

Darden Restaurants (DRI)

\$74.80 (As of 04/28/20)

Price Target (6-12 Months): **\$64.00**

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:B

Value: C

Growth: B

Momentum: B

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 In fact, the company has withdrawn 2020 guidance due to the same.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 Apr 19, sales declined 44.7%. Moreover, for the weeks ended Apr 12 and Apr 19, same-restaurant sales were down 65.2% and 60%, 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.

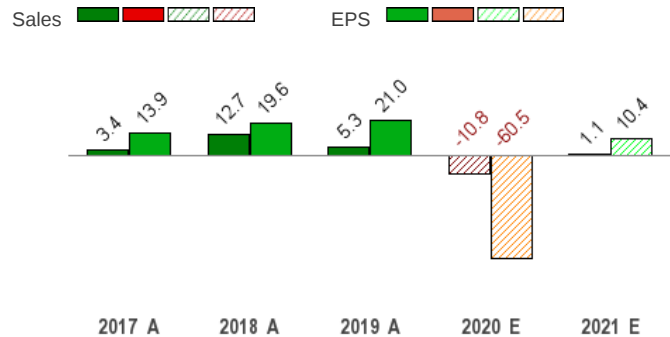
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$128.41 - \$26.15
20 Day Average Volume (sh)	4,122,181
Market Cap	\$9.0 B
YTD Price Change	-31.4%
Beta	1.07
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Restaurants
Zacks Industry Rank	Bottom 36% (163 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.1%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	-21.8%
Expected Report Date	06/18/2020
Earnings ESP	-1.5%
P/E TTM	12.1
P/E F1	32.5
PEG F1	3.2
P/S TTM	1.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,458 E	1,768 E	2,195 E	2,087 E	7,673 E
2020	2,134 A	2,056 A	2,347 A	1,073 E	7,591 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	-\$0.60 E	\$0.22 E	\$1.47 E	\$0.97 E	\$2.54 E
2020	\$1.38 A	\$1.12 A	\$1.90 A	-\$2.09 E	\$2.30 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 04/28/2020. The reports text is as of 04/29/2020.

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.

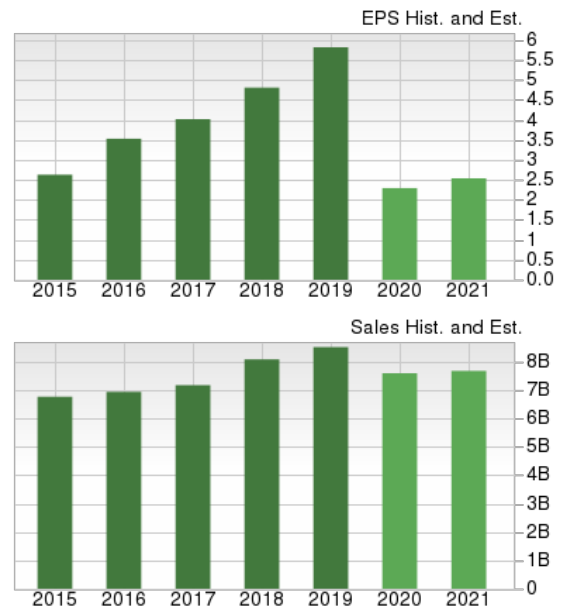
Florida-based *Olive Garden* is the largest full-service Italian restaurant in America. The brand features a menu, which has a variety of Italian food made with fresh ingredients.

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.

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.

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

Recent News

Darden Same-Restaurant Sales Hit by Coronavirus Crisis - Apr 10, 2020

Darden Restaurants recently provided an update on the impact of the coronavirus pandemic on its business from Feb 24 to Apr 19 (within the fourth quarter).

The company's same-restaurant sales declined 44.7% over the period. Moreover, for the weeks ended Apr 12 and Apr 19, same-restaurant sales were down 65.2% and 60%, respectively. For the first six weeks of the fourth quarter, same-restaurant sales were up 3.0% and down 0.2%, 20.6%, 75.2%, 74.9% and 71.2%, respectively.

For the Feb 24 to Apr 19 period, same-restaurant sales were down 38%, 42.6%, 55.9% and 59.2% at Olive Garden, LongHorn Steakhouse, Fine Dining and Other Business, respectively.

However, owing to the pandemic, to-go sales for Olive Garden and LongHorn Steakhouse have improved steadily over the past few weeks.

Valuation

Darden shares are down 28.4% year-to-date and 33.7% in the trailing 12-month period. Stocks in the Zacks sub-industry are down by 10.2%, but Zacks Retail-Wholesale sector are up by 0.3% in the year-to-date period. Over the past year, the Zacks sub-industry is down by 7.4%, but sector is up by 5.2%.

The S&P 500 index is down 11.4% in the year-to-date period and 3.4% in the past year.

The stock is currently trading at 28.65X forward 12-month earnings, which compares to 32.85X for the Zacks sub-industry, 28.48X for the Zacks sector and 20.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 28.65x and as low as 5.2x, with a 5-year median of 18.07x. Our Underperform recommendation indicates that the stock will perform worse-than the market. Our \$64 price target reflects 24.52x 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	28.65	32.85	28.48	20.2
	5-Year High	28.65	32.85	28.48	20.2
	5-Year Low	5.2	20.49	19.06	15.19
	5-Year Median	18.07	23.09	23.16	17.45
P/S F12M	Current	1.17	3.61	1.02	3.22
	5-Year High	1.74	3.93	1.11	3.44
	5-Year Low	0.46	2.82	0.8	2.54
	5-Year Median	1.31	3.3	0.93	3.01
P/CF	Current	7.23	15.39	14.3	14.9
	5-Year High	18.72	20.59	15.21	22.67
	5-Year Low	3.3	8.61	10.76	11.67
	5-Year Median	11.19	16.8	12.86	16.4

As of 04/28/2020

Industry Analysis Zacks Industry Rank: Bottom 36% (163 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Arcos Dorados Holdings Inc. (ARCO)	Neutral	3
Bloomin Brands, Inc. (BLMN)	Neutral	3
Dominos Pizza Inc (DPZ)	Neutral	2
Yum China Holdings Inc. (YUMC)	Neutral	2
Chipotle Mexican Grill, Inc. (CMG)	Underperform	3
Brinker International, Inc. (EAT)	Underperform	3
Restaurant Brands International Inc. (QSR)	Underperform	4
Yum! Brands, Inc. (YUM)	Underperform	4

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	DRI	X Industry	S&P 500	QSR	YUM	YUMC
Zacks Recommendation (Long Term)	Underperform	-	-	Underperform	Underperform	Neutral
Zacks Rank (Short Term)	5	-	-	4	4	2
VGM Score	B	-	-	D	C	B
Market Cap	9.04 B	275.67 M	20.14 B	14.79 B	26.56 B	17.25 B
# of Analysts	14	6	14	10	11	6
Dividend Yield	0.00%	0.00%	2.13%	4.20%	2.13%	1.05%
Value Score	C	-	-	D	F	C
Cash/Price	0.04	0.07	0.06	0.11	0.02	0.10
EV/EBITDA	11.94	11.29	12.15	11.51	18.31	10.91
PEG Ratio	3.37	3.53	2.43	2.31	2.54	7.35
Price/Book (P/B)	3.86	1.66	2.68	3.47	NA	5.43
Price/Cash Flow (P/CF)	8.63	6.65	10.78	9.93	21.86	14.91
P/E (F1)	34.59	34.75	19.06	25.01	30.43	59.61
Price/Sales (P/S)	1.03	0.62	2.12	2.64	4.75	2.10
Earnings Yield	3.07%	0.89%	5.11%	4.00%	3.29%	1.68%
Debt/Equity	2.24	0.99	0.72	2.83	-1.26	0.01
Cash Flow (\$/share)	8.66	1.81	7.01	4.98	4.04	3.08
Growth Score	B	-	-	C	A	B
Hist. EPS Growth (3-5 yrs)	17.80%	7.89%	10.88%	28.00%	0.67%	NA
Proj. EPS Growth (F1/F0)	-60.55%	-78.26%	-6.33%	-27.24%	-18.28%	-59.04%
Curr. Cash Flow Growth	15.99%	5.29%	5.92%	2.55%	3.60%	10.09%
Hist. Cash Flow Growth (3-5 yrs)	14.41%	6.59%	8.55%	30.84%	-6.71%	25.34%
Current Ratio	0.41	0.62	1.23	1.29	0.99	1.30
Debt/Capital	69.14%	63.70%	43.90%	73.88%	NA	0.81%
Net Margin	7.25%	4.05%	11.13%	11.48%	23.12%	6.72%
Return on Equity	32.51%	7.09%	16.47%	31.74%	-13.90%	17.50%
Sales/Assets	0.99	1.07	0.55	0.26	1.14	1.21
Proj. Sales Growth (F1/F0)	-10.80%	-11.25%	-1.35%	-13.44%	-8.24%	-11.29%
Momentum Score	B	-	-	F	F	B
Daily Price Chg	3.31%	2.05%	1.10%	3.45%	0.09%	-0.07%
1 Week Price Chg	8.63%	-0.64%	-1.74%	1.76%	2.04%	-3.13%
4 Week Price Chg	37.35%	19.84%	11.80%	23.63%	28.81%	7.67%
12 Week Price Chg	-35.27%	-32.26%	-17.28%	-19.78%	-17.28%	3.59%
52 Week Price Chg	-36.40%	-44.99%	-10.69%	-24.14%	-15.44%	-3.45%
20 Day Average Volume	4,122,181	267,094	2,660,864	5,002,429	2,660,864	2,536,811
(F1) EPS Est 1 week change	1.82%	-1.83%	0.00%	-4.49%	-4.83%	0.00%
(F1) EPS Est 4 week change	-21.76%	-72.22%	-6.46%	-16.50%	-11.85%	1.54%
(F1) EPS Est 12 week change	-63.99%	-83.20%	-12.81%	-33.53%	-29.79%	-58.68%
(Q1) EPS Est Mthly Chg	-26.29%	-115.13%	-10.84%	-37.41%	-37.94%	16.67%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	B
VGM Score	B

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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