Feb 03, 2020

The Wendys Company (WEN)

$21.67 (As of 01/31/20)

Price Target (6-12 Months): **$23.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 11/08/18) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**4-Sell**
	Zacks Style Scores:	VGM:C
	Value: D | Growth: B | Momentum: D	

Summary

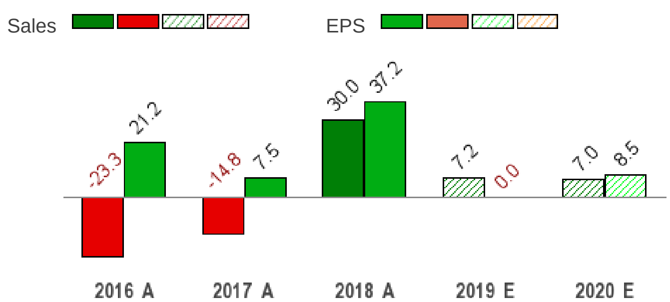
Shares of Wendy's have outperformed the industry in the past year. The outperformance is primarily attributed to the initiatives like menu innovation, increased investments in technology and reimaging of restaurants. Moreover, increased Global system-wide sales in the company-operated and franchise restaurants added to the positives. Notably, the company is benefiting from its transition to a franchised business model. Its international business is poised to be a long-term growth driver. However, incremental capital spending along with fluctuating consumer demand remain potent headwinds. Also, higher costs might dent the company's margin.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$22.84 - $16.25**
20 Day Average Volume (sh)	**2,075,014**
Market Cap	**$5.0 B**
YTD Price Change	**-2.4%**
Beta	**0.65**
Dividend / Div Yld	**$0.48 / 2.2%**
Industry	**Retail - Restaurants**
Zacks Industry Rank	**Top 27% (70 out of 255)**
Last EPS Surprise	**26.7%**
Last Sales Surprise	**0.6%**
EPS F1 Est- 4 week change	**-0.1%**
Expected Report Date	**02/26/2020**
Earnings ESP	**9.8%**
P/E TTM	**32.3**
P/E F1	**33.9**
PEG F1	**2.4**
P/S TTM	**3.0**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	435 E	464 E	461 E	476 E	1,824 E
2019	409 A	435 A	438 A	422 E	1,704 E
2018	381 A	411 A	401 A	398 A	1,590 A

EPS Estimates

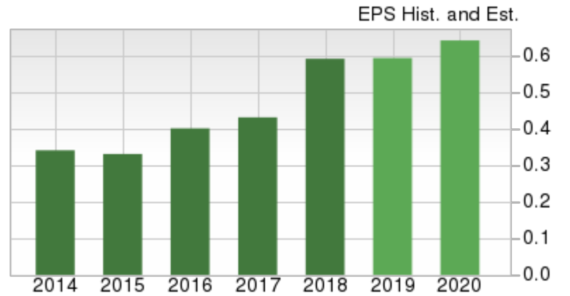
	Q1	Q2	Q3	Q4	Annual*
2020	$0.10 E	$0.18 E	$0.18 E	$0.19 E	$0.64 E
2019	$0.14 A	$0.18 A	$0.19 A	$0.08 E	$0.59 E
2018	$0.11 A	$0.14 A	$0.17 A	$0.16 A	$0.59 A

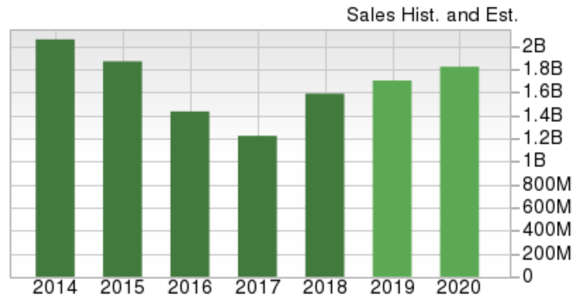
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/31/2020. The reports text is as of 02/03/2020.

Overview

The Wendy's Company, the world's third-largest quick-service restaurant company, operates through its subsidiary holding company — Wendy's Restaurants, LLC. The fast-food chain through its subsidiary operates as a franchisor of the Wendy's restaurant system. As of Dec 30, 2018, The Wendy's system included more than 6,700 franchisees and company-operated restaurants in the United States and 30 countries worldwide.





The company primarily engages in operating, developing and franchising a system of distinctive quick-service restaurants serving high-quality food. As of Dec 30, 2018, it had 6,178 operations running in North America, out of which 353 were company-owned and 5,285 were operated by 330 franchisees.

The company derives revenues from two principal sources: sales at Company-operated restaurants and franchise-related revenues — including royalties, national advertising funds contributions, rents and franchise fees received from Wendy's franchised restaurants. As of Sep 30, 2019, company-operated restaurants comprised 5% of the total Wendy's system.

The Wendy's menu features hamburgers; chicken breast sandwiches and wraps; chicken nuggets; chili, baked and French-fried potatoes; freshly prepared salads; soft drinks and Frosty desserts.

On Sep 29, 2019, the company completed its merger with Triarc in an all-stock transaction in which Wendy's shareholders received 4.25 shares of Wendy's/Arby's Class A common stock for each Wendy's common share owned.

Reasons To Buy:

▲ **Strong International Presence & Expansion Efforts:** Wendy's is steadfast in expanding its presence globally. The company expects global net new unit growth to be 1.5% in 2019. The company's international business is thus poised to be a driver of growth in the future. The company has growth plans and partnerships in Argentina, the Philippines and Japan. Further, Wendy's has long-term development agreements with franchisees in Singapore, the Middle East, North Africa, the Russian Federation, the Eastern Caribbean, Argentina, Japan, Georgia, the Republic of Azerbaijan, Ecuador and Chile.

The company's initiatives like menu innovation, technological upgrades, international expansion and re-imaging of units should help boost the top line

Additionally, the company is exploring growth opportunities in China, Brazil and other key international markets. Wendy's also announced that it will enter Europe by opening restaurants in the UK. Notably, the company anticipates the count to increase to 1500 restaurants internationally and double its sales to approximately $2 billion by 2024. These less saturated emerging markets offer the company enormous growth opportunities. They have significant growth potential due to their relatively low per-capita consumption.

In 2018, the company opened 159 restaurants as part of its expansion endeavors, with an increase of 77 net new units. This suggests roughly 1.2% global net new restaurant growth in 2018. In the third quarter of 2019, Wendy's reported 40 global restaurant openings, with an increase of 24 net new units.

▲ **Transition to a Franchised Business Model:** Wendy's is benefiting from its transition to a franchised business model. In 2017, the company had several first-time builders and doubled the number of franchises from 2015 by building new restaurants. Though the reduction in ownership has been weighing on revenues over the past few quarters, we believe franchising a large chunk of its system will lower Wendy's general and administrative expenses and thereby boost earnings. Moreover, over the long term, it would generate a higher return on equity by lowering capital requirements. This would also boost free cash flow, thereby enhancing shareholder return. In 2018, the company's top line benefited from the Franchise flip that occurred in 2017.

Moving forward, the company plans to continue facilitating franchisee-to-franchisee restaurant transfers through its buy-and-flip strategy. This strategy ensures that restaurants are put in the hands of well-capitalized franchisees, committed to long-term growth. In 2018, Wendy's facilitated 96 Franchise Flips. In 2019, the company expects to complete 100-200 Franchise Flips.

▲ **Re-imaging Restaurants to Improve Guest Experience:** Wendy's remains on track to achieve at least 70% of its Image Activation goal as part of the brand transformation initiative. This program has gained traction in the recent past, leading to increased traffic and higher sales at its restaurants. At the end of 2018, 50% of the global system featured the brand's new image. Interestingly, as a result of this re-imaging, customers have seen some bold designs and friendlier restaurant teams. At the end of the third quarter, 56% of the global system was image activated.

▲ **Focus on Product Innovation:** The company's brand transformation initiative also includes menu innovation, promotional offers and bold new packaging, intended for boosting sales. Meanwhile, the practice of offering customized sandwiches made on order and serving hamburgers made of never-frozen beef would continue to drive sales for the company. We expect the company's solid menu pipeline, limited time offers (LTO), marketing initiatives and increased emphasis on core and price value offerings, to maintain the trend. During the third quarter 2019, Wendy's added the Bacon Jalapeno Chicken Sandwich and the Buffalo Chicken Salad to its Made to Crave chicken line-up, which gained popularity among customers. The company also relaunched its Spicy Nuggets. The company will transition to 100% cage-free eggs for its breakfast items served at U.S and Canadian locations by 2020. The company also intends to eliminate the use of gestation stalls from its pork supply chain by 2022. These efforts will make the company popular among health-conscious diners. All in all, Wendy's expects that its balanced marketing approach, new restaurant development and reimaging of restaurants are all key catalysts. These, in turn, should help the company to achieve its 2020 target of $12 billion in system-wide sales.

▲ **Focus on Technology Utilization:** Wendy's is capitalizing on the benefits of technology. It is investing in areas like mobile payment, mobile ordering and customer self-order kiosks that provide benefits such as consumer convenience, increased customer count, higher check and faster speed of service. We expect these measures to help the company to maintain the trend of positive comps going forward. In addition to improving overall customer convenience, these are likely to drive additional output during peak hours as well as provide labor leverage.

On the mobile ordering front, Wendy's is progressing rapidly to ensure that the facility is can unravel additional prospects around convenience – through delivery and curbside delivery, plus loyalty. In fact, delivery continues to be a major initiative by the company. Moreover, in the fourth quarter of 2017, the company began offering delivery service in partnership with DoorDash and covered more than 60% of its restaurants in North America by 2018. Wendy's will continue to increase its coverage through 2019 to 60%.

Reasons To Sell:

Higher costs, incremental capital spending, along with fickle consumer demand remain potent headwinds

- **Overvalued:** Wendy's valuation looks a bit stretched compared with its industry average. Looking at the company's price-to-earnings (P/E) ratio, which is one of the most commonly used valuation ratio and is best suited for evaluating restaurants, investors might not want to pay any further premium. The company currently has a forward 12-month P/E ratio of 33.11. So, the stock is relatively overvalued right now compared with its peers as the industry's average PE is 23.25 currently.

- **Rising Costs:** The Affordable Care Act, commonly known as Obamacare, would continue to have an adverse impact on restaurant operators. That is, the restaurant operators will have to continue shouldering increased labor costs, which in turn will hurt margins.

  Meanwhile, in order to compensate for these costs, the company is taking steps to re-align and re-invest resources. Though these initiatives might benefit Wendy's over the long term, these are expected to increase costs in the near term, thereby hurting margins. Furthermore, it expects labor inflation of roughly 3-4% and commodity inflation of around 1-2%. The company would also have to improve its focus on cost savings and increasing same-restaurant sales in order to cope up with these inflations.

- **Incremental Capital Spending Owing to Re-imaging:** Wendy's would incur additional capital expenditure in the coming years in a bid to boost the re-imaging program. This might lower free cash flow in the near term. Though the company has transitioned toward a franchise-based model that downscales capital expenditure, it will take time to reap benefits. In fact, the company expects capital expenditure of approximately $75-$80 million in 2019.

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

Last Earnings Report

Wendy's Q3 Earnings Beat Estimates

Quarter Ending	09/2019
Report Date	Nov 06, 2019
Sales Surprise	0.59%
EPS Surprise	26.67%
Quarterly EPS	0.19
Annual EPS (TTM)	0.67

The Wendy's Company's reported better-than-expected third-quarter 2019 results. The company's earnings topped analysts' expectation, marking the fifth consecutive beat. Also, revenues outpaced the Zacks Consensus Estimate, after missing the same in the second quarter.

Delving Deeper

Adjusted earnings of 19 cents per share surpassed the Zacks Consensus Estimate of 15 cents by 26.7%. The bottom line also increased 11.8% year over year, primarily favored by an increase in adjusted EBITDA, fewer outstanding shares and lower depreciation expense.

Quarterly revenues of $437.9 million outpaced the consensus mark of $435.3 million by 0.6%. The top line also improved 9.3% from the year-ago quarter, driven by increased sales from company-operated restaurants and franchise royalties.

Meanwhile, comps at North America system restaurants were up 4.4% compared with 1.4% increase in the second quarter and 0.2% decline in the year-ago period.

System-Wide Sales Discussion

Global system-wide sales — including company-operated and franchise restaurants — were $2.8 million in the reported quarter, up 5.6% from the prior-year period. North America system-wide sales were $2.7 million in the quarter, reflecting a 5.4% year-over-year increase. System-wide sales at the International segment amounted to $0.14 million in the quarter under review, up 8.7% year over year.

Operating Highlights

Company-operated restaurant margin was 16.2% in the reported quarter compared with 15.7% in the year-ago period. The 50-basis points (bps) improvement was primarily attributable to higher pricing and positive mix benefits. However, the positives were partly offset by labor rate inflation and higher commodity costs.

General and administrative expenses in the quarter were $46.2 million, down 0.6% from $46.5 million recorded in the prior-year period. This decline was due to a $2.8-million reduction in its legal reserve owing to an increase in anticipated insurance proceeds available for use related to the proposed settlement of the Financial Institutions case.

Third-quarter operating profit amounted to $79 million, marking a 2.2% improvement from the year-ago quarter. Net income of $46.1 million, however, decreased 88.2% from $391.2 million recorded in the year-ago quarter. This was due to the sale of its ownership interest in Inspire Brands in third-quarter 2018 for $450 million.

Adjusted EBITDA increased 2.5% from the prior-year quarter, given higher franchise royalty revenues and company-operated restaurant margin. Adjusted EBITDA margin, however, declined 170 bps to 25.1%.

Balance Sheet

Cash and cash equivalents as of Sep 30, 2019 were $439.4 million compared with $431.4 million on Dec 30, 2018. Inventories at the end of the third quarter amounted to $3.5 million, slightly lower than $3.7 million at 2018-end. Long-term debt was $2.27 billion as of Sep 30, 2019 compared with $2.31 billion on Dec 30, 2018.

The company repurchased 1.3 million shares for $26.4 million in the third quarter at an average price of $19.91 per share. It currently has $161.1 million remaining under the existing $225-million share repurchase authorization that will expire on Mar 1, 2020.

Other Developments

In the third quarter of 2019, Wendy's had 40 global restaurant openings, with an increase of 24 net new units. Image Activation, which remains an integral part of the company's global growth strategy, includes reimaging of existing restaurants and building new ones. At the end of the third quarter, 56% of the global system was image activated.

Guidance Updated

For 2019, the company now expects global system-wide sales growth of 3.5-4% versus 3-4% expected earlier. Adjusted EPS is anticipated to grow between up 1.5% and down 1.5% (versus prior projection of 3.5-6.5% decline). It further expects adjusted EBITDA growth to be between flat and down 1% (versus flat to down 2% expected earlier). Wendy's still expects global net new unit growth of 1.5% from the prior-year level.

For 2020, global system-wide sales are expected within $12-12.5 billion, with free cash flow of approximately $215-$225 million and adjusted EBITDA of $425M-$435M.

Valuation

Wendy's shares are up 24.1% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and sector has gained 17.3% and 15.2%, respectively.

The S&P 500 index is up 17.4% in the past year.

The stock is currently trading at 33.11x forward 12-month Price to Earnings value, which compares with 24.51x for the Zacks sub-industry, 24.92x for the Zacks sector and 18.51x for the S&P 500 index.

Over the past five years, the stock has traded as high as 37.99x and as low as 22.64x, with a 5-year median of 28.21x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $23 price target reflects 35.93x forward 12-month Price to Earnings value.

The table below shows summary valuation data for WEN.

Valuation Multiples - WEN

		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	33.11	24.51	24.92	18.51
	5-Year High	37.99	26.41	26.2	19.34
	5-Year Low	22.64	20.45	19.07	15.18
	5-Year Median	28.21	23.25	22.96	17.46
P/S F12M	Current	2.73	3.53	1.06	3.43
	5-Year High	3.34	3.85	1.1	3.43
	5-Year Low	1.79	2.91	0.8	2.54
	5-Year Median	2.53	3.25	0.91	3
P/CF	Current	22.01	17.08	14.37	22.63
	5-Year High	24.38	20.39	15.16	22.67
	5-Year Low	9.81	8.5	10.73	11.78
	5-Year Median	16.23	16.51	12.84	16.27

As of 01/31/2020

Industry Analysis **Zacks Industry Rank:** Top 27% (70 out of 255)

Top Peers

BJs Restaurants, Inc. **(BJRI)**	Neutral
Dunkin Brands Group, Inc. **(DNKN)**	Neutral
J d Wetherspoon Plc **(JDWPY)**	Neutral
Dave & Busters Entertainment, Inc. **(PLAY)**	Neutral
Papa Johns International, Inc. **(PZZA)**	Neutral
Red Robin Gourmet Burgers, Inc. **(RRGB)**	Neutral
RESTAURANT GRP **(RSTGF)**	Neutral
Carrols Restaurant Group, Inc. **(TAST)**	Underperform

Industry Comparison Industry: Retail - Restaurants

				Industry Peers		
	WEN Neutral	**X Industry**	**S&P 500**	**DNKN** Neutral	**PZZA** Neutral	**RRGB** Neutral
VGM Score	C	-	-	D	C	D
Market Cap	4.99 B	416.62 M	23.55 B	6.47 B	2.07 B	425.34 M
# of Analysts	10	5.5	13	12	5	5
Dividend Yield	2.22%	0.00%	1.81%	1.92%	1.39%	0.00%
Value Score	D	-	-	D	D	B
Cash/Price	0.09	0.03	0.04	0.10	0.01	0.04
EV/EBITDA	9.92	14.83	13.97	19.76	32.43	12.70
PEG Ratio	2.38	2.17	1.97	2.18	4.70	5.22
Price/Book (P/B)	7.67	2.96	3.21	NA	NA	1.16
Price/Cash Flow (P/CF)	18.84	11.27	13.36	21.77	22.79	3.62
P/E (F1)	34.36	21.92	18.42	23.66	41.16	50.41
Price/Sales (P/S)	2.97	0.94	2.60	4.78	1.31	0.32
Earnings Yield	2.95%	4.32%	5.43%	4.23%	2.42%	1.98%
Debt/Equity	5.62	0.94	0.72	-5.47	-1.46	1.82
Cash Flow ($/share)	1.15	1.53	6.92	3.59	2.84	9.09
Growth Score	B	-	-	C	B	D
Hist. EPS Growth (3-5 yrs)	15.49%	7.71%	10.68%	13.28%	-10.52%	-15.50%
Proj. EPS Growth (F1/F0)	8.11%	8.30%	7.59%	5.46%	40.04%	-10.19%
Curr. Cash Flow Growth	16.17%	7.69%	10.81%	7.69%	-35.21%	-5.58%
Hist. Cash Flow Growth (3-5 yrs)	-3.14%	6.24%	8.78%	6.16%	-2.72%	4.85%
Current Ratio	2.00	0.63	1.22	1.62	0.88	0.38
Debt/Capital	84.90%	61.12%	42.99%	NA	NA	64.57%
Net Margin	7.69%	3.14%	11.69%	17.54%	-0.43%	-0.82%
Return on Equity	24.72%	8.47%	17.33%	-38.96%	-12.34%	4.89%
Sales/Assets	0.34	1.17	0.55	0.37	2.28	1.14
Proj. Sales Growth (F1/F0)	7.03%	3.14%	4.12%	3.27%	2.63%	-2.22%
Momentum Score	D	-	-	C	D	F
Daily Price Chg	-1.07%	-0.75%	-1.98%	-0.41%	-1.01%	-1.62%
1 Week Price Chg	1.84%	-0.35%	-1.09%	-0.32%	2.26%	-0.46%
4 Week Price Chg	-3.00%	0.00%	-2.11%	2.13%	3.15%	-0.39%
12 Week Price Chg	3.29%	0.00%	2.15%	6.38%	3.52%	22.10%
52 Week Price Chg	25.12%	0.00%	14.15%	14.18%	53.18%	2.78%
20 Day Average Volume	2,075,014	219,498	1,808,632	531,565	583,277	238,046
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-6.59%
(F1) EPS Est 4 week change	-0.14%	0.00%	0.00%	0.05%	0.00%	-11.65%
(F1) EPS Est 12 week change	-0.42%	0.31%	-0.09%	0.63%	-2.69%	-35.76%
(Q1) EPS Est Mthly Chg	4.29%	0.00%	0.00%	-0.35%	-0.81%	-1.61%

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	D
Growth Score	B
Momentum Score	D
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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