

Darden Restaurants (DRI)

\$119.21 (As of 01/29/20)

Price Target (6-12 Months): **\$125.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/06/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: F

Summary

Shares of Darden have underperformed the industry in the past year. This can be primarily attributed to lower-than-expected revenues in four of the trailing five quarters. However, the company's earnings have been encouraging as it met/surpassed the Zacks Consensus Estimate for 21 straight quarters. Backed by its various sales-building initiatives and technology-driven moves, the top line is likely to improve in the days ahead. The company continues to expect earnings of \$6.30-\$6.45 and revenues growth of 5.3-6.3% during the fiscal year. Further, the Cheddar's buyout added value to Darden's portfolio of differentiated brands. However, fierce competition and softer-than-expected consumer demand might keep comps under pressure. Further, rising labor costs and non-franchised business model may dampen profits.

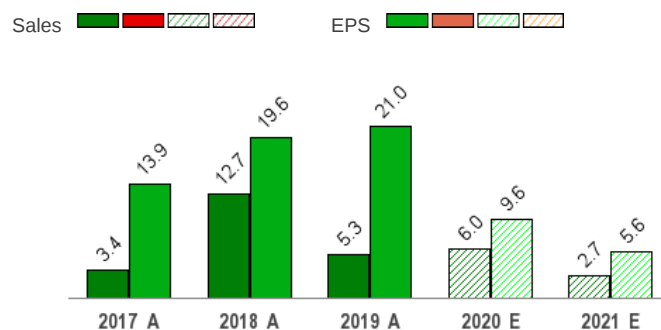
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$128.41 - \$104.25
20 Day Average Volume (sh)	1,518,292
Market Cap	\$14.6 B
YTD Price Change	9.4%
Beta	0.31
Dividend / Div Yld	\$3.52 / 3.0%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 25% (64 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.7%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-0.0%
Expected Report Date	03/19/2020
Earnings ESP	0.8%
P/E TTM	19.7
P/E F1	18.7
PEG F1	1.8
P/S TTM	1.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,229 E	2,150 E	2,437 E	2,434 E	9,260 E
2020	2,134 A	2,056 A	2,323 E	2,505 E	9,017 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	\$1.50 E	\$1.18 E	\$2.07 E	\$1.99 E	\$6.74 E
2020	\$1.38 A	\$1.12 A	\$1.87 E	\$2.01 E	\$6.38 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 01/29/2020. The reports text is as of 01/30/2020.

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.

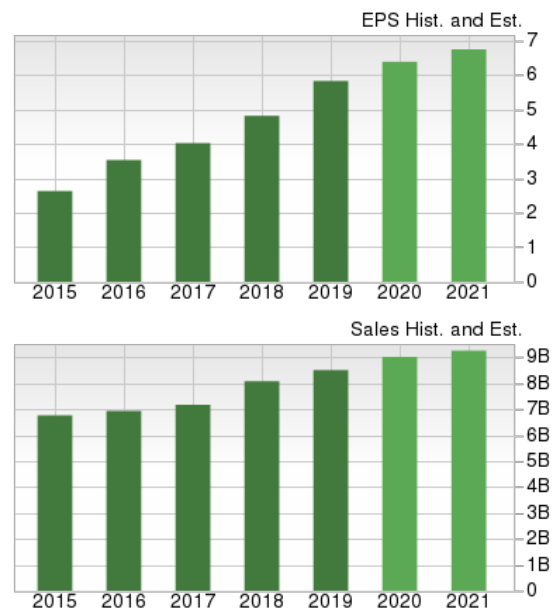
Florida-based *Olive Garden* is the largest full-service Italian restaurant in America. The brand features a menu, which has a variety of Italian food made with fresh ingredients.

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 Buy:

▲ **Impressive Earnings Trend:** We are encouraged by Darden's impressive earnings trend. Notably, the company's earnings met/surpassed the Zacks Consensus Estimate for 21 straight quarters. In second-quarter fiscal 2020, adjusted earnings came in at \$1.12 per share, which outpaced the Zacks Consensus Estimate of \$1.07. The bottom line also improved 21.7% 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. In fiscal 2020, Darden's earnings per share are anticipated to be \$6.30-\$6.45. The stock is anticipated to keep performing well in the days ahead backed by management's focus on improving core operating fundamentals and the Cheddar's acquisition.

Cheddar's acquisition, various sales boosting initiatives along with the cost saving efforts undertaken by the company are expected to drive growth

▲ **Cheddar's Sales Growth Continues:** 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. In second-quarter fiscal 2020, Cheddar's Scratch Kitchen total sales rose 4.2%. The growth was driven by 5.4% increase in new restaurants.

▲ **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. In second-quarter fiscal 2020, Olive Garden's off-premise business improved 17% and accounted for 17% of total sales.

Moreover, second-quarter fiscal 2020 marked Olive Garden's 21st 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 27 consecutive quarters. Moreover, LongHorn has outpaced the industry benchmark in same-restaurant sales and traffic by 640 and 550 basis points, respectively. 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 on the back of various initiatives undertaken and personalized services, which should also aid long-term growth.

▲ **Cost Saving Efforts to Reap Benefits:** The company is focusing on an aggressive cost management plan, under which it trying to significantly cut operating costs. Last year, cost savings have resulted in synergies of about \$10 million. Moreover, the company plans to reinvest any incremental savings into pricing and long-term growth drivers for the business, particularly emphasizing on enhancing quality to drive market share gains.

Reasons To Sell:

- ▼ **Lower-than-Expected Top Line Performance:** Shares of Darden have underperformed the industry in the past year. This can be primarily attributed to the top line miss in four of the trailing five quarters. In second-quarter fiscal 2020, total sales of \$2,056.4 million lagged the consensus mark of \$2,058 million.
 - ▼ **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 second quarter, total operating costs and expenses improved 3.9% year over year, following a rise of 3.2% in the preceding quarter. 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.

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

Last Earnings Report

Darden Q2 Earnings Beat, Sales Lag Estimates

In second-quarter fiscal 2020, adjusted earnings came in at \$1.12 per share, which outpaced the Zacks Consensus Estimate of \$1.07. The bottom line also improved 21.7% 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 \$2,056.4 million lagged the consensus mark of \$2,058 million. However, sales improved 4.2% from the prior-year quarter driven by the addition of 37 net restaurants and a 2% increase in blended comps.

Quarter Ending **11/2019**

Report Date	Dec 19, 2019
Sales Surprise	-0.08%
EPS Surprise	4.67%
Quarterly EPS	1.12
Annual EPS (TTM)	6.06

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 2.6% year over year to \$1,023.6 million. Comps grew 1.5% at the segment, lower than the prior-quarter's comp growth of 2.2%. Traffic declined 1.2%. Pricing improved 2% and menu-mix increased 0.7%.

Sales at Fine Dining improved 5.5% to \$154.8 million. Comps at The Capital Grille rose 1.8% compared with 1.5% growth in first-quarter fiscal 2020. Further, Eddie V's reported comps growth of 0.5%, lower than 1.2% improvement in the prior quarter.

Sales at Other Business grew 3.5% year over year to \$430.7 million. However, comps at Seasons 52 fell 3.5% in the reported quarter compared with a comps decline of 4.2% in first-quarter fiscal 2020. Comps at Yard House inched up 0.7% compared with 1.9% decrease in the prior quarter. Meanwhile, comps slipped 3.4% at Bahama Breeze compared with a decline of 3.2% in the preceding quarter.

At LongHorn Steakhouse, sales advanced 8.4% to \$447.3 million. Comps at the segment increased 6.7%, compared with comps growth of 2.6% in the year-ago quarter. Traffic improved 3.2%. Also, pricing and menu mix grew 1.9% and 1.6%, respectively.

In the reported quarter, comps at Cheddar's decreased 1.2% compared with a 5.4% decline in the prior-year quarter.

Operating Highlights & Net Income

In the fiscal second quarter, total operating costs and expenses increased 3.9% year over year to \$1,896.2 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 Nov 24, 2019, totaled \$157.3 million, down from \$457.3 million as of May 26, 2019.

Inventories totaled \$212.2 million at the end of the reported quarter. Long-term debt as of Nov 24, 2019, was \$928.2 million, up from \$927.7 million as of May 26, 2019.

During the fiscal second quarter, Darden repurchased approximately 1.2 million shares of its common stock for roughly \$136 million.

Fiscal 2020 Outlook

Darden reiterated fiscal 2020 outlook. The company continues to expect total revenue growth of 5.3-6.3% during the fiscal year. This will include the 2% positive synergy from the 53rd week. Comps are projected to increase 1-2%. Darden's earnings per share are anticipated to be \$6.30-\$6.45.

Meanwhile, the company expects inflation to be up 2.5% in 2020. With an effective tax rate of 10-11%, total capital spending is expected to be \$450-\$500 million. Darden plans to open 50 gross and 44 net new restaurants in 2020.

Valuation

Darden's shares are up 13.6% over the trailing 12-month period. Over the past year, the Zacks sub-industry and sector are up 18.4% and 13.4%, respectively.

The S&P 500 index is up 20.2% in the past year.

The stock is currently trading at 18.02x forward 12-months Price to Earnings value, which compares to 24.79x for the Zacks sub-industry, 24.97x for the Zacks sector and 18.81x for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.49x and as low as 15.09x, with a 5-year median of 18.19x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$125 price target reflects 18.91x forward 12-months Price to Earnings value.

The table below shows summary valuation data for DRI.

Valuation Multiples - DRI					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	18.02	24.79	24.97	18.81
	5-Year High	26.49	26.41	26.23	19.34
	5-Year Low	15.09	20.45	19.07	15.18
	5-Year Median	18.19	23.25	22.95	17.45
P/S F12M	Current	1.59	3.56	1.06	3.49
	5-Year High	1.74	3.85	1.11	3.49
	5-Year Low	0.98	2.91	0.8	2.54
	5-Year Median	1.31	3.25	0.91	3
P/CF	Current	11.55	17.24	14.33	22.98
	5-Year High	19.91	20.39	15.17	22.98
	5-Year Low	7.46	8.5	10.73	11.78
	5-Year Median	11.3	16.51	12.84	16.26

As of 01/29/2020

Industry Analysis Zacks Industry Rank: Top 25% (64 out of 255)



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)	Neutral
Yum China Holdings Inc. (YUMC)	Neutral

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	DRI Neutral	X Industry	S&P 500	QSR Neutral	YUM Neutral	YUMC Neutral
VGM Score	B	-	-	B	D	A
Market Cap	14.62 B	428.02 M	23.90 B	18.76 B	32.25 B	16.92 B
# of Analysts	14	5.5	13	11	9	3
Dividend Yield	2.95%	0.00%	1.8%	3.18%	1.58%	1.07%
Value Score	B	-	-	C	D	B
Cash/Price	0.01	0.03	0.04	0.09	0.02	0.10
EV/EBITDA	16.84	14.99	14.05	14.08	17.32	10.91
PEG Ratio	1.82	2.18	2.00	1.90	2.11	2.69
Price/Book (P/B)	6.43	2.94	3.28	4.61	NA	5.43
Price/Cash Flow (P/CF)	13.76	11.58	13.57	10.89	28.25	16.23
P/E (F1)	18.68	22.40	18.76	21.10	25.81	24.16
Price/Sales (P/S)	1.69	0.96	2.63	3.41	5.91	1.95
Earnings Yield	5.35%	4.33%	5.33%	4.74%	3.87%	4.13%
Debt/Equity	2.30	0.94	0.72	3.18	-1.30	0.01
Cash Flow (\$/share)	8.66	1.53	6.89	5.77	3.77	2.77
Growth Score	B	-	-	C	C	A
Hist. EPS Growth (3-5 yrs)	19.97%	7.71%	10.68%	29.98%	0.29%	NA
Proj. EPS Growth (F1/F0)	9.55%	8.26%	7.63%	10.45%	11.98%	6.07%
Curr. Cash Flow Growth	15.99%	7.69%	13.04%	19.29%	-9.66%	8.02%
Hist. Cash Flow Growth (3-5 yrs)	14.41%	6.24%	8.78%	32.62%	-11.09%	NA
Current Ratio	0.34	0.63	1.24	1.09	1.57	1.37
Debt/Capital	69.72%	61.12%	42.99%	76.05%	NA	0.76%
Net Margin	7.23%	3.14%	11.47%	11.64%	20.88%	8.05%
Return on Equity	32.25%	8.47%	17.21%	32.20%	-11.69%	21.63%
Sales/Assets	1.12	1.17	0.54	0.26	1.18	1.40
Proj. Sales Growth (F1/F0)	5.95%	3.14%	4.10%	4.92%	4.76%	6.50%
Momentum Score	F	-	-	A	D	B
Daily Price Chg	1.50%	0.00%	0.90%	0.05%	1.73%	-0.09%
1 Week Price Chg	3.14%	-0.35%	-1.09%	0.17%	-0.40%	-11.23%
4 Week Price Chg	9.36%	1.26%	0.46%	-1.49%	5.86%	-6.25%
12 Week Price Chg	5.69%	1.16%	4.15%	-4.56%	6.53%	5.56%
52 Week Price Chg	12.32%	2.00%	18.27%	0.64%	14.10%	25.41%
20 Day Average Volume	1,518,292	224,753	1,730,811	2,848,335	1,771,298	2,807,758
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.01%	0.00%	0.00%	0.21%	-0.60%	0.45%
(F1) EPS Est 12 week change	-0.10%	0.00%	-0.13%	0.46%	-0.94%	0.45%
(Q1) EPS Est Mthly Chg	0.29%	0.00%	0.00%	0.20%	-0.08%	1.75%

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	B
Growth Score	B
Momentum Score	D
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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