Darden Restaurants Inc. (DRI)

Updated April 29th, 2019 by Ignatius Quek

Key Metrics

Current Price:	$122	**5 Year CAGR Estimate:**	7.5%	**Volatility Percentile:**	67.2%
Fair Value Price:	$93	**5 Year Growth Estimate:**	10.3%	**Momentum Percentile:**	85.2%
% Fair Value:	131%	**5 Year Valuation Multiple Estimate:**	-5.3%	**Growth Percentile:**	95.1%
Dividend Yield:	2.5%	**5 Year Price Target**	$151	**Valuation Percentile:**	19.8%
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Total Return Percentile:**	49.2%

Overview & Current Events

Darden Restaurants Inc. is a restaurant company with a portfolio of brands including Olive Garden, LongHorn Steakhouse, Cheddar's Scratch Kitchen, Yard House, The Capital Grille, Seasons 52, Bahama Breeze, and Eddie V's. The company employs 165,000 team members and as of fiscal year ending May 27, 2018 it owned and operated 1,746 restaurants in the United States and Canada and 71 franchisee operated restaurants. Darden Restaurants Inc. has a market capitalization of $14.4 billion and a 10-year dividend growth CAGR of 15.4%.

On April 2, 2019 Darden Restaurants Inc. reported third quarter results for the period ending February 24, 2019. Reported sales for the quarter was $2.2 billion which was a 5.5% growth over the third quarter of fiscal year 2018. Net earnings were $223.6 million, 2.7% higher than third quarter of fiscal year 2018. For the nine-month period ending February 24, 2019 sales were $6.3 billion which was 5.6% growth over the same period last year. Net earnings were $505.4 million and diluted earnings per share was $4.02 (20.4% higher than the last year). This improvement to net earnings was significantly due to a reduction in federal corporate tax rate from 29.4% to 21.0%, resulting in a $0.37 improvement in diluted earnings per share. Management has provided dilute net earnings per share guidance between $5.76 and $5.80 for fiscal year 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.65	$2.84	$3.39	$3.57	$3.13	$2.15	$5.47	$2.90	$3.80	$4.73	***$5.79***	***$9.47***
DPS	$0.80	$1.00	$1.28	$1.72	$2.00	$2.20	$2.20	$2.10	$2.24	$2.52	***$3.00***	***$4.26***
Shares	140.4	142.4	140.3	133.2	131.6	133.2	129.7	129.3	126.0	126.0	***125.0***	***120.9***

Darden Restaurants, Inc. had demonstrated increased operating margins for the past 5 years. 2014 operating margin was 4.9% and this increased to 9.5% at the end of fiscal year 2018. This performance was attributable to revenue growth outpacing the growth in selling, general and administrative expenses. As a percentage of sales, selling, general and administrative expenses was 10.6% of revenue in 2014, steadily declining to 8.1% in 2018. For the nine months ending February 24, 2019 operating margin maintained at 9.6% and selling, general and administrative expenses was 7.8% of revenue. Net income margin in 2018 improved due to a reduction in federal corporate income tax rate from 35.0% to 21.0% effective January 1, 2018. On June 20, 2018, Darden Restaurants Inc. announced a $500 million share repurchase program. As at February 24, 2019 the aggregate value of shares repurchased was $74 million.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	9.8	11.6	12.0	12.1	14.4	20.9	9.1	21.4	18.7	18.6	***21.0***	***16.0***
Avg. Yld.	3.1%	3.0%	3.1%	4.0%	4.4%	4.9%	4.4%	3.4%	3.1%	2.9%	***2.5%***	***2.8%***

Darden Restaurants Inc. is estimated to grow earnings 12.95% over the next 5 years. In the past 5 years, revenue grew at 5.1% CAGR and operating profit grew 19.9% CAGR. The core businesses of Olive Garden and LongHorn Steakhouse grew in sales and segment profits as well in the nine months ending February 24, 2019. The company would likely benefit from this core business profit growth and the full benefit of reduced corporate tax rate in fiscal year 2019. However,

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Darden Restaurants Inc. had traded at a historical P/E of 16.0x in the past 10 years and we expect growth to taper from 19.9% to 10.0% over the next 5 years. As such we determine the fair value of Darden Restaurants Inc. to be $93, 24% lower than current price of $122.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2024**
Payout	30.2%	35.2%	37.7%	48.2%	63.9%	102.4%	40.2%	72.4%	58.9%	53.3%	***51.9%***	***45.0%***

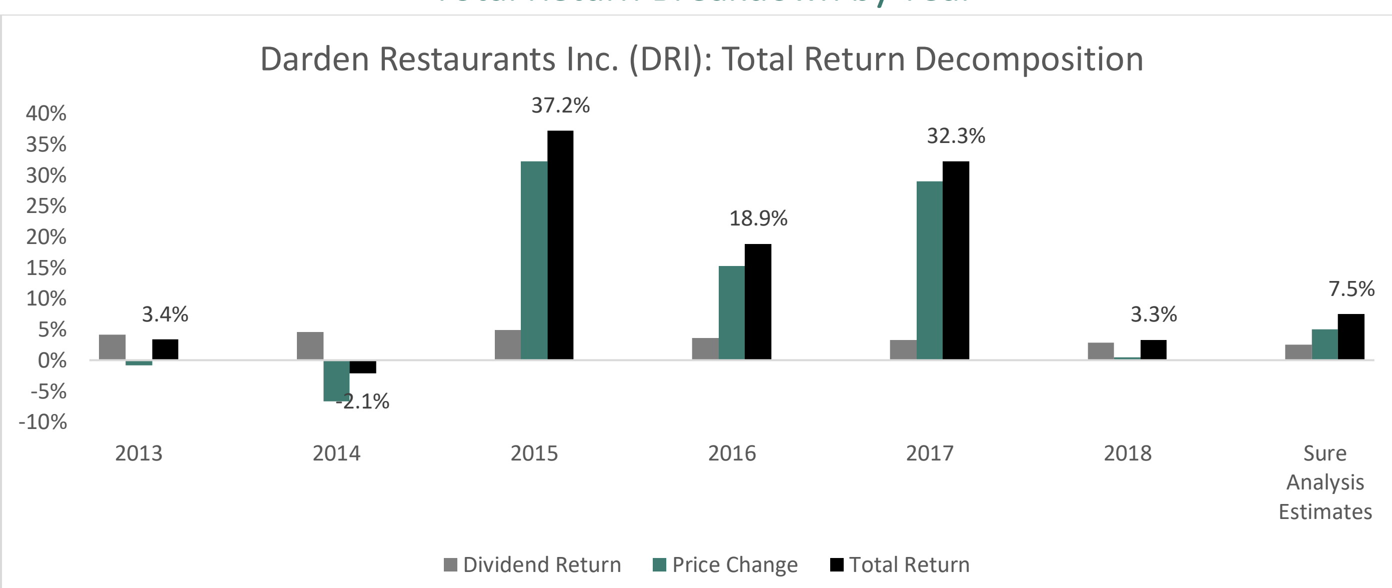
Darden Restaurants Inc. generates stable free cash flow and has demonstrated a record of being able to manage costs while improving sales. This evidence of management efficiency has resulted in 27.2% return on equity in 2018. Its debt level is 1.5x free cash flow and the debt/equity ratio of 1.5 suggests a sustainable debt position. For 2024, due to expectations of lower growth, the payout ratio is lowered to 45% of earnings as management may have use of cash for strategic acquisitions. Darden Restaurants Inc. had also managed to maintain profitability and dividends during the financial crisis. In 2009 dividend yield was 3.1% ($0.80 per share) while earnings per share was $2.65. In addition, based on nine months ending February 24, 2019 segment results, fine dining sales represented 7.2% of total sales and 8.1% of profit. Hence while the business is exposed to consumption and economic cycles, Darden Restaurants Inc. should be able to manage well enough through a crisis.

Final Thoughts & Recommendation

Darden Restuarants Inc. is a well-managed company which has introduced successful marketing and value driven promotional campaigns to customers through a digital transformation strategy relying on data analytics and leveraging its network of 1,746 stores. However, Darden Restaurants Inc. is trading near 5-year highs at $122 and the fair value estimate for this company is $93, representing a 31% premium.

We recommend a hold rating on Darden Restaurant Inc. based on the 5 year price target of $151, the 5 year total returns CAGR is 7.5% attributed to a dividend yield of 2.5%, EPS growth of 10.3% and PE multiple compression of -5.3% to reflect the slower growth expected.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	7,218	4,627	4,980	5,327	5,921	6,286	6,764	6,934	7,170	8,080
Gross Profit	1,581	1,077	1,194	1,239	1,304	1,295	1,423	1,541	1,569	1,745
Gross Margin	21.9%	23.3%	24.0%	23.3%	22.0%	20.6%	21.0%	22.2%	21.9%	21.6%
SG&A Exp.	678	480	539	540	625	665	674	623	627	652
D&A Exp.	283	206	219	241	278	304	319	290	273	313
Operating Profit	372	275	341.1	355	274	309	368	622	678	767
Op. Margin	5.2%	5.9%	6.8%	6.7%	4.6%	4.9%	5.4%	9.0%	9.4%	9.5%
Net Profit	372	405	476	476	412	286	710	375	479	596
Net Margin	5.2%	8.7%	9.6%	8.9%	7.0%	4.6%	10.5%	5.4%	6.7%	7.4%
Free Cash Flow	248	224	194	56	84	141	578	592	623	624
Income Tax	141	52	71	76	37	(9)	(21)	90	155	2

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	5,057	5,276	5,467	5,944	6,937	7,101	5,995	4,583	5,292	5,470
Cash & Equivalents	63	249	71	71	88	98	536	275	233	147
Acc. Receivable	37	53	65	71	85	84	78	64	76	84
Inventories	247	221	300	404	357	197	164	175	179	205
Goodwill & Int.	973	971	971	1,004	1,482	1,447	1,447	1,447	2,152	2,135
Total Liabilities	3,451	3,382	3,530	4,102	4,877	4,944	3,661	2,631	3,191	3,275
Accounts Payable	237	246	251	261	297	233	199	242	250	277
Long-Term Debt	1,632	1,409	1,407	1,454	2,496	2,481	1,452	440	937	927
Total Equity	1,606	1,894	1,936	1,842	2,060	2,157	2,334	1,952	2,102	2,195
D/E Ratio	2.15	1.79	1.82	2.23	2.37	2.29	1.57	1.35	1.52	1.49

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.4%	7.7%	8.7%	8.0%	5.9%	4.0%	11.8%	8.2%	9.1%	10.9%
Return on Equity	23.2%	21.4%	24.6%	25.8%	20.0%	13.3%	30.4%	19.2%	22.8%	27.2%
ROIC	11.5%	12.2%	14.2%	14.4%	9.0%	6.2%	18.7%	15.7%	15.8%	19.1%
Shares Out.	140	142	140	133	132	133	130	129	126	126
Revenue/Share ($)	51.41	32.49	35.50	39.99	44.99	47.19	52.15	53.62	56.91	64.13
FCF/Share ($)	1.77	1.57	1.38	0.42	0.64	1.06	4.45	4.58	4.95	4.95

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise. 2018 refers to fiscal year period ending May 27, 2018.