

Darden Restaurants (DRI)

\$53.89 (As of 03/24/20)

Price Target (6-12 Months): **\$51.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 03/23/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:C

Value: C

Growth: B

Momentum: F

Summary

Shares of Darden have underperformed the industry in the past six months. Despite the company having reported better-than-expected third-quarter fiscal 2020 results, shares are likely to witness a decline owing to the coronavirus outbreak. In fact, the company has withdrawn 2020 guidance due to the same. The company announced for the fourth quarter to date through Mar 15, sales declined 5.9%. Moreover, in the first three weeks of the quarter, same-restaurant sales were up 3%, down 0.2% and 20.6%, respectively. Of late, earnings estimates for fiscal 2020 have witnessed downward revisions. Moreover, fierce competition and softer-than-expected consumer demand might keep comps under pressure. Further, rising labor costs may dampen profits. However, various sales-building initiatives and technology-driven moves bode well.

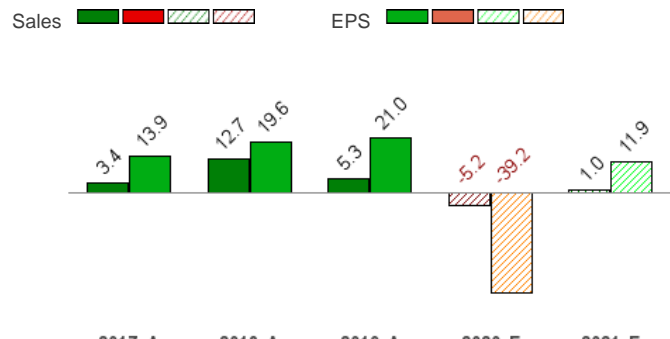
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$128.41 - \$26.15
20 Day Average Volume (sh)	4,756,483
Market Cap	\$6.6 B
YTD Price Change	-50.6%
Beta	0.50
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Restaurants
Zacks Industry Rank	Bottom 44% (142 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.1%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	-44.5%
Expected Report Date	06/18/2020
Earnings ESP	-20.4%

P/E TTM	8.8
P/E F1	15.2
PEG F1	1.5
P/S TTM	0.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,712 E	1,946 E	2,282 E	2,091 E	8,152 E
2020	2,134 A	2,056 A	2,347 A	1,561 E	8,068 E
2019	2,061 A	1,973 A	2,247 A	2,229 A	8,510 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	-\$0.23 E	\$0.60 E	\$1.63 E	\$0.86 E	\$3.96 E
2020	\$1.38 A	\$1.12 A	\$1.90 A	-\$1.26 E	\$3.54 E
2019	\$1.34 A	\$0.92 A	\$1.80 A	\$1.76 A	\$5.82 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/24/2020. The reports text is as of 03/25/2020.

Overview

Founded in 1968 and based in Orlando, FL, Darden Restaurants is one of the largest casual dining restaurant operators worldwide. The company has operations in the United States and Canada with more than 1,700 restaurants.

Beginning fourth-quarter fiscal 2015, the company began reporting its business under four segments: Olive Garden (50.4% of total revenues in fiscal 2019), LongHorn Steakhouse (21.3%), Fine Dining (7.1%) and Other Business (21.2%).

Fine Dining, includes The Capital Grille and Eddie V's while the Other Business segment comprises of Cheddar's Scratch Kitchen, Yard House, Seasons 52, Bahama Breeze, consumer packaged goods and franchise revenues. Notably, all the company owned restaurants fall under full-service segment of the restaurant industry.

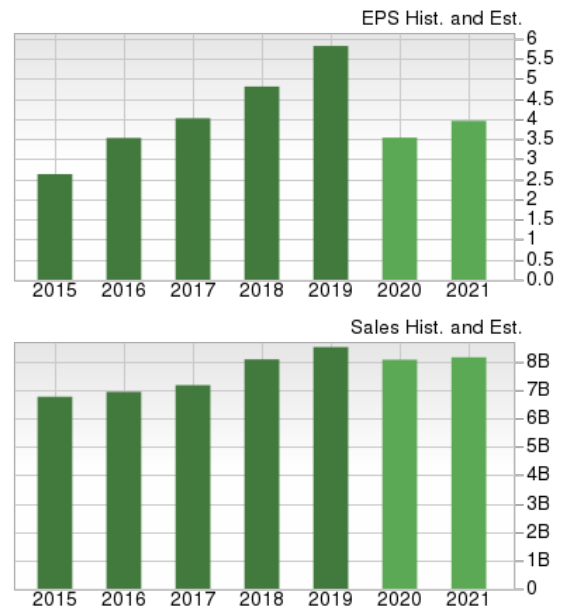
Florida-based *Olive Garden* is the largest full-service Italian restaurant in America. The brand features a menu, which has a variety of Italian food made with fresh ingredients.

LongHorn Steakhouse is a full-service steakhouse restaurant, with locations primarily in the eastern United States. The brand offers signature fresh steaks and chicken as well as salmon, shrimp, ribs, pork chops, burgers and prime rib.

Cheddar's Scratch Kitchen is a full-service restaurant operating in Texas and throughout the southern, mid-western and mid-Atlantic regions of the United States. The casual dining menu features modern classics and American favorites cooked from scratch.

On Nov 9, 2015, Darden completed the spin-off of Four Corners Property Trust, Inc.

On Apr 24, 2017, the company completed the acquisition of the Cheddar's Scratch Kitchen for \$799.8 million in total consideration. The acquired operations of Cheddar's Scratch Kitchen included 140 company-owned restaurants and 25 franchised restaurants. On Aug 28, 2017, Darden completed the acquisition of 11 Cheddar's Scratch Kitchen franchised restaurants from an already existing franchisee.



Reasons To Sell:

▼ **Coronavirus to Hurt Performance:** The coronavirus pandemic will hurt the company's results in the coming quarters. The company has withdrawn 2020 guidance owing to the deadly pandemic. The company announced for the fourth quarter to date through Sunday, Mar 15, sales declined 5.9%. Moreover, in the first three weeks of the quarter, same-restaurant sales were up 3%, down 0.2% and 20.6%, respectively. Moreover, for the fiscal week ending Mar 15, same-restaurant sales by segment — Olive Garden was down 18.7%; LongHorn was down 15.9%; Fine Dining was down 27.7% and other business was down 27.5%. The company has also suspended the quarterly cash dividend.

High costs, coronavirus outbreak, a tricky consumer spending environment in the U.S. restaurant space along with the company's limited international presence raise concerns.

▼ **Margins Likely to Be Under Pressure:** Higher labor costs due to increased wages and costs incurred due to the implementation of the Affordable Care Act are expected to continue to keep profits under pressure. Further, the non-franchised model makes the company susceptible to increased expenses. Since all the restaurants are owned and operated by Darden, instead of signing franchise agreements and putting the burden of costs into the franchisee, the company is solely responsible for the expenses of operating the business.

Total operating costs and expenses increased 4.8% year over year in fiscal 2019. Moreover, in the fiscal first, second and third quarter of 2020, total operating costs and expenses rose 3.2%, 3.9% and 4.4%, respectively. The upside can be attributed to an overall increase in food and beverage costs, restaurant expenses, and labor costs. Increase in expenses might hurt the company's margin in the coming quarters.

▼ **Limited International Presence:** Darden's restaurants are located in the United States and Canada, and the company has no exposure in international markets. While several other fast casual restaurateurs are capitalizing on the emerging market potential, Darden seems to be slow on this front. We believe that the company needs to expand its presence beyond the United States in order to offset the impact of cutthroat competition in the saturated domestic market.

▼ **Industry Susceptible to Consumer Discretionary Spending:** Darden operates in the retail restaurant space that is highly dependent on consumer discretionary spending. Consumers' propensity to spend largely depends on the overall macro-economic scenario. Although higher disposable income and increased wages are favoring the industry right now, it can change with the slightest disruption in the economy. Darden, therefore, is highly vulnerable to the inconsistent nature of consumer discretionary spending. If the company does not make pragmatic use of advanced technologies to innovate across value chains, it has high chances of fading out like many other retailers.

Risks

- **Impressive Earnings Trend:** We are encouraged by Darden's impressive earnings trend. Notably, the company's earnings met/surpassed the Zacks Consensus Estimate for 22 straight quarters. In third-quarter fiscal 2020, adjusted earnings came in at \$1.90 per share, which outpaced the Zacks Consensus Estimate of \$1.88. The bottom line also improved 5.6% year over year. The company's relentless efforts to augment the basic operating factors of the business — food, service and ambiance drove the bottom line.
 - **Cheddar's a Long-term Growth Driver:** Darden's acquisition of the small restaurant chain, Cheddar's Scratch Kitchen (Cheddar's), in April 2017 has added an undisputed casual dining value to the company's portfolio of differentiated brands. It also helped Darden to further enhance its scale. Further, management made significant operational readjustment to the brand, which is expected to reap long-term benefits. Apart from making good progress with the integration of Cheddar's, the company seems to gain more confidence in its outcome. Over the current fiscal year, Darden plans to make significant non-guest facing changes, which is anticipated to have an impact on restaurant level execution. Moving forward, the company considers Cheddar a significant prospect for long-term growth.
 - **Brand Renaissance Plan for Olive Garden and Other Initiatives to Boost the Top Line:** In order to boost the performance of the Olive Garden brand, the company implemented a set of initiatives under its Brand Renaissance Plan. These included simplifying kitchen systems, improving sales planning and scheduling, operational excellence to improve guest experience, developing new core menu items, allowing customization and making smarter promotional investments. The revamped restaurants are already generating high same-restaurant sales and returns. Moreover, third-quarter fiscal 2020 marked Olive Garden's 22nd consecutive quarter of positive comps. Meanwhile, the company is also focusing on technology-driven initiatives like the system-wide rollout of tablets in order to capitalize on the digitization, which has rapidly penetrated the U.S. fast-casual restaurant sector. This initiative has been providing a boost to the company's sales for the past few quarters.
 - **Initiatives to Attract Guests at LongHorn and Other Units:** At LongHorn, the company strives to attract its guests by focusing on core menu, culinary innovation and providing regional flavors. It is also working on its marketing strategy to improve execution; customer relationship management and digital advertising as well as a strong promotional pipeline that leverage the segment's expertise. Further, the company continues to focus on strengthening its in-restaurant execution through investments in quality and simplification of operations in order to augment the guest experience. Owing to these efforts, segmental comps registered growth for 28 consecutive quarters. Meanwhile, the Capital Grille, Yard House, Seasons 52, Bahama Breeze and Eddie V have also posted positive comps in most of the quarters, since the beginning of fiscal 2014. Sales are being driven by various initiatives undertaken and personalized services, which are likely to aid long-term growth as well.
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Last Earnings Report

Darden Q3 Earnings Top, View Withdrawn Due to Coronavirus

Darden Restaurants reported third-quarter fiscal 2020 results, wherein both earnings and revenues surpassed the Zacks Consensus Estimate. The company reported better-than-expected earnings for the fifth straight quarter.

In the quarter under review, adjusted earnings came in at \$1.90 per share, which outpaced the Zacks Consensus Estimate of \$1.88. The bottom line also improved 5.6% year over year. Earnings were aided by the company's relentless efforts to augment the basic operating factors of the business — food, service and ambiance.

Total sales of \$2,346.5 million beat the consensus mark of \$2,322 million. Moreover, sales improved 4.5% from the prior-year quarter driven by the addition of 40 net restaurants and an improvement of 2.3% in blended comps.

Quarter Ending 02/2020

Report Date	Mar 19, 2020
Sales Surprise	1.04%
EPS Surprise	1.06%
Quarterly EPS	1.90
Annual EPS (TTM)	6.16

Sales by Segments

Darden reports business under four segments — Olive Garden, LongHorn Steakhouse, Fine Dining that includes The Capital Grille and Eddie V's, and Other Business.

Sales at Olive Garden increased 3.5% year over year to \$1,169.3 million. Comps grew 2.1% at the segment, higher than the prior-quarter's comp growth of 1.5%. Traffic increased 0.2%. Pricing improved 1.8% and menu-mix increased 0.1%.

Sales at Fine Dining improved 8% to \$188.4 million. Comps at The Capital Grille climbed 4.2% compared with growth of 1.8% in second-quarter fiscal 2020. Further, Eddie V's reported comps growth of 3.9%, higher than 0.5% improvement in the prior quarter.

Sales at Other Business grew 4.3% year over year to \$478.1 million. Moreover, comps at Seasons 52 rose 3% in the reported quarter against a comps decline of 3.5% in the prior quarter. Comps at Yard House inched up 1.8% compared with 0.7% increase in the previous quarter. However, comps slipped 0.5% at Bahama Breeze compared with a decline of 3.4% in the preceding quarter.

At LongHorn Steakhouse, sales advanced 5.7% to \$510.7 million. Comps at the segment increased 3.9%, compared with comps growth of 2.6% in the year-ago quarter. Traffic improved 1.6%. Further, pricing and menu mix grew 1.9% and 0.4%, respectively.

In the reported quarter, comps at Cheddar's decreased 1.6% compared with a decline of 1.2% in the prior-year quarter.

Operating Highlights & Net Income

In the fiscal third quarter, total operating costs and expenses increased 4.4% year over year to \$2,068.2 million. The rise can be attributed to an overall increase in food and beverage costs, restaurant expenses, and labor costs.

Balance Sheet

Cash and cash equivalents as of Feb 23, 2020, totaled \$321.7 million, down from \$457.3 million as of May 26, 2019.

Inventories totaled \$229.6 million at the end of the reported quarter. Long-term debt as of Feb 23, 2020, was \$928.5 million, up from \$927.7 million as of May 26, 2019.

During the fiscal third quarter, Darden repurchased approximately 0.6 million shares of its common stock for roughly \$69 million.

Withdraws Fiscal Outlook

Due to coronavirus outbreak the company has withdrawn 2020 guidance. The company announced for the fourth quarter to date through Sunday, Mar 15, sales declined 5.9%. Moreover, in the first three weeks of the quarter, same-restaurant sales were up 3%, down 2% and 20.6%, respectively. The company has also suspended the quarterly cash dividend.

Valuation

Darden shares are down 50.6% year-to-date and 54.7% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are down by 24.5% and 5.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector is down by 18.4% and 13.8%, respectively.

The S&P 500 index is down 23.8% in the year-to-date period and 13.8% in the past year.

The stock is currently trading at 8.19X forward 12-month earnings, which compares to 19.28X for the Zacks sub-industry, 22.01X for the Zacks sector and 14.72X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.44x and as low as 5.2x, with a 5-year median of 18.11x. Our Underperform recommendation indicates that the stock will perform worse-than the market. Our \$51 price target reflects 6.97x forward 12-months earnings.

The table below shows summary valuation data for DRI.

Valuation Multiples - DRI					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	8.19	19.28	22.01	14.72
	5-Year High	26.44	26.59	26.19	19.34
	5-Year Low	5.2	19.28	19.06	14.72
	5-Year Median	18.11	23.1	23	17.42
P/S F12M	Current	0.72	2.71	0.88	2.65
	5-Year High	1.74	3.92	1.11	3.43
	5-Year Low	0.46	2.71	0.8	2.54
	5-Year Median	1.32	3.29	0.92	3
P/CF	Current	5.21	13.09	12.28	12.74
	5-Year High	20.59	20.59	15.2	22.67
	5-Year Low	8.61	8.61	10.76	11.66
	5-Year Median	16.77	16.77	12.87	16.38

As of 03/24/2020

Industry Analysis Zacks Industry Rank: Bottom 44% (142 out of 254)



Top Peers

Arcos Dorados Holdings Inc. (ARCO)	Neutral
Bloomin Brands, Inc. (BLMN)	Neutral
Chipotle Mexican Grill, Inc. (CMG)	Neutral
Dominos Pizza Inc (DPZ)	Neutral
Brinker International, Inc. (EAT)	Neutral
Restaurant Brands International Inc. (QSR)	Neutral
Yum! Brands, Inc. (YUM)	Underperform
Yum China Holdings Inc. (YUMC)	Underperform

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	DRI Underperform	X Industry	S&P 500	QSR Neutral	YUM Underperform	YUMC Underperform
VGM Score	C	-	-	D	C	C
Market Cap	6.61 B	227.52 M	17.21 B	11.54 B	20.96 B	16.12 B
# of Analysts	15	6	13	10	11	6
Dividend Yield	0.00%	0.00%	2.52%	5.38%	2.70%	1.12%
Value Score	C	-	-	C	F	F
Cash/Price	0.07	0.07	0.07	0.16	0.03	0.11
EV/EBITDA	9.86	9.88	10.28	10.03	15.46	10.13
PEG Ratio	1.55	1.66	1.56	1.27	1.40	5.74
Price/Book (P/B)	2.82	1.50	2.27	2.71	NA	5.08
Price/Cash Flow (P/CF)	6.22	5.07	9.16	7.75	17.25	13.94
P/E (F1)	15.87	12.47	13.51	13.67	18.17	54.19
Price/Sales (P/S)	0.75	0.41	1.74	2.06	3.74	1.84
Earnings Yield	6.57%	7.55%	7.33%	7.33%	5.50%	1.84%
Debt/Equity	2.24	0.95	0.70	2.83	-1.26	0.01
Cash Flow (\$/share)	8.66	1.79	7.01	4.98	4.04	3.08
Growth Score	B	-	-	C	A	A
Hist. EPS Growth (3-5 yrs)	17.80%	7.72%	10.85%	28.00%	0.67%	NA
Proj. EPS Growth (F1/F0)	-39.20%	4.12%	3.92%	3.86%	8.01%	-57.89%
Curr. Cash Flow Growth	15.99%	5.49%	5.93%	2.55%	3.60%	10.09%
Hist. Cash Flow Growth (3-5 yrs)	14.41%	5.92%	8.55%	30.84%	-6.71%	25.34%
Current Ratio	0.41	0.60	1.23	1.29	0.99	1.30
Debt/Capital	69.14%	63.25%	42.57%	73.88%	NA	0.81%
Net Margin	7.25%	3.89%	11.64%	11.48%	23.12%	8.12%
Return on Equity	32.51%	7.33%	16.74%	31.74%	-13.90%	22.96%
Sales/Assets	0.99	1.09	0.54	0.26	1.14	1.29
Proj. Sales Growth (F1/F0)	-5.20%	2.00%	2.57%	2.78%	2.56%	-11.61%
Momentum Score	F	-	-	F	B	A
Daily Price Chg	31.34%	14.71%	11.24%	19.08%	23.25%	3.97%
1 Week Price Chg	-40.29%	-32.39%	-16.96%	-29.83%	-25.98%	-2.47%
4 Week Price Chg	-51.78%	-45.65%	-26.70%	-38.62%	-28.88%	-2.08%
12 Week Price Chg	-50.56%	-47.58%	-30.27%	-39.42%	-30.85%	-10.64%
52 Week Price Chg	-54.75%	-53.88%	-21.88%	-39.91%	-29.46%	-1.02%
20 Day Average Volume	4,756,483	554,437	4,249,353	4,844,307	3,906,587	4,017,333
(F1) EPS Est 1 week change	-42.20%	-1.61%	-0.11%	-4.95%	-1.22%	0.00%
(F1) EPS Est 4 week change	-44.49%	-4.30%	-1.58%	-5.09%	-1.68%	0.00%
(F1) EPS Est 12 week change	-44.50%	-7.01%	-2.61%	-4.91%	-7.76%	-57.32%
(Q1) EPS Est Mthly Chg	-162.52%	-2.82%	-1.24%	-2.33%	-2.82%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	B
Momentum Score	F
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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