

## The Wendys Company (WEN)

**\$22.16** (As of 12/30/19)

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

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:C

Value: C

Growth: B

Momentum: C

### Summary

Shares of Wendy's have outperformed the industry year to date. The trend is expected to continue post third-quarter 2019 earnings release. Earnings and revenues not only topped the respective Zacks Consensus Estimate by 26.7% and 0.6% but also grew 11.8% and 9.3% year over year. Wendy's have been benefiting from menu innovation, increased investments in technology and reimagining of restaurants. The company's raised guidance for 2019 global system-wide sales growth is an added positive. Its international business is poised to be a long-term growth driver. Over the past 30 days, earnings estimate for the current year and 2020 have witnessed downward revision. Moreover, incremental capital spending along with fluctuating consumer demand remain potent headwinds. Also, higher costs might dent the company's margin.

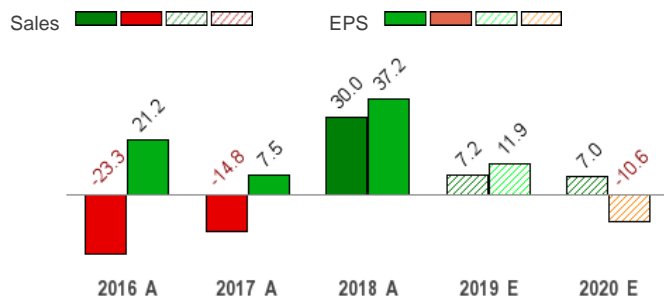
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$22.84 - \$15.33
20 Day Average Volume (sh)	2,104,792
Market Cap	\$5.1 B
YTD Price Change	42.0%
Beta	0.64
Dividend / Div Yld	\$0.48 / 2.2%
Industry	<a href="#">Retail - Restaurants</a>
Zacks Industry Rank	Top 20% (50 out of 253)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	26.7%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	-0.4%
Expected Report Date	02/20/2020
Earnings ESP	0.0%
P/E TTM	33.1
P/E F1	33.6
PEG F1	2.3
P/S TTM	3.0

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	433 E	462 E	462 E	477 E	1,823 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	\$0.08 E	\$0.10 E	\$0.18 E	\$0.18 E	\$0.59 E
2019	\$0.14 A	\$0.18 A	\$0.19 A	\$0.15 E	\$0.66 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, except sales and EPS estimates, is as of 12/30/2019. The reports text and the analyst-provided sales and EPS estimates are as of 12/31/2019.

## Overview

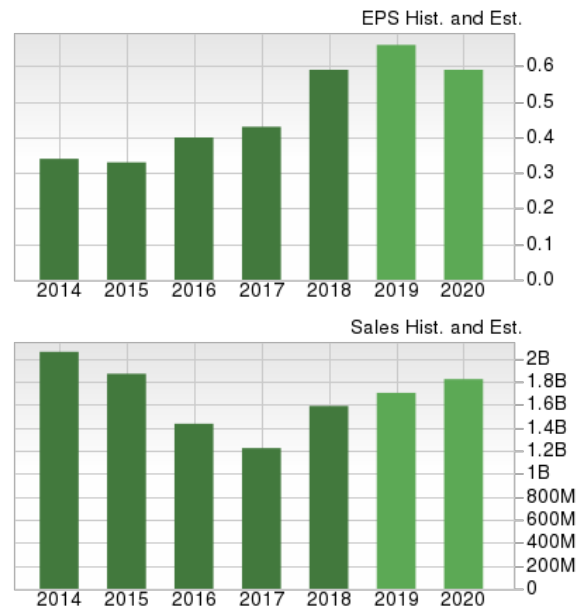
The Wendy's Company, the world's third-largest quick-service restaurant company, operates through its subsidiary holding company — Wendy's Restaurants, LLC. The fast-food chain through its subsidiary operates as a franchisor of the Wendy's restaurant system. As of Dec 30, 2018, The Wendy's system included 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.



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## 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 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.

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%.

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## Reasons To Sell:

▼ **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 34.58. So, the stock is relatively overvalued right now compared with its peers as the industry's average PE is 23.17 currently.

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

▼ **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.

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## Last Earnings Report

### Wendy's Q3 Earnings Beat Estimates

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.

Quarter Ending **09/2019**

Report Date	Nov 06, 2019
Sales Surprise	<b>0.59%</b>
EPS Surprise	<b>26.67%</b>
Quarterly EPS	<b>0.19</b>
Annual EPS (TTM)	<b>0.67</b>

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## Valuation

Wendy's shares are up 41.9% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and sector has gained 20.1% and 25.3%, respectively.

The S&P 500 index is up 27.2% in the past year.

The stock is currently trading at 34.58x forward 12-month Price to Earnings value, which compares with 24.08x for the Zacks sub-industry, 25.08x for the Zacks sector and 18.65x 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 28.11x. 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 F12M	Current	34.58	24.08	25.08	18.65
	5-Year High	37.99	26.41	26.13	19.34
	5-Year Low	22.64	20.45	18.99	15.17
	5-Year Median	28.11	23.17	22.89	17.44
P/S F12M	Current	2.8	3.33	1.02	3.39
	5-Year High	3.34	3.85	1.1	3.41
	5-Year Low	1.59	2.79	0.8	2.54
	5-Year Median	2.52	3.24	0.9	3
P/CF	Current	22.51	16.67	14.26	22.53
	5-Year High	24.38	20.39	15.11	22.67
	5-Year Low	9.81	8.5	10.69	11.78
	5-Year Median	16.2	16.44	12.82	16.19

As of 12/30/2019

## Industry Analysis Zacks Industry Rank: Top 20% (50 out of 253)



## 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
RESTAURANT GRP (RSTGF)	Neutral
Carrols Restaurant Group, Inc. (TAST)	Neutral
Red Robin Gourmet Burgers, Inc. (RRGB)	Underperform

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	WEN Neutral	X Industry	S&P 500	DNKN Neutral	PZZA Neutral	RRGB Underperform
<b>VGM Score</b>	<b>C</b>	-	-	<b>D</b>	<b>C</b>	<b>C</b>
Market Cap	5.10 B	427.91 M	23.75 B	6.23 B	2.04 B	424.68 M
# of Analysts		3.5	13			
Dividend Yield	2.17%	0.00%	1.79%	2.00%	1.41%	0.00%
<b>Value Score</b>	<b>C</b>	-	-	<b>D</b>	<b>D</b>	<b>B</b>
Cash/Price	0.09	0.04	0.04	0.10	0.01	0.05
EV/EBITDA	10.06	14.23	13.92	19.24	31.99	12.69
PEG Ratio	2.33	2.22	2.12	2.21	6.48	4.38
Price/Book (P/B)	7.85	2.71	3.32	NA	NA	1.16
Price/Cash Flow (P/CF)	19.27	11.36	13.73	20.95	22.42	3.61
P/E (F1)	33.61	23.75	19.56	24.03	56.69	42.29
Price/Sales (P/S)	3.04	0.89	2.67	4.60	1.29	0.32
Earnings Yield	2.66%	4.16%	5.10%	4.16%	1.76%	2.38%
Debt/Equity	5.62	0.92	0.72	-5.47	-1.46	1.82
Cash Flow (\$/share)	1.15	1.53	6.94	3.59	2.84	9.09
<b>Growth Score</b>	<b>B</b>	-	-	<b>C</b>	<b>B</b>	<b>D</b>
Hist. EPS Growth (3-5 yrs)	15.49%	7.71%	10.53%	13.28%	-10.52%	-15.50%
Proj. EPS Growth (F1/F0)	0.17%	4.57%	6.30%	7.87%	-16.12%	-55.14%
Curr. Cash Flow Growth	16.17%	7.73%	14.83%	7.69%	-35.21%	-5.58%
Hist. Cash Flow Growth (3-5 yrs)	-3.14%	7.10%	9.00%	6.16%	-2.72%	4.85%
Current Ratio	2.00	0.60	1.23	1.62	0.88	0.38
Debt/Capital	84.90%	55.55%	42.99%	NA	NA	64.57%
Net Margin	7.69%	3.14%	11.08%	17.54%	-0.43%	-0.82%
Return on Equity	24.72%	8.47%	17.10%	-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)	7.18%	0.96%	2.86%	3.60%	2.06%	-1.74%
<b>Momentum Score</b>	<b>C</b>	-	-	<b>D</b>	<b>F</b>	<b>F</b>
Daily Price Chg	0.00%	0.00%	-0.43%	1.01%	-1.15%	5.77%
1 Week Price Chg	-0.45%	0.00%	0.13%	-0.76%	1.83%	2.82%
4 Week Price Chg	0.77%	-1.65%	2.78%	-1.65%	1.44%	20.18%
12 Week Price Chg	10.19%	-1.23%	8.67%	-0.65%	18.00%	0.27%
52 Week Price Chg	41.96%	7.22%	27.07%	17.22%	60.06%	22.83%
20 Day Average Volume	2,104,792	175,531	1,731,328	544,078	514,555	216,653
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.39%	0.00%	0.00%	-0.02%	-1.83%	-1.02%
(F1) EPS Est 12 week change	1.12%	1.14%	0.14%	2.54%	-0.82%	-28.15%
(Q1) EPS Est Mthly Chg	-2.41%	0.00%	0.00%	0.13%	-0.27%	0.00%

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## 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.

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### 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	C
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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### Disclosures

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