WESTPEAK RESEARCH ASSOCIATION

# BJ's Restaurants, Inc. (NASDAQ:BJRI)

**Restaurants – Casual Dining**

## "Brewing Value"

*Mar 2, 2018*

*BJ's Restaurants Inc. (BJ's) is a U.S. based company that owns and operates domestic full service, casual dining restaurants. BJ's signature concept offers specialty pizza, desserts, and self-brewed craft beers.*

### Thesis – Consumers Driving Growth and M&A Opportunity

We believe the market has improved its opinion of BJ's after poor earnings in 2017 partly influenced by natural disasters. The company showed strong earnings in the last quarter of 2017 while heading into 2018 with encouraging sales trends and consumer traffic. While there are still growth obstacles in the highly competitive restaurants industry, the company can differentiate itself from market competitors with its brewhouse operations. As the company matures, it will reap the benefits of its aggressive expansion activities in the past and reward shareholders with the recently announced dividend policy. We believe that revenue will continue to grow driven by maturing restaurant locations, improving operational efficiencies, and increasing consumer discretionary income. Coupled with the increased M&A activity in the restaurants industry, we believe BJ's has strong prospects for long term growth.

### Drivers – Craft Beer and Quality Food

In a highly competitive industry, BJ's success will depend heavily on its ability to differentiate itself. We believe BJ's brewery concept, along with providing superior quality food, will help the company attract and retain a loyal customer following.

### Valuation and Recommendation

We believe BJ's current price is undervalued in the market. Our 12-month target price of $52.00 represent an 17% upside and is based on a weighted DCF with a WACC of 7.4% (50%) and comparable companies analysis (50%). We are initiating a **Buy** rating for this stock as BJ's has a fundamentally strong business model that can provide consistent positive cash flows for investors. We recommend BJ's to investors with medium risk tolerance looking for long-term growth.

**Analyst:** Franklin Wang, BCom '20
contact@westpeakresearch.com

| Equity Research | US |
|---|---|
| **Price Target** | **USD$ 52.00** |
| **Rating** | Buy |
| **Share Price (Mar. 2nd Close)** | USD$ 44.40 |
| **Total Return** | 17% |

| Key Statistics | |
|---|---|
| **52 Week H/L** | $47.38/$27.90 |
| **Market Capitalization** | $900M |
| **Average Daily Trading Volume** | 0.36M |
| **Net Debt** | $139M |
| **Enterprise Value** | $1.06B |
| **Net Debt/EBITDA** | 1.3x |
| **Diluted Shares Outstanding** | $20.6M |
| **Free Float** | 98% |
| **Dividend Yield** | 1.12% |

**WestPeak's Forecast**

| | 2018E | 2019E | 2020E |
|---|---|---|---|
| **Revenue** | $1.09B | $1.14B | $1.20B |
| **EBITDA** | $118M | $124M | $130M |
| **Net Income** | $41.5M | $47.1M | $52.7M |
| **EPS** | $1.91 | $2.16 | $2.42 |
| **P/E** | 22.7x | 20.1x | 18.0x |
| **EV/EBITDA** | 8.9x | 8.5x | 8.1x |

**1-Year Price Performance**

# Business Overview/Fundamentals

## Business Summary

BJ's Restaurants Inc. (BJ's) is a U.S. based company that owns and operates domestic full service, casual dining restaurants. The first BJ's restaurant opened in 1978 and now operates 197 restaurants across 25 states. The states with the highest concentration of BJ's restaurants are California, Texas, Florida, and Ohio, totaling 129 locations. BJ's signature dishes include deep-dish pizza, a variety of entrées, and specialty desserts. BJ's also prominently features proprietary craft beers which differentiates them from its mass market competitors.

Competing in the casual dining segment of the restaurant industry, BJ's aims to attract customers through its higher quality ingredients and more contemporary/approachable "casual plus" experience. The "casual plus" concept targets average customer checks between $12.00 to $18.00. BJ's estimates that the average per-customer check in 2017, including beverages, was approximately $15.75.

## The Menu

BJ's signature menu offering is its deep-dish pizza with sales representing approximately 13% of total restaurant-sales. In addition to pizza, BJ's broad menu includes appetizers, specialty salads, soups, pastas, sandwiches, entrées, and desserts. BJ's also offers alternative small plate appetizers and lower calorie entrées containing approximately half the calorie of a regular entrée. This allows BJ's to capture portions of health focused consumers prevalent in younger and wealthier demographics.

*Source: Company Website*

The beverages menu consists of the company's own craft beer brand along with as many as 30 popular domestic and imported beers on tap. A popular selection of wines and spirits can also be found on the beverages menu. BJ's house beers accounted for approximately 7% of total restaurant sales, while other alcoholic beverages accounted for 13%. Approximately 46% of the proprietary craft beer is produced by BJ's internal brewing operations with the remaining 54% produced by other independent third-party brewers using BJ's proprietary recipes.

Pizza and alcoholic beverages combined account for more than 30% of sales revenue, maintaining a gross margin above 80%. Menu options are evaluated three times a year to adapt to changing consumer tastes and trends.

## Restaurant Operations

Each restaurant typically employs approximately 110 hourly employees (down from 150 through streamlining labour scheduling process), many are paid minimum wage and work part time. All new hourly employees undergo formal training from certified employee instructors at each restaurant. As newly opened restaurants mature, hiring and training costs decrease as efficiency increases. To promote employee retention, experienced restaurant manager level employees with good standing are eligible to be selected to participate in equity-based awards.

Typical restaurant hours are from 11:00 a.m. to 12:00 a.m. Sunday through Thursday and 11:00 a.m. to 1:00 a.m. Friday and Saturday. Restaurants are open every day of the year except Thanksgiving and Christmas. Most restaurants offer in-house and third-party delivery services. BJ's also have developed a mobile application to facilitate ordering take-out, delivery, and reservations. Off-premise sales grew 1.4% last year to 7% of sales with the help of the app and third-party integration. However, off-premise sales may result in lower check prices and more overhead costs especially if third party delivery companies are used.

## Site Selection and Expansion

Site selection for new restaurant openings favor high-profile locations in mature trade areas with dense population. BJ's generally targets geographic regions that allow the capacity of multiple restaurants in a local area. This "clustering" approach reduces supply and distribution costs, as well as improves marketing efficiency and brand awareness.


*Source: Company Presentation*

Geographically, new restaurant expansions are selected in major cities along main interstates creating a continuity of brand extension. The company opened ~15 new locations annually between 2014 to 2017, but only ~5 new restaurants are expected to be open in 2018. This slowdown in expansion is due to a challenging competitive environment, increasing construction costs, and tightening labour market conditions. Management thinks that the slower pace of expansion will create continued growth as expansion costs decrease and newly opened locations become more efficient. We believe this is a constructive strategy considering the capital cost and debt the company has accumulated in the past with its aggressive expansionary activities. The slowdown will allow the company to refocus its efforts in growing same store sales and brand awareness. BJ's management is still committed to the long-term growth of its concepts towards their estimated domestic capacity of 425 locations.

## Marketing

BJ's spends between 2-3% of revenue on marketing. Management has been slowly increasing marketing expenditures to improve brand awareness in the sluggish retail sales environment. While management values investing in high quality food and services, they do recognize the importance of marketing to create an edge among competitors. Estimated unaided awareness for BJ's brand in 2016 is only at 7%, which is lower than the industry average of 25%. A portion of the marketing fund is dedicated to the maintenance of BJ's loyalty program which awards repeat customers with points towards free meals. BJ's advertising campaign is focused on limited TV ads, paper, radio, digital, and social media platforms.

## Dividend and Share Repurchase Policy

The slowdown of BJ's expansion process has induced the company to create a dividend policy for shareholders. BJ's issued its first ever dividend of $0.11 in Q3 of 2017. This is expected to be a recurring quarterly dividend. This signals that the company is entering a more mature phase of its growth. We expect a long running dividend to reward shareholders who are looking for long term returns from the company. Management believes that this dividend will also complement BJ's ongoing share repurchase program. Since its approval in 2014, BJ's has repurchased and retired approximately 9.1 million shares of BJ's common stock for $348 million. This reduced total common shares outstanding by 30%. By the end of Q4 2017, BJ's had $42.5 million remaining under the authorized share repurchase program, equivalent to ~one million shares.

## Tax Cut and Jobs Act

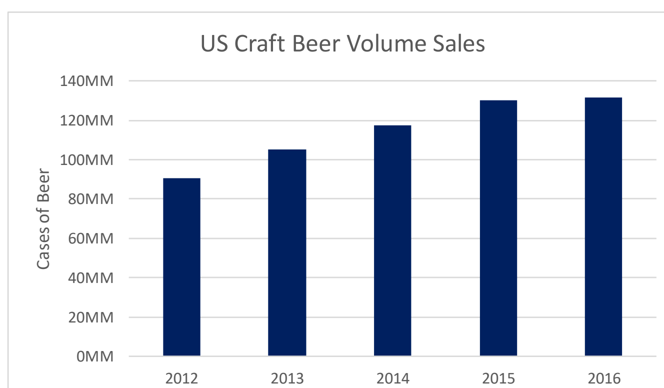
Along with the sweeping tax cut to corporate income tax, BJ's should benefit from this bill in several areas. As the company heads into a more mature phase of operations, this tax break will help freeing up more cash flow toward capital investment and creating shareholder value. In the short term, the bill is expected to reduce taxes on average for all income groups and boost GDP growth. This increase in disposable income will translate into higher traffic and revenue growth for BJ's. Another benefit is tax reduction for alcohol manufacturers. BJ's will benefit from lower alcohol purchasing prices as well as tax reduction in brewing operations. The tax act's overall effect should boost revenue and reduce cost for the company.

# Competitive Advantage

## Brewhouse Operations

*Source: Company Website*

BJ's proprietary craft beers with over 150 awards combined is the most important differentiating factor between BJ's and many of its mass market competitors. While total beer consumption was flat, craft beer consumption increased 45% over the last five years (*Nielson*). In contrast, self-brewed craft beers are typically not offered at similar mass market chain restaurants. Through in-house breweries, which are used to research and test different types of beers, BJ's can offer a large variety of craft beer selections to its customers, including seasonal offerings. The company is constantly testing and innovating new beers at its R&D brewery. Through research and innovation, BJ's is able to follow consumer taste changes and trends closely, modifying their recipes if necessary. In 2013, food consulting firm Technomic found that craft beer selection alone is enough to draw 49% of consumers to a restaurant.



*Source: Nielson*

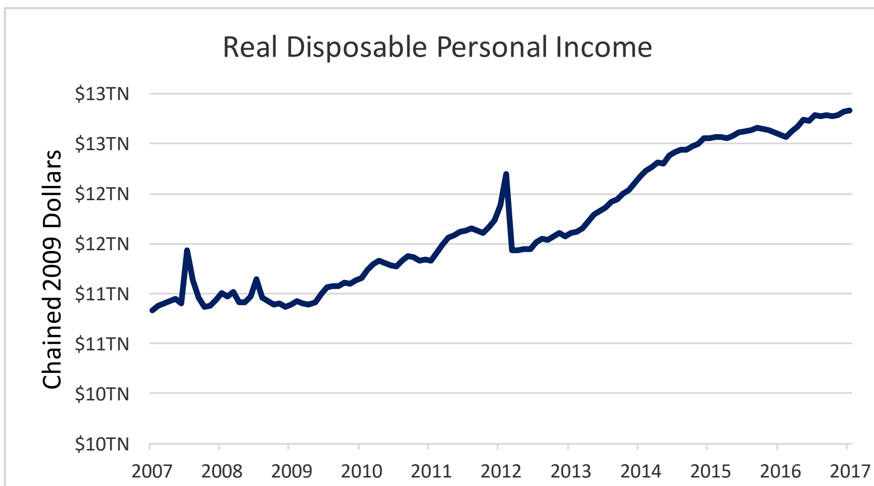
### Economies of Scale

The restaurant concept with microbrewery attachment is largely reserved by independent operations in the US. A majority of self-brewing operations belongs to private local establishments. BJ's focus on capital expenditures has allowed them to build multiple brewing hubs as well as micro-breweries on site. Compared to its private competitors, BJ's can establish supply routes and delivery operations for its craft beers with lower cost and higher efficiency. The concentrated brewing hubs lower the cost of acquisition and production for BJ's. The same routes can also be used to distribute other essential supplies such as produces and meats. The scale at which BJ's operates allows them to have more competitive pricing than its local private competitors, while still offering high quality ingredients and craft beers.

## Industry Analysis

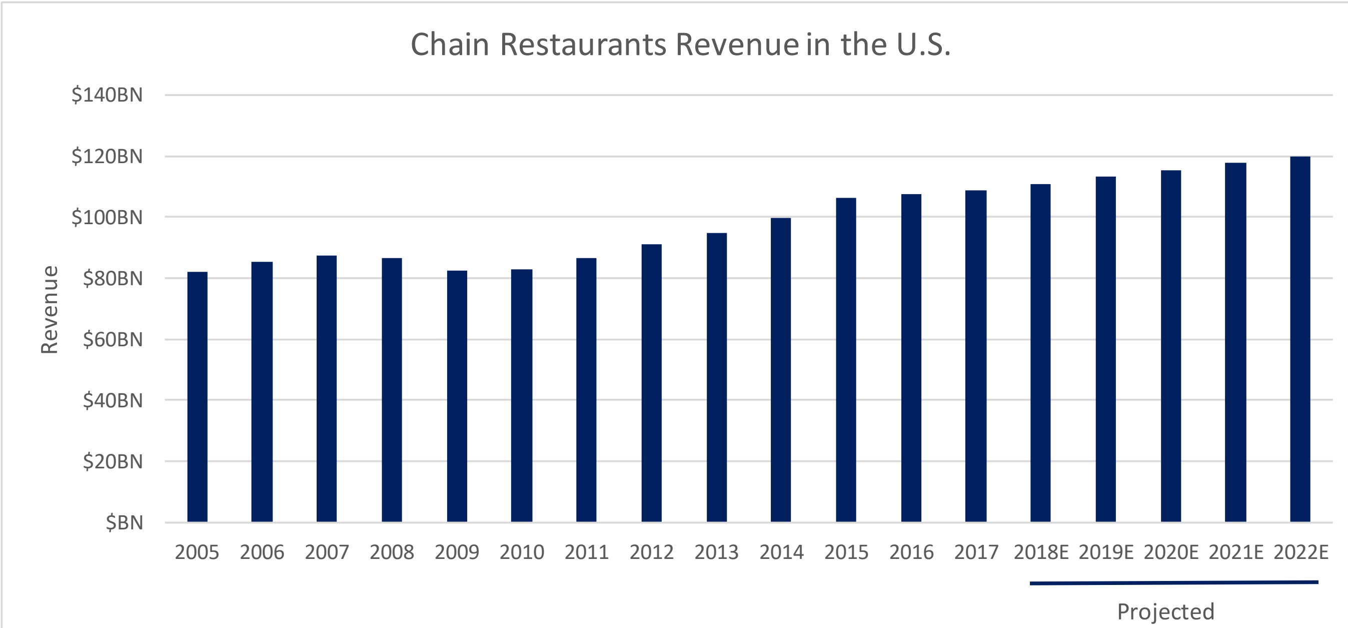
### The Casual Dining Industry

The casual dining industry has experienced steady growth over the last five years. Revenue has increased at a CAGR of 3.6% from $91.2 billion to $108.8 billion since 2012 (*IBISworld*). As per capita disposable income increased and unemployment declined, consumer confidence drove a rise in demand for sit down and takeout meals. The industry is projected to grow in line with GDP at an annualized rate of 2.0% over the next five years (to $120 billion). As disposable income continues to trend upwards, consumers are expected to increase their spending at restaurants. In 2016, annual spending on food at restaurants exceeded spending on groceries for the first time (according to the United States Department of Agriculture). This shift is primarily due to longer working hours and cultural changeva toward urban markets and higher disposable income.




*Source: U.S. Bureau of Economic Analysis*

However, the competition among casual dining restaurants and other food services operators are fierce. Fast casual and fast food companies still appeal to many consumers that are on a smaller monetary or time budget. Increased selections for consumers has resulted in highly competitive pricing within the industry which reduce margins. Industry employment also increased along with revenue as restaurants have to hire more employees to meet demand. This is another advantage for fast-casual restaurants where labour costs can be easier streamlined or replaced with automation. Newer technology such as third-party deliveries drive higher traffic but at the same time reduce average customer check.




*Source: IBISWorld*

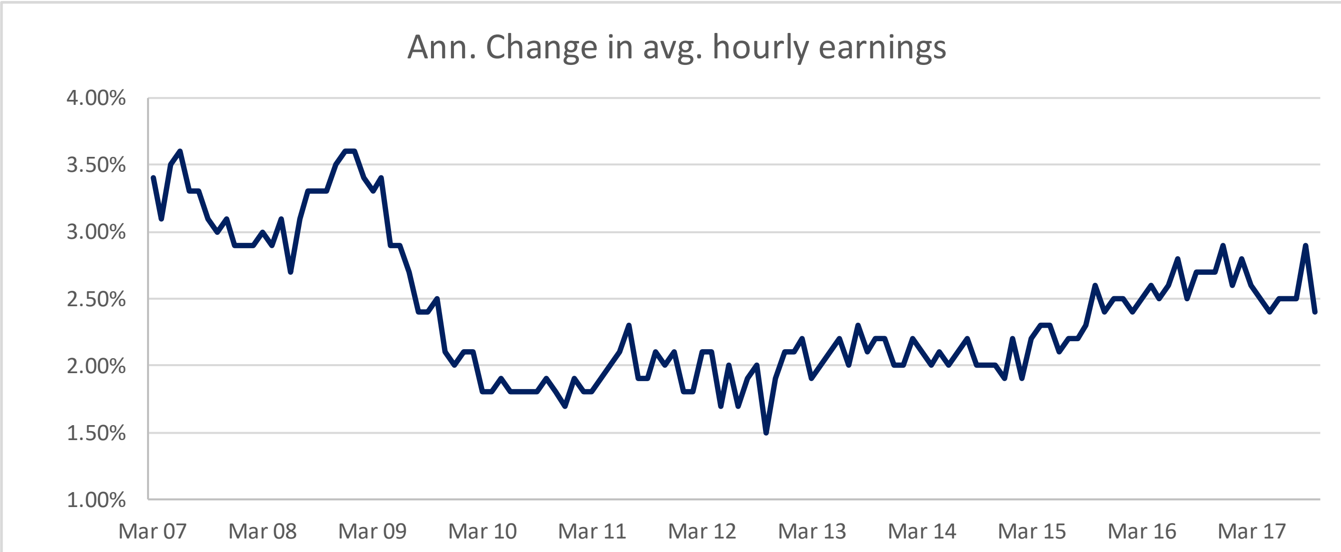
## Industry Concentration and Cost Structure

The industry concentration is low composed of an vast array of restaurant operators and concepts. Recent years have seen firms offload struggling brands to private equity firms, further reducing concentration in the industry. Franchising activity also increased, further adding to the industry's fragmentation.

Two thirds of the industry's cost are in its wages and purchases of input. The remaining costs are made up of rent, utilities, depreciations, and other expenses. The industry profit is estimated equivalent to 4.9% of revenue in 2017, an increase over the past five years. As revenues increases due to higher consumer disposable income, total profits are rising as well. To further Increase margin expansion, many firms have started to implement cost cutting measures such as reduce labour reliance with newer technology.

## Labour Outlook

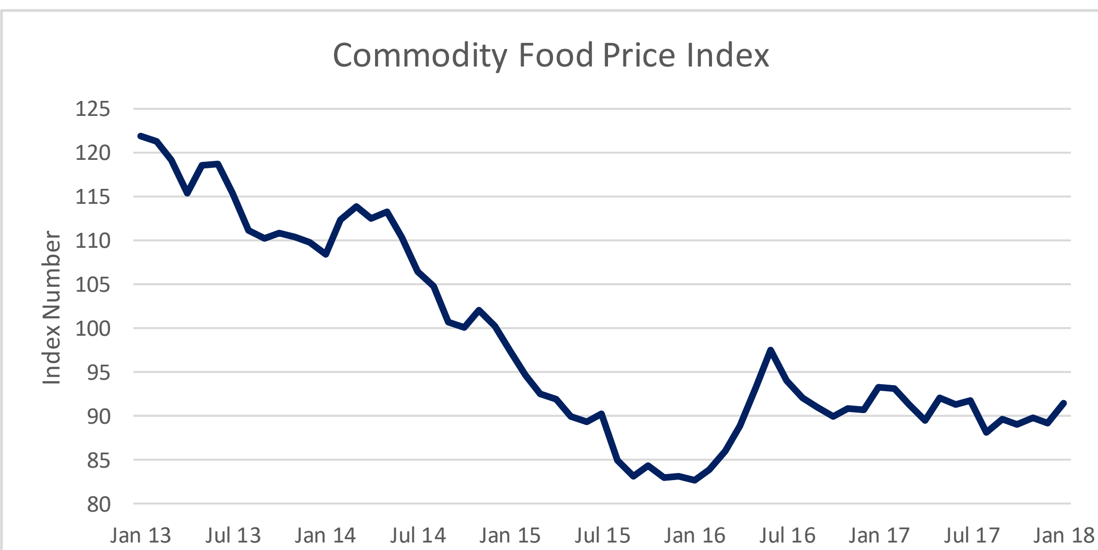
The industry remains labour intensive as many restaurants rely on wait staff to fulfill orders and provide service. Industry employment is project to grow 1.9% annualized in the next five years. Part time and seasonal employee will partially inflate employee numbers. Industry average wage is projected to decrease slightly from $18,110 in 2017 to $18,066 in 2022 (*IBISWorld)*. This decline in wages as a share of revenue is due to the automation of food preparation and is expected to continue. Newer technology such as electronic ordering has helped the industry to go leaner on its workforce and reduce labour costs. Consequently, hourly earnings have increased at a slower pace in the recent years, with only 0.1% real growth after adjusting for inflation.




*Source: US Bureau of Labor Statistics*

## Input Prices

Key supply industries include Beef, Pork, Poultry, Seafood, alcohol, fruit and vegetable wholesaling. The consumer shift in looking for alternative protein sources has caused meat and seafood prices to be flat or decreasing in the last five years. Fruits and vegetables prices however, had increased at an annualized rate of 3.5% and 3.8%, respectively. Overall food commodity prices have decreased due to intense competition domestically and internationally. However, due to the recent tax reform policies, the threat of inflation could reverse that trend and see higher input prices. We expect food prices to increase slightly in the next five years partly cause by inflationary pressures.




*Source: Indexmundi*

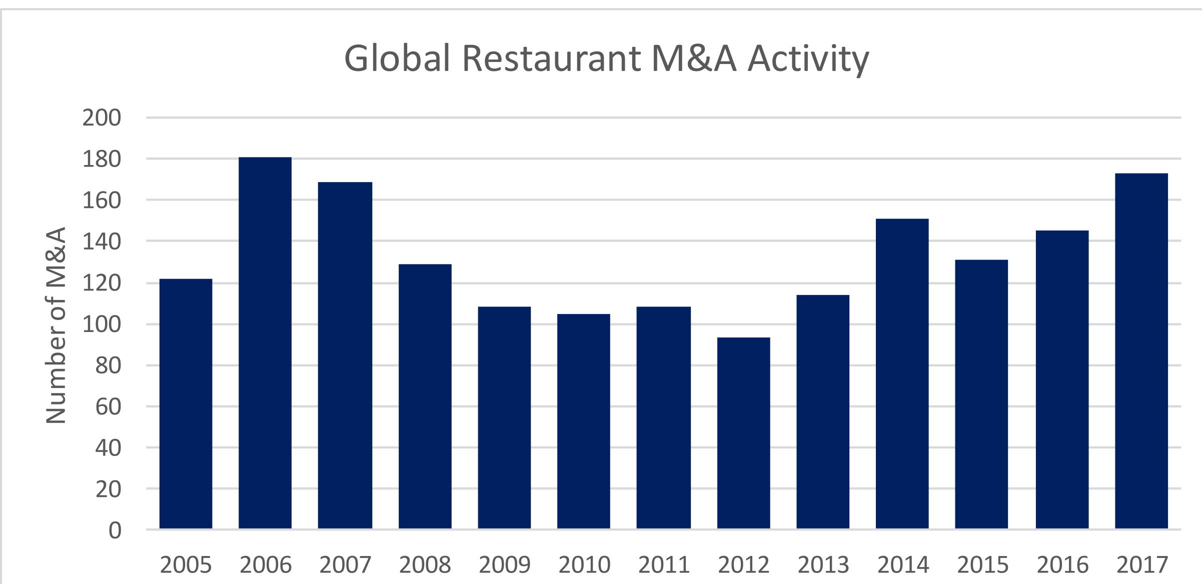
## Service Trends

Recent trends in the industry include third-party delivery services and providing healthy alternatives. Third-party delivery companies have seen significant success overseas in countries such as China. While they can increase exposure to additional markets, third-party delivery creates more choices for consumers and could ultimately increase competition and reduce margins. Such companies also create higher labour costs as firms need to hire or divert additional labour to pickups.

Society's increasing awareness of health risks relating to fat, sugar, and carbs has encouraged restaurants to market healthier alternative dining options. For many establishments, the health factor is becoming increasingly important to attract customers. The need to increase menu variety along with increased produce costs could reduce margin for the industry. At the same time, restaurants can often charge a premium for healthier alternative dining options.

## Consolidation

Industry M&A activities have been on the rise over the last five years. As some companies have been divesting brands to focus on core branding, private equity firms have played a bigger role in the industry investment and purchasing of struggling brands. Industry consolidation has led to existing brand names growing at a faster rate than new enterprises under new management. This consolidation has helped the industry battle against increased competition in the broader food services sector. The streamlined process for their services and supply chain allowed for more efficient operations.




*Source: Bloomberg*

# Catalyst

## M&A Activity in the Restaurant Sector

Over the past five years, the industry has seen an increasing trend in M&A activities. 2017 saw a significant jump (+19% y/y) in restaurant mergers and acquisitions. Notable acquisitions include Buffalo Wild Wings (BWLD) by Roark Capital, Ruby Tuesday (RT) by NRD Capital, and Popeyes Louisiana Kitchen (PLKI) by Restaurants Brands International. Corporate buyers and private equity firms have shown willingness to purchase performing chains and struggling chains with value. The newly passed tax cut will also fuel future M&A activities through increasing companies' cash flows. BJ's has shown interest in an inorganic growth strategy. However, with growing brand recognition and increasing locations, we view BJ's as a potential target for acquisition by larger restaurant-focused groups or private equity firms. BJ's is not as heavily levered with debt-to-EBITDA of 1.54x compared to industry average of 3.4x. Matched with its competitors, BJ's is more attractive for companies that are looking to add value to their operations. BJ's existing brewing operations and supply routes can support multiple brands in high value locations. Typically, the concept of having a brewery attached to restaurant operations is normally reserved for smaller, independent operations. Through M&A opportunities, investors can aggressively expand BJ's concept to a national level, further solidifying its brand as the premier "casual plus" dining experience. With its current location concentration positioned largely in three states (California, Texas, and Florida), large cap firms could also be inclined to acquire BJ's to diversify brand concentration or to increase presence in some of the largest markets in the US.

# Management Team

## Mr. Gregory A. Trojan – President and CEO

Mr. Trojan has served as President since 2012 and CEO since 2013. Prior to joining BJ's, Mr. Trojan has served as President, CEO and Director at Guitar Center, Inc. a retailer of musical instrument products from 2010 to 2012. From 1998 to 2006, Mr. Trojan served as CEO of House of Blues Entertainment, Inc. an operator of restaurant and music venues, concerts, and media properties. In 2016, his total annual compensation was $2.88 million, which consists of $0.85 million base salary, $0.50 million short term compensation, and $1.52 million in stocks, options and other compensations. Including common stock purchasable upon exercise of options, Mr. Trojan currently holds 0.27% shares outstanding, equivalent to a market value of $2.1 million.

## Mr. Gregory S. Levin – CFO, Executive VP and Secretary

Mr. Levin has been CFO since 2005, Executive VP since 2007 and Secretary since 2008. Prior to joining BJ's, Mr. Levin served as CFO of Santa Barbara Restaurant Group Inc. in 2004. He served as VP and Controller of California Pizza Kitchen Inc. since 1999, CFO and Secretary from 2001 to 2004. In 2016, his total annual compensation was $0.97 million, which consist of $0.4 million base salary, $0.16 million short term compensation, and $0.41 million in stocks, options and other compensations. Mr. Levin currently holds 0.2% of shares outstanding, equivalent to a market value of $1.59 million

## Management Conclusion

We believe that BJ's management team is strong and experienced in the restaurant sector. With the company's executive compensation strategy strongly linked to company and individual performance, management's incentives should be aligned with shareholders'. The company requires a minimum of 80% of targeted consolidated income from operations for bonus eligibility with a cap of 120% to target to discourage any actions that focus on short-term performance in detriment of longer-term goals. Furthermore, the company is allocating more stock option award into performance and restricted stocks awarded to place greater emphasis on company performance against targeted metrics. We believe these initiatives will incentivize management to focus on the extended growth of the company.

# Shareholder Base, Liquidity, Capital Structure

## Shareholder Base

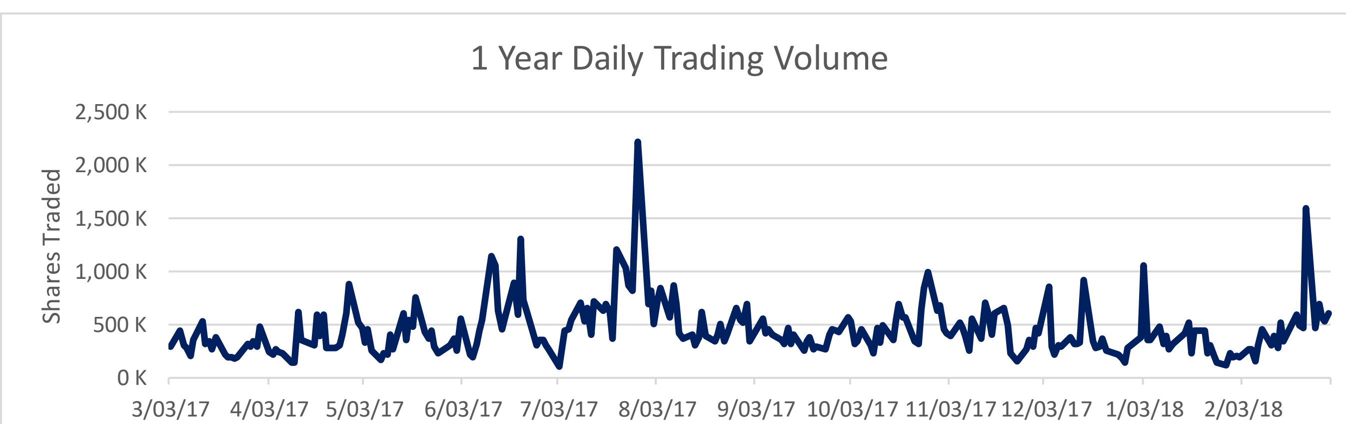
BJ's has a total of 21.8 million diluted shares outstanding. The company's largest shareholders are Blackrock Inc. and Vanguard Group Inc., who owns ~23% of total shares outstanding. With 91.7% shares outstanding owned by institutional investors, 20.2 million shares in public float and a short interest of 1.3 million shares, the stock could see short-term volatility. Insider ownership accounts for 6.8% of total shares outstanding.

| Top 5 Institution Holdings | | |
|---|---|---|
| Owner Name | Shares Held | % of Total |
| BLACKROCK INC. | 2,538,232 | 13% |
| VANGUARD GROUP INC | 1,802,167 | 10% |
| ARTHUR ZASKE & ASSOCIATES, LLC | 1,083,432 | 6% |
| DIMENSIONAL FUND ADVISORS LP | 1,075,435 | 6% |
| RE ADVISERS CORP | 831,230 | 4% |

*Source: NASDAQ*

## Liquidity

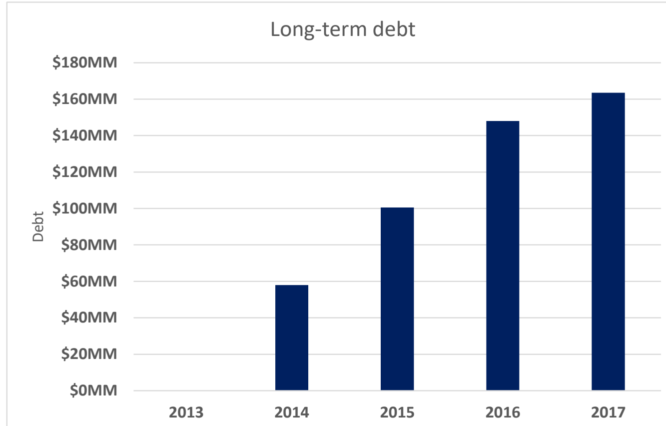
BJ's average daily trading volume was approximately 360,000 shares amounting to $12.96 million at the volume weighted price of $36. While this is volume isn't high for a company its size, it is above average among its competitors. Based on its current market capitalization of $769 million and trading history, we believe that there is little liquidity risk for investors.




*Source: Yahoo Finance*

## Capital Structure

The company, as of Q4-2017, has $163.5 million in long-term debt and $258 million total equity resulting in a debt-to-equity ratio of 0.63 and debt-to-EBITDA of 1.54x. While this is slightly higher than some competitors, it is still much lower than the industry average. The increased leverage was used to fund BJ's rapid expansion and share buybacks in the last four years. BJ's debt is acquired through a revolving line of credit for up to $250 million maturing on Nov 18, 2021. This loan is offered to BJ's at an interest rate of LIBOR plus ~1.75%. We expect BJ to focus on reducing its leverage given a less aggressive expansion plan.




*Source: Company Filing*

# Valuation

## Comparable Companies Analysis

For our comparable analysis, we decided to choose companies that have similar offerings in the casual dining industry. These companies are chain operated casual dining restaurants that compete in the same space as BJ's. Many of the companies are larger in their scale due to greater number of established locations, but we believe their trends are positively correlated to BJ's. All firms have a market capitalization under 5 billion. Notable exclusions from our comparable analysis are fast casual and fast food restaurants that operate in the same food services space. We believe that their scale and operational strategies are not representative of the BJ's.

**Texas Roadhouse, Inc. (TXRH)**

Texas Roadhouse, Inc. is a full-service, casual dining restaurant chain specializing in steak dishes.

**Red Robin Gourmet Burgers Inc. (RRGB)**

Red Robin Gourmet Burgers, Inc. engages in the development, operation, and franchising of full-service restaurants that specialize in gourmet burgers.

**Bloomin' Brands Inc. (BLMN)**

Bloomin' Brands Inc. operate, design and develop restaurant concepts. Its brands include Outback Steakhouse, Carrabba's Italian Grill, Bonefish Grill, and Fleming's Prime Steakhouse & Wine Bar.

**Denny's Corp. (DENN)**

Denny's Corp. operates as a family restaurant chain under Denny's restaurant brand. It is open for breakfast, lunch, dinner, and late night. It offers burgers, sandwiches, salads, and entrées.

**Chuy's Holdings Inc. (CHUY)**

Chuy's Holdings Inc. operates as an holding company with interest operating a chain of restaurants with Texas-Mexican inspired foods.

**Ruth's Hospitality Group, Inc. (RUTH)**

Ruth's Hospitality Group, Inc. develops and operates fine dining restaurant under Ruth's Chris Steak House offering a selection of Prime and Choice grade steaks.

**Dave & Buster's Entertainment, Inc. (PLAY)**

Dave & Buster's Entertainment, Inc. owns and operates casual dining venues with entertainment modules. It offers an opportunity to Eat, Drink and Play games including sports-oriented redemption games, video games, interactive simulators and traditional games.

**Brinker International, Inc. (EAT)**

Brinker International, Inc. owns, develops and franchises chili's Grill and Bar and Maggiano's Little Italy restaurant brands.

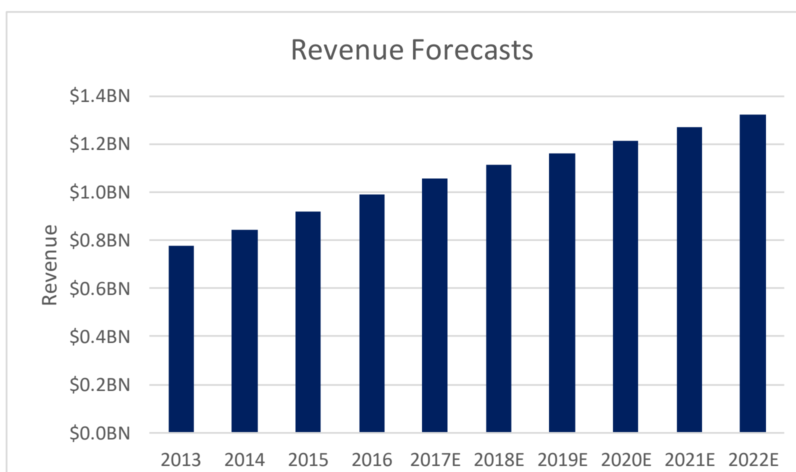
**DineEquity Inc. (DIN)**

DineEquity Inc. owns and franchises casual and family dining restaurants under Applebee's and IHOP brands.

## Discounted Cash Flow Analysis

**Revenue Forecasts**

Our revenue forecasts are based on management's expected new restaurant openings for 2017 and 2018 combined with estimated average revenue per restaurant. While new restaurant openings are expected to be between 4-6 in 2018 compared to 10 in 2017, we expect per restaurant sales to increase as newly opened restaurants ramp up operations. We also expect 2018 average revenues to increase compared to 2017 accounting for lower natural disaster related interruptions to operations. We believe overall revenue will grow as general economic conditions improve and consumer disposable income increases. We estimate average per restaurant revenue will increase at a rate of 2% per year matching industry's consensus growth rate. We believe this is fairly conservative as management is expecting 2.5% increase in average check.



*Source: WestPeak Estimates*


Franklin Wang | contact@westpeakresearch.com

**Cost Forecasts**

The three major costs for the company is in purchasing, labour, and operations. We believe cost will grow at a slower rate compared to revenue growth, increasing margin expansion for the company. Food commodities may see the largest increase due to inflationary pressure and global demand for meats and vegetables. Aggregate food commodity basket is expected to increase around 1% for next year. With 2017 cost of sales at 26.0% of revenue, we estimate cost of sales to stay in line with 2017 since the company have already secured 60% of its commodities for 2018. This is similar to management's expected cost of sales of upper 25% to 26% range.

We expect labour costs to be stable as a percentage of revenue. The company is consistently streamlining labour costs with more efficient scheduling techniques and new technology. Reduction in training costs from new restaurant openings should also help reduce labour charges. Labour costs have been stable around 35% of revenue in the past, and management is targeting labour of 36%. The industry is expecting labour cost to stay flat over the next 5 years with innovative technology improvements and automation. Therefore, we applied 36% to our labour cost assumptions for 2018 and beyond.

Operating occupancy costs was relatively stable as well over the last five years between 20.6% to 22.4% of revenue. Management is targeting operating occupancy around 21% for 2018. We believe this target is reasonable especially with lower fluctuations from new restaurant openings. Therefore, we used operating and occupancy cost of 21% as expected by management

General and administrative is expected to be $61 million for 2018. This is an increase of $5 million compared to 2017 due to incentive compensation which will only be given out if restaurant growth targets are achieved. At the same time, G&A spending is expected to stay flat for operating purposes in 2018. This increase in G&A cost translates to 20 basis points of revenue, therefore, we used G&A cost of 5.6% for 2018 and beyond compared to 5.4% of revenue in 2017.

**Capital Expenditures**

BJ's has been aggressively expanding in the last four years. As this trend is slowing down, we expect capital expenditures to decrease as well. Management is expecting gross capital expenditures to be around $50 to $55 million for 2018. Our model assumes capital expenditures of $55 million for 2018 which is 9.3% of beginning P&E. We estimate BJ's will keep its capital expenditure similar to 2018 for the next five years at its current expansion pace.

**Depreciation and Amortization Expense**

Estimated useful life for the company's PP&E has historically averaged ~9 years. We expect this to stay the course as there is little change to the company's core property and equipment.

**Net Working Capital**

We assume that net working capital growth will be in line with revenue growth. Management has not indicated any significant changes to net working capital. We expect a slight reduction in accounts payable as the reduced number of restaurant openings will require less short-term capital.

**Effective Tax Rate**

Management has indicated an expected tax rate of 15% for 2018 largely due to the tax cut. This reduction in BJ's tax rate represents an estimated cash savings of approximately $5 million.

**Terminal Growth Rate**

We used a terminal growth rate of 2% which is in line with GDP and industry growth.

**Weighted Average Cost of Capital (WACC)**

We found the weighted average cost of capital (WACC) for BJ's to be 7.4%. We calculated WACC based on our estimated pre-tax debt interest rate of 4% which resulted in 3.4% after tax cost of debt at 15% tax rate. We calculated our cost of equity based on historical market return of 9% (based on S&P 500) and risk-free rate of 2.2%. We used the company's 5-year beta of 0.89 taken from Bloomberg. We expect the company's performance reflective of general market conditions. We believe the WACC of 7.4% is fair considering the lower risk nature of chain restaurants and BJ's low cost of debt. We have also included a sensitivity analysis to show the effect of changing WACC and growth rates.

**Discount Cash Flow Summary**

Using our assumptions, our discount cash flow analysis resulted an implied price of $53.00. We believe our assumptions are within expectations and the company can surprise estimates depending on increased consumer spending.

## Precedent Transaction Analysis

Based on recent M&A activity, we view the idea of an acquisition very possible given the industry trend and the relatively low cost of debt. Companies may be encouraged to complete M&A deals sooner as interest rates are expected to rise as inflationary pressure set in. Coupled with expected inflow of cash caused by recent tax reform policies and BJ's relatively low debt position, we believe BJ's is an attractive target for acquisition. Based of 12 M&A deals in North America since 2015, we found the median EBITDA multiple of 13.5x. Using an EBITDA multiple of 13.5x, the target share price would be $60.00, representing a 38% upside.

North American Restaurant M&A deals since 2015

| Date | Target Name | Acquirer Name | Announced Total Value (mil.) | TV/EBITDA | Deal Status |
|---|---|---|---|---|---|
| Dec-17 | Imvescor Restaurant Group Inc | MTY Food Group Inc | $208 | 16.96x | Pending |
| Nov-17 | Buffalo Wild Wings Inc | Arby's Restaurant Group Inc | $2,832 | 11.49x | Completed |
| Oct-17 | Dunkin' Brands Group Inc | JAB Holding Co Sarl | $5,450 | 11.6x | Proposed |
| Apr-17 | Panera Bread Co | 3G Capital Inc | $7,119 | 17.23x | Withdrawn |
| Apr-17 | Panera Bread Co | JAB Holding Co Sarl | $7,481 | 18.1x | Completed |
| Mar-17 | Checkers & Rally's Restaurants Inc | Oak Hill Capital Partners LP | $525 | 15.79x | Pending |
| Feb-17 | Popeyes Louisiana Kitchen Inc | Restaurant Brands International Inc | $1,800 | 21.28x | Completed |
| Feb-17 | CEC Entertainment Inc | Ares Management LP | $2,000 | 11.05x | Withdrawn |
| Dec-16 | Fiesta Restaurant Group Inc | Potential Buyer | $797 | 10.99x | Withdrawn |
| May-16 | Krispy Kreme Doughnuts Inc | JAB Holding Co Sarl | $1,296 | 19.35x | Completed |
| Dec-15 | Bob Evans Farms Inc/DE | Post Holdings Inc | $950 | 8.7x | Withdrawn |
| May-15 | Frisch's Restaurants Inc | NRD Capital Management LLC | $173 | 7.11x | Completed |

*Source: Bloomberg*

# Recommendation

We believe that the market has undervalued BJ's in the past year partly due to operations impacted by natural disasters. BJ's have expanded considerably in the last five years and is poised at an advantageous position to reap the benefits. With newly established locations becoming more mature and increased efficiency across all of its restaurants, BJ's will see considerable growth in the future. Current upward trends in consumer traffic and spending is also expected to improve which will positively impact all restaurant operations. Based on our discounted cash flow analysis and comparable company analysis, we recommend BJ's as a **Buy** with an implied target share price of $52, representing an 17% upside. We recommend BJ's to investors with medium risk tolerance who are looking to hold the stock for long term growth.

# Risks

## Increases in Food and Labour and Construction Costs

BJ's operating costs and margins are heavily impacted by the price of food commodities, labour, and energy. It is uncertain if food prices will stay at its current low point for an extended period. The company enters into yearly fixed price purchase commitments for many of its commodities to mitigate some volatility in commodity prices. If inflationary pressure exceeds expected parameters, possible increases in input prices will need to be offset by increases in menu prices.

Labour costs are subject to local, state, and federal regulations including minimum wage, employee benefits, and insurance arrangements. The company is focused on maintaining customer demand with sufficient labour resources while increasing investments in new technology to reduce labour requirements. However, upward pressure on wages as the economy is nearing full employment will also put pressure on BJ's labour costs.

Construction costs is at an all time high for non-residential buildings. Not only does this increase the costs of new expansion plans, it also hinders the speed which BJ's can expand. In turn, this may result in slower revenue growth.


*Source:Turner*

## Expansion Dependency Risk

New restaurant openings have been a key factor in driving revenue growth for the last few years. However, continued rapid expansion could also adversely affect financial performance due to acquiring more debt to fund capital expenditures. The company tries to carefully balance the pace of new restaurant openings so that it won't overexert its financial commitments while achieving sustained growth. The rate of expansion is expected to decelerate as the company enters a more mature phase of its operations. As the expansion pace slows, the company will need to drive growth through increasing same restaurant sales.

## Location Concentration Risk

Currently the company has most of its restaurants located in California, Texas, and Florida. This location concentration has made the company more susceptible to natural disasters and government regulations. As evident from last year's Hurricanes in the South, which disproportionally impacted BJ's operations in Texas and Florida. The company is attempting to increase its geographic diversity by expanding further along the east coast. However, this requires increased investment to establish new supply routes and consumer awareness on the east coast

# Appendices:

## Exhibit 1: Model Summary

### Model Summary

| | Dec-13 | Dec-14 | Dec-15 | Dec-16 | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 | Dec-22 |
|---|---|---|---|---|---|---|---|---|---|---|
| | **FY2013** | **FY2014** | **FY2015** | **FY2016** | **FY2017** | **FY2018** | **FY2019** | **FY2020** | **FY2021** | **FY2022** |
| **Income Statement** | | | | | | | | | | |
| **Revenue** | **775.1** | **845.6** | **919.6** | **993.1** | **1,031.8** | **1,090.1** | **1,139.8** | **1,191.0** | **1,243.8** | **1,298.3** |
| **EBITDA** | **72.9** | **90.8** | **122.5** | **125.9** | **106.6** | **118.6** | **124.0** | **129.6** | **135.3** | **141.3** |
| **Net income** | **21.0** | **27.4** | **45.3** | **45.6** | **44.8** | **41.6** | **47.2** | **52.8** | **58.4** | **64.1** |
| **Earnings per share, diluted** | **$ 0.73** | **$ 0.97** | **$ 1.73** | **$ 1.88** | **$ 2.06** | **$ 1.91** | **$ 2.17** | **$ 2.43** | **$ 2.68** | **$ 2.94** |
| **Cash Flow Statement** | | | | | | | | | | |
| **Capital expenditures** | **(117.1)** | **(88.1)** | **(86.1)** | **(109.4)** | **(70.7)** | **(54.8)** | **(55.6)** | **(55.9)** | **(55.7)** | **(55.6)** |
| **Proceeds from sale of assets** | **7.8** | **13.1** | **3.5** | **4.5** | **17.9** | **-** | **-** | **-** | **-** | **-** |
| **Dividends paid** | **-** | **-** | **-** | **-** | **(2.3)** | **(9.6)** | **(9.6)** | **(9.6)** | **(9.6)** | **(9.6)** |
| **Dividend per share, $/share (diluted)** | **$ -** | **$ -** | **$ -** | **$ -** | **$ 0.10** | **$ 0.44** | **$ 0.44** | **$ 0.44** | **$ 0.44** | **$ 0.44** |
| **Dividend Payout** | **0.0%** | **0.0%** | **0.0%** | **0.0%** | **5.1%** | **23.0%** | **20.3%** | **18.1%** | **16.4%** | **15.0%** |
| **Balance Sheet** | | | | | | | | | | |
| Total current assets | 70.8 | 81.3 | 93.0 | 77.1 | 60.3 | 85.5 | 136.2 | 191.8 | 252.4 | 318.3 |
| Total non-current assets | 540.0 | 565.8 | 588.7 | 631.8 | 624.6 | 613.9 | 605.2 | 597.7 | 590.9 | 584.7 |
| **Total assets** | **610.9** | **647.1** | **681.7** | **708.9** | **685.0** | **699.4** | **741.3** | **789.5** | **843.3** | **903.0** |
| Total current liabilities | 92.1 | 107.0 | 116.9 | 125.7 | 122.5 | 104.9 | 109.2 | 114.1 | 119.2 | 124.4 |
| Total non-current liabilities | 117.3 | 191.4 | 248.3 | 308.3 | 303.7 | 303.7 | 303.7 | 303.7 | 303.7 | 303.7 |
| **Total liabilities** | **209.4** | **298.4** | **365.2** | **434.0** | **426.2** | **408.6** | **412.9** | **417.8** | **422.8** | **428.1** |
| **Total shareholders' equity** | **401.4** | **348.7** | **316.5** | **274.9** | **258.7** | **290.8** | **328.4** | **371.7** | **420.5** | **475.0** |
| **Cash and cash equivalents** | **23.0** | **30.7** | **34.6** | **22.8** | **24.3** | **47.3** | **96.4** | **150.2** | **209.1** | **273.0** |
| **Long-term debt** | **-** | **58.0** | **100.5** | **148.0** | **163.5** | **163.5** | **163.5** | **163.5** | **163.5** | **163.5** |
| **Net Debt** | **(23.0)** | **27.3** | **65.9** | **125.2** | **139.2** | **116.2** | **67.1** | **13.3** | **(45.6)** | **(109.5)** |
| **Net Debt/EBITDA** | **(0.3 x)** | **0.3 x** | **0.5 x** | **1.0 x** | **1.3 x** | **1.0 x** | **0.5 x** | **0.1 x** | **(0.3 x)** | **(0.8 x)** |
| **Operating Metrics** | | | | | | | | | | |
| **Return on Equity (ROE)** | **5.2%** | **7.9%** | **14.3%** | **16.6%** | **17.3%** | **14.3%** | **14.4%** | **14.2%** | **13.9%** | **13.5%** |
| **Return on Assets (ROA)** | **3.4%** | **4.2%** | **6.6%** | **6.4%** | **6.5%** | **6.0%** | **6.4%** | **6.7%** | **6.9%** | **7.1%** |
| **Return on Invested Capital (ROIC)** | **3.6%** | **5.1%** | **8.6%** | **8.0%** | **5.1%** | **7.3%** | **8.3%** | **9.3%** | **10.3%** | **11.3%** |
| **Valuation Metrics** | | | | | | | | | | |
| **P/E** | **45.5 x** | **39.2 x** | **27.5 x** | **21.5 x** | **18.2 x** | **19.4 x** | **17.1 x** | **15.3 x** | **13.9 x** | **12.6 x** |
| **EV/EBITDA** | **12.8 x** | **12.1 x** | **10.7 x** | **8.8 x** | **9.0 x** | **7.8 x** | **7.1 x** | **6.3 x** | **5.6 x** | **5.0 x** |
| **FCF Yield to Market Capitalization** | **-2.8%** | **0.3%** | **3.1%** | **2.1%** | **3.5%** | **4.5%** | **7.7%** | **8.3%** | **8.9%** | **9.5%** |
| **FCF Yield to Enterprise Value** | **-2.9%** | **0.3%** | **3.0%** | **1.8%** | **3.0%** | **3.9%** | **7.1%** | **8.1%** | **9.4%** | **11.0%** |
| **Free Cash Flow** | | | | | | | | | | |
| EBIT | 23.9 | 35.4 | 63.1 | 61.6 | 37.9 | 53.1 | 59.7 | 66.2 | 72.8 | 79.5 |
| Less: Tax expense | (3.6) | (5.3) | (9.5) | (9.2) | (5.7) | (8.0) | (8.9) | (9.9) | (10.9) | (11.9) |
| Add: Depreciation and amortization | 49.0 | 55.4 | 59.4 | 64.3 | 68.7 | 65.5 | 64.3 | 63.4 | 62.5 | 61.8 |
| Less: Capital expenditures | (117.1) | (88.1) | (86.1) | (109.4) | (70.7) | (54.8) | (55.6) | (55.9) | (55.7) | (55.6) |
| Less: Change in net working capital | 20.7 | 6.0 | 11.8 | 13.0 | (1.8) | (19.8) | 2.7 | 3.1 | 3.2 | 3.3 |
| **Unlevered free cash flow** | **(27.1)** | **3.4** | **38.7** | **20.3** | **28.3** | **36.0** | **62.2** | **66.9** | **71.9** | **77.0** |


Franklin Wang | contact@westpeakresearch.com

## Exhibit 2: Valuation Summary


## Exhibit 3: Discounted Cash Flow Analysis Summary

**Discounted Cash Flow Valuations**

| Perpetuity Growth Method | | | Exit Multiple Method | | |
|---|---|---|---|---|---|
| **Perpetuity growth rate** | | **2.0%** | **Terminal EV/EBITDA multiple** | | **10.1 x** |
| PV sum of unlevered FCF | | 262.4 | PV sum of unlevered FCF | | 262.4 |
| PV of terminal value | | 1,031.7 | PV of terminal value | | 1,049.1 |
| **Enterprise value** | | **1,294.1** | **Enterprise value** | | **1,311.5** |
| Add: Cash | | 24.3 | Add: Cash | | 24.3 |
| Less: Debt | | 163.5 | Less: Debt | | 163.5 |
| Less: Other EV adjustments | | - | Less: Other EV adjustments | | - |
| **Equity value** | | **1,154.9** | **Equity value** | | **1,172.3** |
| Shares outstanding | | 21.9 | Shares outstanding | | 21.9 |
| **Implied share price** | **$** | **52.74** | **Implied share price** | **$** | **53.53** |
| | | | | | |
| Current price | $ | 43.35 | Current price | $ | 43.35 |
| **Implied price** | **$** | **52.74** | **Implied price** | **$** | **53.53** |
| **Total return** | | **21.7%** | **Total return** | | **23.5%** |



Franklin Wang | contact@westpeakresearch.com

## Exhibit 4: DCF Sensitivity Analysis

| | | WACC | | | | |
|---|---|---|---|---|---|---|
| | | **8.4%** | **7.9%** | **7.4%** | **6.9%** | **6.4%** |
| Perpetuity Growth Rate | **1.00%** | $ 38.08 | $ 41.39 | $ 45.23 | $ 49.72 | $ 55.05 |
| | **1.50%** | $ 40.54 | $ 44.30 | $ 48.70 | $ 53.91 | $ 60.20 |
| | **2.00%** | $ 43.38 | $ 47.69 | $ 52.80 | $ 58.96 | $ 66.52 |
| | **2.50%** | $ 46.71 | $ 51.72 | $ 57.75 | $ 65.15 | $ 74.46 |
| | **3.00%** | $ 50.66 | $ 56.57 | $ 63.82 | $ 72.94 | $ 84.76 |



Franklin Wang | contact@westpeakresearch.com

## Exhibit 5: Comparable Company Analysis

# Comparable Company Analysis

| Company | Ticker | Equity Value | Enterprise Value | NTM EV/EBITDA | 2018E EV/EBITDA | 2019E EV/EBITDA | NTM P/E | 2018E P/E | 2019E P/E |
|---|---|---|---|---|---|---|---|---|---|
| | | | | EV/EBITDA Multiple | | | P/E Multiple | | |
| Red Robin | RRGB | 737.8 | 999.7 | 7.1 x | 7.2 x | 6.8 x | 21.3 x | 21.3 x | 18.1 x |
| Bloomin' Brands, Inc. | BLMN | 2,181.7 | 3,298.4 | 8.4 x | 8.5 x | 8.4 x | 16.8 x | 16.8 x | 15.6 x |
| Brinker International, Inc. | EAT | 1,664.9 | 3,023.7 | 7.4 x | 7.4 x | 7.5 x | 10.4 x | 10.4 x | 9.7 x |
| Dave & Buster's Entertainment, Inc. | PLAY | 1,862.8 | 2,162.4 | 8.1 x | 8.1 x | 7.5 x | 18.2 x | 18.2 x | 16.2 x |
| DineEquity, Inc. | DIN | 1,416.4 | 2,697.5 | 12.7 x | 12.7 x | 11.6 x | 15.6 x | 15.6 x | 13.3 x |
| Ruth's Hospitality Group, Inc. | RUTH | 757.0 | 782.1 | 11.1 x | 11.1 x | 10.8 x | 18.5 x | 18.5 x | 17.2 x |
| Chuy's Holdings, Inc. | CHUY | 470.7 | 453.3 | 10.3 x | 11.1 x | 10.1 x | 24.6 x | 24.6 x | 22.8 x |
| Denny's Corporation | DENN | 995.4 | 1,279.6 | 12.0 x | 12.0 x | 11.8 x | 25.0 x | 25.0 x | 22.8 x |
| Texas Road house | TXRH | 4,086.1 | 3,999.2 | 12.8 x | 12.8 x | 11.6 x | 24.4 x | 24.4 x | 21.5 x |
| **BJ's Restaurants** | **BJRI** | **893.0** | **1,058.3** | **8.9 x** | **8.9 x** | **8.6 x** | **24.4 x** | **24.2 x** | **21.7 x** |
| **Median** | | | | **10.3 x** | **11.1 x** | **10.1 x** | **18.5 x** | **18.5 x** | **17.2 x** |
| **Mean** | | | | **10.0 x** | **10.1 x** | **9.6 x** | **19.4 x** | **19.4 x** | **17.5 x** |
| **High** | | | | **12.8 x** | **12.8 x** | **11.8 x** | **25.0 x** | **25.0 x** | **22.8 x** |
| **Low** | | | | **7.1 x** | **7.2 x** | **6.8 x** | **10.4 x** | **10.4 x** | **9.7 x** |

| | EV/EBITDA Implied Price | | | P/E Implied Price | | |
|---|---|---|---|---|---|---|
| Median | $ 51.28 | $ 55.73 | $ 52.45 | $ 32.92 | $ 33.10 | $ 34.45 |
| **Mean** | **$ 49.56** | **$ 50.08** | **$ 49.12** | **$ 34.58** | **$ 34.77** | **$ 34.95** |
| High | $ 65.50 | $ 65.52 | $ 62.37 | $ 44.44 | $ 44.69 | $ 45.66 |
| Low | $ 33.09 | $ 33.11 | $ 32.91 | $ 18.50 | $ 18.60 | $ 19.44 |

## Legal Disclaimer

The content, opinions, estimates, and projections contained in this report are those of WestPeak Research Association (known as "WestPeak" or "WestPeak Research") and its directors, analysts, and affiliates and are subject to change without notice. The content, opinions, estimates, and projections on this report may not have been updated directly by WestPeak and its directors, analysts, and affiliates and may also have been altered or without your or our knowledge. WestPeak and its directors, analysts, and affiliates, without exception, do not accept any liability for factual, typographical, and grammatical errors, omissions, or content in this report. WestPeak and its directors, analysts, and affiliates do not accept any liability for damages arising from the use of or reliance on any of the content, opinions, estimates, and projections on this report. WestPeak and its directors, analysts, and affiliates endeavor to ensure that the content, opinions, estimates, and projections have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. Information may be available to WestPeak and its directors, analysts, and affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This report is for information purposes only and is not an offer to sell or the solicitation of an offer to buy any security. WestPeak and its directors, analysts, and affiliates may have a personal long or short position in any of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that WestPeak and its directors, analysts, and affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein. The reader, by the viewing of and use of the content, opinions, estimates, and projections contained in this report is assumed by WestPeak and its directors, analysts, and affiliates to have fully read, understood, and unconditionally agreed to all the terms and conditions set forth in this legal disclaimer.

Franklin Wang
Analyst

WestPeak Research Association
contact@westpeakresearch.com