	\$51
Cracker Barrel	\$67	\$50
Chili's Grill & Bar	\$66	\$49
Denny's	\$65	\$49
Buffalo Wild Wings	\$63	\$47
Cheddar's Scratch Kitchen	\$64	\$46
Outback Steakhouse	\$60	\$44
Texas Roadhouse	\$57	\$41

Source: BofA Global Research estimates, Placer

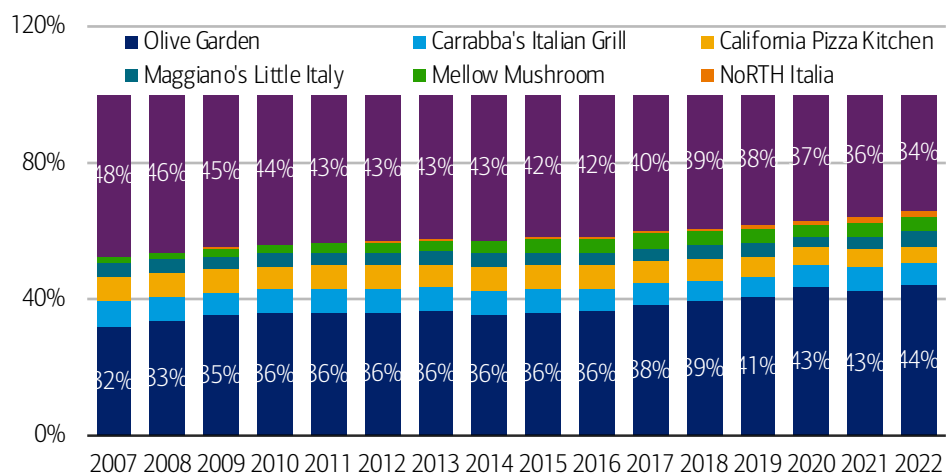
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Dominant market share mitigates cyclicality

In an industry where scale is the only sustainable competitive advantage, Olive Garden stands out for its dominance -- it is 6.5x as large as the next biggest Italian CDR, Carraba's. Its practice of reinvesting its low-cost advantages has translated into an average of ~1 ppt of market share gain annually for 15 years. In contrast, other chains have mostly held share and independents have shrunk. In the steak category, Texas Roadhouse and LongHorn Steakhouse have gained share at the expense of most other chains and independents. All three saw same store sales declines less precipitous than those of casual dining overall during the GFC. Among the varied menu restaurants, however, the presence of multiple large chains – and the absence of relative scale advantages – dictated that GFC SSSG declines were equally steep across concepts.

Exhibit 8: Olive Garden has gained share steadily in the Italian/Pizza full service category while other chains have mostly held share and independents have shrunk

Market share among the top six chains and "all other" in the Italian Casual Dining Segment

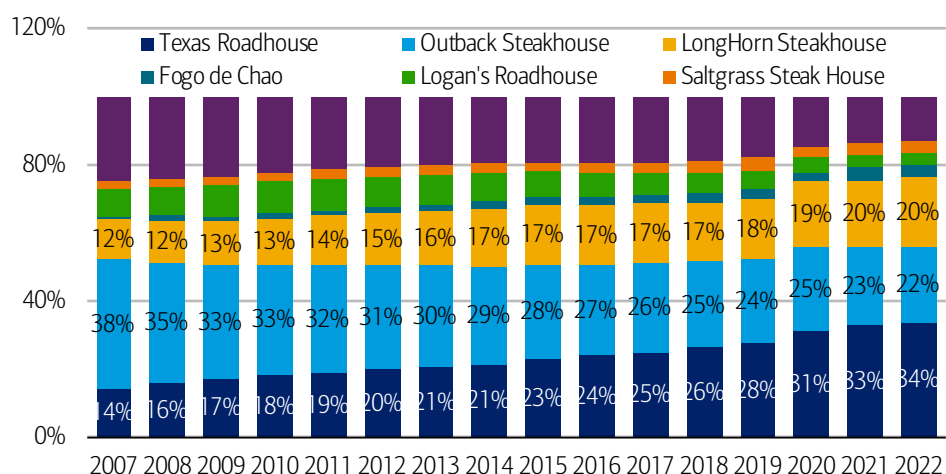


Source: Technomic

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Exhibit 9: Texas Roadhouse and LongHorn Steakhouse have gained share at the expense of most other chains and independents

Market share among the top six chains and "all other" in the Steakhouse Casual Dining Segment

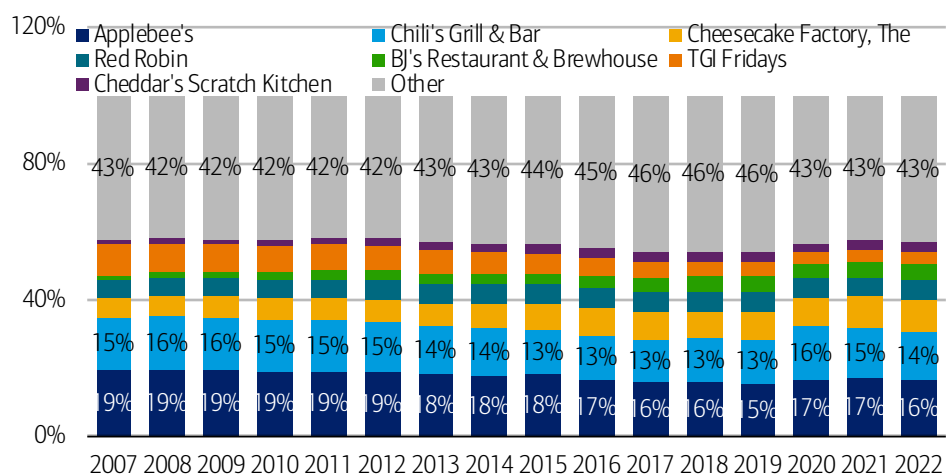


Source: Technomic

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Exhibit 10: Market shares in the varied menu CDR segment have been very stable

Market share among the top seven chains and "all other" in the Varied Menu Casual Dining Segment

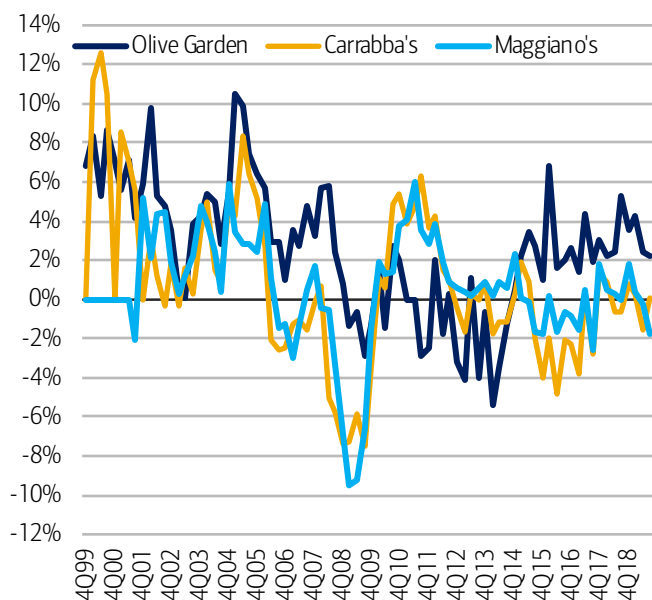


Source: Technomic

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Exhibit 11: Olive Garden's SSSG declines were more moderate than those of its Italian CDR competitors during the GFC

Same Store Sales Growth by Italian CDR chain over time

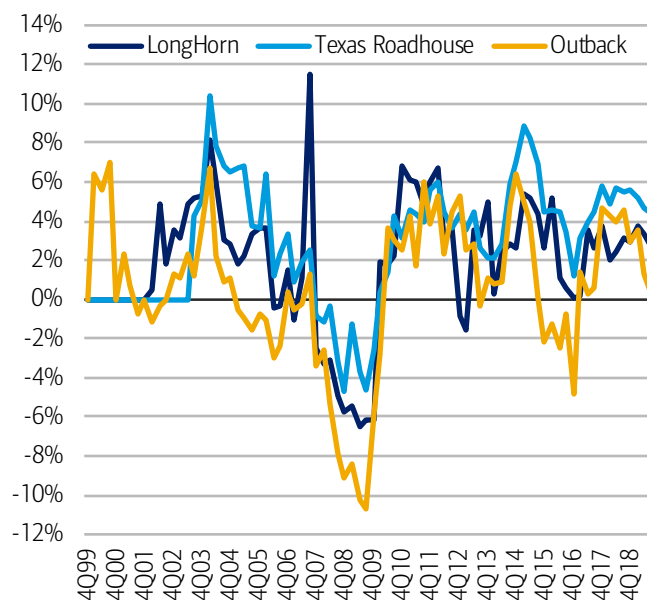


Source: Company reports, Bloomberg

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Exhibit 12: Reinvestment in quality and value during the GFC helped moderate declines at Texas Roadhouse and LongHorn during the GFC

Same Store Sales Growth by Steakhouse CDR chain over time

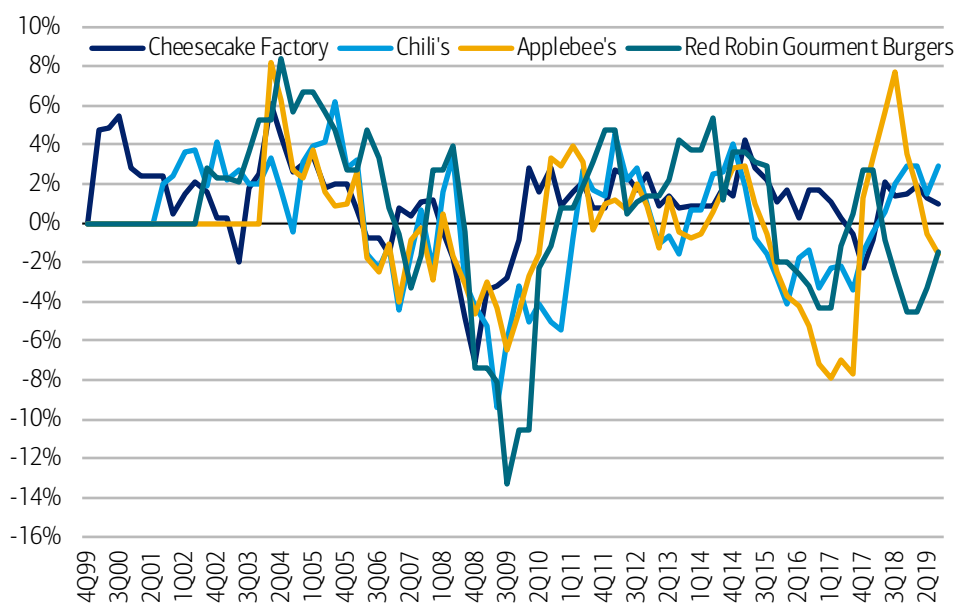


Source: Company reports, Bloomberg

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Exhibit 13: Varied menu casual diners suffered some of the steepest same store sales declines during the GFC

Same Store Sales Growth by Varied Menu CDR chain over time



Source: Company reports, Bloomberg

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... and sustains supra-competitive returns

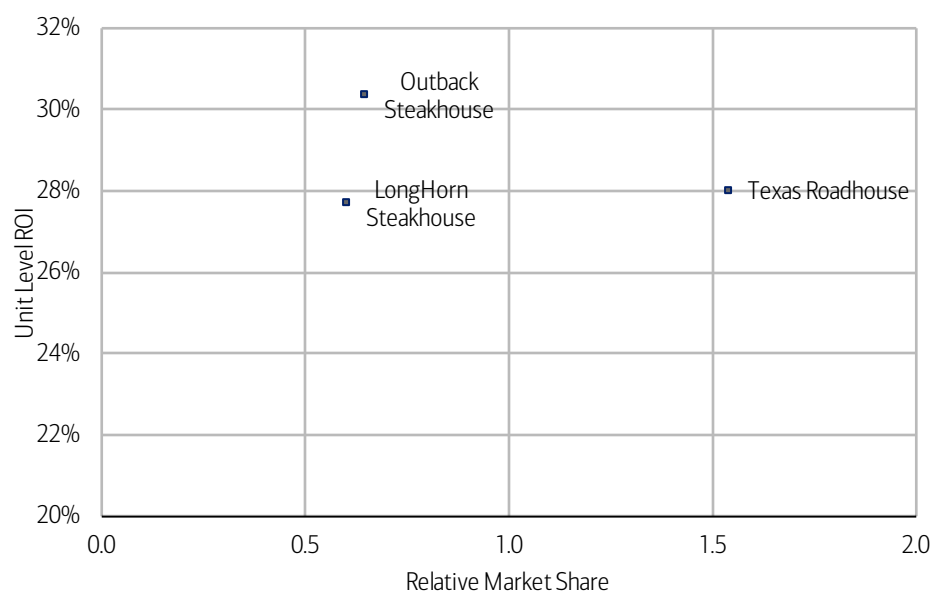
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We favor industry leaders in single-cuisine categories

The sustained advantage provided by scale – when continuously reinvested in the business – underpins our Buy Ratings on Darden and Texas Roadhouse.

Exhibit 14: Unit level returns are correlated with relative market share; Texas Roadhouse unit returns appear lower than expected while Outback returns look elevated

Relative market share (x-axis) vs 2021 unit level ROI (y-axis) adjusted for property ownership

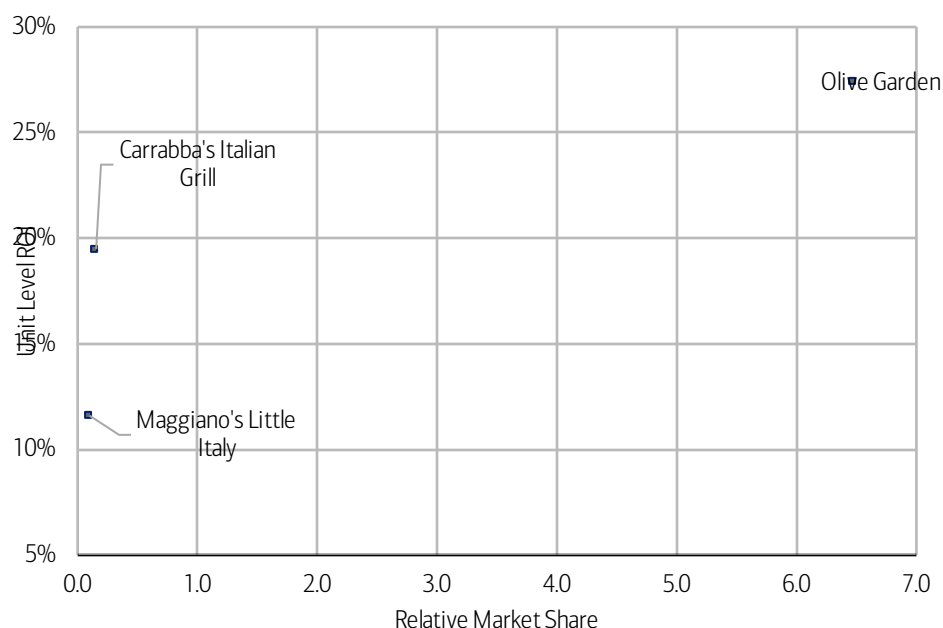


Source: Technomic, BofA Global Research estimates

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Exhibit 15: Olive Garden's returns are commensurate with its dominant market share

Relative market share (x-axis) vs 2021 unit level ROI (y-axis) adjusted for property ownership

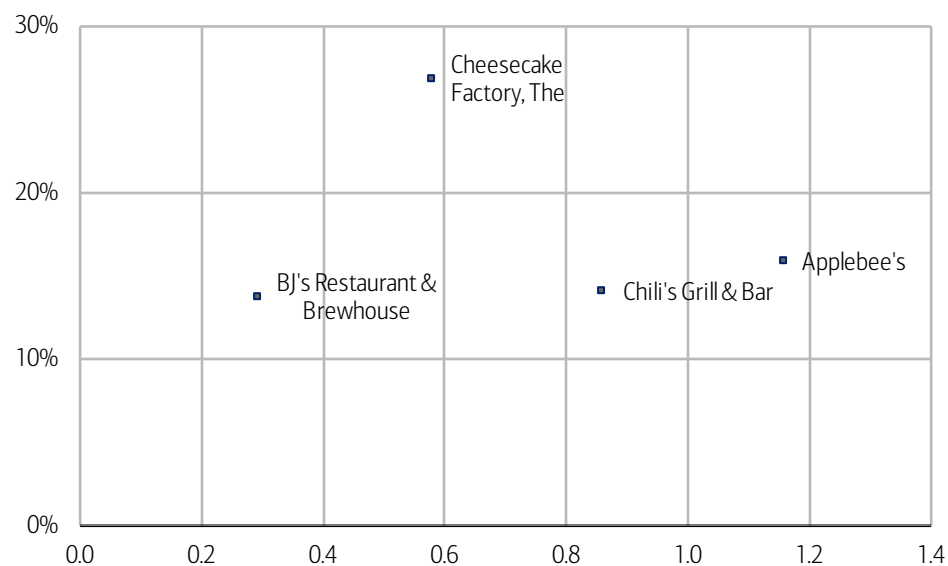


Source: Technomic, BofA Global Research estimates

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Exhibit 16: Returns are very similar for mainstream varied menu casual diners, but CAKE's polished casual positioning distinguishes it from lower price point competitors

Relative market share (x-axis) vs 2021 unit level ROI (y-axis) adjusted for property ownership

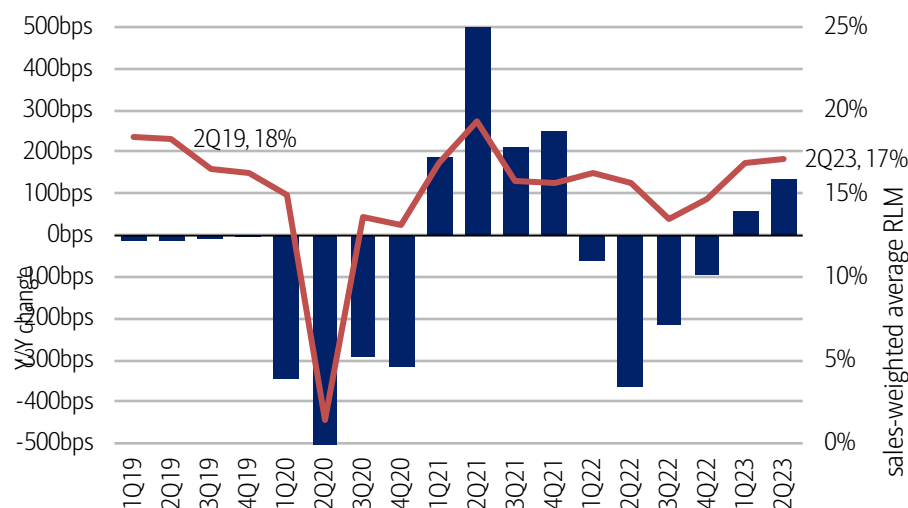


Source: Technomic, BofA Global Research estimates

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Exhibit 17: Margins have largely recovered to pre-COVID levels, suggesting that from here margin expansion will require positive SSSG or idiosyncratic cost opportunities

Sales weighted average Restaurant Level Margin vs y/y change



Source: Company reports, BofA Global Research estimates

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Exhibit 18: Stocks mentioned

Prices and ratings for stocks mentioned in the report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
DRI	DRI US	Darden Restaurants	US\$ 140.67	B-1-7
TXRH	TXRH US	Texas Roadhouse	US\$ 96.19	B-1-7

Source: BofA Global Research

Price objective basis & risk

Darden Restaurants (DRI)

Our 12-month \$187 price objective is based on a target relative P/E multiple (0.9x) on our forward estimates (F25, \$9.79). Our target relative multiple (vs the S&P) is in line with Darden's 10-year historical average multiple of 0.9x, and implies a 19.2x absolute P/E multiple. We believe the historical average multiple is relevant as Darden's returns and growth have consistently outpaced those of the market. While investors remain cautious on restaurant spending, we believe fundamental outperformance by best-in-class operators like DRI will prove attractive.

Downside risks are 1) lower-than-expected customer acceptance of menu price increases, 2) inability to offset higher than expected food or labor costs with increased pricing, 3) macroeconomic pressures that slow consumer income growth, 4) slower-than-expected unit growth as a result of inflationary pressures (i.e., utilities costs) and supply-chain constraints.

Texas Roadhouse (TXRH)

Our PO of \$133 is based on a relative multiple of 1.4x (vs the S&P 500, or a 21.8x absolute multiple) on our 12-month forward EPS (3Q24-2Q25, \$6.11). We expect

continued topline growth and further operating leverage. TXRH's relative valuation is currently in-line with its 5-year historical average and slightly above its 10- and 15-year averages.

Downside risks are: i) lower-than-expected retail beef prices and as a result, decreased value proposition for steakhouses, ii) traffic growth deceleration in response to menu price increases, iii) greater than expected slowdown in consumer spending / macroeconomic risk pressuring discretionary income, iv) slower than expected unit growth at Texas Roadhouse.

Analyst Certification

We, Sara Senatore and Katherine Griffin, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

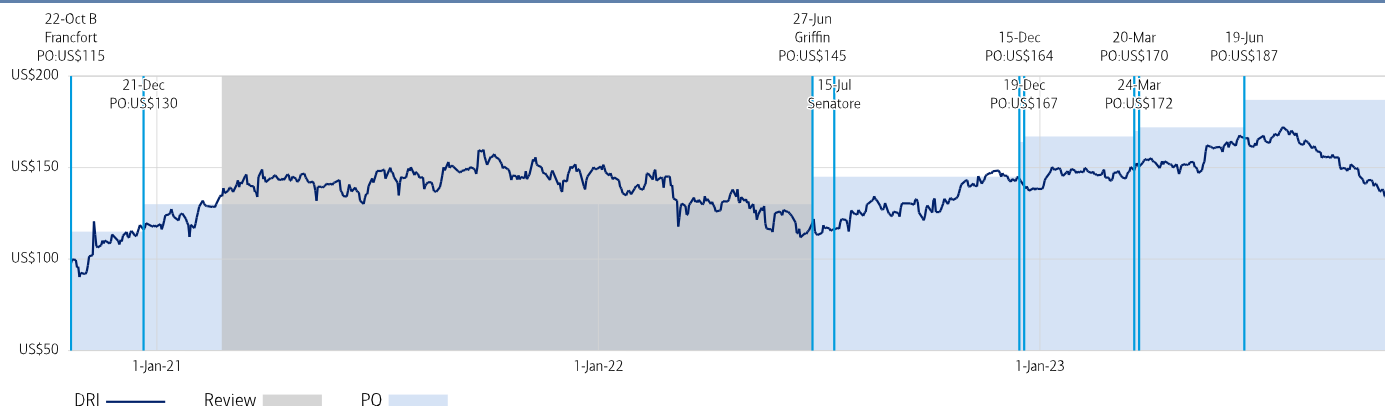
US - Restaurants Coverage Cluster

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 John's 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

Disclosures

Important Disclosures

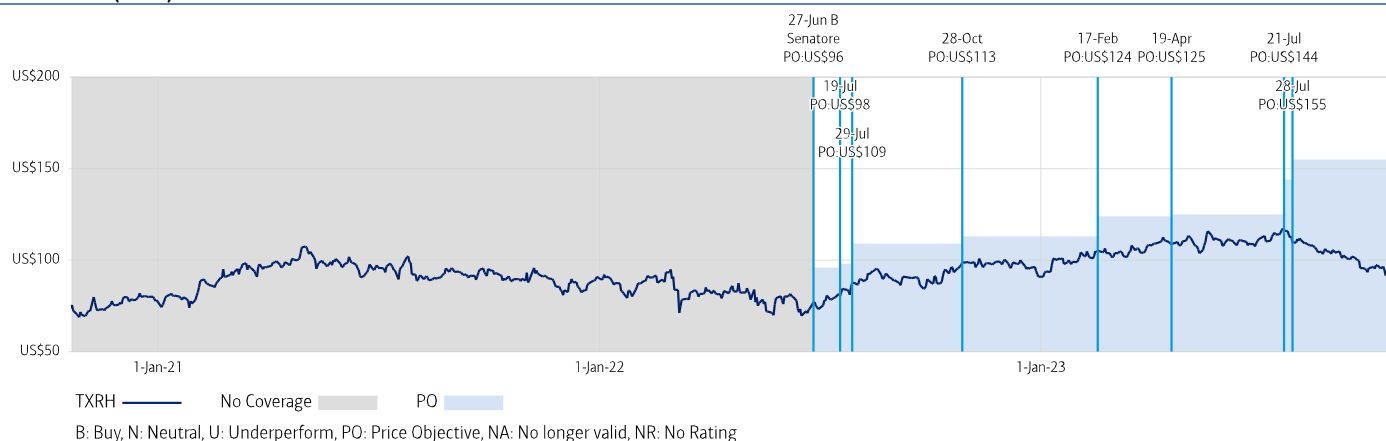
Darden Restaurants (DRI) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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.

Texas Roadhouse (TXRH) Price Chart



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Equity Investment Rating Distribution: Restaurants Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	18	56.25%	Buy	8	44.44%
Hold	8	25.00%	Hold	4	50.00%
Sell	6	18.75%	Sell	5	83.33%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

^{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.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

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.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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The date and time of completion of the production of any recommendation in this report shall be the date and time of dissemination of this report as recorded in the report timestamp.

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