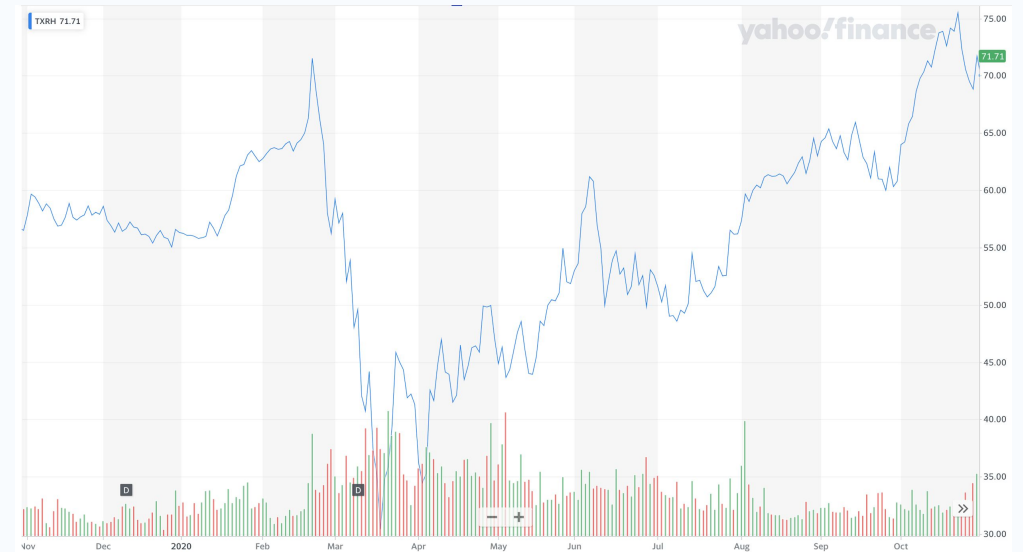




Ticker Symbol:
TXRH



Deep Dive: Finance

Board Education Program

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Investment Overview

Company Description

- Chain of casual-dining restaurants in the US, Middle East, and Asia
- Over 600 locations in 49 states, as well as locations in 10 other countries
- Serves American cuisine; primarily known for its steak dishes and free bread rolls
- All locations have stayed open during COVID, but To-Go and Curbside options also available

Thesis Highlights

- Texas Roadhouse has experienced excellent growth over the past years and is well-positioned to continue the trend
- Honest, passionate CEO and board members who have continuously proved their abilities with the company's performance in the past
- Strong, unique brand images and marketing strategies
- Very stable financial conditions, such as low debts and high FCF

Financials

TXRH	Thousands
Stock Price	\$72.11
Market Cap	5,004,400
Debt	828,230
Preferred & Other	15,600
Cash	328,600
Enterprise Value	5,448,900
EV/EBITDA	31.2x
EV/EBIT	96.6x
P/E	92.0x
Gross Margin	13.01%
Operating Margin	2.29%

Casual Dining Industry Overview

Casual dining is a mature and highly competitive industry.

- **Casual dining restaurants tend to operate on low margins**
 - Cost of labor comprised of 32% of net sales in Q1 2019
 - Increases in cost of produce; e.g. vegetables up 19% and beef up 2.8% at start of 2019
- **Some chains steadily raise menu prices, but customers are focused on value**
 - Face competition from lower-priced fast food and fast casual alternatives
- **New technologies such as mobile payments, online ordering, and home delivery are increasingly adopted to offer customers more convenience**
 - Greater focus on takeout and delivery options during the pandemic
- **Significant COVID-induced disruptions during 2020**
 - Growth centered around offering customers more value and creating a differentiated dining experience
 - 100,000+ restaurant closures during COVID, primarily small local restaurants
 - Decreased market saturation but also expected \$240B lost sales this year

Texas Roadhouse Overview

Unique, strong consumer brand in highly competitive industry

- A growing restaurant company operating in the casual dining segment
- Serves American cuisine; known for its hand-cut steaks (account for 44% of the menu), fall-off-the-bone ribs, and fresh-baked bread
- Strong Southern, enjoyable cultures established through interior design (wood-based and cactuses), free peanuts, and dancing waitresses
- **Trademarks:** restaurants average 5,000 guests a week (one of the highest in the industry), serve 300,000 meals a day, the average restaurant seats 291 guests¹
- A dinner-only concept during the week
 - Reduces the real estate costs since do not have to be located in high-traffic business districts
- **Primary Market:** middle class consumers/families with disposable income who seek not only good foods but also entertaining experience in a restaurant
- Cash-positive even during the COVID-19 crisis



Business Segment Breakdown

1. Company restaurants (514)

- a. 484 Texas Roadhouse restaurants and 28 Bubba's 33 restaurants
- b. FY 2019: \$2.7B revenue for restaurant sales
- c. Cost of sales decreased 3 consecutive years from 2017 to 2019 (32.8% to 32.3%) but labor cost increased from 32.6% in 2018 to 33.1% in 2019
- d. Capex concentrated in new company restaurants and refurbishing existing ones (76% of total capex)
- e. Main avenue for growth: planned 20+ restaurant openings (including 7 Bubba's) in 2020

2. Franchise restaurants (97)

- a. 69 domestic, 28 international
- b. FY 2019: \$22M revenue in franchise royalties and fees
 - i. Increased \$1.7M (8.1%) in 2019, driven by sales growth at franchises
 - ii. 5-10% ownership interest in 24 of these franchises; no ownership interest in 6 more
- c. Anticipated up to 8 Texas Roadhouse franchise openings in 2020, mostly international

Porter's 5 Forces Analysis

- **Bargaining Power of Buyers: strong**
 - Customers have virtually no switching cost to eat elsewhere
 - Many options available to customers, especially through mobile order apps like Doordash
- **Bargaining Power of Suppliers: moderately strong**
 - Most of TXRH's meat is supplied by JBS Swift and Smithfield Foods (meat industry is heavily consolidated)
- **Threat of New Entrants: weak**
 - During the pandemic, limited threat from new restaurants opening; more so competition from existing restaurants vying for limited sales
- **Threat of Substitutes: moderate**
 - Casual dining restaurants are most popular for family dining and older generations
 - Potential for fast casual to upstage casual dining among millennials and Gen Z by offering more value and convenience
- **Industry Competition: strong**
 - Many casual dining chains (Olive Garden, Outback Steakhouse, Cheesecake Factory) offering comparable food at comparable prices

SWOT Analysis

Strengths

▪ Honest, Experienced CEO & Managers

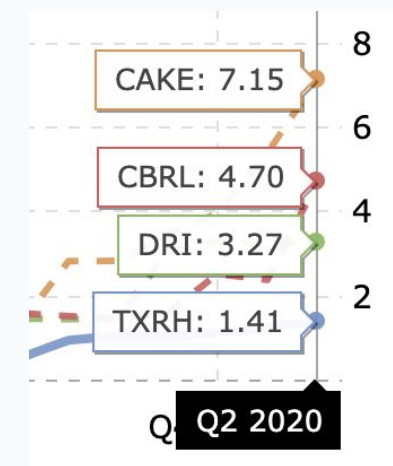
- Kent Taylor, the founder and CEO of TXRH, has more than 30 years of experience in the restaurant industry
- CEO and Board Directors gave up salaries and bonuses to pay workers during COVID-19 outbreak

▪ Stable, Strong Financials

- ROE of 17.2% and ROIC of 16.8% (5-year average); Cash on hand: \$300M+ while less than \$200M long term debt after Q3, 2020¹
 - Debt/Equity ratio of 1.41, which is lower than its competitors²
- Revenue of Q3, 2020, is only down 3.0% compared with that of Q3, 2019³
 - Revenue up more about 50% from Q2 to Q3: strong recovery

▪ Unique, Entertaining Brand

- TXRH isn't just a restaurant—it's a place one can have fun in
- Regular contests of burger eating and hotdog eating that engage customers
- Line dancers (waitresses) serve as a form of entertainment



1. <http://d18rn0p25nwr6d.cloudfront.net/CIK-0001289460/aaac975b-cdbd-4d2a-bfd3-526db80225dc.pdf>

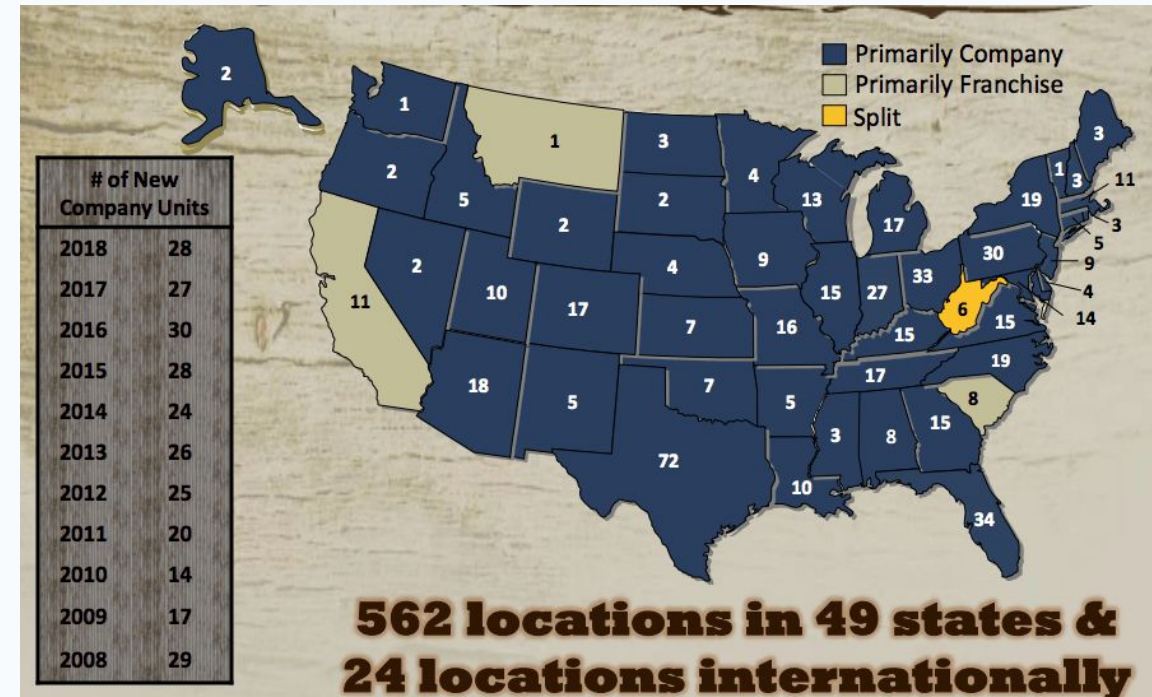
2. <https://www.macrotrends.net/stocks/stock-comparison?s=debt-equity-ratio&axis=single&comp=TXRH:CAKE:DRI:CBRL>

3. <http://d18rn0p25nwr6d.cloudfront.net/CIK-0001289460/a365a0c0-8577-4d26-a557-84ceb79ed39b.pdf>

SWOT Analysis

Weaknesses

- **Relatively High Attrition Rate**
 - Higher attrition rate compared to other organization in the industry
 - Extra expenses incurred in training and developing employees
- **Limited Exposure on Global Market**
 - Only 4% of its restaurants have international exposure
 - Lack of diversification, meaning domestic crisis would be very detrimental
- **Gaps in the Product Range**
 - 44% of the menu depends on steaks
 - Lack of choice may give a new competitor a foothold in the market



SWOT Analysis

Opportunities

- **Large Room to Grow**
 - Currently, its primary products (steaks and ribs) are very limited and can be grown into much more, diverse food products
- **Increasing Exposure on Global Market**
 - Currently only 28 international locations in 10 foreign countries
 - Increasing exposure on global market may provide more diversified, stable income
- **Investment in Adjacent Markets**
 - Stable free cash flows generated by current model
 - Is launching a new channel “Texas Roadhouse Butcher Shop,” an online store offering frozen steaks for delivery in November¹
 - Collaborating with Amazon and a steak supplier
- **New Trends in Consumer Behavior**
 - Focus on engaging with customers through digital platforms (social media, email, app, etc.)



SWOT Analysis

Threats

- **COVID-19 Crisis & Restrictions on Dining**
 - The restaurants' strength, its entertaining, enjoyable experience, restricted due to COVID-19
 - Vulnerable to government regulations on dining
- **Mature, Highly Competitive Industry**
 - Old, mature industry with small room to grow
 - Consumers have lots of options available in the segment (Applebee's, Olive Garden, Outback Steakhouse, Cheesecake Factory, etc.)
- **Increasing Tax Rates & Pay Level**
 - Government's monetary policy on increasing tax rates and minimum wage present serious pressure on profitability
- **Increasing Isolationism**
 - The business model heavily depends on its abilities to provide interactive, community-like experiences



Economic Moat Analysis

Strong Brand, Cost Advantage

- **Strong Brand Name:** uniquely entertaining, enjoyable dining experience through different events
 - More than just dining: line dancers, burgers & hotdogs eating contests
 - Consumers expect—and get—high quality steaks and libs (USDA Choice Sirloin)
- **Cost Advantage**
 - Has a strong base of reliable supplier of raw materials
 - Overcome any supply chain bottlenecks
- **Strong Distribution Network**
 - A reliable distribution network; able to reach majority of its potential markets
 - Hard to establish the distribution network TXRH has in a short period of time even with plenty of capital resources and funds



Investment Thesis

Overview

- **TXRH has a strong brand image and local marketing**
 - Has historically outcompeted other casual dining restaurants
- **TXRH has remained open during the pandemic**
 - Also has improved its takeout and curbside pickup options
- **Strong financials: limited debt and high free cash flows**
 - Despite recent volatility, could be a good long-term holding
 - Fundamentally sound and competitive franchise with high growth potential after the pandemic



Investment Thesis

TXRH has strong, community-based marketing.

- TXRH relies on **local and regional marketing**, especially since it is not a large national brand
 - Example: murals for each restaurant are custom and centered around the local community
- Engages customers through **digital marketing tools**
 - Launched a **customer loyalty app** in 2017: lets customers get on the waitlist, earn rewards, and receive exclusive perks
 - Also pushes **gift card sales** (e.g. recent promotion of \$5 bonus per \$30 e-gift card)
 - Very active Twitter (100K) and Facebook (2.6M) accounts



Investment Thesis

TXRH is competitively positioned in the casual dining industry.

- During Q1 2019, TXRH **raised menu prices 1.5%**² but still led **same-store growth** in the casual dining industry (5.2%), with a **2.6% increase in traffic**²
- During the pandemic, members of C suite have forgone salaries
 - **No employee layoffs!**
- Locations in 49 states but primarily concentrated in the South
 - As of October 2020, **188 (33%) of its restaurants operating at full capacity**, 111 at 75% capacity³
 - **To-go made up 23% of sales** during 3 months ended Sep 2020³
- Strong reputation: Harris Poll's **2019 Brand of the Year** (based on sample of 45K+ US consumers), ahead of Olive Garden and Cheesecake Factory⁴



(1) <https://www.restaurantbusinessonline.com/operations/texas-roadhouse-bump-menu-prices-another-15>

(2) <https://www.fsrmagazine.com/chain-restaurants/texas-roadhouse-and-rising-labor-costs-square>

(3) <https://www.restaurantbusinessonline.com/financing/texas-roadhouse-leans-premise-same-store-sales-turn-positive> 14

(4) <https://www.fsrmagazine.com/slideshows/texas-roadhouse-americas-brand-year>

Investment Thesis

TXRH has high growth potential post-COVID.

- Unlike competitors like Cracker Barrel and Cheesecake Factory, Texas Roadhouse has maintained **positive net income** over LTM
 - **Low Debt/EBITDA** relative to restaurant brands (Darden, Yum!), restaurant chains (Cheesecake Factory), and fast-food chains (Wendy's)
- As of Feb 2020, TXRH had **40 consecutive quarters of sales growth**¹
- Same-store sales has recovered from -13% in July to **0.8% in Oct** as compared to same month in 2019²
- Though historical returns are not future returns, worth noting its **400% return from 2010 to 2020**³
- Expects at least **20 openings in 2020**



(1)<https://www.fool.com/investing/2020/02/20/texas-roadhouse-sees-strong-growth-in-q4.aspx>

(2)<https://www.restaurantbusinessonline.com/financing/texas-roadhouse-leans-premise-same-store-sales-turn-positive>

(3) <https://www.fool.com/investing/2020/05/08/texas-roadhouse-foot-traffic-growth-earnings-q1.aspx>

Analysis of Financials

Moat: Compound Growth Rate	10 Years	7 Years	5 Years	3 Years	1 Year
BVPS+Dividend Growth Rate	12.4%	13.4%	14.3%	13.7%	5.3%
EPS Growth	13.9%	13.7%	14.9%	14.7%	10.3%
OCPS Growth	12.5%	14.4%	14.3%	13.3%	6.1%
Sales Growth	11.3%	11.8%	11.7%	11.5%	12.2%

- Overall, very stable, **10%+ growth rate** over the last **10 years** in major financial data¹
 - Temporarily slowed down significantly due to COVID
 - Long-term, expected to recover as things get back to normalcy
- As mentioned earlier, expects at least **20 openings in 2020**
 - Result in **accelerating revenue growth**
- Key points from **2020 Q3 Earnings Call: Strong Recovery & Fast Adaptation**²
 - “Our sales momentum continued in **October** with a return to a **positive comp of 0.8%**”
 - “We were **pleased** to see **To-Go average weekly sales** stay **fairly consistent** throughout the quarter, averaging approximately **21,000** per restaurant.”

Comps Analysis

Company	Price	Shares (millions)	Market Cap	EV	EBIT	EBITDA	EV/Revenue	EV/EBIT	EV/EBITDA	Debt/EBITDA	P/E
Darden Restaurants (DRI)	102.12	130.2	13296.0	18391.5	188	519.6	2.6x	97.8	19.7x	6.2x	NM
Cheesecake Factory (CAKE)	31.06	45.6	1415.8	3123.4	60.2	31.5	1.5x	51.9x	99.2x	7.8x	NM
Cracker Barrel (CBRL)	119.94	23.7	2842.6	4057.7	61.4	179.6	1.6x	66.1x	22.6x	9.2x	NM
Denny's (DENN)	9.08	63.8	579.3	1039.7	33.5	50.0	3.2x	31.0x	20.8x	9.5x	51.7x
Texas Roadhouse (TXRH)	72.11	69.4	5004.4	5448.9	56.4	174.8	2.2x	96.6x	31.2x	4.3x	92.0x
Mean	66.9	66.5	4627.6	6412.2	79.9	191.1	2.3	72.9x	24.9x	7.7x	71.9x
Median	72.11	63.8	2842.6	4057.7	60.2	174.8	2.2	81.3x	22.6x	9.2x	71.9x
Standard Deviation	46.7	39.8	5127.7	6885.8	61.5	196.0	0.8	31.5x	5.5x	2.9x	28.5x

- Comparable Companies: 1 multi-brand restaurant operator & 3 individual casual-dining restaurants, all with strong brand name and unique products
- Strength of TXRH:
 - **Low Debt/EBITDA (4.3x)**: low debt in the current situation, where COVID may present serious restrictions on earnings capabilities, having low debt is crucial for the restaurant industry
 - **Positive Net Income (P/E: 92.0x)**: as evident with its positive P/E ratio, Texas Roadhouse has proven its abilities to generate income even through very challenging times
- Weaknesses of TXRH:
 - **High EV/EBIT & High EV/EBITDA**: relatively higher than the other companies in the industry; historically much lower

Comps Valuation

Implied Pricing	Bear Case	Base Case	Bull Case
EV/Revenue	1.5x	2.2x	3.0x
Revenue	2485.4	2485.4	2485.4
Implied EV	3728.1	5467.9	7456
Cash	328.6	328.6	328.6
Debt	757.5	757.5	757.5
Preferred and Other	15.6	15.6	15.6
Market Cap	4829.8	6569.6	8558
Diluted Shares	69.4	69.4	69.4
Implied Price	\$69.59	\$94.66	\$123.31
ROI	-3.49%	31.28%	71.01%

- Great return on investment: 31.28% in base case; only -3.49% possible loss in bear case
- Multiples Used:
 - Bear Case → 1.5x (about one standard deviation lower than the industry mean)
 - Base Case → 2.2x (industry median)
 - Bull Case → 3.0x (about one standard deviation higher than the industry mean)
- Valuation very sensitive to slight changes in matrix
- Although temporarily halted to improve the company's cash position, Texas Roadhouse usually pays dividends (around 2% of annual yield)

Catalysts and Risks

Risks

1. Rising labor costs
2. Prolonged pandemic conditions that inhibit capacity and traffic
3. Competition from fast-food chains, quick-service restaurants, and other casual dining restaurants

Catalysts

1. Positioned to open new restaurant and franchise locations during the pandemic
 - a. Relatively low debt
2. Other expansion opportunities, e.g. providing high-quality (uncooked) steaks
3. Current focus on improving digital experience through its app, email marketing, and promotions

Recommendation: Target Price \$94.66

Thesis Summary

- Texas Roadhouse has experienced excellent growth historically
- Strong, community-oriented brand image coupled with high value for its food
- Though casual dining has struggled in 2020, COVID impact on TXRH may be overstated

Investment Support

- TXRH leads competitors in low debt and strong cash flows
- Very consistent growth over the past 10 years; strong management
- Same-store sales have exceeded sales from a year ago
- Remains cash positive and plans to keep expanding