

RealMoney Investment & Trading Ideas



Mixed Reviews for Restaurant Week

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Well, Restaurant Week is drawing to a close. While the techs have gotten all of the headlines the past five days, there was plenty to report in the casual-dining and quick-service restaurant sectors. Personally, it was tough listening to all of these calls when I have had to follow the rules of Passover this entire week.

With all of the reports this week, we got a very clear indication of the operating environment and trends in the sector. Here is what is worth taking away when looking for investments in this area:

1. Commodity cost pressures are being felt by companies across the entire sector. Those with the ability to better manage their food costs are weathering this issue much better than those that can't. Cody Willard and I dubbed this chickenomics, or the chickonomy.
2. With some rare exceptions, you want to stay out of the purely domestic plays. U.S. sales growth was flat to down for most companies. If you want a U.S. play, stick to an early-stage growth company, like **Red Robin Gourmet** (RRGB), **Buffalo Wild Wings** (BWLD) or **Chipotle Mexican Grill** (CMG), which attract diners, especially the college and post-college-aged crowds. These companies are small enough to have huge growth potential mask any short-term economic issues. I think that BWLD offers the best growth/value opportunity.
3. The American casual-dining concept is slowly being exported around the world. China is clearly the fastest growing market, where **McDonald's** (MCD) and **Yum Brands** (YUM) have a huge leg up on the competition. This is not counting out The Middle East, Latin America and Europe, where our taste for food is slowly being acquired as well. The real international sleeper stock could be **Brinker** (EAT). A major hurdle for EAT will be the sale of its Macaroni Grill division. Once that occurs, the stock may be in store for some good growth.
4. Look for companies that are refranchising their stores. This is the process by which the parent company sells its own restaurants to franchisees. The parent receives an upfront payment and future royalty fees. There should be a resultant decline in revenue to reflect the swap of restaurant sales for franchise fees at those refranchised units. The cash received is then being turned around and paid back to shareholders or used to pay down debt if any exists. MCD and YUM have been quite successful in that effort.

Another Point of View

Oppenheimer's new restaurant analyst, Matt DiFrisco, unveiled his new coverage on the sector earlier this week. It is worth reading. I believe that he only rolled out half of his coverage and might have more to opine on next month. His top choices were:

- **Darden** (DRI)
- **Starbucks** (SBUX)
- **Burger King** (BKC)
- **Texas Roadhouse** (TXRH)

- **Red Robin**
- **Einstein Noah Bagels (BAGL)**

I concur with his call on RRGB for the reasons I mentioned above. However, I have to disagree with him on SBUX. I would not touch that one until it gets close to \$10-\$12. SBUX is in disarray, and it will take a few quarters if not years to turn this company around. SBUX will never again enjoy its super premium multiple that it once coveted. Clearly, I covered my SBUX short way too early but a profit is a profit is a profit.

Overall, this group has been beaten down so much that some opportunities for trades or long-term investments are now appearing. I think that the China play for MCD and YUM can last another decade or more. As tax rebates begin to flow through to consumers, we might get a short-term bump in restaurant spending, which would improve revenues, EPS and same-store sales in the second quarter. Let's also remember that the Easter holiday was shifted from April to March this year, thus hurting first-quarter results and will benefit second-quarter results on a comparative basis.

Lastly, **Wendy's (WEN)** finally made a deal to be taken over by **Triarc (TRY)** after a protracted effort by the company's management to sell the company. Clearly there is a right price for restaurant stocks out there, even if it is damaged goods, such as WEN. Maybe even **Ruby Tuesday (RT)** will have a savior.

First Quarter Awards

Best Managed: McDonald's (with YUM a close second).

Worst Managed: Ruby Tuesday. This company's management is totally clueless, no matter what the business and economic environment may be.

Broken Company: Starbucks. Bringing back Howard Schultz is not going to pull SBUX out of its tailspin, just as Michael Dell could not do the same for **Dell (DELL)**.

Biggest Disappointment: **Ruth's Chris (RUTH)**. This company has so much promise that remains undelivered. The company's Chairman, CEO and President, Craig Miller, announced Thursday his departure from RUTH. C'est la vie.

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At the time of publication, Rothbort was long McDonald's and Buffalo Wild Wings, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

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