Buy, Sell, or Hold - Brinker International, Darden Restaurants, and DineEquity

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Three companies with a strong and pervasive presence in the restaurant industry and stock market will be analyzed in this paper: Brinker International, DineEquity and Darden

Restaurants. Each of these companies owns restaurants in nearly every state in the United States, has a market cap of at least $1 billion and operates well-known, family-friendly casual dining facilities. In addition, these companies have operated for more than 20 years and have maintained a strong branded portfolio of restaurants and retained a loyal customer base in nearly every level of income. Each of these companies was selected because we've experienced their restaurants first hand and personally have enjoyed our dining experiences. In addition, we feel that these companies have expanded much in their histories and that they definitely have the potential for growth.

To determine whether Brinker International, Darden Restaurants or DineEquity are good investments, we used analyst opinions and a series of valuation methods to determine whether to buy, sell or hold either of these stocks. We used Intrinsic Value, WACC, ROIC, Current Ratio, P/E Ratio and Dividend Yield. Intrinsic Value is used to determine the real value of the stock, as the market price is only the price that the stock is currently selling for. Also known as the discounted cash flow method, the value is determined by taking the free cash flow of one year and multiplying it with the expected growth rate then calculating the net present value of the cash flows by dividing it by the discount rate. Finally, you divide the number with the number of shares outstanding to get the intrinsic value per share.

The WACC or weighted average cost of capital is overall cost of debt and equity used to finance a business and the basis for determining the discount rate used in the discounted cash flow method to find the intrinsic value of a company. It is also used to see how much in interest is paid for every dollar it finances as well as showing what the minimum amount the company needs to earn on a new investment. The WACC is determined by finding the market value of debt, preferred stock and common stock, the cost of debt, preferred and common stock, then finding the total market value of all securities and adding the weights of these findings minus the tax rate on the debt. So, for instance if a company needed to raise the funds to purchase equipment or inventory, the WACC is the amount that the company would need to pay its investors per dollar that it raises. ROIC or return on invested capital is used to measure the return an investment generates and is calculated by subtracting dividends from net income and dividing the total capital invested.

The current ratio is a liquidity ratio used to determine a company's ability to pay its short term obligations and it's found by dividing current assets by current liabilities. We used the P/E ratio which is a measurement of what an investor would pay for $1 of profit. It's found by dividing price per share divided by earnings per share (earnings/total shares outstanding). Finally we used the dividend yield to find how much in dividends the company is paying out to shareholders. This is found by dividing the annual dividend by the stock price.

Brinker International (EAT)

Brinker International (NYSE: EAT) is one of the largest restaurant chains in the world. Operating over 1,600 restaurants and employing over 100,000 employees in 31 countries worldwide, this casual dining restaurant company owns Chili's and Maggiano's restaurants and services more than one million customers daily (Brinker Company, 2016). Since going public in 1995, Brinker has sought to enhance the restaurant experience for customers by reinvesting in their business. They have been met steadily with competition in recent years from companies like DineEquity and Darden Restaurants, but has continually reimagined its brand by enhancing its kitchen equipment, operations software, introducing Ziosk tabletop entertainment and pay at the table capabilities and improving the look of their restaurants. 2015 brought an increase in consumer confidence and an increase in employees overall. Trading at $54.90 per share, the company has experienced gains of 22.85% in the last 52 week period, compared to 5.41% of gains on the S&P 500. On average, the company has approximately 1.3 million shares being traded daily, a market cap of $2.73 billion and shares outstanding of 49.66 million.

According to analyst Ezequiel Minaya of MarketWatch, Brinker most recently reported a sharper decline in sales (1.1%) than what had been anticipated (0.2%). Minaya attributes this drop to a combination of slow traffic and shifting consumer palates to a healthier dining experience. Though sales dropped in the most recent quarter, the company's share price rose as investors favored Brinker's plans to increase its leverage by $50 million and use some of the proceeds to buy back stock – the business also got a boost from the acquisition of 103 stores once owned by a franchisee.

Canaccord analysts are hesitant about Brinker's long term positioning. Analyst Lynne Collier believes Chili's location within the bar will continue to be challenged as competitors continue to increase discounts and promotions. Collier recommends "investors stay on the sidelines to wait for a better entry point." Argus's John Staszak urges current shareholders to hold arguing that Brinker management is relying on share buybacks to stimulate EPS growth. The Street and Zacks also provide Brinker with a "hold" status. The intrinsic value of Brinker, or the real value of the company is $45.43 per share. Brinker International's current WACC is 2.09% (lower than both Darden Restaurants and DineEquity).

The company's current return on investment capital is 23.83% - this means that Brinker generates a higher return on investment than it costs the business to raise the money for that investment. Brinker is therefore earning excess returns.

As of June 2016, Brinker International's current ratio is 0.41 - a figure 90% lower than the 302 companies in the Global Restaurants industry. This means that the company may experience challenges meeting its short term financial obligations. Brinker's quick ratio measures 0.25 (95% lower than competing global industries) meaning that the company cannot readily payback its current liabilities. Brinker's price to earnings ratio is approximately 15.72 (78% higher than competing global industries).

November 16, 2016, Brinker paid out a $0.34 per share dividend to common stockholders, representing a 6% increase from 2015. Brinker also doubled their 5 year return compared to the S&P 500. Since 2010 Brinker has returned $2.3 billion to shareholders in the form of share buybacks ($1.9 billion) and dividends ($384 million) combined, to represent 85% of Brinker's current market cap. Brinker's current dividend yield is 2.41%. The company holds a dividend payout ratio of 0.81 - a high figure that calls into question the sustainability of consistently high dividend payments.

Darden (DRI)

Darden Restaurants (NYSE: DRI) is a well-known American based firm based in Orlando, Florida. It operates over 1500 restaurants in the United States and Canada including Longhorn Steakhouse, The Capital Grille, Olive Garden, and Bahama Breeze. The company was started by entrepreneur William Darden in 1968 with the first Red Lobster opening that year and later was purchased by General Mills. Red Lobster started the restaurant division of this company through a divestiture. This division became what is now Darden Restaurants in 1995 as a result of a spinoff (Nef, 2016"). Since 1995, Darden Restaurants has had multiple mergers, acquiring Rare Hospitality, Eddie V's and Yard House. In addition, the company has also experienced much change. In 2014 Darden Restaurants sold Red Lobster to Golden Gate Capital for $2.1 billion (Darden sell Red Lobster for $2.1 billion, 2016) and in 2015, the company spun off Four Corners Property Trust (Darden Restaurants Record and Distribution Dates for Spin-off of Four Corners Property Trust, Inc, 2016). Darden also experienced much changed in their leadership. In an interesting turn of events, Starboard Value, shareholder of less than 10% of Darden Restaurants stock, replaced the company's board of directors and its CEO.

New leadership has increased Darden Restaurants outlook. Over the past year, Darden's stock price has fluctuated from a high of $74.99 to a low of $55.01. Gaining .78 cents per share value, the company increased its value by over $100 million (Lachapelle, 2016). After the Darden Restaurants takeover by hedge fund Starboard, improvements in the company's stock price and value have increased tremendously, setting the company, it seems, on the right course. Currently, Darden has a total market cap of $9.22 billion with more than 123 million shares outstanding, making it larger than that of both Brinker International and DineEquity combined. Darden also holds more restaurants in their portfolio, including Olive Garden which makes up more than half the company's restaurants and profits.

Looking at Darden's Restaurants financial profile on the Value Line Investment Survey, we feel that the company is financially strong. Analysts view the company positively; they have above average rankings overall; and they have gains that are at 50% in the next 3-5 years. According to Value Line, the stock has an average safety rating, a financial rating of B++. Darden also has a cash flow per share of $5.23, showing that the company is very profitable and has cash and marketable securities (that can be turned to cash at any time) of $535 million. According to the Value Line Investment Survey, the company seems stable and financially strong (Nef, 2016).

Based on the ratings of 25 MarketWatch analysts, a recommendation of hold has been assigned to Darden Restaurants stock. This means that Darden's stock, according to MarketWatch is determined "to have a greater amount of risk and/or less timely appreciation potential" (Darden Restaurants, 2016).

Current ratio is .69 while the industry average is .73 showing that it has a less than average ability to meet its short and long term obligations. Its quick ratio is .54 while the industry average is .18 demonstrating that Darden's assets are highly liquid by comparison to other companies in the same industry.

The P/E ratio is 24.4 which is slightly below the industry average of 25.4 (Darden Restaurants, 2016), showing that the current share price relative to EPS is above the average and the company is likely overvalued as a result. The intrinsic value of Darden Restaurants is $41.51 as of November 27, 2016. Its differs significantly from the market price of the stock because there is strong demand to invest in this company. This can be seen in two ways. The company is either overvalued or fairly valued, but cannot be undervalued because its current stock price is trading at $72.88 per share, 57% above its intrinsic value. Darden Restaurant's WACC is 3.3%, well below the industry average of 7.8% (Cost of Capital by Sector, 2016). This shows that the risk associated with investing with this company is low.

Darden's dividend payout ratio is 82.6% while the industry average is 51.76%. This shows that the stock pays out above average returns of its net income to stockholders and is a good income stock for an investors' portfolio. Darden's dividend yield is 2.96%, well above the yields of DineEquity and Brinkers and above other well known restaurant companies of all areas of the restaurant industry.

DineEquity (DIN)

DineEquity, Inc. (NYSE: DIN), formerly known as IHOP (International House of Pancakes) Corporation, opened its first restaurant in Toluca, CA in 1958. It currently has nearly 1700 restaurants in the United States, with more locations throughout the world. In 2007, the company acquired Applebee's for $2.1 billion (IHOP Stock jumps on $2.1B Applebee's Bid,

2007) and brought with it more than 2000 restaurants worldwide. Founded in 1980 in Atlanta, GA, Applebee's brought revitalization to the IHOP brand through their bar and grill offering greatly expanding IHOP's pancakes and breakfast specials. DineEquity currently franchises 99% of their operating restaurants, a strategy that has helped the company maintain strong free cash flows and has revitalized their management team and dining experience by adding new operations software, pay at the table capabilities, Ziosk entertainment and enhancing social media presence and experiences (DineEquity, 2016).

DineEquity posted year-over-year growth in earnings and have generated substantial adjusted free cash flow. They've increased their quarterly dividend by 5.4%, effective with the next dividend to be paid in January. They also completed their restaurant support center consolidation, which enables them to reallocate resources as needed," said Julia A. Stewart, Chairman and Chief Executive Officer of DineEquity, Inc. DineEquity current stock price is $81.88 with a 52 week high low of $98.82/$75.05, and has a total market cap of $1.5 billion with $18.21 million shares outstanding. For the ninth consecutive year, Applebee's Neighborhood Grill & Bar will honor veterans and active members of the United States military by offering each a free meal at any of the nearly 1,900 Applebee's restaurants in the United States on Veterans Day,Friday, November 11, 2016. On Friday, November 11 Veterans and Active Duty Military can enjoy three of IHOP restaurant's hot-off-the-griddle, world famous Buttermilk Pancakes with glazed strawberries, blueberry compote and whipped topping for free at participating U.S. locations. Prior to the Veterans Day special, DineEquity was trading at around $77.09 per share with a noticeable increase in stock price on November 11, 2016 to $82.48 per share.

Analyst assessments have been very positive overall for DineEquity. Of 6 analysts covering DineEquity, 5 have given it a buy rating, and 1 gave it a sell (Zacks, 2016). These companies include Zacks, The Street, Nomura and Maxim Group and KeyBanc capital markets. With no sell ratings, this puts DineEquity in a good position in the marketplace overall, showing that the company is not only doing well, but is recommended for investors to purchase.

The Intrinsic Price or real value of DineEquity is $66.48. The weighted average cost of capital is 3.82% and the company has a return on invested capital of 22.31%, showing that the company is profitable. The WACC is 3.82% which is below the 7.8% industry average. Their current ratio is 1.36, while the industry average is 1.09. DineEquity’s P/E ratio is 15.92, well below the industry average and shows that they need some improvements in that area.

The company’s dividend has grown by 22.67%. This is a reliable dividend stock because it has more than enough cash flows to keep paying out. Free cash flows have been $125 million for over 4 years, which is more than enough to sustain the current 4.3% yield (Maher, 2016). DineEquity Inc's Dividend Payout Ratio for the three months at 3rd quarter end was 0.69. During the past 13 years, the highest Dividend Payout Ratio of DineEquity Inc was 1.19. The lowest was 0.31.

Conclusion

Our analysis of Brinker International, Darden Restaurants and DineEquity has led us to conclude that we would give Darden a buy rating, while Brinker and DineEquity should receive a hold rating. We do not believe that any of the stocks are worthy to be sold, as all of them have proven to be established dining restaurant companies for over 20 years with a strong customer base. Factors that led us to rate Darden Restaurants as a buy take into account their trending stock increase in 2016. Darden’s second quarter 2016 stock price closed at $61.56, with a significant increase in the third quarter ending at $64.79 per share. We predict that the fourth quarter stock price will be worth over $70 per share. Darden reflects a market capitalization of 9.22 billion, which gives them the opportunity to define themselves as a well established player in the dining industry. Investors are more likely to seek investment options in Darden's future, due to the fact that they would generate higher returns in regards to increases in share value and dividend payments.

We concluded that Brinker International and DineEquity would prove to be an investment and we have decided to give them a hold rating. Brinker reflected similar stock price increases with the second quarter stock price closing at $47.14, with a slight increase in the third quarter, ending at $49.14. We predict that the fourth quarter stock price will close at a low $50 per share. DineEquity reflected a second quarter stock price of $81.37, with a slight decrease in the third quarter, ending at $79.10. We predict that the fourth quarter stock price will close at $85 per share. Brinker has a market capitalization of 2.73 billion, while DineEquity reflects market capitalization of $1.50 billion . Both companies fall well below Darden's market cap, but should be considered as an opportunity for growth potential even though they carry a higher risk for investors. Both companies are in the process of expanding and investors are looking for opportunities, like Darden to pursue in investing.

After further analysis, we started to look beyond the financial numbers and started to evaluate Brinker, Darden and DineEquity from a consumer's perspective. As consumers, we are looking to dine at restaurants that are worth the experience as well as the price reflected on the menu. Darden has acquired a variety of food chains that tailor to a wide range of consumers depending on personal preferences and their income level. DineEquity and Brinker have yet to establish themselves as Darden, but we decided to hold these two companies due to the fact that they show potential in growth. Both are looking to attract consumers through changes coming soon from their kitchen to the table. In order for them to continue to stay ahead of the game, they will need to dedicate themselves to revamping their casual dining atmosphere without a fine dining price to gain consumers interests.

	Brinker	***DineEquity***	***Darden***
Ticker	*EAT*	*DIN*	*DRI*
Country of Origin	*United States*	*United States*	*United States*
Market	*NYSE*	*NYSE*	*NYSE*
Current Price	*$54.90*	*$81.88*	*$74.95*
Current Bid	*$54.88*	*$75.64*	*$74.91*
Current Ask	*$54.89*	*$82.36*	*$74.92*
Days Range	*$54.17-$55.28*	*$81.18- $83.60*	*$74.50-$74.99*
52 Week High	*$55.28*	*$98.82*	*$74.99*
52 Week Low	*$43.20*	*$75.05*	*$55.01*
52 Gain/Loss	*22.85%*	*0.32%*	*23.44%*
3 Year High	*$63.40*	*$114.23*	*$74.95*
3 Year Low	*$43.20*	*$74.07*	*$39.18*
Shares Outstanding	*49.66M*	*18.21M*	*123.08M*
Total Market Cap	*$2.73B*	*$1.50B*	*$9.22B*
P/E Ratio	*16.46*	*15.00*	*24.70*
Volume	*1,355,234*	*206,907*	*278,735*
Average Volume	*1,286,404*	*164,465*	*1,732,903*
Stock Splits	*12/1/2006 '3:2*	*5/28/99 '2:1*	*5/2/2002 '3:2*
EBITDA	*480.28M*	*262.18M*	*910.5M*
Beta	*-0.04*	*0.30*	*-0.07*
Earnings Date	*Jan. 25 2017*	*Oct. 27- 31, 2016*	*Dec. 16-20, 2016*
Dividend & Yield	*1.36*	*3.88*	*2.83*
Dividend Date	*Sept. 29, 2016*	*October 7, 2016*	*Oct. 5, 2016*
Ex-Dividend Date	*Sept. 7,2016*	*December 14, 2016*	*NA*

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