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Consumer | Restaurants

July 15, 2021

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2Q preview and 2H outlook: Looking for homeruns, but seeing mostly singles and doubles

We see good—not great—upside for most names in 2H: Over the first half of the year, casual dining stocks such as DRI have generally outperformed (up an average of 25% vs. 16% for S&P 500) while quick service names have risen an average of 11% YTD. Among the fast food names, DPZ has been an outlier—up 24% YTD. Looking ahead for the 2nd half, we anticipate solid but unspectacular returns (generally 10%-15%) for global franchised names such as Outperform-rated MCD, YUM and DPZ (10-15% upside) supported by strong near-term domestic sales and an improving rate of recovery overseas. In casual dining, we continue to see good upside for DRI (12% upside to our $165 target plus a 2.6% yield) although valuation is more of a constraint today. We see the most upside in EAT (see the next bullet).

In this 2Q preview and 2H outlook we provide our views on sales and update EPS estimates: With this report, we are nudging up our earnings and targets for Outperform-rated quick service names such as McDonald's, Domino's and Yum! Brands based on our industry discussions and proprietary panel analysis (see Figures 18 and 22). We also see good upside to consensus international segment sales estimates through 2022 (see Figures 8 and 9). We are trimming our Restaurant Brands estimates and target slightly due to sluggish trends at Burger King US, but we would see solid risk reward in this In Line-rated name if we can get more comfortable with the Tim Horton's turnaround. Relative to 2Q consensus estimates, we see the most upside for Domino's, Texas Roadhouse and Starbucks. Among the restaurant stocks in our coverage, we see the most upside in EAT currently (31% upside to our $80 target). In our view, Brinker's 12x NTM P/E and 8x NTM FCF valuation is a step too far from more trusted casual dining peers (e.g. DRI)—and current valuation reflects investor concern about both sales and profit downside to higher consensus.

America is still eating at home a lot more than in 2019: For years, America has been shifting eating occasions back home and COVID may prove to be a permanent step-change acceleration in this trend. On-premise occasions are down a remarkable 36% and 7% in casual dining and fast food respectively. Examples of surprising on-premise weakness—and potential upside—include Darden's Olive Garden (on-premise SSS -18% vs pre-COVID in May) and Chipotle (on-premise SSS -30% vs. pre-COVID in April). We generally view on-premise occasions as a source of upside in the fall (as kids and parents go back to school & work and as labor constraints to hours/seat capacity ease).

See pages 14-31 for our company specific previews for CMG, DPZ, SBUX, MCD, QSR, TXRH, YUM, WEN and EAT (earnings dates from 7/20 to 8/18).

At 2pm today, we will host our Let's Talk Food Costs conference call with Kevin Good of CattleFax to discuss the inflation outlook. In addition, we will present some of our recent thinking about demand trends, earnings outlook and stocks. Register here.

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Key Points

Casual dining and Domino's outperform in 1H

Over the first half of the year, restaurant stocks have generally been a tale of two segments. Casual dining stocks have generally outperformed (up an average of 25% vs. 16% for S&P 500) while quick service names have largely lagged the market (up 10% YTD). Among the fast food names, Domino's has been an outlier—up 24% YTD.

For investors following the leading pizza delivery player, it has become more clear that it will lap difficult 2Q and 2H comparisons as at-home eating occasions are remaining remarkably robust—a trend that is also bolstering at-home packaged food sales (up 15% on a two-year basis). With this preview, we are also increasing our Domino's US 2Q SSS estimate to 20.5%—6pp+ above consensus (14%) and representing a 5pp acceleration in 2-year SSS vs. 1Q. This is based on our proprietary panel analysis.

For the casual dining names, the stock story has been propelled by surprisingly strong sales trends that were evident by March. Solid stock performance has sustained for stocks like Darden that showed in its May-ending quarter and FY22 guidance that it can manage rising inflation—resulting in a step-change in post-COVID earnings expectations. Before COVID (in early calendar 2020), Darden's consensus CY22e EPS was $7.59—a full 5% below today's CY22 consensus of $7.99.

We see many singles and doubles looking ahead for 2H

Looking ahead for the 2nd half, we anticipate solid but unspectacular returns to continue for the global franchised names such as Outperform-rated **MCD, YUM and DPZ** (10-15% upside) and casual dining names like **Darden Restaurants** (12% upside to our $165 target plus a 2.6% yield). For the global franchised names, a big area of fundamental upside will come from the international recovery—which could prove significantly stronger than current 2022 consensus estimates imply. For example, consensus 2022e SSS imply 5% 3-year SSS for McDonald's IOM (International Operated Markets) vs. 11% implied by our 12% 2022e SSS estimate and 19% 3-year SSS in 2019. Yum Brands' consensus SSS estimates for the KFC international business are similarly conservative. Recent overseas economic data (see Figure 28) and read-through companies (e.g. UK pub results) imply a stronger and earlier recovery in key markets—something that could help make up for a weak quarter-to-date July in US fast food due to weather.

2nd half home run seekers will need to take on investor "distrust" names

We see most of our Outperform-rated names as a variety of singles and doubles—but unlikely home runs. The biggest sales and earnings revisions are largely behind the casual dining names and fast food valuations are within striking distance of multi-year highs. Big (e.g. 20%+) upside will need come in the form of individual stock valuations that reflect significant investor distrust. The biggest "distrust" names are Outperform-rated **Brinker International** in casual dining (~30% upside to our $80 target) and In-Line rated **Restaurant Brands** (13% upside to our target) in quick service. EAT and QSR are up only 11% and 5% year-to-date and each stock valuation is an outlier relative to peers. Brinker's stock trades at 12x NTM EPS and 8x NTM free cash flow—far below high quality peers such as DRI (21x) and TXRH (25.5x) and similar to only a few other casual dining names (e.g. DIN or BLMN). For Restaurant Brands, its 5.3% NTM FCF yield is a big step apart from global peers such as MCD (3.7%) and YUM (3.9%) in spite of higher unit growth. While Restaurant Brands valuation is relatively attractive with global unit growth of 5%+, Burger King US sales continue to lag peers and we will be watching for a clearer picture on Tim Horton Canada's turnaround acknowledging early signs are encouraging.

For Brinker, our base case scenario has home run-like upside of 30%, and reflects a steady build in 2-year SSS as on-premise capacity and sales build, and as off-premise business contributes 15pp+ to FY22 SSS versus FY19–putting little burden on the on-premise business. While there has been some investor concern about Brinker's margins and earnings power—we do not see a dramatically different earnings outlook than we did 2-3 months ago. Brinker's analyst day on September 15 (last one occurred in 2019) should provide insights on unit development opportunities, restaurant level margins and virtual brands.

The on-premise traffic recovery and the stickiness of check and off-premise sales gains

So far, the sales recovery in both US fast food and casual dining chain same store sales (SSS) has been as strong or stronger than we would have expected in 2020. In calendar 2Q, overall fast food industry chain SSS were 14% above 2019 levels. This represents a 2-year CAGR SSS growth of ~7%--above the 5-year average of 2-3%. Still, we estimate that fast food traffic remains about 7% below 2019 levels, largely driven by quick service on-premise business traffic declines since 2019 and partially offset by drive-thru (up 16%) and delivery (up 124%). Of course, these sub-channel trends—in addition to digital ordering (up ~140% vs. 2019 to 17% mix of sales)—have favored the large scale fast food players in our coverage.

Our casual dining 2-year sales estimates remain above consensus for the second half

For casual dining, SSS recovery has plateaued since April with 2-year sales growth of +2-3% (Knapp) as dine-in sales have been slower to recover while off-premise remains strong. Casual dining on-premise sales declines of ~30% or more has surprised us—and seems to largely be tied to consumer comfort with indoor dining (See Evercore ISI Survey Figure 23). In addition, labor shortages and on-premise capacity restrictions have also been factors. For example, a 50% seat capacity limit in California was only lifted on June 15.

Off-premise sales have remained strong, similar to food at home sales (which increased 13% on a 2-year basis). Our calendar 2H21 two-year SSS estimates for Olive Garden of +6% (cons +3%), Chili's of +10% (cons ~6%) and Texas Roadhouse of +19% (cons 13%) assume on premise sales will continue to recover through 2H21 (see below for company details). Stepped up off-premise mix should prove to be a positive for Darden's restaurant level margins, close to margin-neutral for Texas Roadhouse, and a modest drag for Brinker due to delivery fees and packaging.

We are generally increasing our estimates

With this report, we are nudging up our earnings and targets for Outperform-rated quick service names such as McDonald's (PT from $260 to $275), Domino's (PT from $470 to $550) and Yum! Brands (PT from $130 to $140) based on our industry discussions and proprietary panel analysis. We also see good upside to consensus international segment sales estimates through 2022. We are trimming our Restaurant Brands estimates and target slightly due to sluggish trends at Burger King US, but we would see solid risk-reward in this In Line-rated name if we can get more comfortable with the Tim Horton's turnaround. A summary of our changes can be seen below.

Company Changes										Estimates				
				Rating			Target Price			Current Year			Next Year	
Symbol	Company	Price		Curr	Prev		Curr	Prev		Curr	Prev		Curr	Prev
CMG	Chipotle Mexican Grill, Inc	$1621.69	-	OPF	OPF	▲	$1800.00	$1725.00	▲	$25.88	$25.72	▲	$34.61	$34.33
DPZ	Domino's Pizza, Inc	$485.65	-	OPF	OPF	▲	$550.00	$470.00	▲	$14.17	$13.49	▲	$16.33	$15.62
DRI	Darden Restaurants, Inc.	$147.16	-	OPF	OPF	-	$165.00	$165.00	-	$4.31	$4.51	-	$7.45	$7.75
EAT	Brinker International, Inc.	$61.06	-	OPF	OPF	-	$80.00	$80.00	-	$3.21	$3.21	-	$5.29	$5.29
MCD	McDonald's Corp	$237.12	-	OPF	OPF	▲	$275.00	$260.00	▲	$8.83	$8.82	▲	$10.08	$10.04
QSR	Restaurant Brands International	$63.84	-	IL	IL	▼	$72.00	$75.00	▼	$2.73	$2.78	▼	$3.21	$3.25
SBUX	Starbucks Corporation	$120.00	-	IL	IL	-	$120.00	$120.00	▲	$3.11	$3.04	▲	$3.74	$3.64
TXRH	Texas Roadhouse, Inc.	$96.30	-	IL	IL	-	$110.00	$110.00	-	$3.49	$3.33	-	$4.03	$3.90
WEN	Wendy's Company	$22.59	-	IL	IL	-	$24.00	$24.00	▲	$0.74	$0.74	▲	$0.86	$0.86
YUM	Yum! Brands, Inc	$116.97	-	OPF	OPF	▲	$140.00	$130.00	▲	$4.48	$4.47	▲	$4.95	$4.93

Source: Evercore ISI Research

We see the most upside to 2Q sales estimates for Domino's, Starbucks and Texas Roadhouse

We are raising our Domino's system-wide US SSS estimate from a 1% decline to 4% growth based on our proprietary panel data, representing 2-year SSS of 20% (vs. ~15% 2-year SSS in 1Q and ~20% in 2Q20 and 3Q20; cons. 14%). For Starbucks US, we are raising our US SSS estimate to 87% (prev. 81%; 12% 2-year SSS vs. March 11% and cons. 8%), which we also believe reflects our proprietary Evercore ISI consumer panel. Finally, we assume stabled 2-year SSS at TXRH of 21% (April 2-year SSS 21%). We are surprised consensus assumes a 7+pp slowdown (cons. 14% 2-year SSS) when industry sales have held steady through the quarter.

American families and potential restaurant workers have been staying home...perhaps creating an area of upside this fall

Americans are still eating at home a lot more at home than they did in 2019. For years, America has been shifting eating occasions back home and the COVID period may result in a permanent step-change in at-home occasions. That said, we generally see upside to current levels of on-premise sales for both casual dining and fast food, beginning in the fall.

Relative to 2019 levels, on-premise occasions in May were down a remarkable 36% in casual dining and fast food traffic was down 7% (countered by drive-thru traffic +16%). While many chains have had solid overall sales growth, this has been accompanied by surprising on-premise weakness. Examples have included Darden's Olive Garden (on-premise SSS -18% vs pre-COVID in May) and Chipotle (on-premise SSS -30% in April).

Factors driving upside to on-premise business in the coming quarters could include:

- **Kids and parents going back to school & work:** As of May, between 25-30M US adults were working from home at least a few days a week—up from only 5-6M pre-COVID.

- **Labor constraints easing as enhanced unemployment ends leading to higher hours of operation and on-premise seat capacity utilization:** The labor shortage in America is real—and that is particularly so for the restaurant and hospitality industry. Increasingly it is staffing levels—rather than seating restrictions—that are the constraint on sales. Most operators see labor availability easing a bit lately as summer job seekers (high school and college aged) and 15+ states have voluntarily ended enhanced unemployment benefits. However, the much bigger relief will happen this fall with the full end of enhanced unemployment and beginning of in-person school. As we showed on page 3 of our 'Recent Thoughts' **here**, there have been 1.4M new private sector job openings since the start of 2021 that have not been filled—almost 800k of these have been in leisure, hospitality and food service (i.e. restaurants). Entry level positions are having a hard time competing with these government benefits. While hourly worker inflation has been moving up from 5% to near 10%, it is worth noting that most restaurant labor costs are not minimum wage hourly. In the case of a casual dining chain like Olive Garden, only about one-third of labor is indexed to hourly minimum wage with the recent salaried and tip-wage earners.

- **Increasing consumer comfort with indoor dining:** According to the NPD Group and CivicScience only 64% of surveyed adults were "comfortable eating in a restaurant now" in May. Of course, this means that 36% of adults were not comfortable as of last month—the same percentage that on premise full service dining traffic declined YOY in that month.

- **Stickiness of off-premise demand gained (and lingering benefits of digital connectivity) could be a nice area of upside:** For example, Brinker International's Chili's is now likely to get 12pp+ SSS boost in FY22 relative to FY19 from its off-premise business—making consensus SSS estimates implying total 3-year SSS growth of 7% highly achievable. Chili's may not have the consumer preference scores or preferred employer status of an Olive Garden or Texas Roadhouse and this could slow Chili's on-premise sales recovery. Still, we see Brinker International as among the greatest long-term beneficiaries of off-premise business as a result of its efforts with DoorDash, virtual brands, loyalty and take-out. Chili's off-premise mix seems likely to finish in the 32-35% range—a full 12pp-15pp higher than its pre-COVID level of 20%. This makes the Chili's CY22 vs. CY19 SSS growth of 9% that is implied by consensus appear conservative. Chili's 2-year SSS growth reached 10% in April.

Offsetting some of these benefits would be a return of restaurant capacity as independent restaurants reopen. As of this spring, we estimate that the number of US restaurants had decreased (net of reopens) by 8% overall and by 10-12% for full-service restaurants.

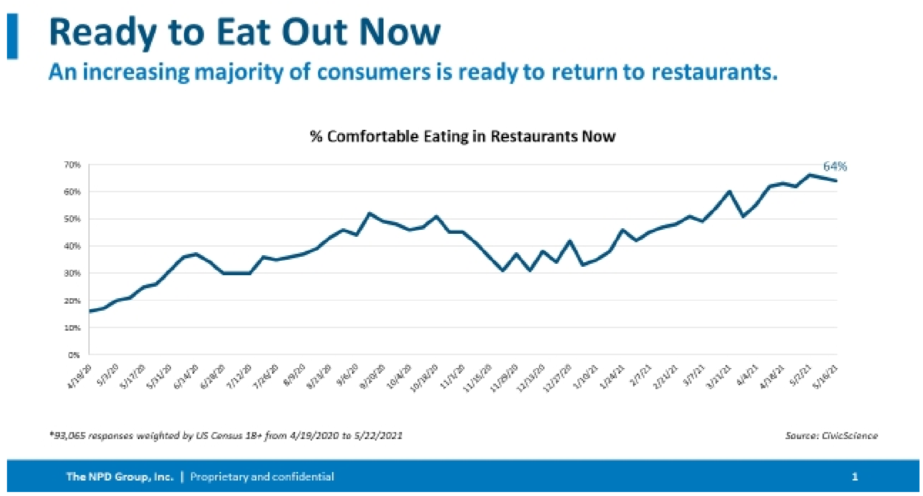
Comfort with dining inside has continued its upward trend through June

Figure 1: Dining comfort levels over time

Source: Evercore ISI Research Surveys

There are 36% of consumers that are still uncomfortable dining out, something that may ease and provide a lift for casual diners in 2H

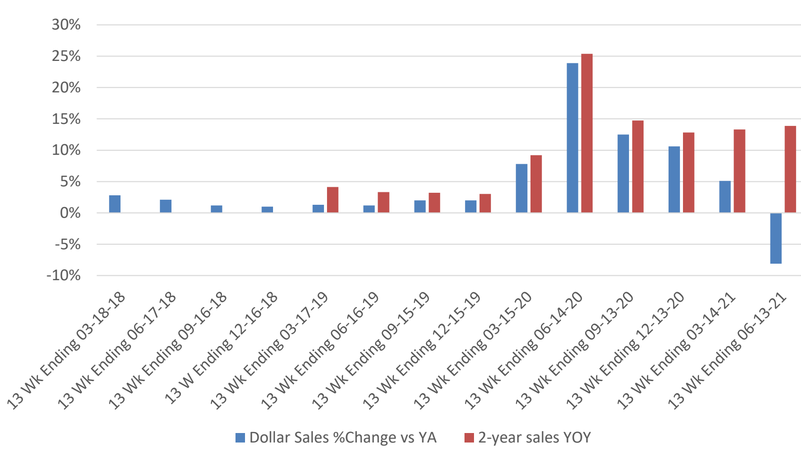
Figure 2: % of consumers comfortable eating in restaurants now



Source: NPD Group

We have been surprised by the stickiness of sustained double-digit food at home consumption growth

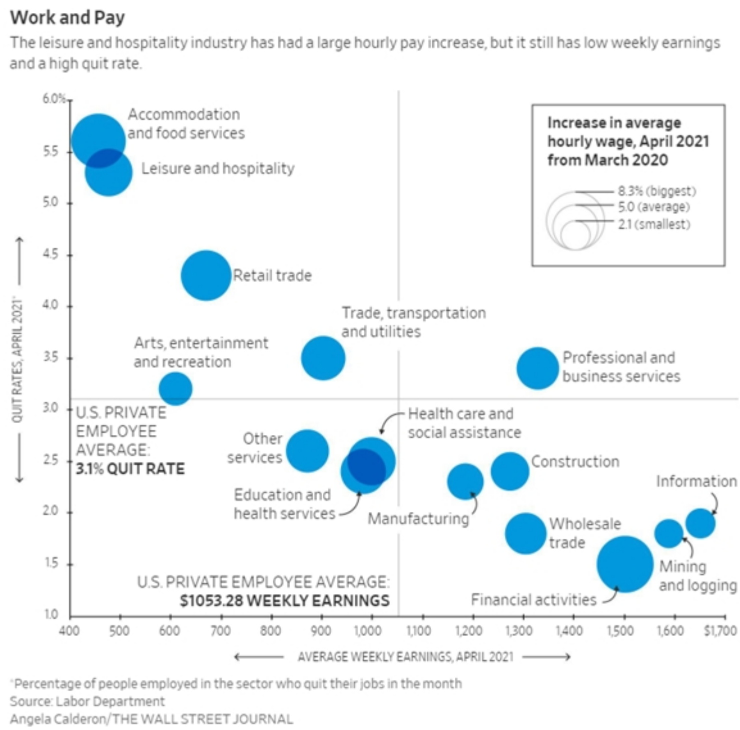
Figure 3: Measured Channel Dollar Sales



Source: IRI, Evercore ISI Research

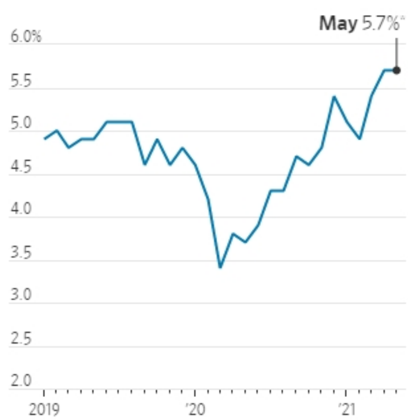
Labor continues to be a pressure point among company operated systems, especially among those with a lower-quality employee value proposition

Figure 4: Quit rates, average weekly earnings, and increase in hourly wage by sector



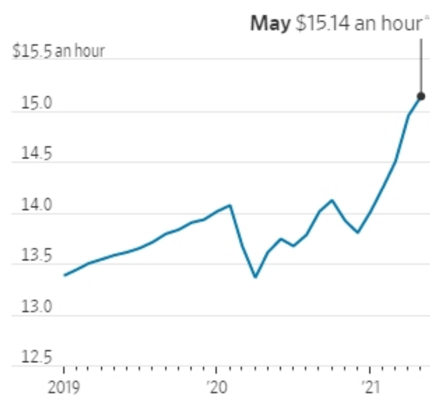
Source: Labor Department, Wall Street Journal

Figure 5: % of foodservice/accommodation workers quitting jobs



Source: Labor Department

Figure 6: Avg. wages for hotel and foodservice employees



Source: Labor Department

Note: For production / nonsupervisory employees

Figure 7: Casual dining pre-COVID vs. current estimates

EAT		2019	2021e	2022e	2023e
Current	SSS	2.3%	22.3%	6.8%	2.3%
	AUV ($M)	$2.86	$3.01	$3.15	$3.23
	RLM	12.9%	14.7%	15.2%	15.3%
	EPS	$4.03	$4.51	$5.60	$6.19
Pre-COVID	SSS	2.3%	1.5%	1.5%	1.5%
	AUV ($M)	$2.86	$3.00	$2.98	$3.03
	RLM	12.9%	12.7%	12.6%	12.5%
	EPS	$4.03	$4.87	$5.17	$5.75
Spread	**AUV ($M)**		**$0.0**	**$0.2**	**$0.2**
	% change		*0.4%*	*5.6%*	*6.7%*
	RLM		**195 bp**	**255 bp**	**277 bp**
	EPS		**($0.36)**	**$0.43**	**$0.44**
	% change		*(7.4%)*	*8.3%*	*7.6%*

TXRH		2019	2021e	2022e	2023e
Current	SSS	4.7%	39.6%	5.5%	4.0%
	AUV ($M)	$5.5	$6.2	$6.5	$6.7
	RLM	17.3%	17.4%	17.3%	17.2%
	EPS	$2.46	$3.49	$4.03	$4.52
Pre-COVID	SSS	4.7%	3.5%	3.5%	3.5%
	AUV ($M)	$5.5	$5.7	$5.8	$5.9
	RLM	17.3%	16.6%	16.5%	16.5%
	EPS	$2.46	$2.79	$3.05	$3.42
Spread	**AUV ($M)**		**$0.5**	**$0.7**	**$0.8**
	% change		*9.0%*	*11.7%*	*12.8%*
	RLM		**81 bp**	**78 bp**	**71 bp**
	EPS		**$0.70**	**$0.98**	**$1.10**
	% change		*25.0%*	*32.1%*	*32.1%*

DRI		2019	2021e	2022e	2023e
Current	OG SSS	2.6%	27.5%	13.8%	2.8%
	OG AUV ($M)	$5.0	$4.8	$5.4	$5.5
	RLM	21.7%	21.3%	23.0%	23.1%
	EPS	$6.06	$5.89	$7.72	$8.50
Pre-COVID	OG SSS	2.6%	2.4%	2.0%	2.0%
	OG AUV ($M)	$5.0	$5.3	$5.4	$5.5
	RLM	21.7%	22.0%	22.1%	22.2%
	EPS	$6.06	$7.03	$7.66	$8.34
Spread	**OG AUV ($M)**		**($0.5)**	**$0.0**	**$0.1**
	% change		*(8.7%)*	*0.5%*	*1.2%*
	RLM		**-64 bp**	**93 bp**	**97 bp**
	EPS		**($1.14)**	**$0.06**	**$0.16**
	% change		*(16.2%)*	*0.8%*	*2.0%*

Source: Company Data, Evercore ISI Research

Food inflation poised to increase as contracts roll off

While we hear plenty of stories about the local restaurant operator with product shortages (e.g. no wings) or 20-50% YOY inflation in key costs. For those big chains with floating rate exposure, we could see input inflation touch the low double digits by late 3Q. For example, we expect this to be the case for Burger King US. That said, the average mega-chain has a goal of relative stability and visibility in its costs—this is made possible with captive suppliers, system distribution agreements and other hedging practices. For Darden, McDonald's and Brinker, we are hearing of a 3%-type inflation today and this remaining through much of 2H21. Of course, contracts can only last for so long—so the key variable will be where input costs are closer to 4Q21. By then, the labor shortage impact to supply chains (and the restaurants themselves) should be less acute. By the end of the year, the question of transitory vs. sustained inflation should become more clear—just as contracts are beginning to roll off. The higher the levels of sustained inflation, the more we would avoid casual dining in favor of global franchised names like MCD, YUM and DPZ and even high pricing-power company-operated names like CMG and SBUX. Keep in mind that chains like Chili's and Olive Garden over-index to family occasions which means one payer is often paying for many. The higher check means a greater frequency risk if pricing pass-through is too high. We expect both Darden and Brinker to be conservative with pricing with a goal of sustaining long-term traffic share.

Labor productivity that lingers (resulting in permanently higher margins)

Going forward, long-term labor productivity gains are perhaps the major variable and area of upside. During COVID, virtually every chain needed to remove labor (and other) costs. By doing so, restaurant companies were afforded a "zero-based budgeting" exercise. As one restaurant executive put it, "It is easier to check out the engine when the wheels are off the bus". In CY22, we are modeling 100bp, 10bp and 60bp lower labor costs as a percentage of sales (vs. CY19) at Darden, Texas Roadhouse and Brinker in spite of relatively rapid wage inflation—largely as a result of COVID-era productivity and accelerated sales gains. Ahead of COVID, Texas Roadhouse was already focusing on labor efficiency after going too far with labor investments in 2017-2018. For Darden Restaurants, the COVID era allowed for a continuation of long-term productivity efforts at Olive Garden (e.g. enabled by menu simplification and reduced back-of-house labor) and an overdue focus on streamlining Cheddar's. For Brinker, that had previously been the most aggressive about labor cost control, the COVID benefits to labor productivity may be relatively small before considering the benefits of off-premise sales layers.

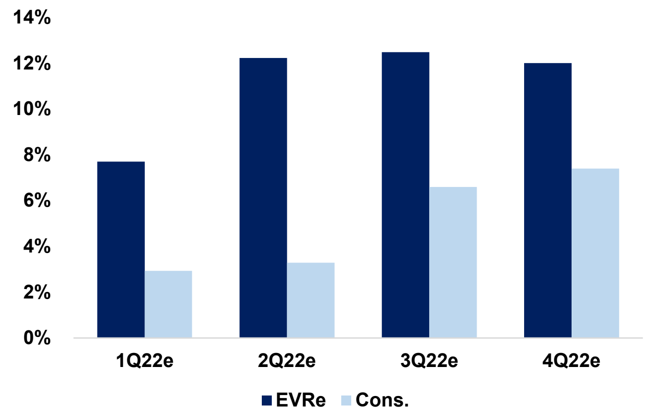
Fast food international businesses—the next reopening trade?

While the vaccine timing is a constraint to international fast food SSS trends, we see upside to 2022 consensus—particularly for McDonald's International Operated Markets (IOM) which represent 52% of 2019 company profit and 70% of company-operated restaurants. As of 2019, McDonald's IOM 3-year cumulative SSS growth was 19%. In 2H22, consensus SSS imply 3-year SSS growth of 6% vs. EVRe of 8%+. Key reasons to expect a strong recovery: 1) In international markets, the competition generally lacks a drive-thru (whereas 75% of McDonald's IOM units have a drive-thru). This is a big contrast to the US where some of McDonald's previously share-losing competition has likely survived or thrived (e.g. Jack in the Box), 2) McDonald's pre-COVID sales mix from walk-in was a relatively high 60-65% (e.g. only half of drive-thru unit pre-COVID sales came through the drive-thru window)—leaving a lot to lose during COVID, and a big recovery ahead, 3) strong social safety nets in developed markets, and 4) IOM is gaining traffic share in nearly every market right now (in spite of some markets being down

LDD in January). Furthermore, consensus for KFC International implies 3-year stacked SSS (2022 vs. 2019) of 5% versus 12% in 2019.

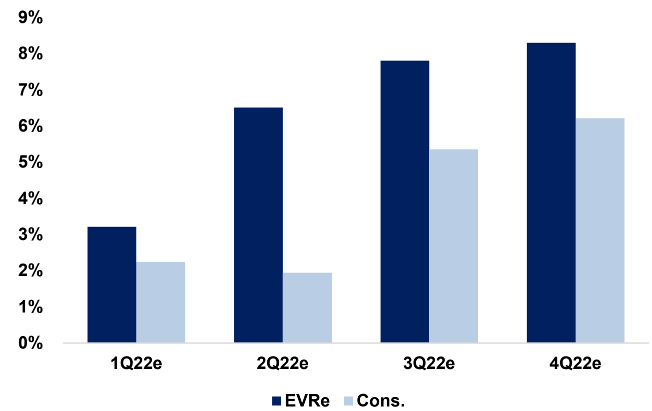
KFC International digital channel mix has increased dramatically over the last year, providing a pathway to higher SSS over time. Over the last year, KFC has increased it digital channel mix from 20% to 43%. Given the lack of drive-thru presence overseas (<25% of international units have drive-thru's), customers were driven towards digital channels (MO&P and delivery). Over 80% of markets have hit the critical 20% digital threshold (where the flywheel effect accelerates).

Figure 8: MCD IOM 3-year SSS growth (2022 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

Figure 9: KFC International 3-year SSS growth (2022 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

Our top post-COVID questions heading into 2H in casual dining

1. **Will pent up demand and stimulus lead to big near-term upside to SSS?** Consensus calendar 2H21 SSS estimates for Chili's and Olive Garden imply ~6% growth and ~2% growth versus 2H19, respectively. Given incremental the pent up demand, high GDP growth (relative to 2019) and potential for step-change in off-premise business, could these estimates prove ridiculously low? Note: our SSS estimates are ~2pp higher than consensus for Chili's and Olive Garden respectively in these same quarters.
2. **Will the boost to casual dining chain SSS from independent capacity reductions materialize as much as hoped?** In theory, a 10% reduction in industry capacity could bolster Darden's SSS by 3pp or more. Will the reality of independent capacity reductions turn out as favorably as hoped for the surviving chains? If the economy is as strong as Evercore ISI economists believe, will independent restaurants reopen quickly making the boost to chains a fleeting one (e.g. largely in 2H21)?
3. **Will inflation limit upside for company operated chains?** Will inflation in labor, food and building costs begin to catch up casual dining restaurant companies in 2022–thereby limiting upside EBITDA and FCF scenarios? Hint: Grain-based inflation will ultimately catch up to the proteins, building costs are going up for greenfield sites, and labor inflation may ramp up.
4. **Will third party delivery prove to be a "deal with the devil"?** Will Brinker be able to pivot toward mobile order & pick up and get control of its delivery customer's data? Will Darden's reticence to sell its food through DoorDash prove prescient? Will desperate consumers and independent restaurants turn their back on expensive (unsustainable?) third-party delivery fees and ultimately help Domino's reassert delivery dominance in suburban markets?
5. **Will Darden start to close its unit growth gap with Texas Roadhouse and will "sports viewing" concepts start to create increased competition for grill & bar chains?** Will unit growth in Cheddars, Buffalo Wild Wings and Bubba's surge in 2022

and beyond— becoming a competitive headwind for traditional grill & bar peers? Will Darden close its unit growth gap with Texas Roadhouse with the help of Cheddars?

6. **How much of Chili's increase in off-premise will stick?** Will Chili's retain 25%, 30% or 35% off-premise mix after reopening? And if it is 30% in FY22 (vs. 20% in FY19), does this mean our 11% implied SSS growth from FY19 to FY22 is too low (since on premise will likely also be significantly higher)?
7. **How quickly will business and travel-related dining return?** How fast will business and travel-related dining return? Could Darden's destination, business-oriented and urban center locations ultimately surpass pre-COVID levels due to a diminished competition?

Our top post-COVID questions heading into 2H in fast food

1. **Can fast food chains hold onto some check as they experience a traffic rebound?** Fast food industry traffic remains down 5%-8% versus pre-COVID levels, but check growth has more than made up for this. We wonder how much of the check gains will remain as adult-only occasions (e.g. commuting breakfast and lunch, and late night) return and if chains that lean toward adult-only occasions (e.g. Taco Bell) will increasingly outperform varied menu and family-oriented chains that won during COVID (i.e. Arby's, Sonic, Jack-in-the-Box).
2. **How will margin structure (franchisee profitability) change with the reopening?** How will additional labor, new menu news (vs. COVID menu rationalization), food inflation and labor inflation with mandated state increases in addition to a rapidly falling unemployment environment affect franchisee profitability?
3. **How will the pizza chains fare against tough delivery comparisons?** How much will increased carry-out offset some of the delivery share donation as America's mobility increases? Will Domino's come out with new menu news to better compete with Papa John's and Pizza Hut? Will value matter more in 2H once stimulus is used up?
4. **How high could Chipotle's 2H21 SSS growth really be?** Consensus 3Q SSS of 9% (vs. EVRe 9%) implies 2-year SSS growth of 18% versus January's 24% 2-year SSS growth. We are interested to see if Chipotle could post significant upside given a) 80% of Chipotle's orders were from inside the restaurant before COVID, b) off-premise sales grew by ~$730k during COVID (equal to ~33% of 2019 average unit sales), c) a ~130% increase in loyalty members since year-end 2019, and d) the introduction of new products (e.g. quesadilla). Importantly, Chipotle also seems to have significant capacity upside—with easily $2M of sales capacity per assembly line (or $4M+ selling capacity)

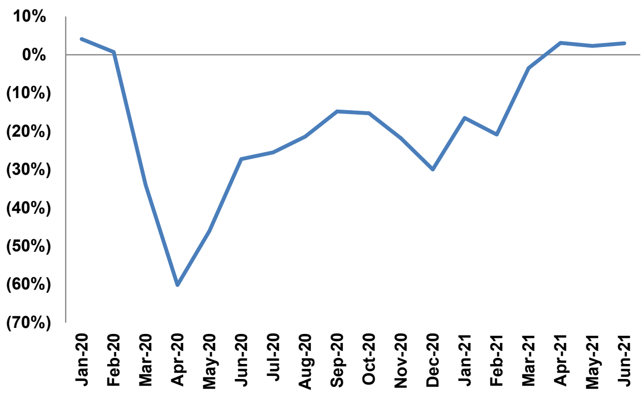
We broadly see upside to 2Q sales estimates across our coverage universe

Figure 10: EVRe 2-year SSS vs. consensus

	1-yr SSS Est. EVR 2Q21	1-yr SSS Est. Cons. 2Q21	2-yr SSS Est. EVR 2Q21	2-yr SSS Est. Cons. 2Q21	EVR ISIe vs. Cons.
Maggiano's	180%	128%	(7%)	(25%)	1832 bp
Starbucks Americas	87%	75%	10%	3%	714 bp
Texas Roadhouse	81%	70%	21%	15%	679 bp
Domino's US Franchised	4%	(1%)	20%	14%	617 bp
Taco Bell Global	22%	16%	12%	7%	524 bp
KFC US	7%	3%	14%	10%	417 bp
McDonald's US	27%	24%	16%	13%	329 bp
McDonald's IOM	68%	63%	(2%)	(5%)	299 bp
Chipotle	32%	30%	19%	17%	207 bp
Domino's Intl Franchised	12%	10%	13%	12%	192 bp
KFC International	37%	34%	0%	(2%)	190 bp
Tim Horton's Canada	29%	27%	(10%)	(11%)	126 bp
Pizza Hut US	2%	1%	7%	6%	74 bp
Burger King US	13%	12%	2%	1%	63 bp
Chili's	58%	58%	7%	7%	47 bp
Popeyes US	1%	1%	30%	30%	0 bp
Wendy's US Systemwide	14%	14%	9%	9%	-26 bp
Starbucks International	60%	61%	1%	1%	-57 bp
Burger King ROW	20%	23%	(2%)	1%	-246 bp

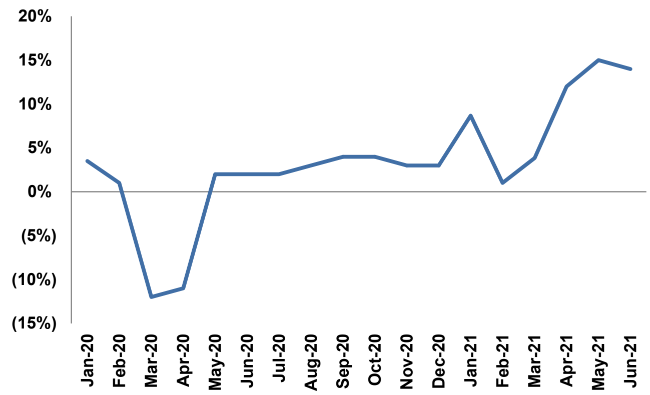
Source: ConsensusMetrix, Evercore ISI Research

Figure 11: Casual dining SSS vs. 2019



Source: KnappTrack, Evercore ISI Research

Figure 12: Quick service SSS vs. 2019

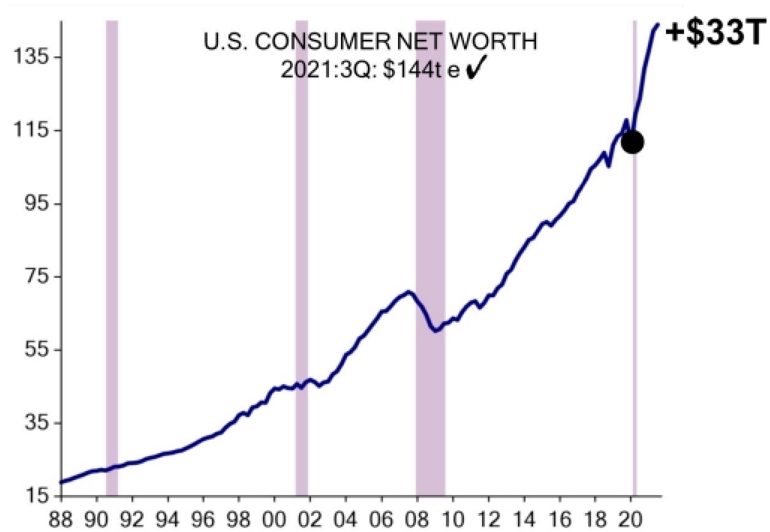


Source: NPD SalesTrac, Evercore ISI Research

Child Tax Credit checks will total ~$100B in 2H of this year, or at a $200B annual rate. This $200B is ~1% of GDP over a half year, or at a 2% annual rate. So all else equal, this would lift GDP by about +2% in both 3Q and 4Q.

Consumer Net Worth is on track to hit $144T in 3Q vs. its recession low of $111T just six quarters ago. CNW lifts consumer spending with a half-year lag.

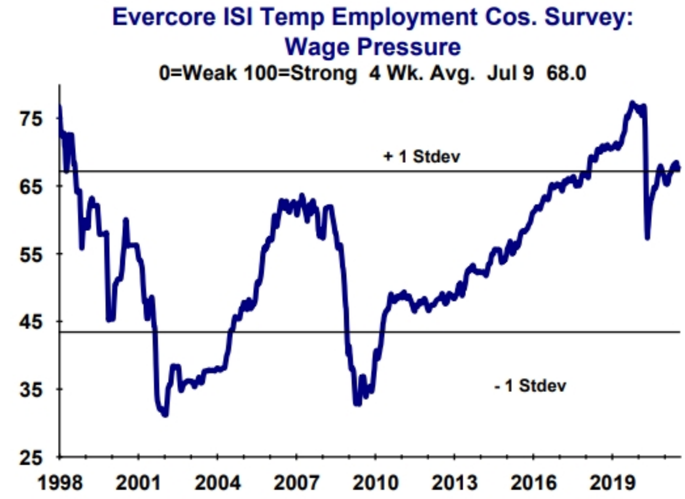
Figure 13: US Consumer Net Worth



Source: Evercore ISI Research

Wage pressure for temp employment remains 1 standard deviation above the average

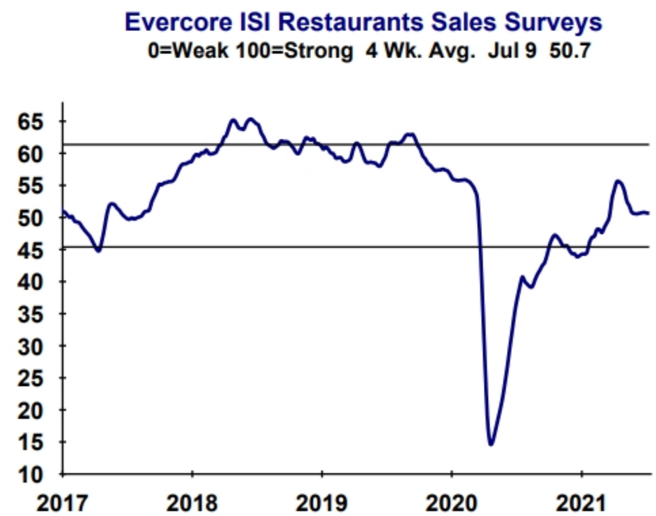
Figure 14: Wage pressure for temporary employment



Source: Evercore ISI Surveys

The lack of on-premise traffic and reduced operating hours due to staffing issues countered by strong off-premise and quick-service sales leaves Evercore ISI's restaurant survey around its long-term average

Figure 15: Evercore ISI Restaurants Sales Surveys



Source: Evercore ISI Surveys

Figure 16: Restaurants comp sheet

Company	Ticker	Current Price	Rating	Target Price	Implied Upside	Market Cap (B)	Target P/E CY21	Target P/E CY22	Target FCF Yield CY22	Stock Performance 2020	12M	YTD	1M	1W	EVR ISI EPS CY21	EVR ISI EPS CY22	Cons. EPS CY21	Cons. EPS CY22	P/E CY21	P/E CY22	EV/EBITDA CY21	EV/EBITDA CY22	Div. Yield	FCF Yield CY21	FCF Yield CY22	LT EPS Growth	PEG CY22	Net debt/ EBITDA CY21
Evercore ISI Restaurant Sector Comp Sheet																												
Updated July 14, 2021																												
Franchised Quick-Service Restaurants																												
McDonald's	**MCD**	$237	Outperform	$275	16%	$176.9	31x	27x	3.6%	9%	28%	10%	(0%)	1%	$8.83	$10.08	$8.65	$9.58	26.9x	23.5x	19.5x	17.5x	2.2%	3.5%	4.2%	8%	2.9x	2.8x
Yum! Brands	**YUM**	$117	Outperform	$140	20%	$34.9	31x	28x	3.6%	8%	34%	8%	(2%)	1%	$4.48	$4.95	$4.23	$4.69	26.2x	23.6x	19.0x	17.8x	1.7%	3.7%	4.1%	12%	2.0x	4.4x
Restaurant Brands	**QSR**	$64	In Line	$72	13%	$29.9	26x	22x	5.2%	(4%)	18%	5%	(6%)	(1%)	$2.73	$3.21	$2.67	$3.10	23.4x	19.9x	18.6x	16.6x	3.3%	4.9%	5.7%	11%	1.8x	4.9x
Domino's Pizza	**DPZ**	$485	Outperform	$550	13%	$18.8	39x	34x	3.1%	31%	21%	27%	7%	2%	$14.17	$16.33	$12.98	$14.99	34.3x	29.7x	25.3x	22.7x	0.8%	2.9%	3.3%	14%	2.1x	4.9x
Wendy's Company	**WEN**	$23	In Line	$24	6%	$5.0	32x	28x	5.2%	(1%)	6%	4%	(6%)	(1%)	$0.74	$0.86	$0.74	$0.85	30.5x	26.2x	14.9x	14.1x	1.6%	5.2%	5.4%	10%	2.6x	4.0x
Wingstop	WING	$154				$4.6				54%	23%	20%	6%	2%			$1.43	$1.83	107.8x	84.3x	59.7x	48.7x	0.4%					5.1x
Jack in the Box	JACK	$106				$2.4				19%	50%	16%	(10%)	(3%)			$6.84	$7.21	15.5x	14.7x	13.7x	13.8x	1.5%					6.4x
Papa John's	PZZA	$111				$3.7				34%	26%	31%	8%	6%			$2.80	$3.11	39.6x	35.6x	19.2x	18.1x	0.8%					1.8x
Franchised QSR mkt cap wtd avg							31x	27x	3.8%	10%	27%	11%	(1%)	1%					28.4x	24.7x	20.2x	18.2x	2.1%	3.7%	4.3%	9.3%	2.6x	3.4x
Company-Owned Quick Service Restaurants																												
Starbucks	**SBUX**	$120	In Line	$120	0%	$141.2	36x	31x	3.2%	22%	65%	12%	6%	3%	$3.35	$3.84	$3.25	$3.38	35.7x	31.2x	23.6x	21.0x	1.5%	2.1%	3.1%	11%	2.8x	3.1x
Chipotle	**CMG**	$1,620	Outperform	$1,800	11%	$45.6	70x	52x	1.9%	66%	48%	16%	18%	3%	$25.88	$34.61	$24.51	$32.49	62.6x	46.8x	38.6x	30.2x	-	1.6%	2.1%	20%	2.3x	-0.7x
Yum! China	YUMC	$65				$27.3				19%	29%	14%	(6%)	(2%)			$2.02	$2.37	32.1x	27.4x	15.3x	13.5x	0.7%					-1.1x
Shake Shack	SHAK	$98				$3.8				42%	110%	20%	2%	(4%)			-$0.05	$0.43	NM	226.8x	67.1x	36.5x	-					3.3x
Company-owned QSR mkt cap wtd avg							44x	36x	2.9%	31%	57%	13%	7%	2%					40.3x	37.4x	26.4x	22.2x	1.1%	2.0%	2.9%	13.2%	2.7x	1.8x
Casual Dining																												
Darden	**DRI**	$147	Outperform	$165	12%	$19.3		21x	5.6%	9%	102%	24%	6%	(1%)	$5.89	$7.72	$6.09	$7.82	25.0x	19.1x	18.8x	15.2x	2.6%	5.1%	6.2%	10%	2.0x	-0.2x
Texas Roadhouse	**TXRH**	$96	In Line	$110	14%	$6.7		27x	3.4%	39%	97%	24%	(1%)	2%	$3.49	$4.03	$3.43	$3.96	27.6x	23.9x	17.1x	15.4x	-	4.2%	3.9%	10%	2.4x	-0.7x
Cracker Barrel	CBRL	$146				$3.5				(14%)	44%	10%	(7%)	(1%)			$8.07	$9.65	18.1x	15.1x	14.3x	11.6x	-					3.7x
Cheesecake Factor	CAKE	$52				$2.4				(5%)	153%	44%	(5%)	1%			$2.19	$3.14	23.9x	16.7x	16.8x	13.1x	-					6.4x
Dave & Buster's	PLAY	$37				$1.8				(25%)	225%	28%	(10%)	(1%)			$1.04	$2.48	35.6x	15.0x	14.5x	10.4x	-					7.5x
Bloomin' Brands	BLMN	$27				$2.4				(12%)	187%	44%	(1%)	4%			$2.20	$2.44	12.5x	11.3x	9.9x	9.5x	-					4.8x
Dine Brands	DIN	$86				$1.5				(31%)	143%	49%	(7%)	(2%)			$6.56	$7.27	13.1x	11.8x	12.3x	11.3x	-					6.4x
Brinker Intl	**EAT**	$61	Outperform	$80	31%	$2.3		14x	8.2%	35%	180%	11%	3%	2%	$4.51	$5.60	$4.42	$5.44	13.5x	10.9x	10.4x	9.4x	-	12.9%	13.3%	6%	1.8x	2.8x
Denny's	DENN	$15				$1.0				(26%)	91%	8%	(9%)	(2%)			$0.42	$0.71	36.4x	21.6x	17.5x	13.7x	-					4.8x
BJ's Restaurants	BJRI	$46				$1.1				1%	181%	24%	(8%)	0%			$0.61	$2.37	76.1x	19.6x	18.5x	11.4x	-					6.3x
Casual Dining mkt cap wtd avg								22x	5.3%	7%	117%	25%	1%	(0%)					25.1x	21.1x	16.6x	16.0x	1.2%	5.5%	6.2%	9.3%	2.1x	1.7x
Evercore ISI Restaurants							38x	29x	4.3%	21%	60%	14%	2%	1%					30.6x	25.5x	20.6x	18.0x	2.0%	4.6%	5.1%	11%	2.3x	2.5x
S&P 1500 Restaurants	SP395	$2,129								17%	46%	13%	3%	2%									1.5%					
Retail	XRT	$95								40%	124%	50%	(0%)	1%									0.7%					
Consumer Discretionary	XLY	$181								28%	38%	13%	5%	0%									0.6%					
S&P 500	**SPX**	**4,374**								**16%**	**38%**	**16%**	**3%**	**1%**					**23.8x**	**21.3x**			**1.4%**					

Source: FactSet, Evercore ISI Research

CMG: Pricing and digitally-enabled operating leverage drive margins

Tweaking 2Q estimates higher ahead of earnings next week: We are raising our SSS slightly from 31% to 32% in 2Q21e (cons. 29%; guidance "high 20s to 30%) which equals a 19% 2-year stacked SSS (roughly a 2pp deceleration vs. 1Q). We believe sales continued traffic momentum (especially in-restaurant) and pricing (4% increase in early to mid-June to help offset labor initiatives) helped offset headwinds such as lower marketing spend and quesadilla sales normalizing. Our 2Qe EPS of $6.94 (cons. $6.50) assumes a restaurant level margin of 23.9% (cons. 23.7%). Our restaurant level margin assumes COGS at 30.8% of sales (-290bp vs. 2019; cons. 30.7%; guidance "mid-to-high 30% range" as the benefit from price increases (delivery and in-store) are offset by seasonally higher avocado prices), labor expense at 23.9% of sales (-180bp vs. 2019; cons. 24.2%; guidance low-24% range as sales leverage is helped by higher prices and seasonally higher sales, and other restaurant expenses at 16.0% of sales (+250bp vs. 2019; cons. 15.9%) helped by lower marketing expenses. We assume SSS for 2H remain slightly above 18% on a 2-year basis (~50bp higher than consensus). Our 2021 EPS estimate of $25.88 is ~5% above street estimates driven by both sales upside and margin upside. We are raising our price target slightly to $1,800 (prev. $1,725) which equates to 47x our LTM 6/30/23 EPS of $38.27 and 29x our LTM EBITDA as of 6/30/23 of $1.72B.

A few reasons to expect upside to sales over the next few quarters: First, it is likely that dining rooms sales will return, opening the door for incremental sales on the front make line on increased mobility nationwide (front line AUVs recently ~$1.2M vs. ~$1.7M pre-COVID and $2.4M peak in 2015). Second, Chipotle has ~21M digital customers for marketing/promotions. Third, new products in 2021 such as Cilantro Lime Cauliflower Rice, digital-only quesadillas, and smoked brisket will lead to trial. Fourth, as dining rooms have partially reopened Chipotle has seen 50-60% of the dining room business come back, while also retaining 80-85% of digital business (which now represents ~50% of sales versus 20% pre-COVID). Remember that the Street is implying ~$500k higher AUVs vs. 2019 when the digital business alone has grown $700k+ during COVID.

A few reasons margins may surprise to the upside as well: First, increased prevalence of Chipotlanes (margin accretive unit growth where ~40% of orders come from mobile order & pickup (MO&P) vs. ~25% traditionally). Second, mobility and the return of in-store dining which drives high-margin beverage attach. Third, increased digital penetration (21M+ loyalty members, most per unit in restaurants). Fourth, net menu price increases across menu items and channels will boost margins. Fifth, sales leverage inherent with higher AUVs. Sixth, look for margin-accretive innovation (e.g. quesadillas) to boost incremental margins. Potential setbacks to margin improvement could include continued wage and food cost inflation and higher-than expected reliance on delivery as a channel.

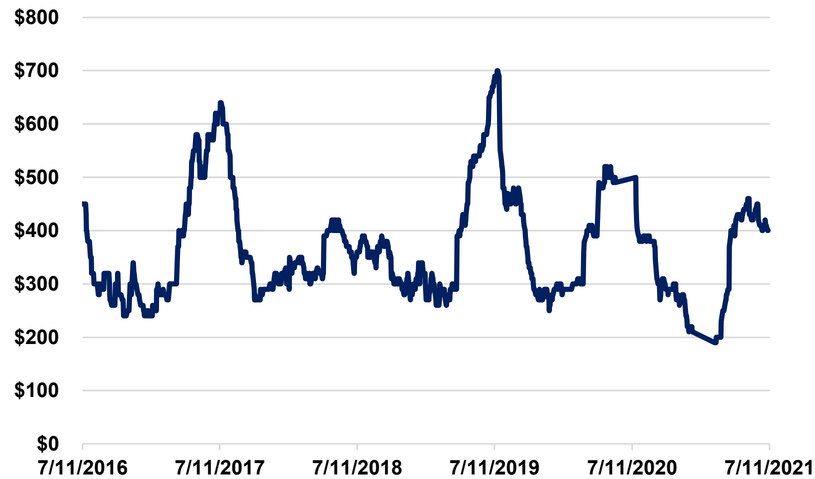
Three additional reasons to be excited about Chipotle:

- **Average unit sales are poised to move "step change" higher than past peak due to high retained off-premise business.** Across the system, on premise order sales is ~70% of pre-COVID levels. On-premise order sales may not return to pre-COVID levels quickly, but digital off-premise sales are sustaining over $1M/restaurant (versus ~$400k pre-COVID) even in the most "reopened" markets. Chipotle serves digital orders and in-person orders through two different "make lines"—each with $2M+ capacity. This makes $3.0 million in AUV very much in the company's sights over time (our estimates imply this happens by the beginning of 2025).
- **Return on investment for new Chipotle restaurants is on its way to 65-70%, making this a very special growth story.** The company estimates that its ROIC today is roughly 56% at current 22% restaurant level margins, $2.3M AUVs and an average investment cost of $925-950k. Over time, the company anticipates value-engineering its costs lower as an offset to the inevitable surge in building costs while its profit per restaurant grows. The company believes it is on its way toward the zone of a 65-70% unit-level ROIC (ex: $2.5M AUVs at 25% margins at a build cost of $925k equals 68% returns).
- **Chipotle is very much in control of its digital future with a growing percentage of its orders through its own app.** This is an extremely important point that has relevance to Chipotle's long-term margins and control of its marketing. Chipotle's percentage of digital orders is staying near 50% with a >50% of those orders as high margin mobile order & pick up. Of its delivery orders, ~40% of its delivery orders are now processed through Chipotle's app—meaning that it uses a delivery company as a

white-label service rather than the control point for the customer order. It is bullish that Chipotle is maintaining 20% two-year SSS growth while transitioning toward higher margin and more sustainable customer relationships. The lifetime value of Chipotle's customer relationships has likely grown dramatically over the last year as a) Chipotle has established more direct digital relationship with its consumers (with CRM opportunities ahead), and 2) these customers have learned to use Chipotle for dinner and family meal solutions in addition to adult-lunch occasions (often during the week).

Avocado prices are seasonally higher, but below levels seen in 2019 and 2020

Figure 17: Avocado prices over time



Source: Bloomberg

DPZ: Poised to lap COVID comps in style

Set to continue its impressive run; raising price target: For investors following the leading pizza delivery player, it has become more clear that it will lap difficult 2Q and 2H comparisons as at-home eating occasions remain remarkably robust—a trend that is also bolstering at-home packaged food sales (up 15% on a two-year basis). We are raising our US SSS estimate from a 1% decline to 4% growth, representing 2-year SSS of 20% (vs. ~15% 2-year SSS in 1Q and ~20% in 2Q20 and 3Q20; cons. 14%). Our new $550 price target (prev. $470) is based on 32x (<1 std. dev. above the 5-year median NTM multiple of 30x) our new LTM EPS as of 6/30/23 of $17.25 and 23.5x our EBITDA as of 6/30/23 of $1,049M. Domino's target 2022 FCF yield of 3.1% represents a premium to franchised peers such as YUM, (3.6%), MCD (3.6%), QSR (5.2%), and WEN (5.2%). Domino's deserves to trade at a premium given a stronger total shareholder return (TSR) of 14% compared to peer group average of ~12%. Relative to the S&P500, DPZ is currently trading at a 54% premium vs. 66% average over the last five years. Relative to itself, DPZ is currently <1 standard deviation above its 5-year median, justified in our view given the visibility on retail sales growth driven by industry leading unit growth and traffic/mix driven SSS growth. We assume 4.5x debt / EBITDA as of 6/30/23 (midpoint of 3-6x guidance), potentially conservative given the continued low cost of debt and willingness to live above the midpoint of stated guidance (recap from 5.1x to 5.7x in 2019).

Domino's continues to stay ahead of competitors with technology and visibility. During the Evercore ISI Restaurant Technology Symposium in March, it was Chipotle's CTO Curt Garner that noted the trouble with curbside pick-up was visibility. The wait might be only 2 minutes—making it more than competitive with the average 5-6 minute drive-thru experience. However, the lack of visibility (he compared it to being underwater) made the wait seem much longer. Interestingly, Domino's has attempted to take give visibility to the curbside experience by instituting a 2 minute carside delivery guarantee (or a free pizza in the next order). See a recent review from Business Insider **here** calling Domino's 2-minute curbside pickup guarantee "one of the quickest ways I've ever picked up food". Domino's is no stranger to offering customer's guarantees, as its original delivery slogan was that your delivery would arrive within 30 minutes or less or your order was free. Domino's will be launching traditional marketing in the coming weeks with digital advertising happening now (see **here** and **here**) including a prize campaign with Draft Kings.

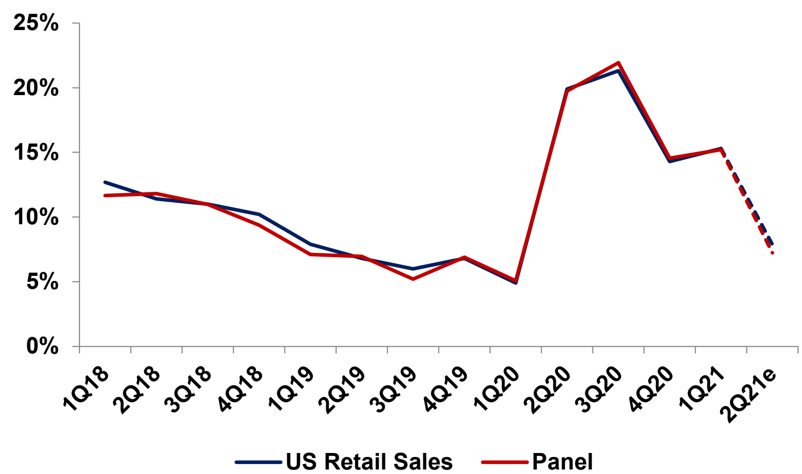
Confidence continues to build heading into a period of rapid delivered food inflation. Consumers ordering food for delivery are going to find service to be more limited (due to labor availability and opting out by restaurants) and higher-than-average delivered food cost increases. For example, Chipotle customers will be paying roughly 17% more for delivered food this year. Heading into 2H21, we expect Domino's value positioning (e.g. $5.99 and $7.99 price points) and convenience advantages to be widening—leading to accelerating delivery share gains. In addition, Domino's will bring back 4+ value "boost" weeks (vs. zero such weeks in 2H20 and 1Q21) while marketing to its carside delivery platform and reinforcing its new "Avoid the Noid" advertising. See a recap note of our June 17 fireside chat with CEO Ritch Allison in which we discussed a variety of these initiatives **here**. We continue to view Dominos as well positioned to grow sustainable total shareholder return of ~14% driven by highly visible global net unit growth of 6-8% (backed by best-in-class unit economics; $177k in EBITDA per store in 2020), continued buybacks +3-4%, ~1% dividend yield and 3%+ SSS.

Competitive advantages set to widen: We remain constructive on Domino's positioning as the value leader, preferred employer, marketing juggernaut, technological first-mover, and franchisee entrepreneurial engine. Domino's hopes to lean on technology-enabled carry-out (currently ~43% of transactions and ~1/3 of sales) to combat labor pressures and grow share (currently 15% share vs. 36% share in delivery) in a pizza sub-segment market that seems to have more share opportunity (2.5x the number of QSR pizza transactions are carry-out vs. delivery). The company plans to utilize strategic menu price increases and delivery fee increases to incentive carry-out business and combat labor inflation while sticking to their $5.99 and $7.99 value price points. The overhang of third-party delivery appears to be dissipating as Domino's has ample data and 1x1 relationships (27M active loyalty users) to drive frequency and mix-driven ticket growth. Domino's unit growth outlook remains robust as the US franchisee base is coming off its best profitability year ever (>$1M of EBITDA per franchisee) and benefit from highly attractive new store ROIC (~3-year payback period). Internationally, the company mentioned momentum in both developed (i.e. Germany, UK, Japan) and developing (i.e. India, China) economies with line of sight for 5,300+ additional units within their top 15 markets alone. See our initiation **here** where we discuss Domino's virtuous cycle in more detail.

Our proprietary panel data suggests YOY US retail sales growth of ~8%, split evenly by ~4% SSS growth and ~4% unit growth

~4% SSS growth implies 2-year SSS growth around levels seen in 2Q and 3Q of last year

Figure 18: DPZ Panel Data, r = 0.995

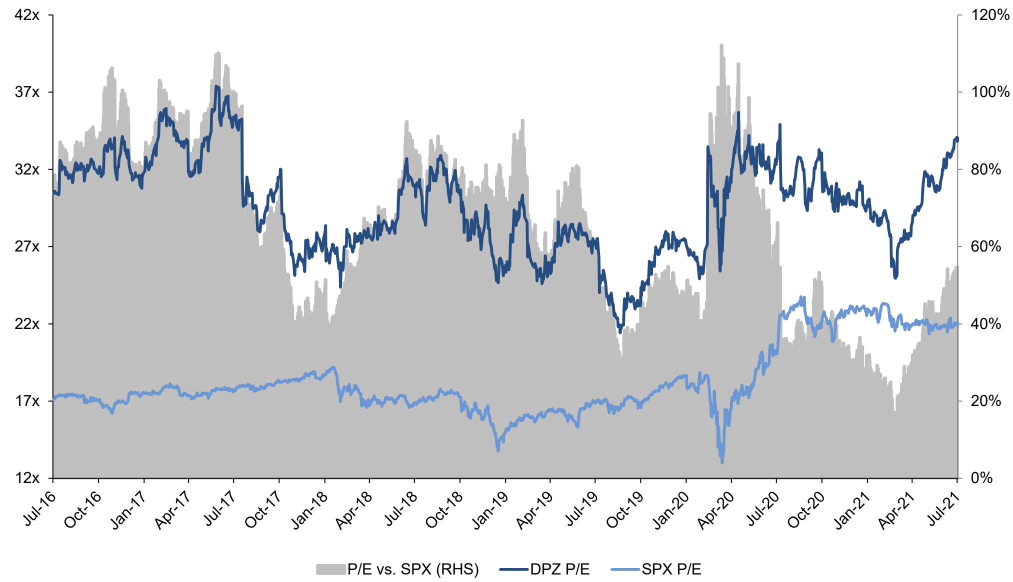


Source: StudyLogic, Evercore ISI Research

Despite being the most expensive franchised name we cover on an absolute basis, DPZ's gap to the S&P500 is 12pp below the 5-year median (54% vs. 66% historically)

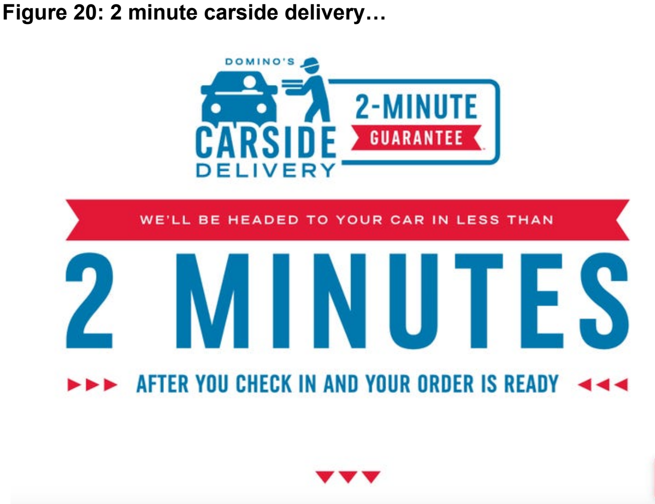
DPZ would require 3-turns of multiple expansion to reach its 5-year median gap to the S&P

Figure 19: NTM P/E over time (DPZ vs. SPX)



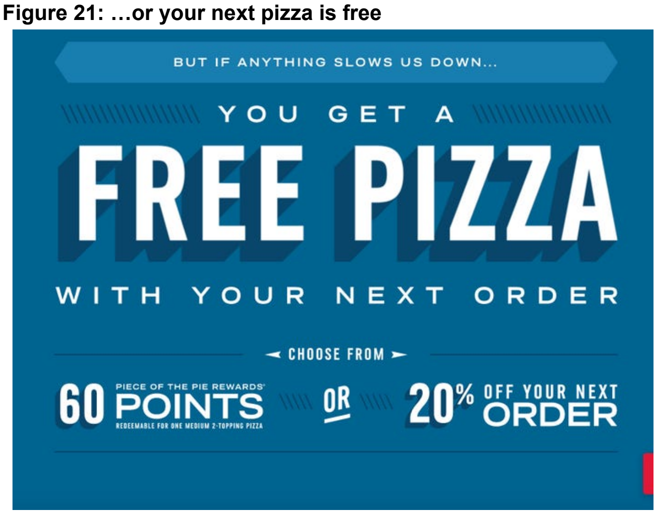
Source: FactSet, Evercore ISI Research

Figure 20: 2 minute carside delivery…



Source: Company advertisement

Figure 21: …or your next pizza is free



Source: Company advertisement

SBUX: Looking for next potential upside catalysts

Raising our near-term SSS estimates to reflect panel insights: Ahead of F3Q21 earnings on 7/29, we are raising our US SSS estimate to 87% (prev. 81%; 12% 2-year SSS vs. March 11% and cons. 8%) which we believe reflects our proprietary Evercore ISI consumer panel. Our new FY21 EPS estimate $3.11 (cons. $3.00; guidance: $2.90-3.00) assumes EBIT margins of 18.3% and 19.2% in F3Q and F4Q, respectively (FY21e EBIT margin of 17.4% vs. guidance 16.5-17.5%). This higher estimate better captures the likely benefits from lower real estate costs, a strong high-income consumer backdrop, digital user growth (e.g. 'Stars for Everyone' rollout) and other learned efficiencies. In FY22 we assume Americas company-operated AUVs are 20% greater than FY19 and International AUVs are 4% greater than 2019. We note our FY22e EPS assumes Starbucks' corporate EBIT margin is greater than FY18 levels (18.9% vs. 18.0%). Our price target of $120 is based on 30x (~1 standard deviation above SBUX's 5-year NTM median P/E) our LTM EPS as of 6/30/23 of $4.07. Looking out to FY23 and beyond, we view Starbucks to be a highly sustainable and high ROIIC HSD revenue growth business able to deliver LDD EPS growth (+2% dividend).

Some positives we are considering…

1. **Amazing cold beverage growth looks likely to continue:** In normal times, Starbucks' SSS growth is typically driven by a combination of cold beverage growth and digital user growth/engagement. Heading into late FY21 and FY22, Starbucks looks likely to have its hot streak of cold beverage contribution to growth continue. Since FY16, cold beverage has driven ~200% of Starbucks' US SSS growth as its cold beverage mix has increased from 45% to 60%. Beginning three years ago, Starbucks shifted its cold beverage efforts away from Frappuccino limited time offers (e.g. Zombie Frappuccino) toward more brand-forward offerings such as Cold Brew, Iced Shaken teas, and Cold Brew Nitro. Recently the company introduced Iced Shaken Espresso—a platform that would also seem to have significant promise.
2. **Double-digit Rewards member growth seems likely to continue after Stars for Everyone launch (in the middle of COVID):** Even with traffic down over 20%, Starbucks' rewards membership grew 18% YOY in F2Q (22.9M active members). Rewards customers contributed 52% of US company-operated sales in F2Q, up from 44% last year before the onset of COVID-19 and up from 50% in F1Q. This is a direct result of the Stars for Everyone launch and a positive sign for active rewards user growth—and the digital marketing upside—to continue.
3. **Potential market share gains from weaker (or closed) competition:** Starbucks has about 70% share of the specialty coffee market—about 10x the sales of the independent specialty coffee shops (7% share) and 3x the share of all other regional chains put together. That said, Starbucks has done the right things for its partners (employees), gotten additional trial through its at-home products (e.g. K-cups and RTD coffee), and largely kept its stores open during COVID.
4. **Operational initiatives at scale:** Ongoing initiatives underway to drive productivity include the deployment of handheld POS systems to improve throughput at the drive-thru (capacity and margin enhancement potential), new equipment (espresso machines and ovens) that help to reduce transaction times out-the-window, and operational engineering work enhanced by AI and consumer insights to ensure that our operating routines achieve higher levels of labor efficiency.

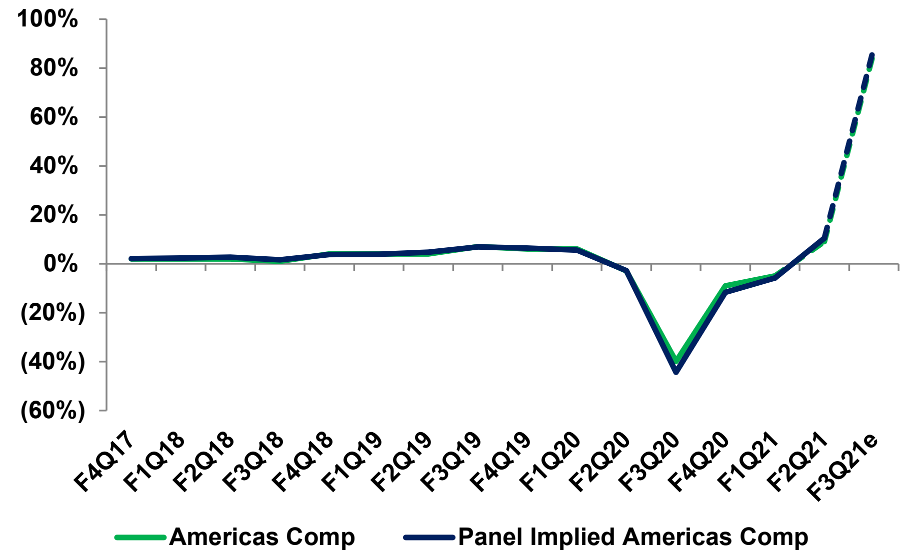
Some negatives we are considering…

1. **Ongoing soft urban and commuter traffic:** Starbucks noted that it was planning on its 15% of stores in urban areas facing structurally lower daytime traffic for a while. For example, the company noted that it was planning for 25% less daytime traffic in midtown Manhattan in the medium-term than pre-COVID. With ~50% of sales historically from breakfast, what do consumer routines look like in a work-from-home post-COVID environment?
2. **Unclear store-level capacity and in-store traffic upside as the chain laps 21% check growth:** Relative to FY19, Starbucks' latest quarter featured a 16% decrease in traffic relative but a 27% increase in check growth (group orders, premium beverage mix, increased customization, and record food attachment) as more US consumers visited Starbucks drive-thru's (almost 60% of US company operated units). How much will the check shrink next year as (some of) America gets back to the commuting grind? How much will in-store business from vaccinated consumers take the pressure off the drive-thru?

Our panel suggests 2-year SSS for Starbucks US accelerated slightly from 11% in March to ~12% for F3Q

The panel output gives us a retail sales estimate in which we back out unit growth to estimate SSS for the quarter

Figure 22: Starbucks America's Panel Data, r=0.99



Source: StudyLogic, Evercore ISI Research

Figure 23: Store OpEx detail

	FY 2018 2018	1Q19 12/31/18	2Q19 3/31/19	3Q19 6/30/19	4Q19 9/30/19	FY 2019 2019	1Q20 12/31/19	2Q20 3/31/20	3Q20 6/30/20	4Q20 9/30/20	FY 2020 2020	1Q21 12/31/20	2Q21 3/31/21
Company-operated sales	$19,690	$5,370	$5,159	$5,535	$5,480	$21,544	$5,781	$4,766	$3,444	$5,174	$19,165	$5,727	$5,653
Wages & Benefits	$5,319			$1,500	$1,546	$5,942	$1,598	$1,608	$1,478	$1,448	$6,132	$1,602	$1,665
% of company-operated sales	*27.0%*			*27.1%*	*28.2%*	*27.6%*	*27.6%*	*33.7%*	*42.9%*	*28.0%*	*32.0%*	*28.0%*	*29.5%*
Occupancy	$2,251			$612	$620	$2,411	$619	$594	$556	$620	$2,388	$628	$626
% of company-operated sales	*11.4%*			*11.0%*	*11.3%*	*11.2%*	*10.7%*	*12.5%*	*16.1%*	*12.0%*	*12.5%*	*11.0%*	*11.1%*
Other Expenses	$1,903			$531	$543	$2,141	$605	$520	$505	$615	$2,244	$633	$532
% of company-operated sales	*9.7%*			*9.6%*	*9.9%*	*9.9%*	*10.5%*	*10.9%*	*14.6%*	*11.9%*	*11.7%*	*11.1%*	*9.4%*
Total Store Operating Expenses	**$9,472**			**$2,643**	**$2,709**	**$10,494**	**$2,822**	**$2,721**	**$2,538**	**$2,683**	**$10,764**	**$2,863**	**$2,823**
% of sales	*48.1%*			*47.8%*	*49.4%*	*48.7%*	*48.8%*	*57.1%*	*73.7%*	*51.9%*	*56.2%*	*50.0%*	*49.9%*
% of Store OpEx													
Wages & Benefits	*56.2%*			*56.8%*	*57.1%*	*56.6%*	*56.6%*	*59.1%*	*58.2%*	*54.0%*	*57.0%*	*56.0%*	*59.0%*
Occupancy	*23.8%*			*23.1%*	*22.9%*	*23.0%*	*21.9%*	*21.8%*	*21.9%*	*23.1%*	*22.2%*	*21.9%*	*22.2%*
Other Expenses	*20.1%*			*20.1%*	*20.1%*	*20.4%*	*21.4%*	*19.1%*	*19.9%*	*22.9%*	*20.8%*	*22.1%*	*18.9%*
Company-operated store count	14,164	15,479	15,636	15,579	15,669	15,588	15,957	16,134	16,230	16,454	16,236	16,690	16,699
Wages & Benefits / store	$0.376			$0.096	$0.099	$0.381	$0.100	$0.100	$0.091	$0.088	$0.378	$0.096	$0.100
YOY Growth						*1.5%*			*(5.5%)*	*(10.8%)*	*(0.9%)*	*(4.1%)*	*0.0%*
Occupancy / store	$0.159			$0.039	$0.040	$0.155	$0.039	$0.037	$0.034	$0.038	$0.147	$0.038	$0.037
YOY Growth						*(2.6%)*			*(12.8%)*	*(4.8%)*	*(4.9%)*	*(2.9%)*	*1.9%*
	).134			$0.034	$0.035	$0.137	$0.038	$0.032	$0.031	$0.037	$0.138	$0.038	$0.032
						2.2%			*(8.8%)*	*7.8%*	*0.6%*	*0.1%*	*(1.0%)*
	).0%			*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
	1.9%			***32.2%***	***30.6%***	***31.3%***	***31.2%***	***22.9%***	***6.3%***	***28.1%***	***23.8%***	***30.0%***	***30.1%***

SI Research

Coffee bean prices on international markets have surged as crops in top producer Brazil have been damaged by the worst drought in almost a century, leading to the first supply shortfall in the coffee market in four years

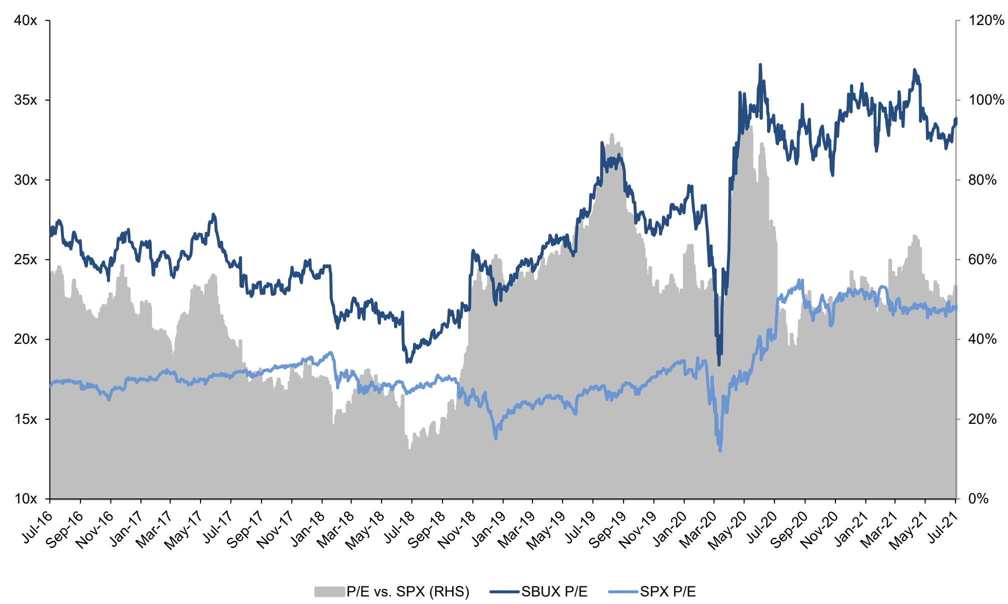
We would expect SBUX to be locked in for the months ahead, but we are curious whether these elevated levels were considered when forecasting margin guidance over the medium-term

Figure 24: Arabica coffee prices

Source: Financial Times, Refinitiv

Starbucks is currently trading at a 53% premium to the S&P500, 4pp above 5-year median of 49%

Figure 25: NTM P/E SBUX vs. SPX



Source: FactSet, Evercore ISI Research

MCD: US momentum continues ahead of a European rebound

Broad strength in quick-service with McDonald's among the growth leaders; raising price target: Overall, fast food industry traffic trends remain 6-7% below those of 2019—caused by diminished commuting that weighs on work-lunch (i.e. Subway/Panera) and breakfast-oriented (i.e. Dunkin) players. While McDonald's provided rough guidance that 2Q 2-year SSS growth would be roughly equal to 1Q's ~13.5%, we believe the first half of the quarter will carry the quarter above this trend. As a result, we are raising our 2Qe US SSS from 25% to 27% (2-year now 16%; consensus 1-year 23%). In the coming months, we look forward to seeing the potential lift from the reopening of dining rooms, increasing capacity from higher labor availability, continued pre-Labor Day vacationing, and traction of MyMcDonald's). We are raising our price target to $275 (prev. $260) which is derived from 26x our LTM EPS estimates as of 6/30/23

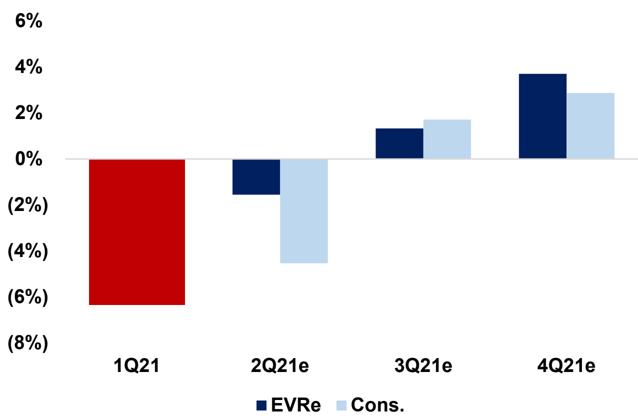
($10.51)—toward the high end of the 5-year valuation range reflecting our strong SSS growth outlook.

US momentum stalled slightly QTD due to weather, but expect underlying fundamentals to remains strong: We estimate McDonald's US 2-year SSS growth was ~15% in April, 17% in May and 15% in June. We believe the new chicken sandwich has been a hit while the BTS celebrity meal—while not the sales driver that the Travis Scott meal was—was a solid performer. In July, we believe weather has been a headwind while the launch of loyalty has also hindered drive-thru speed (resulting in a 5pp+ slowdown in some regions). McDonald's US franchisees have enjoyed "blowout" record cash flow per restaurant in 2020 and so far in 2021. And McDonald's US operators may hold onto more of the record cash flow for longer. The McDonalds system gets relatively stable pricing from its suppliers (relative to competitors such as Burger King and Wendy's), giving it an advantage during the front end of an inflation cycle. Loyalty is off to a strong start with strong app downloads (see statistic below). In the near-term the launch of loyalty is causing a 10-15 second slowdown in drive-thru times as customers struggle to pull up the smart phone bar code that is necessary to redeem loyalty benefits.

IOM upside may rear its head in 2H: For example, the 3-year SSS implied by 2022e consensus for McDonald's International Operated Markets (IOM) is only ~6% versus the 3-year growth of 19% in 2019. This seems conservative given momentum heading into COVID (+6% SSS in 4Q19), relatively high competitor closures (e.g. often independent walk-in locations), and social safety nets in key markets. The European Union's statistics office Eurostat said retail sales in the 19 countries sharing the euro increased 4.6% month-on-month in May and were 9.0% higher than a year earlier. We are optimistic about the return to 2019 sales levels in 3Q for the IOM region.

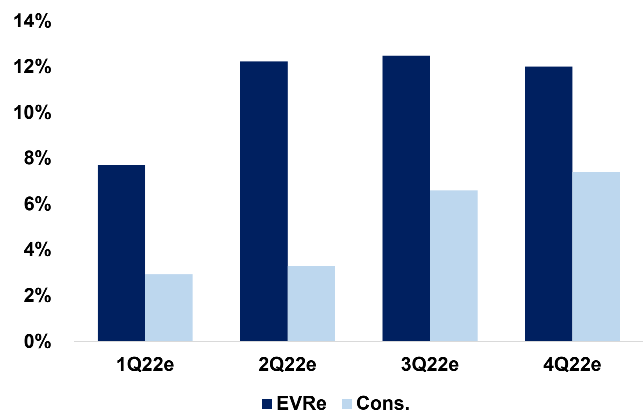
Digital sales boost from COVID: For McDonald's, its COVID digital sales layer boost has been less as a result of its drive-thru enabled footprint. Mickey D's has made more of a global bet on drive-thru units (~95% of US units and ~75% of IOM units have a drive-thru) and this has hindered digital adoption to this point. As a result, we believe its global top six markets digital order mix (excluding kiosks) has increased from 10% pre-COVID to 17% recently with that mix higher in urban areas and in locations that lack a drive-thru.

Figure 26: MCD IOM 2-year SSS (2021 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

Figure 27: MCD IOM 3-year SSS (2022 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

Near-peak Eurozone economic sentiment bodes well for MCD's IOM business

Figure 28: Eurozone Economic Sentiment

Source: Evercore ISI Research

McDonald's recent loyalty launch spurred significant download in June

Figure 29: Most downloaded QSR apps in June

10 Most Downloaded QSR Apps in June 2021

United States

#1	McDonald's 1.6M	#6	Taco Bell 644k
#2	Starbucks 939k	#7	Dunkin' 556k
#3	Domino's Pizza 928k	#8	Subway 508k
#4	Wendy's 809k	#9	Pizza Hut 501k
#5	Chick-fil-A 774k	#10	Burger King 477k

Outsmart your competition with app intelligence from apptopia.com

apptopia

Source: AppTopia

QSR: Eyes on Tim's as the Ch'King underperforms expectations

Adjusting estimates ahead of the quarter: We are expecting EBITDA of $552M (cons. $537M) and EPS of $0.65 (+98% YOY and -8% vs. 2019; cons. $0.62). We maintain our quarterly SSS estimates which assume 2-year SSS of +2% for BK US (cons. +1%), -10% for TH Canada (cons. -11%), and +30% for Popeye's US (cons. +30%). We assume trends for BK US roughly remain the same for the remainder of the year while we assume improvement at TH Canada to 2-3% 2-year SSS declines before turning positive vs. 2019 in 2022. We are slightly reducing our price target to $72 (prev. $75) which equates to 22x our LTM as of 6/30/23 EPS of $3.30 (cons. $3.33) and 17x our LTM 6/30/23 EBITDA estimate of $2.62B (cons. $2.64B). This reflects our declining confidence in BK US but remain steadfast in our view that unit growth and Tim Horton's Canada are the two larger storylines with upside unlock potential. Our target 2022 FCF yield of 5.2% is higher than most peers (MCD: 3.6%, YUM: 3.6 %, DPZ: 3.1 %, and WEN: 5.2%).

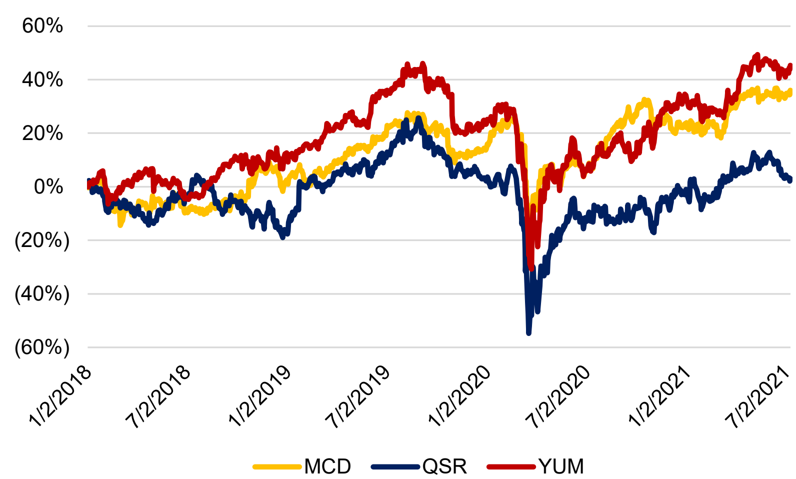
As Canada reopens, a light will be shined on the Tim's business: There are reasons to hope for improvement in 2-year SSS trends later in 2021, including 1) innovation (new dark roast coffee, new coffee brewers & water filtration systems, new fresh cracked eggs breakfast sandwiches, and non-breakfast "craveables" sandwiches), 2) new digital menu boards (40k by 2022), 3) an improved (but still transaction based) digital loyalty program (30%+ of all 1Q21 sales came through our digital channels (nearly 2x 2Q21)), 4) improved restaurant-level profitability, 5) increased media weight (C$80 million combined with a 50bp of increased ad fund contributions from franchisees) behind a new advertising campaign, and 6) strengthening relationships with franchisees. The company mentioned last quarter the recent improvement to coffee occasions (2% growth) and breakfast daypart being down LSD towards the end of the quarter. While Canada remains under broad restrictions (at least relative to the US), there are indications the system is healthier and ready for improved trends once mobility improves. With execution, we believe the street's estimates for ~flat SSS in 2022 vs. 2019 could be extremely conservative.

Disappointed in the Ch'King sandwich launch: We have been amazed that Burger King's SSS growth has not responded more fully in what has been a strong month for fast food SSS growth. We estimate that the industry average SSS in June was over 10%--lapping at least low-single digit SSS growth in June 2020. Burger King SSS may be only up low single digit in the month in spite of 7% product mix from the new Ch'King sandwich. The product seems to be cannibalizing the Whopper—perhaps indicative of a failure to recruit new premium consumers. Coming out of COVID, it appears that those fast food brands that have recruited premium consumers and families looking for safe and familiar meals have won. McDonald's and Chick-fil-A have been the gold standard brands in this respect—and the gap in two-year SSS growth has become striking between these two brands and the east-coast rival Burger King. Notably, sales mix from high ticket and high margin Impossible Whopper is ~5.5-6% (down from ~7.5% at launch but up from 4% during the winter).

See our Day 3 takeaways from the Summit here where we discuss takeaways from our meeting with QSR management.

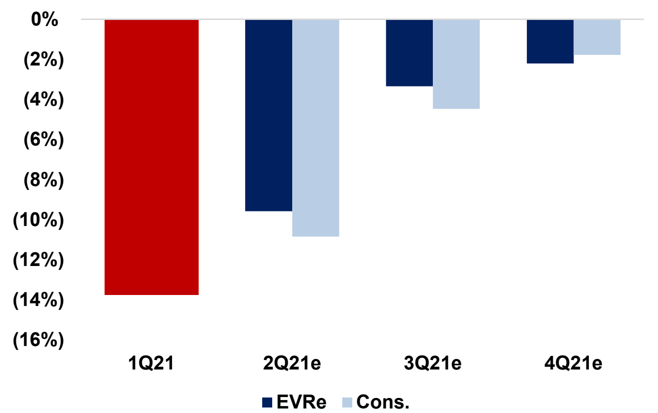
Restaurant Brands has lagged global franchised peers MCD and YUM by 30%+ since 2018 (and is virtually flat over that time frame)

Figure 30: Stock price performance since 2018



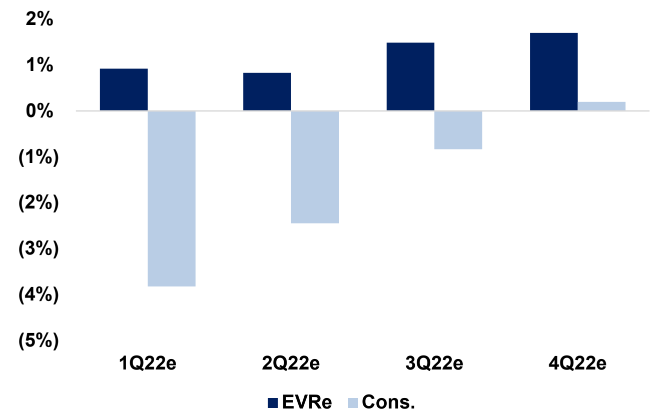
Source: FactSet

Figure 31: Tim Horton's Canada 2-year SSS (2021 vs. 2019)



Source: Company Data, ConsensusMetrix, Evercore ISI Research

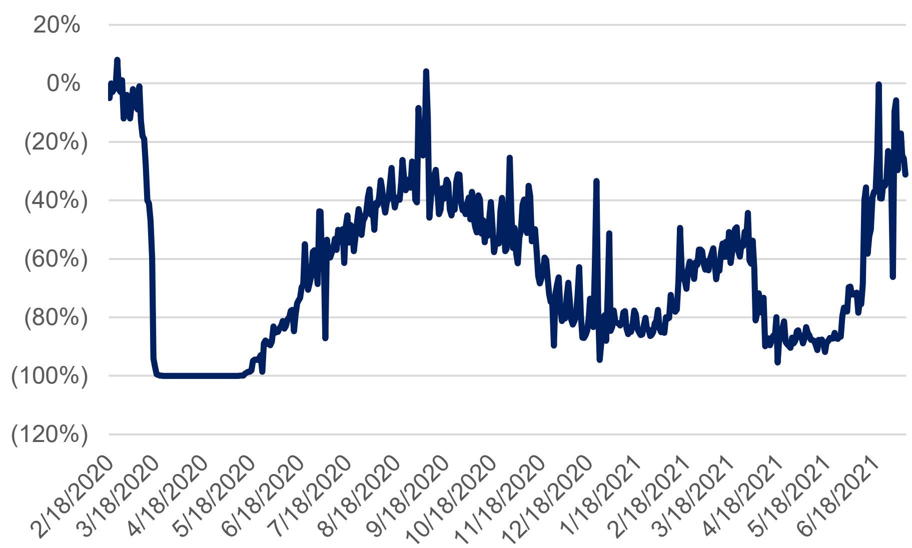
Figure 32: Tim Horton's Canada 3-year SSS (2022 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

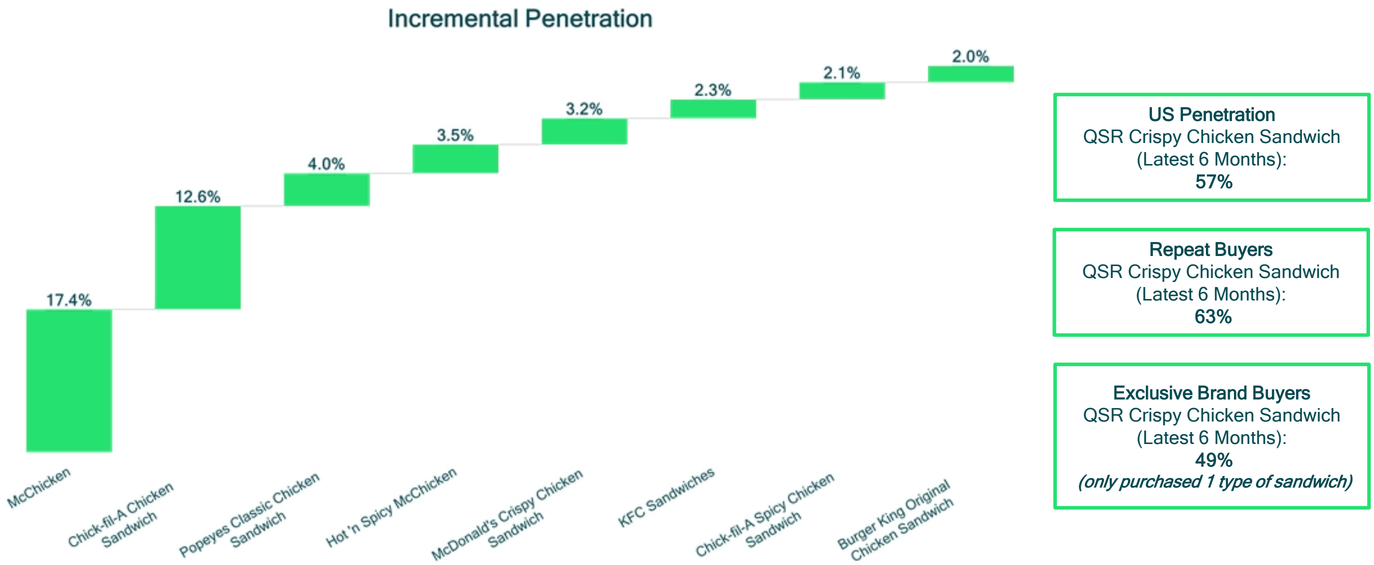
Canadian in-restaurant dining returned in a big way towards the end of 2Q, potentially a good sign for mobility and by association Tim's business

Figure 33: Canada seated diners from online, phone, and walk-in reservations



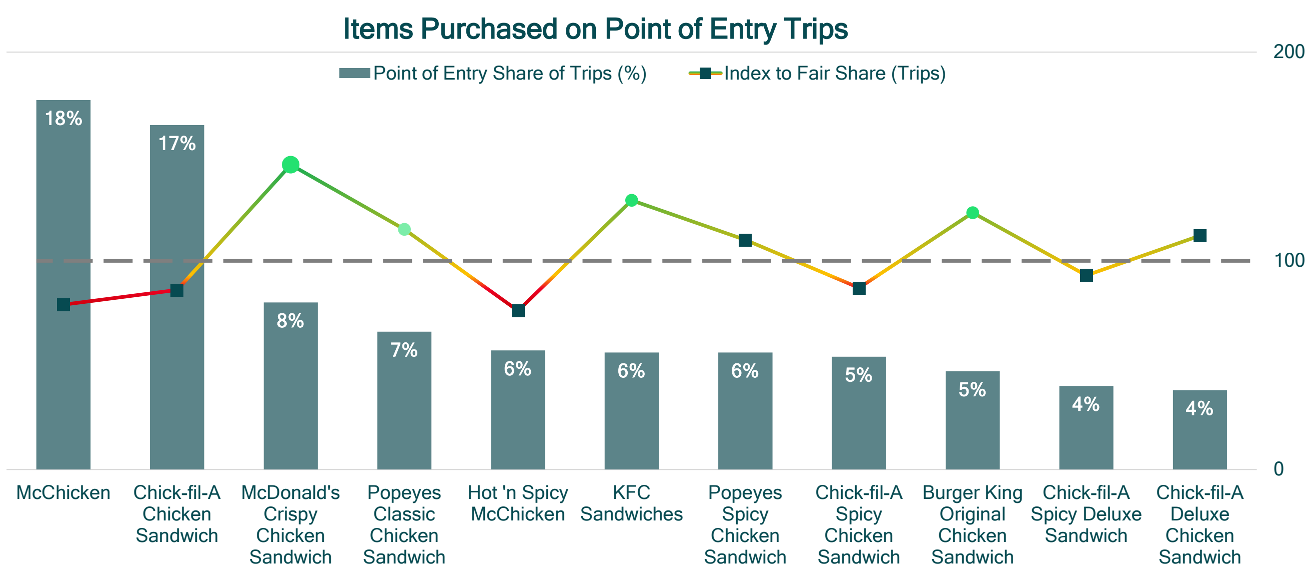
Source: OpenTable

Figure 34: McDonald and Chick-fil-A's Classic Chicken Sandwich continues to dominate the Fried Chicken Sandwich category



Source: Numerator Insights, L6M, Week Ending 5/30/21

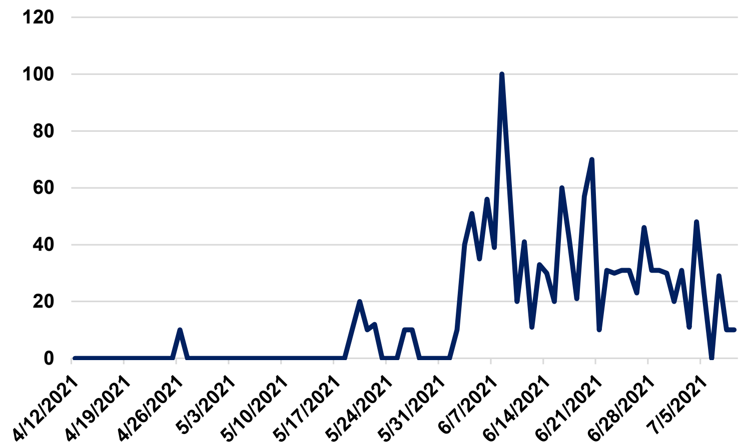
Figure 35: McDonald's New Crispy Chicken Sandwich and the KFC Chicken Sandwich are capturing more than their fair share of trips among new category entrants



Source: Numerator Insights, Point of Entry, 11/30/2020 to 05/30/2021

Ch'King interest on Google appears to be waning following the nationwide launch in early June

Figure 36: Ch'King Interest over time (past 90 days)



Source: Google Trends

TXRH: Thinking about 2022 sales upside and margin headwinds

Maintaining SSS, EPS and target ahead of 2Q update: Our 2Qe SSS is now 21% on a 2-year stacked basis (prev. 19%; cons. 14%) and EPS is now $1.13 (vs. cons. $0.95). Our 2021e and 2022e EPS go up ~5pp and 3pp, respectively, reflecting a more rapid-than-expected and sustained SSS strength, labor productivity, and incremental off-premise business. We remain more cautious than consensus on restaurant-level-margin given the Company's reticence to price aggressively, our cautious inflationary protein outlook in 2022, and conservative consensus labor inflation assumptions in both 2022 and 2023 (consensus assuming 4% labor inflation CAGRs in 2022 and 2023 vs. 7-9% in 2017-2019 and 5.5% just before COVID). Our price target of $110 (+20%) upside equates to 25.5x (pre-COVID 5-year range of 22-27x) our LTM as of 6/31/23 EPS of $4.29. Our target multiple is 28% higher than DRI, roughly consistent with TXRH's pre-COVID historical premium of 32% (see Figure 9). Our target valuation equates to a PE-to-growth ratio of ~2.0x against our 13% long-term EPS growth (driven by 4-5% SSS, 5-6% unit growth, and a bit of share repurchases). This excludes the company's 1-2% dividend yield. Our price target also equates to 27x our CY22 EPS of $4.03 and 25.5x our LTM 6/30/23 EPS of $4.29. This is exactly in line with the company's historical 35% premium to the S&P500 (currently trading at 20x CY22 consensus EPS). Our target valuation is at the high end of the 5-year valuation range and equates to a PE-to-growth ratio of 2.2x against our 13% long-term EPS growth (driven by 4-5% SSS, 5-6% unit growth, and a bit of margin leverage).

Off-premise momentum sticking: Off-premise sales are remaining sticky at $25k/week (~19-20% mix in March / April)—something that could sustainably add 10%+ to average unit sales (AUV). April-to-date SSS trends imply 21% 2-year SSS growth. Remarkably, the brand is achieving these SSS trends with 75%-80% seating capacity. At this point, we are most curious about where 2022 restaurant margins shake out. Of course, Texas Roadhouse is the least directly impacted by marketing savings (since it was zero pre-pandemic). However, Texas Roadhouse may be more effective given its digital connections are a new way to communicate with consumers. In addition to Brinker, Texas Roadhouse's step up in off-premise business mix has been impressive. While take-out and steak seem to be a less-than-perfect match, take-out mix has increased from 7% to 20% at the Roadhouse and this seems to be a lasting area of potential upside. For Olive Garden, its large take out mix of ~16% has increased to 33% during COVID (as of the week ended 3/21/21)—creating potential for some upside, but perhaps more modest than those chains less committed to take-out pre-COVID (e.g. Texas Roadhouse) or those that embraced delivery (Chili's).

We believe the Street is underestimating the sales potential of Texas Roadhouse but overestimating the margin expansion implied

Figure 37: 2022 TXRH EVRe vs. cons.

Evercore Estimates Vs. Consensus	EVR Est.	YOY Change	FY 2022 Cons. Est.	Delta	Delta (%)
Sales	**3,767.7**	**11.1%**	**3,605.9**	**161.8**	**4.5%**
Comp (company-owned)	**5.5%**		**4.1%**	**142 bp**	
Cost of sales % of sales	32.7%		32.3%		
Restaurant labor % of sales	33.1%		33.0%		
Other restaurant expenses % of sales	15.2%		15.0%		
Restaurant level profit	**646.1**	**10.0%**	**639.7**	**6.4**	**1.0%**
Restaurant level margin	**17.3%**		**17.9%**	**(60 bp)**	
Restaurant level margin change	(16 bp)				
G&A	180.5	8.8%	167.0	13.6	8.1%
Operating income (EBIT)	**333.4**	**N/A**	**336.6**	**(3.2)**	**(1.0%)**
Operating margin	**8.9%**		**9.3%**	**(47 bp)**	
Operating margin change	13 bp		37 bp		
Tax rate	15.0%		15.4%	(42 bp)	
Net income	280.6	14.7%	277.5	3.1	1.1%
EPS	**4.03**	**15.6%**	**3.96**	**0.07**	**1.8%**

Source: ConsensusMetrix, Evercore ISI Research

YUM: Underappreciated in an inflationary and reopened world

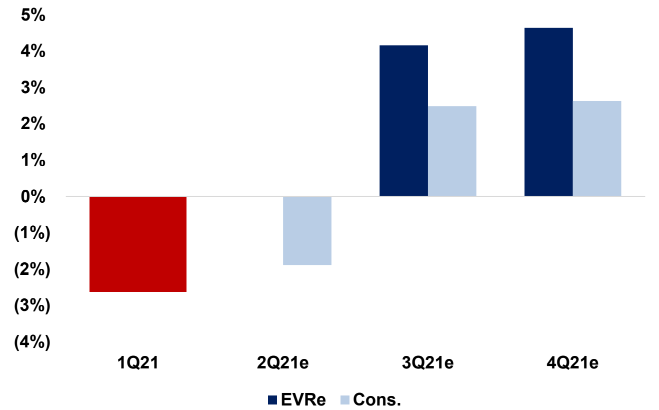
We are maintaining out 2Q SSS estimates but bias is for possible some upside at Taco Bell US and KFC: We are maintaining our SSS estimates for KFC US +7% (cons. +3%; 2-year +14%), Taco Bell +21%; (cons. +16%; 2-year +12%) and Pizza Hut +2% (cons. +1%; 2-year +7%). Internationally, we are maintaining our Pizza Hut International SSS estimate of +18% (cons. +18%; 2-year -4%) and KFC International SSS estimate of +37% (cons. +34%; 2-year flat) – both showing modest sequential improvement on a 2-year basis. We are likely at the inflection point for international to begin to accelerate sales on a 2-year basis as we go into the 2H with consensus currently +3% for KFC international and -1% for Pizza Hut International. Our 2Q EPS remains $1.05 (+28% YOY; cons $0.96). We are raising our price target to $140 (prev. $130) which is based on 27x (1-std dev above the post-YUMC spin median) our LTM EPS as of 6/30/23 of $5.16 and equals a 3.5% 2022e FCF yield. This valuation would put YUM toward the high end of peers, which is justified given the competitive position, digital capabilities, unit economics of global KFC and Taco Bell and 4% long-term unit growth. We estimate that Yum Brands will deliver a low-double-digit EPS algorithm long-term (equal to 2.0x PEG) although that growth will be relatively constrained over the 2019-2021 period due to COVID-19.

Different helpings of international recovery, technological enablement and better brand management point to a positive outlook for Yum Brands: For Yum Brands' KFC brand (50% of YUM profit), International 3-year SSS estimate is projected to be 8% in 2022 (vs. 11% in 2019). In our view, this estimate could prove conservative given digital interaction step-up. In many ways, KFC International is experiencing a digital step-change in interaction similar to that of Chipotle in the US. For Chipotle, that digital sales mix increased from ~20% pre-COVID to ~50% today. For KFC Global, that digital mix increased to 43% in 1Q21 from 23% two-years earlier. For a brand that has less than 25% of its international units with drive-thru, this 20pp digital interaction step-up could represent a semi-permanent sales layer that is both good for restaurant-level labor efficiency and marketing effectiveness.

KFC US continues to impress on the back of its new chicken sandwich offering: The chicken sandwich continues to perform well (4x the old sandwich volumes), mixing at 10% of sales. Notably, the sandwich drew a large uptick in 18- 34 year old business, making it a highly incremental launch. Customer survey work from Numerator (see Figure 34-35) highlights KFC's good performance. In fact, the sandwich has done well enough to warrant its own national media advertising budget. This could prove critical for brand equity as boneless chicken accounts for ¾ of all chicken occasions, 40% of which are chicken sandwich occasions. Kevin Hochman highlighted the seven straight years of US SSS growth and noted that 2021 will be the first net positive unit growth year since 2004. The new restaurant pipeline in the US is "the largest in a decade".

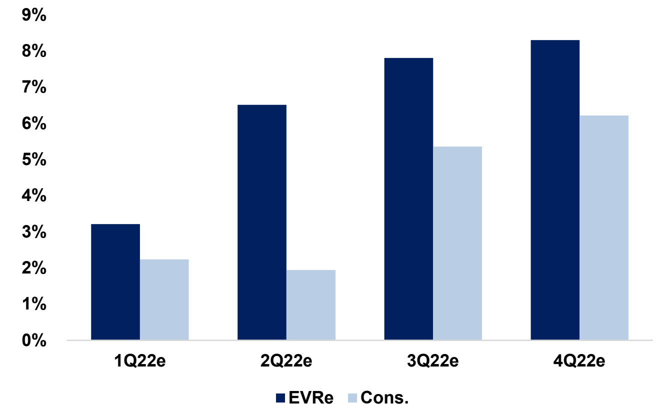
See our takeaways from KFC's Investor Day here.

Figure 38: KFC International 2-year SSS (2021 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

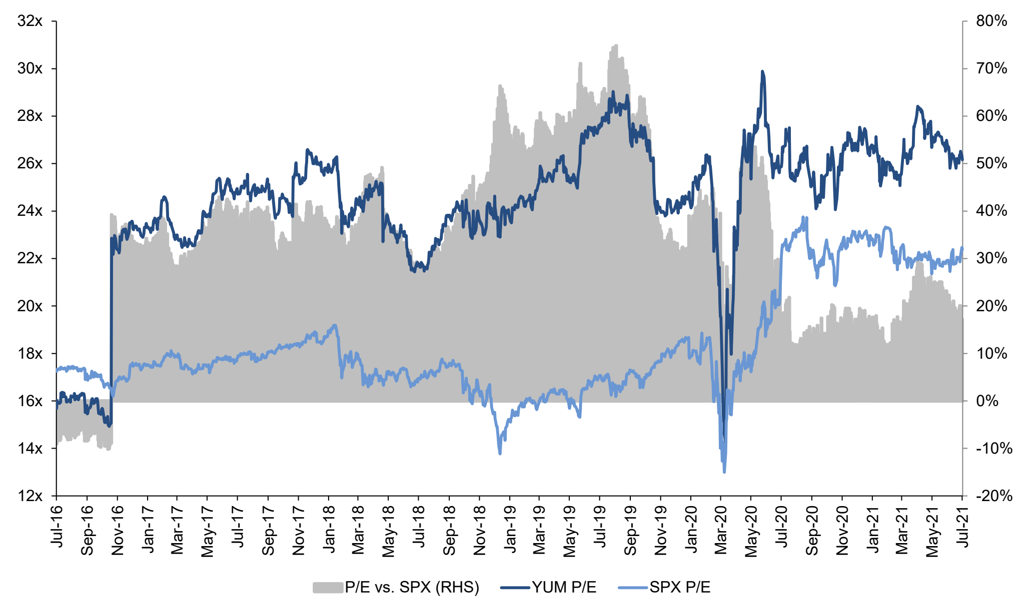
Figure 39: KFC International 3-year SSS (2022 vs. 2019)



Source: ConsensusMetrix, Evercore ISI Research

Post YUMC spin, YUM has historically traded at a 36% premium vs. the S&P500 vs. 17% today

Figure 40: NTM P/E (YUM vs. SPX)



Source: FactSet, Evercore ISI Research

WEN: Balanced offering

We are maintaining our 2Q US system SSS of +14% (cons +14%) with 2-year SSS +9%, similar to 1Q adjusting for calendar shifts: We expect breakfast to have contributed LSD SSS representing HSD sales mix. We assume restaurant level margins of 17.5% (cons 16.8%) which will benefit from sales leverage and lower commodity costs (similar to 1Q). Our 2Q EPS remains $0.17 (+48% YOY; cons $0.18). In 2H21, we are largely assuming recent 2-year stacked SSS trends of 10-11% are sustained. As we think about 2H21, we acknowledge that herd immunity may increase supply of competing (e.g. non-drive thru) restaurant options, but will also help further build the new breakfast business while restoring weekday lunch and late-night traffic. We expect restaurant-level margin to remain elevated for the remainder of the year as check remains elevated, digital mix increases, and inflation remains in check. Our 2021e company-operated margin of 16.9% (guidance 16-17%) is slightly above consensus (16.8%) and 2019 (15.5%). We expect margins to moderate slightly in 2022e (EVRe 16.4%; cons. 16.8%) as traffic returns and

YOY inflation is more of a factor but believe digital efficiencies and continued elevated check will keep margins above 2019. Our $24 target is derived from a discounted cash flow analysis and equates to a 5.2% 2022 FCF yield and 14x our new LTM EBITDA as of 6/30/23 of $512M.

We generally see solid execution across the board: Wendy's continues to execute well across a multi-faceted plan that includes breakfast expansion, fortified tech capabilities (and related fee collection), and a combination of high- and low-priced marketing. We have been impressed by the performance of Wendy's barbell marketing approach—with bundled value ($5 biggie bag, 2/$4 breakfast sandwich and 2/$5 offerings) and premium sandwiches (e.g. Made to Crave) contributing to sales in a world of rising inflation. The company noted its new classic chicken sandwich is holding its own in the chicken wars, selling 2x the old version. This is a good sign that Wendy's can withstand other competitor offerings (e.g. Burger King's hand-breaded chicken launch). In fact, Wendy's recently overtook Burger King as the 2nd largest burger player in the US.

Labor and commodity inflation remain in check: The company continues to expect flat YOY commodity inflation for the year (inflationary in 2Q/4Q, deflationary in 3Q) and 2-3% labor inflation (accounts for the refranchising of higher-labor NYC stores) which get you to 16-17% company operated restaurant-level margins for 2021. The key variable will be check growth, which remains elevated relative to pre-COVID as family orders, delivery and digital mix all have positive contributions to check. The company noted not being locked in for 4Q on beef costs, which could provide some variability, but highlight that beef costs are only ~15-20% of Wendy's input basket.

Tech, breakfast, and unit growth will be areas to watch: Tech enablement and a successful breakfast launch have been positive for Wendy's unit growth story. The company's 13M loyalty members and 8% digital mix provide a vast array of data that allow for labor efficiencies (e.g. prepayment) in addition to personalized marketing / frequency opportunities. The company's new incentive program and cheaper building costs (now ~$1.4M vs. ~1.9M previously) should bode well to get unit growth to 3% (150 new franchisees in various stages of due diligence). With breakfast, we are eager to see what continued marketing dollars (~$15M incremental spend this year and in 2022), high customer satisfaction, and a return to routines can do for the breakfast daypart. We remain keen to see how Wendy's builds breakfast mix to 10% (from 7% currently) as awareness hovers slightly over 50% mix over 15 months into the launch.

EAT: Can core traffic share gains continue as virtual brands stick?

For F4Q (ending June), we are assuming in-line SSS for Chili's but better flow-through. Our 4Q21e EPS of $1.80 (cons. $1.66; guidance $1.55-1.70) assumes 2-year Chili's SSS of 7% (cons. 7%) and 2-year Maggiano's SSS of -7% (cons. -25%). Labor productivity and a 53rd week (~80bp tailwind) should allow for strong restaurant level margins (EVRe 17.5%; cons. 16.8%). Our FY22 EPS of $5.29 assumes 3-year SSS for Chili's to be ~10-11%, potentially conservative as IJW adds 4-5pp, Maggiano's Classics could add LSD mix, and core Chili's off-premise may settle out 10pp above pre-COVID levels (30% mix vs. ~20% pre-COVID). We assume Chili's AUVs to be $3.1M (+9% vs. 2019), helped by +1.5% of pricing. We also slightly lower our restaurant level margin from 15.4% to 15.3% (cons. 14.9%; 13.9% in FY19; pre-COVID peak ~15%) to reflect slightly higher inflation pressure. We will be watching for the national launch of Maggiano's virtual brand sometime in the F2H22 (currently tested in ~80 stores). Our $80 price target equals 13x our FY23 EPS (ending 6/30/23) of $6.00 and 11x CY22 EBITDA. Brinker's pre-COVID NTM P/E trading range was between 10-14x. Our target also represents 14x our CY22 EPS. This is slightly lower than the 15x implied by EAT's historical discount to the S&P500 (pre-COVID 5-year median of 30% and S&P500 currently trading at 20x consensus CY22 EPS estimates). Finally, our 13x target multiple implies a ~1.4x PEG (assuming 9% LT earnings growth), justifiable in our view given the lower visibility when compared to DRI and TXRH.

Our summarized thesis: For Brinker, our stock thesis has morphed from one of very significant EPS upside to one of a combination of slight valuation and EPS upside. Brinker's equity value trades at 9x free cash flow—almost as cheap as it has ever been in spite of lower debt leverage (EVRe <3x debt/EBITDA by the end of this calendar year vs. recent history ~4x). We are largely maintaining our FY22e and FY23e SSS and EPS but shifting the quarters somewhat as a result of price realization timing and the launch of a 2nd virtual brand. In many ways we see Brinker proceeding with a prudent long-term strategy that has it focused on long-term value (3 for $10), building digital and off-premise business and capturing modest marketing and in-restaurant efficiencies. We look forward to Brinker's F4Q EPS on August 18th and Analyst Day on

September 15th. See our Day 2 takeaways from the Evercore ISI Consumer and Retail Summit where we spoke with CEO Wyman Roberts here.

Virtual brands help leverage the asset base: Brinker's Chili's restaurants have ample capacity to leverage existing capabilities while driving top line growth. Management mentioned that low-single-digit top line growth can provide attractive earnings growth, and we would agree. Remember, the company's $3.5M AUV goal is 23% (or $650k) above FY19's $2.8M—unthinkable growth without a major off-premise sales layer that is reinforced by a COVID-bolstered growth in digital relationships, the DoorDash relationship and 1-3 virtual brands. Annualized off-premise sales have grown by $600k+ per restaurant during the pandemic, and retaining 50% (~$300k) of that off-premise step-up plus the addition of another $100k+ from a new (Maggiano's Classics) virtual off-premise brand would get Brinker 60%+ of the way toward its goal. As it stands now, our FY22e Chili's SSS growth of 11% (cons. 10%) implies a $3.1M AUV— including an estimated ~$930k off-premise sales layer (equal to 30% mix) and an implied 5% FY22 vs. FY19 dining room SSS decline. As a matter of fact, Brinker filed a trademark for "It's Just Burritos and Bowls" on July 1st, hinting at the potential next concept in the virtual brand journey.

Room for pricing, but staying conservative: Brinker has kept its pricing levels steady for ~18 months, before it takes 1.5-2% pricing in July. The company remains confident in a pricing strategy that prioritizes long-term traffic share gains. Price, value, and variety will continue to matter post-COVID, and we believe Chili's is well positioned to continue to capture share. Brinker described the inflation across the cost structure as real but not systemic in any fashion (and therefore will impact sales minimally). Labor hours and staffing are pretty close to where they need to be with the help of various bonuses and retention benefits.

We believe still largely underestimates the margin potential at Brinker, leading to outsized EPS growth and potentially multiple expansion

Figure 41: EVRe vs. cons. estimates

Evercore Estimates Vs. Consensus	FY 2022 EVR Est.	YOY Change	Cons. Est.	Delta	Delta (%)
Sales	**3,841.1**	**15.1%**	**3,723.7**	**117.4**	**3.2%**
Comp (company-owned)	**19.0%**		**14.7%**	**425 bp**	
Cost of sales % of sales	26.5%		26.4%	6 bp	
Restaurant labor % of sales	33.5%		33.0%	44 bp	
Restaurant expenses % of sales	24.7%		25.7%	(97 bp)	
Restaurant level profit	**579.9**	**28.7%**	**543.0**	**36.8**	**6.8%**
Restaurant level margin	**15.3%**		**14.9%**	**47 bp**	
Restaurant level margin change	161 bp				
G&A	163.7	20.1%	149.4	14.3	9.6%
Operating income (EBIT)	**320.1**	**45.4%**	**311.6**	**8.5**	**2.7%**
Operating margin	**8.3%**		**8.4%**	**(4 bp)**	
Operating margin change	174 bp		192 bp		
Tax rate	11.0%		10.8%	24 bp	
Net income	245.8	63.1%	235.8	10.0	4.2%
EPS	**5.29**	**64.9%**	**5.03**	**0.26**	**5.2%**

Source: ConsensusMetrix, Evercore ISI Research

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Hold	288	35	Hold	38	13
Sell	24	3	Sell	2	8
Coverage Suspended	11	1	Coverage Suspended	4	36
Rating Suspended	11	1	Rating Suspended	3	27

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