

The Wendys Company (WEN)

\$14.06 (As of 03/24/20)

Price Target (6-12 Months): **\$15.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/08/18)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: D

Growth: D

Momentum: F

Summary

The Wendy's Company reported mixed fourth-quarter 2019 results with earnings missing the Zacks Consensus Estimate but revenues beating the same. Earnings declined 50% on a year-over-year basis while revenues improved 7.4% year over year. Revenues grew on the back of increased Global system-wide sales for the company-operated and franchise restaurants. Moreover, the company's transition to a franchised business model bodes well. However, incremental capital spending along with fluctuating consumer demand and coronavirus-related woes are adding to the downside. Also, increase in labor and commodity inflations are likely to dent the company's margins going forward. Notably, earning estimates for 2020 have declined in the past 30 days, indicating analysts' concern for the growth potential of the stock.

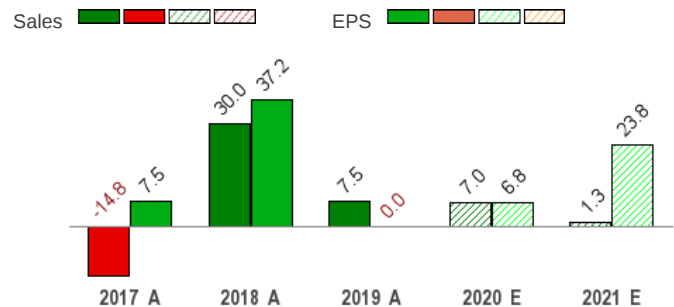
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$24.04 - \$6.82
20 Day Average Volume (sh)	6,903,399
Market Cap	\$3.1 B
YTD Price Change	-36.7%
Beta	0.84
Dividend / Div Yld	\$0.48 / 3.4%
Industry	Retail - Restaurants
Zacks Industry Rank	Bottom 44% (142 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-11.1%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	-4.3%
Expected Report Date	05/13/2020
Earnings ESP	-0.5%
P/E TTM	23.8
P/E F1	22.3
PEG F1	1.6
P/S TTM	1.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	432 E	464 E	468 E	457 E	1,851 E
2020	429 E	459 E	457 E	482 E	1,828 E
2019	409 A	435 A	438 A	427 A	1,709 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.16 E	\$0.21 E	\$0.22 E	\$0.19 E	\$0.78 E
2020	\$0.11 E	\$0.17 E	\$0.17 E	\$0.17 E	\$0.63 E
2019	\$0.14 A	\$0.18 A	\$0.19 A	\$0.08 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 03/24/2020. The reports text is as of 03/25/2020.

Overview

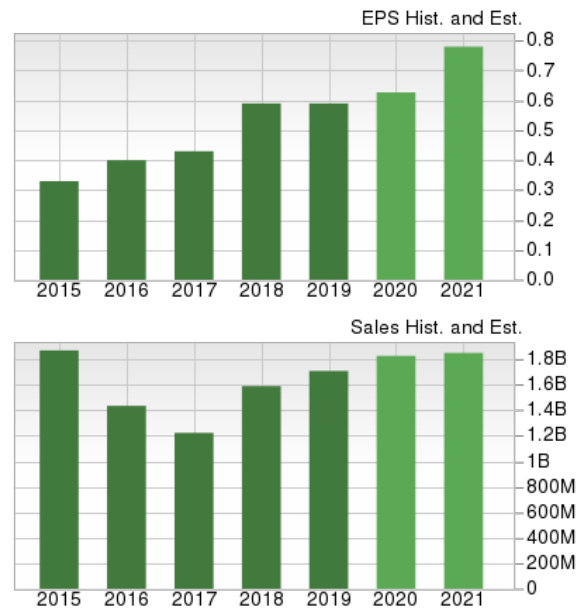
The Wendy's Company, the world's third-largest quick-service restaurant company, operates through its subsidiary holding company — Wendy's Restaurants, LLC. The fast-food chain through its subsidiary operates as a franchisor of the Wendy's restaurant system. As of Feb 26, 2020, The Wendy's system included more than 6,700 franchisees and company-operated restaurants in the United States and 30 countries worldwide.

In 2019, the company realigned its management and operating structure to increase efficiencies and accelerate long-term growth. This eventually led to the combination of its Canadian business with its International segment and separating its real estate and development operations into its own segment. As a result, the company now operates under the following three segments, namely Wendy's U.S., Wendy's International and Global Real Estate & Development.

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'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 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.

During fourth-quarter 2019, the company's system-wide sales increased 4.4% year over year. It also continued with restaurant expansion opening 182 new restaurants across the globe in 2019.

- ▲ **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 2020, the company expects to complete approximately 100 Franchise Flips, which will further strengthen its franchise base. It also plans to re-franchise its company-operated New York market in 2020. The company expects these restaurants under the franchisees to unlock significant growth in this market.

- ▲ **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 fourth quarter of 2019, 58% 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 fourth quarter of 2019, Wendy's created a differentiated menu featuring Baconator, Frosty-ccino and Honey Butter Chicken Biscuit to its breakfast line-up, which is expected to drive sales. Moreover, 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 reimagining 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. In 2019, it had 2.5% of its U.S. sales coming through digital channels, which doubled from the level at 2018 end.

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.

In 2020, the company is likely to expand its delivery business with additional partners in Grubhub and Uber Eats alongside improving its mobile ordering capabilities as well as launching loyalty program.

Reasons To Sell:

▼ **Coronavirus Likely to Hurt 2020 Results:** The recent outbreak of coronavirus in China has now become a global crisis. The Retail - Restaurants industry is currently grappling with the situation and The Wendy's Company is not the exception. Although, the company's 2020 guidance does not include any impact of the coronavirus outbreak and there have been no reported cases of COVID-19 at any of its property, uncertainties arising from the outbreak may affect results going forward.

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 21.48. So, the stock is relatively overvalued right now compared with its peers as the industry's average PE is 16.29 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 4% and commodity inflation of more than 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 million in 2020.

Moreover, on the flip side, the company exited the Malaysian market in the first quarter of 2019. It also exited Brazil in the fourth quarter of 2019. As a result of the closure, the company generated a profit headwind of approximately \$2 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 Q4 Earnings Miss Estimates, Revenues Beat

The Wendy's Company's reported mixed fourth-quarter 2019 results, with earnings missing the Zacks Consensus Estimate and revenues beating the same.

Delving Deeper

Adjusted earnings of 8 cents per share lagged the Zacks Consensus Estimate of 9 cents by 11.1%. The bottom line also plunged 50% year over year, primarily due to a decline in adjusted EBITDA. However, quarterly revenues of \$427.2 million beat the consensus mark of \$423.6 million by 0.8%. The top line also increased 7.4% from the year-ago quarter's figure on increased sales from company-operated restaurants and franchise royalties. Meanwhile, comps at North America system restaurants moved up 4.3% compared with 0.2% increase in the year-ago quarter.

System-Wide Sales Discussion

Global system-wide sales — including company-operated and franchise restaurants — were \$2.8 million in the reported quarter, up 5.9% from the prior-year quarter's levels. North America system-wide sales were \$2.6 million in the quarter, up 5.7% year over year. System-wide sales in the International segment amounted to \$0.15 million in the quarter under review, up 9.8% year over year.

Operating Highlights

Company-operated restaurant margin was 14.3% in the reported quarter compared with 16% in the year-ago quarter. The decline was mainly due to labor rate inflation, higher insurance costs, increased commodity costs and declining customer count partially. This was partially offset by pricing actions and positive mix benefits. General and administrative expenses in the quarter were \$53.9 million, down 24.5% from \$71.4 million recorded in the prior-year quarter. The decline was primarily caused by the \$27.5-million legal reserve that was recorded in fourth-quarter 2018, relating to the settlement of the Financial Institutions case. Quarterly operating profit amounted to \$36.7 million, down almost 20% from the year-ago quarter's reported figure. However, net income of \$26.5 million rallied 41% from \$18.8 million in the year-ago quarter. The increase was primarily driven by a cash settlement related to a previously-held investment, partially offset by a fall in operating profit and a higher provision for income taxes. Adjusted EBITDA declined 22.6% from the prior-year quarter's figure, given an increase in franchise support and other costs, general and administrative expenses and decline in net rental income. The downside was partially offset by an increase in franchise royalty revenues and fees. Notably, adjusted EBITDA margin declined 760 basis points to 19.5%.

Balance Sheet

Cash and cash equivalents as of Dec 29, 2019 were \$300.2 million compared with \$431.4 million on Dec 30, 2018. Inventories at the end of the fourth quarter amounted to \$3.9 million, up from \$3.7 million at 2018-end. Long-term debt was 2,257.6 million as of Dec 29, 2019 compared with \$2305.6 million on Dec 30, 2018. On the share repurchase front, the company repurchased 1.9 million shares for \$28.8 million in the first quarter of 2020. This led to the completion of its \$225-million share repurchase authorization that was set to expire on March 1, 2020. The board of directors also approved a new \$100-million share repurchase authorization, expiring on Feb 28, 2021.

Other Developments

In the quarter under review, Wendy's had 71 global restaurant openings with an increase of 45 net new units. Image Activation, which is an integral part of the company's global growth strategy, includes reimaging of existing restaurants and building new ones. At the end of the fourth quarter, 58% of the global system was image activated.

2019 Highlights

In 2019, total revenues amounted to \$1,709 million compared with \$1,589.9 million in 2018. Adjusted earnings per share (EPS) for the year were at 59 cents, flat on a year-over-year basis. Adjusted EBITDA was \$412.8 million compared with \$415.4 million in 2018.

2020 Guidance

For 2020, the company expects global system-wide sales in the range of \$12.0-\$12.5 billion. Adjusted EPS is anticipated in the range of 60-62 cents per share. It further expects adjusted EBITDA in the range of \$425-\$435 million. For 2020 free cash flow is expected between \$230 million and \$240 million, excluding approximately \$20-million tax-effected impact from the settlement of the Financial Institutions case that was finalized in January 2020.

Quarter Ending 12/2019

Report Date	Feb 26, 2020
Sales Surprise	0.85%
EPS Surprise	-11.11%
Quarterly EPS	0.08
Annual EPS (TTM)	0.59

Valuation

Wendy's shares are down by 36.7% in the year-to-date period and 17.2% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are down by 35% and 18.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry has declined 29.8% and the sector is down by 10.8%.

The S&P 500 index is down 30.2% in the year-to-date period and 21.1% in the past year.

The stock is currently trading at 21.48x forward 12-month earnings, which compares with 16.29x for the Zacks sub-industry, 20.68x for the Zacks sector and 13.4x for the S&P 500 index.

Over the past five years, the stock has traded as high as 37.79x and as low as 11.46x, with a 5-year median of 28.18x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$15 price target reflects 23.07x forward 12-month earnings.

The table below shows summary valuation data for WEN.

Valuation Multiples - WEN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	21.48	16.29	20.68	13.4
	5-Year High	37.79	26.59	26.19	19.34
	5-Year Low	11.46	16.29	19.06	13.4
	5-Year Median	28.18	23.1	23	17.42
P/S F12M	Current	1.71	2.31	0.83	2.43
	5-Year High	3.34	3.92	1.11	3.43
	5-Year Low	0.91	2.31	0.8	2.43
	5-Year Median	2.55	3.29	0.92	3
P/CF	Current	11.32	11.26	11.59	11.66
	5-Year High	24.38	20.59	15.2	22.67
	5-Year Low	6.01	8.61	10.76	11.66
	5-Year Median	16.3	16.77	12.88	16.38

As of 03/24/2020

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



Top Peers

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

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	WEN Neutral	X Industry	S&P 500	DNKN Neutral	PZZA Neutral	RRGB Neutral
VGM Score	F	-	-	D	D	D
Market Cap	3.14 B	227.52 M	17.21 B	4.26 B	1.67 B	132.51 M
# of Analysts	13	6	13	11	5	6
Dividend Yield	3.41%	0.00%	2.52%	3.12%	1.73%	0.00%
Value Score	D	-	-	D	D	B
Cash/Price	0.14	0.07	0.07	0.22	0.02	0.36
EV/EBITDA	15.36	9.88	10.28	14.01	29.17	9.72
PEG Ratio	1.55	1.66	1.56	1.64	4.71	25.47
Price/Book (P/B)	6.26	1.50	2.27	NA	NA	0.37
Price/Cash Flow (P/CF)	11.96	5.07	9.16	13.66	17.09	1.33
P/E (F1)	22.30	12.47	13.51	16.15	37.71	246.24
Price/Sales (P/S)	1.83	0.41	1.74	3.11	1.03	0.10
Earnings Yield	4.48%	7.55%	7.33%	6.19%	2.66%	0.39%
Debt/Equity	7.04	0.95	0.70	-5.76	-1.52	1.86
Cash Flow (\$/share)	1.18	1.79	7.01	3.77	3.04	7.72
Growth Score	D	-	-	C	A	D
Hist. EPS Growth (3-5 yrs)	15.68%	7.72%	10.85%	13.23%	-13.64%	-21.29%
Proj. EPS Growth (F1/F0)	6.26%	4.12%	3.92%	0.66%	17.61%	-93.28%
Curr. Cash Flow Growth	-0.70%	5.49%	5.93%	5.44%	8.17%	-15.30%
Hist. Cash Flow Growth (3-5 yrs)	-1.18%	5.92%	8.55%	5.81%	-2.98%	-0.74%
Current Ratio	1.58	0.60	1.23	1.56	0.87	0.54
Debt/Capital	87.57%	63.25%	42.57%	NA	NA	65.09%
Net Margin	8.01%	3.89%	11.64%	17.66%	0.30%	-0.60%
Return on Equity	22.61%	7.33%	16.74%	-41.48%	-15.60%	2.21%
Sales/Assets	0.33	1.09	0.54	0.36	2.21	1.05
Proj. Sales Growth (F1/F0)	6.94%	2.00%	2.57%	2.31%	2.00%	-5.82%
Momentum Score	F	-	-	D	F	F
Daily Price Chg	23.12%	14.71%	11.24%	27.42%	-3.91%	17.93%
1 Week Price Chg	-34.88%	-32.39%	-16.96%	-35.95%	2.70%	-28.57%
4 Week Price Chg	-38.76%	-45.65%	-26.70%	-30.07%	-22.96%	-67.22%
12 Week Price Chg	-36.70%	-47.58%	-30.27%	-31.77%	-17.83%	-68.93%
52 Week Price Chg	-17.20%	-53.88%	-21.88%	-29.36%	5.40%	-64.73%
20 Day Average Volume	6,903,399	554,437	4,249,353	1,840,137	1,506,059	954,712
(F1) EPS Est 1 week change	0.00%	-1.61%	-0.11%	-1.61%	-8.99%	-89.54%
(F1) EPS Est 4 week change	-4.30%	-4.30%	-1.58%	-1.61%	-12.69%	-93.61%
(F1) EPS Est 12 week change	-3.69%	-7.01%	-2.61%	-4.16%	-12.58%	-94.35%
(Q1) EPS Est Mthly Chg	8.33%	-2.82%	-1.24%	-1.44%	-7.79%	-63.28%

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	D
Momentum Score	F
VGM Score	F

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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