WESTPEAK
RESEARCH ASSOCIATION

Denny's Corp. (NASDAQ:DENN)

Restaurants – Full-Service

"Handle with Care"

March 13, 2018

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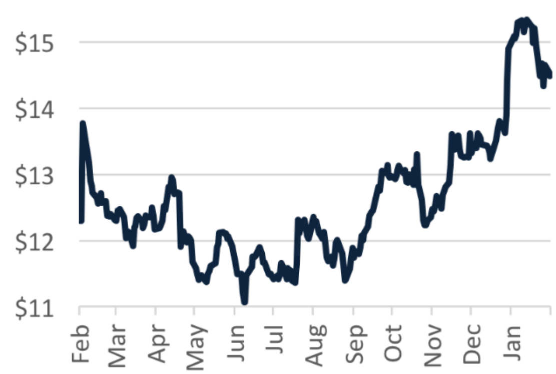
Equity Research	Canada
Price Target	**CAD$ 16.00**
Rating	**Hold**
Share Price (Mar. 13 Close)	CAD$ 16.15
Total Return	1.0%

Key Statistics	
52 Week H/L	$16.2/$10.90
Market Capitalization	$972M
Average Daily Trading Volume	4M
Net Debt	$295M
Enterprise Value	$1,273.3M
Net Debt/EBITDA	2.9x
Diluted Shares Outstanding	$65.3M
Free Float	3.5%
Dividend Yield	N/A

WestPeak's Forecast

	2017E	2018E	2019E
Revenue	$528M	$549M	$571M
EBITDA	$102M	$106M	$109M
Net Income	$43M	$70M	$74M
EPS	$0.63	$1.02	$1.08
P/E	25.0x	24.2x	20x
EV/EBITDA	12.5x	12.1x	11.7x

1-Year Price Performance



Denny's (also known as Denny's Diner) is a full-service, diner-style restaurant chain. Open 24/7 in most locations, the company owns or franchises over 1,700 restaurants in over 15 different countries.

Thesis

Over the past decade, Denny's, like most other U.S. full-service diners, has lost a large majority of their customers. Revenues have been decreasing after reaching a peak in the early 1990's, as a result of changing consumer preferences. Denny's new brand-revitalization strategy along with a revamped online platform, however, positions the company to increase same-store sales, target new consumer segments, and achieve greater customer loyalty. We anticipate management's new strategic direction will be significant tail-wind for the brand over the next several years, but these growth prospects have largely been priced in by the market.

Drivers

Worldwide, the market for food delivery stands at $100 billion, or 1 percent of the total food market (McKinsey). A new venture into an online platform allows Denny's to target new customer segments and increase revenues. Secondly, brand revitalization strategies will increase same-store sales and improve the customer retention rate. Finally, the expansion of new fast-casual restaurants in non-traditional locations (e.g. college campuses) and into locations with limited diner-style restaurant exposure will also allow Denny's to reach previously untapped markets and increase revenues.

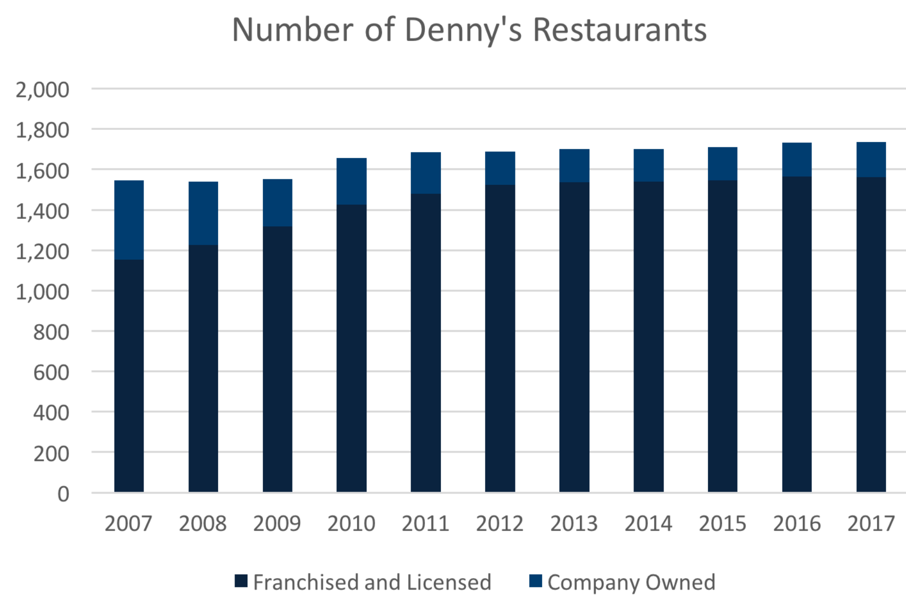
Valuation

The valuation of Denny's Corp was done by using a comparable analysis and a discounted cash flow. We determined a target share price of $16 representing a 1% downside. We recommend a hold rating for Denny's Corp.

Business Overview/Fundamentals

Denny's revenues are derived primarily from two sources: the sale of food and beverages from their company-owned restaurants and the collection of royalties and fees from restaurants operated by franchisees. The company currently operates in fifteen different countries, with 92% of their restaurants being located in the United States. They have more than 1600 restaurants in the U.S. with a strong presence in the West Coast, Southwest, Texas, and Florida.

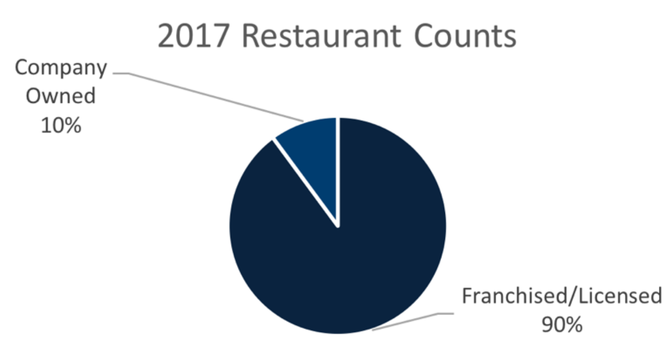
Denny's has been around for 65 years and carries around the preconception of being an aging restaurant chain. A 2014 study published by Morgan Stanley revealed that the fast-casual industry's core customers are baby boomers between 50 and 68 years old. However, the company is taking steps to target key customer segments (i.e. millennials, baby boomers, and second-generation immigrants) and retain the loyalty of patrons. Through the launch of brand revitalization strategies, Denny's will bring back the atmosphere of the 90's diner and align their menu with the preferences of 21st century consumers.



Source: Company Website

Franchise Operations

Approximately 90% of Denny's restaurants are now franchised or licensed, with 258 franchisees representing 1557 units. As seen in the graph above, over the past several years the company has remained consistent with this ratio of store counts in their heavily franchise based business model. This model has served the company well as it has been able to operate profitably with lower risk because the start-up capital required for new locations is generated by the franchisees. Thus, the company earns revenue through royalties and franchise fees. However, over the last four quarters franchise revenues have been declining. Denny's management, attributes the decline as a result of the company acquiring numerous franchise resturants. Hence, revenues from previous franchisee owned restaurants are not reflected in company restaurant sales. This means revenues from



Source: Company Website

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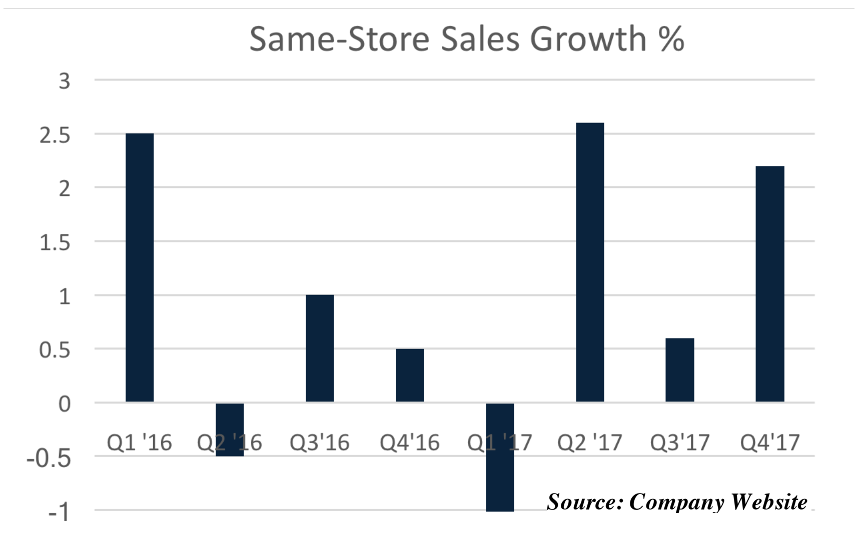
previous franchisee owned restaurants, are not reflected in company restaurant sales. These acquisitons, however, raise concern about the profitability of franchisee operated restaurants and the broader implications of a potential shift towards a fully-franchised system.

The total estimated initial fee for franchising a Denny's restaurant, is estimated to be between $700,000 - $2.4 million USD according to the company website. Through incentive programs, such as the New & Emerging Markets Program (EM), potential franchisees can save over $1 million if they develop six restaurants in markets with limited Denny's exposure. These estimated savings include reduced initial fees, marketing fees, royalty rates, and credits for training fees. Incentives like the EM program provide reliable, timely access to capital; crucial for seizing valuable market share in key locations, ensuring the integrity and quality of the Denny's brand is not lost in the process. Since their 2010 inception, these generous incentives have led to 34 franchisees with more than 10 restaurants collectively comprising 58% of the franchise system

In 2018, management anticipates keeping the 90% ratio of franchisee restaurants by opening approximately 35 franchised restaurants. We believe this heavily franchised system is critical to the company's growth and strategy, as a limited number of franchisees owning a large number of restaurants ensures the implementation of new menu or location changes can be completed quickly and efficiently. Past performance also indicates management's direction is effective, as since the system's 2010 inception the company has seen increasing performance in terms of both top-line and bottom-line revenue growth. A franchisee-model drives the company's growth because franchisees undertake the start-up capital required with opening new locations. As a result, the company is able to cut costs and increase revenues through their franchise, royalty, and advertising fees.

Restaurant Sales

Same-store sales growth are increasing for the second consecutive year, which we believe are due to brand-revitalization strategies enhancing the quality of food, service, and atmosphere. It's important to note that in Q1 2017, the significant decline in same-store sale, is not limited to Denny's as the restaurant industry experienced a 2.1-percent decline in same-store sales (NRN) during the same period due to the increasing presence of meal replacement kits, prepared foods, among other factors (IBIS).



A significant factor in increasing sales is through a brand revitalization strategy launched in 2014 to improve the atmosphere at Denny's diners. CEO John Miller, believes the restaurant remodeling will result in a dining experience that gives off a warmer feel that's less like a cafeteria and more like a restaurant (CNBC Mad Money). At the end of 2017, remodels were completed at all company restaurants and in 67% of the system. Management anticipates 80% of all restaurants to be upgraded to the new image by the end of 2018.

We believe costs associated with remodeling to be a necessary expenditure when it comes to targeting new customers and ensuring the loyalty of older ones. In the modern food-service industry, it's vital for full-service restaurants to adapt their locations to suit the needs of previously untargeted generations (e.g. millennials) who seek a fun, relaxed restaurant with a modern atmosphere.

Overall, the changes to their menu, service, and atmosphere have been very successful, evidenced by an increase in same-store sales and improved overall guest satisfaction-an important factor in ensuring a healthy customer retention rate. In addition, Denny's overall guest satisfaction scores trended positively during the year and are now at their highest levels since the system began measuring more than five years ago (Company Website). Management also reported a 2.9% increase in domestic system wide sales at existing stores for its December quarter, which is the company's best performance in approximately a decade.

Source: Company Website

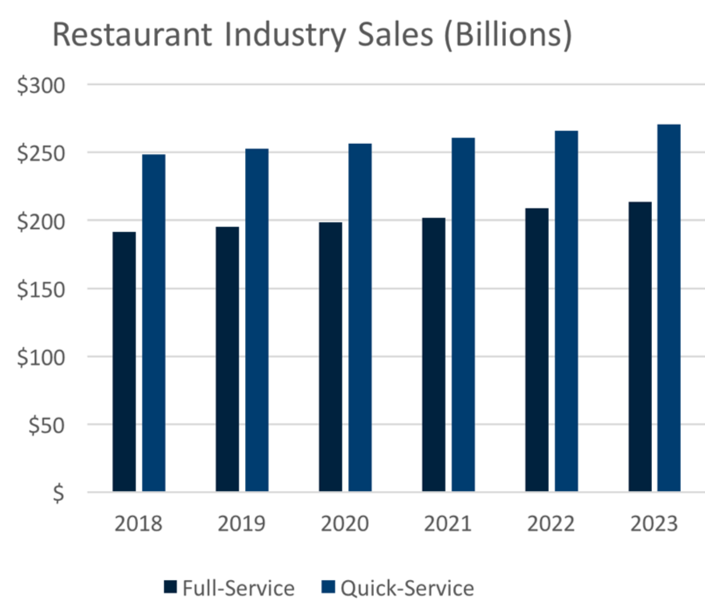
Online Platform

Online food-delivery platforms are expanding both choice and convenience, allowing customers to order from a wide array of restaurants from the comfort of their home. Digital ordering has tripled over the past five years, now representing 25% of all restaurant transactions, according to research firm NPD Group. In the current-day climate, it would be foolish to not take advantage of shifting customer needs to increase revenues. Denny's has developed a new platform to bolster their online sales, developed in partnership with digital ordering provider, Olo. Denny's on Demand is a complete revamp of the brand's mobile app, making it simple and convenient for customers to find a local restaurant and place an order. Ordering is available 24/7 on both the company's website and mobile application. The online platform launched in 2017, but has already resulted in an increase in off-premise sales-purchases made by consumers away from the physical restaurant location. These online transcations currently represent about 8.7% of total sales, up from 6.6% the year prior. We agree with management's strategic direction regarding initiatives launched for the online platform and expect deliveries to contribute to approximately 25-40% of total sales by 2022. This growth will be driven through an increase in consumer demand for food delivery and a disruption in a market typically reserved for fast-casual restaurants. In the years to come, we expect "Denny's on Demand" will bring increased consumer retention and are confident in the platforms ability to appeal to changing consumer needs. However, it's important for management to ensure off-premise sales don't cannibalize in-store sales.

Source: Company Presentation

Industry Overview

The restaurant industry can be classified under two broad categories: Full-service and limited-service restaurants. Full-service restaurants, offer full table services and Denny's diners would fall under the category. Limited-service restaurants include fast-food chains and are usually designed for a quicker dining experience. McDonald's and Subway are two prominent examples of limited-service restaurants, as they operate two of the biggest fast-food chains worldwide. In terms of market share, these limited-service restaurants are larger comprising 55% of the US restaurant industry (IBIS). In the fast food industry restaurants mainly compete on the price of their food, as opposed to the full-service industry where restaurants compete on the quality of their products. The restaurant industry as a whole, is also expected to grow at a rate of 3.5% in 2018, according to restaurant industry tracker Technomic.



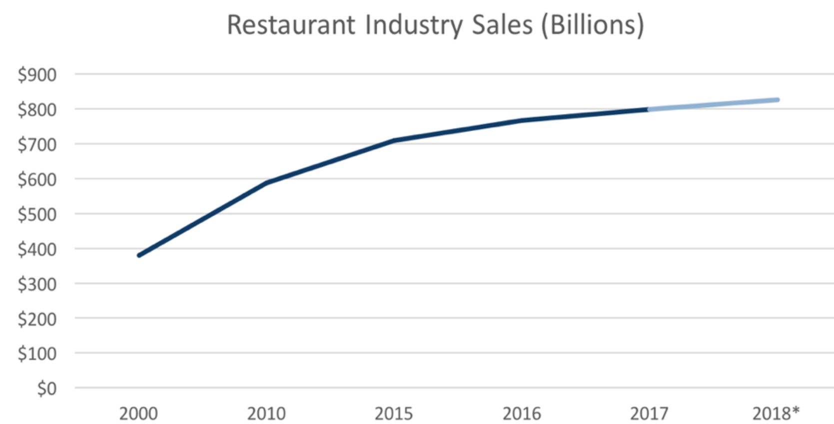
Source: IBIS World

Industry Drivers

In the restaurant industry growth is affected by a variety of macro factors including, but not limited to consumer disposable income, target demographics, off-premises market (i.e. takeout, delivery, mobile orders), and the consumer price index. Top-line growth within companies, however, is typically generated through two main avenues: opening locations and boosting same-store sales. Denny's strategic direction targets these two avenues, through brand revitalization strategies and the opening of non-traditional locations, such as college campuses.

Industry Analysis

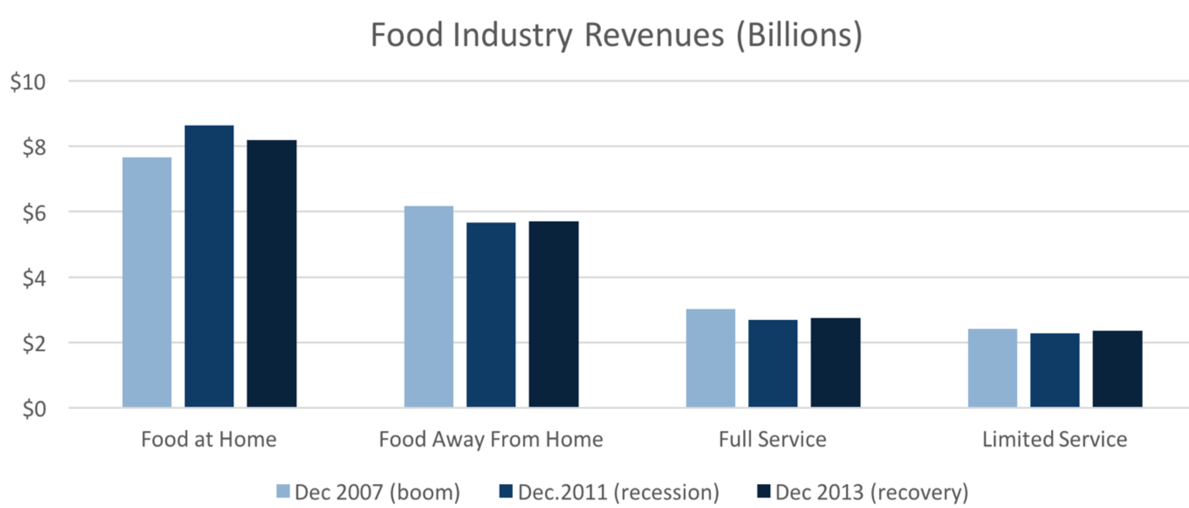
In the full-service restaurant industry, food services are provided to customers who order and are served while seated, then pay after finishing their meal. Denny's is able to gain a competitive advantage from their direct competitors operating in the diner industry (e.g. IHOP or Waffle House) through their accessibility to families who can't afford the expensive experience of dining at a full-service restaurant. Their value menu allows Denny's to appeal to potential consumers from a wide range of incomes, as well as compete with fast-casual restaurants using a cost leadership strategy. While the quality of value-menu items may not be as high as other items, the company still maintains a large customer base by committing to the lowest prices in their industry segment, compared to other full-service restaurants without value menu offerings. However, this isn't a strong enough competitive advantage to protect itself from competitors in different markets, for example fast-food/casual restaurants who can easily compete on price.



Source: National Restaurant Association

High Threat of Discretionary Spending

It is important to note in recessions, grocery stores are significant substitutes to the restaurant industry, as consumers can't afford the cost of eating at restaurants (see table below). Hence, eating out is discretionary spending and the greatest competitive challenge to the industry often comes from substitute products and services. Besides grocery stores, other products/services with increased sales during recessions include meal kit services and bakeries.



Source: Bureau of Labour Statistics

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High Threat of New Entrants

There are low barriers to entry in the industry, because opening up a restaurant requires little upfront capital, due to advances in technology and regulations. In fact, online delivery through platforms such as UberEats or GrubHub means many restaurants are even being run without a physical storefront. As a result, these low barriers to entry means consumers have low switching costs and can easily switch from restaurants to new entrants in the market.

Bargaining Power of Suppliers (High) and Buyers (Low)

In the industry, large suppliers, such as US Foods or Sysco Corporation - the largest North American food distributor in the food-service industry- sell to a vast number of restaurants, which makes bargaining with suppliers a difficult task. For example, fast food operations are particularly vulnerable to suppliers because low profit margins mean very little room for price increases without passing on the costs to customers. As a result, customers cannot typically bargain for their food prices because of these low margins, however, they may switch to lower cost alternatives or competitors. Denny's has numerous distributors, but McLane Company is the nationally recognized supplier to the Denny's system, internationally and domestically, servicing over 1,700 Denny's restaurants (Company Website). Denny's has established policies to identify, control and manage market risks which may arise from changes in commodity prices, however, they do not use derivative instruments for trading purposes. Between 2013-17, gross margins have been increasing at an annualized rate of 3.2%, increasing profitability through the benefits of economies of scale. We believe Denny's gross margins are sustainable for the foreseeable future, through analyzing margins of similar peers and utilizing management's guidance.

High Intensity of Competitive Rivalry

There is a vast number of competitors from different avenues: fast food/casual chains, full-service restaurants, online delivery platforms, meal kits, diners, and high-end dining experiences. Specifically, Denny's is positioned as a full-service, diner catered towards families. However, their unique positioning does not necessarily eliminate the threat from these other avenues, especially the rapidly-growing fast-food/casual industry.

Capital Allocation

The company has not historically paid cash dividends, however, in recent years they have undertaken share repurchase programs. Since initiating the share repurchase programs in November 2010, the company has repurchased a total of 43.2 million shares of common stock for $355.6 million.

In May 2016, the Board of Directors approved a new share repurchase program, authorizing repurchases up to 100 million common stock. During the quarter ended Dec 2017, the company cumulatively purchased approximately 100 million shares, thus ending the program. Subsequently, the board approved a new share repurchase program, authorizing repurchases up to $200 million of the company's common stock.

The continuance of these share repurchase program indicates management continues to believe shares are undervalued, however, in the process giving the impression management believes the corporation does not have many profitable opportunities for growth.

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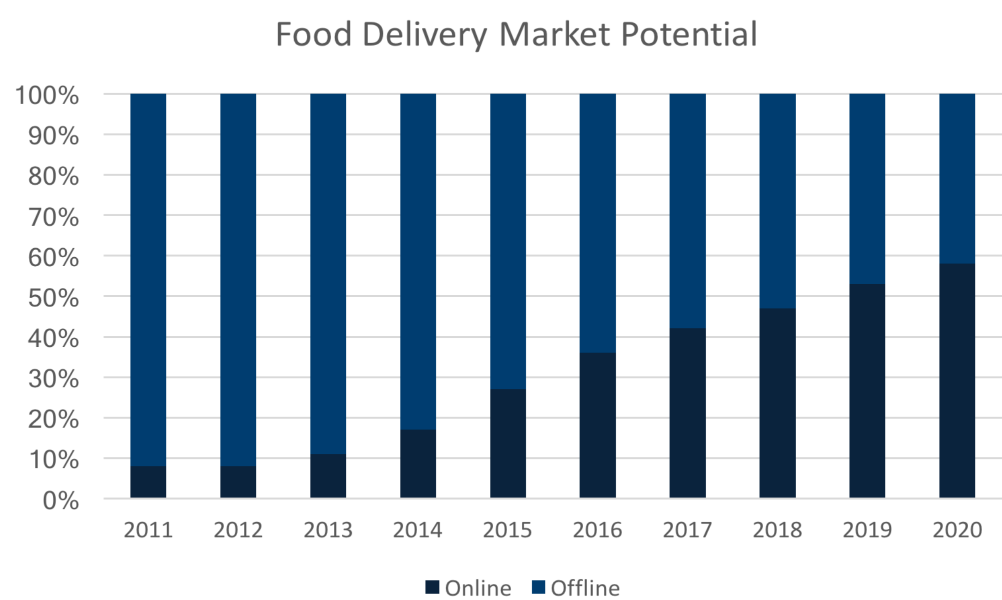
Catalysts

Online Sales

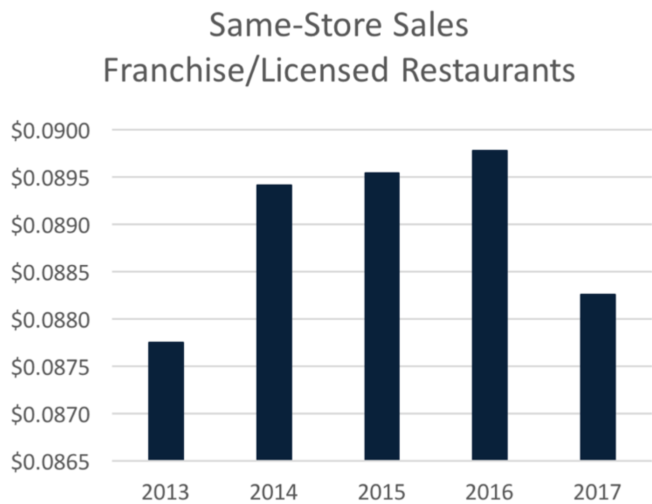
We believe Denny's new online platform will result in increased, sustainable revenues, as new food-delivery platforms have a proven track record of retaining customers, with 77% of customers never switching or rarely switching aggregator platforms (McKinsey). The Denny's On Demand platform initiative has already resulted in a substantial increase in off-premise sales, which currently represent about 8.7% of total sales. We believe this number only has room to grow once Denny's rolls out the service across the entire system.

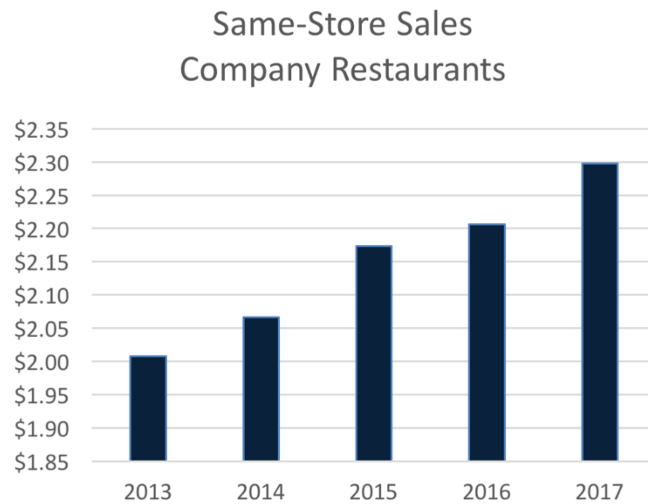


Source: IBIS World

Revitalization Strategy

CEO John Miller has stated he believes the success of Denny's brand, is highly dependent on the company's revitalization strategy which is driven by its remodeling program. We agree with his outlook, as it's been nearly five years since Denny's launched its revitalization initiatives and increasing revenues/same-store sales are clear indications the company's strategic direction is working. The company has also posted positive system-wide same-store sales in 17 of the last 19 quarters. Segmenting same-store sales by restaurant type indicates there is evidence for the success of Denny's new revitalization strategy since its initial rollout. The graphs below display revenues per restaurant (millions) and one can see the difference in growth between the company restaurants and franchise and licensed restaurants. We believe the difference in same-store sales growth, with a significant growth seen in company restaurants can be attributed to Denny's first implementing their revitalization strategy in these locations. This includes remodeling locations to improve the dining atmosphere and changing the menu to better suit consumer preferences. We believe as more franchise and licensed restaurants are remodeled, this large section of the company's restaurant portfolio (90%) will begin to see significant increases in same-store sales growth. It's important to note, however, the blip in 2017 same-store sales for franchise and license restaurants is not unique to Denny's as the restaurant industry as a whole underwent a similar impact to same-store sales.





Source: Company Website

Expansion into New Markets

In 2017, Denny's opened 39 restaurants, including 7 international locations, bringing the total restaurant count to 1,735. In 2018, the company plans to open approximately 40-50 new restaurants globally, with approximately flat net restaurant growth across the system. We have full confidence in management's strategic direction when it comes to expansion, as 2017 also marks the ninth consecutive year of positive net system growth for the brand. However, we believe it's important to note overall net system growth has remained flat due to the closing down of numerous unprofitable franchised and company restaurants.

One key goal for Denny's management going into 2018 is to increase net restaurant growth through all avenues: domestic, international and nontraditional. Currently half of all domestic stores, are in four states; California, Arizona, Texas, and Florida. Management has stated future domestic growth will focus on markets in which they have modest penetration, with a focus on locations alongside the East Coast, such as New York. As a result, an increase in domestic brand awareness will result in increased revenues through both same-store sales and online sales in new locations. New non-traditional avenues include fast-casual spots which have been developed for college campuses and contract service providers. We believe these restaurants will be instrumental in developing brand recognition and consumer loyalty among younger generations.

Finally, focus on expanding into international markets means increased revenues for the company, while at the same time incurring limited risks due to the nature of franchisee-operated restaurants, which compose the majority of new restaurant openings. The company currently has 80 planned international locations in the pipeline and we anticipate an increased awareness of the Denny's brand overseas will result in increased revenues for years to come. However, international locations are not as profitable as domestic restaurants, due to low brand awareness in international markets. As a result, these predominantly franchised international restaurants may take longer to reach expected sales and profit level, thereby affecting the brand's overall growth and profitability. We anticipate it will be a number of years before Denny's builds a strong reputation overseas, but our analysis indicates the brand awareness achieved through international operations outweighs any short-term profitability risk.

Management Team

John Miller – CEO

John Miller is President and Chief Executive for Denny's Corporation. Mr. Miller joined Denny's in 2011 and brings more than 30 years of restaurant management experience to the company. We believe his strong background in senior positions at Brinker International and Macaroni Grill will allow him to successfully lead the strategic direction of the diner chain. In recent conference calls and interviews, Mr. Miller has been very optimistic about both the company's growth, as well as the full-service restaurant industry's. In 2016, he was paid 5,194,167 in total compensation (Morningstar), of which 2.1M comes from performance incentives. He currently owns 1.22% of the company (Bloomberg), which we believe in conjunction with his non-equity compensation mitigates principal agent conflicts as his compensation is directly tied to the company's overall performance.

F. Mark Wolfinger – CFO & CAO

Executive Vice President, Mark Wolfinger, is responsible for the overall financial direction of the company. Mr. Wolfinger joined management in 2005, with experience as CFO of Fanka Business Systems and Seni. With over 10 years of experience on the board, Mr. Wolfinger's influence on the company's direction is significant and we believe under his expertise the national dining chain can continue to grow. In 2016, he was paid 2,130,341 in total compensation (Morningstar), of which 900K comes from performance incentives. Currently owns 1.03% of the company (Bloomberg).

Christopher D. Bode - COO

Senior Vice President, Christopher Bode, is responsible for directing all of the company and franchise operations. Mr. Bode joined management in 2011, with experience as COO of QSR Management, LLC and Vice President of Development & Construction of Dunkin' Brands, LLC. With proven experience in operations, we have full confidence in Mr. Bode's ability to carry out Denny's expansion into domestic and international markets. In 2016, he was paid 1,102,972 in total salary (Morningstar). Currently owns 0.07% of the company (Bloomberg).

John W. Dillon – CMO

Senior Vice President, John Dillon, is responsible for directing all of the marketing efforts for Denny's. His strong background in market strategy and research inspires confidence in Denny's new rebranding strategy, which we believe is an essential component of ensuring the company's future growth. Currently owns 0.08% of the company (Bloomberg).

Shareholder Base and Liquidity

Shareholder Base

Denny's shareholder base is institutionally backed with over 96% of the company's ownership belonging to institutional investors, indicating management has the backing of a number of reputable institutions. The company's current insider ownership is 3.6%, with CEO John Miller and CFO Mark Wolfinger holding over 50% of the insider shares. While such a structure could lead to a management team that is unaccountable for its performance, however, we believe strong performance incentives sufficiently align management's interests with those of its shareholders.

Top Shareholders	Shares Owned	% of Free Float	Insider?	Filing Date
(Name)	*(mm shares)*	*(%)*	*(Y/N)*	*(Date)*
T Rowe Price Group Inc	9.9	15.1%	N	09/30/17
Avenir Corporation	6.9	10.5%	N	09/30/17
Wells Fargo & Company	5.0	7.6%	N	11/30/17
Blackrock	4.5	6.9%	N	09/30/17
Renaissance Technologies LLC	3.8	5.9%	N	09/30/17
Brown Advisory Inc	3.2	5.0%	N	10/31/17
Vanguard Group	3.0	4.5%	N	09/30/17
Dimensional Fund Advisors	2.5	3.9	N	09/30/17
Keeley-Teton Advisors	2.2	3.3%	N	01/12/18
John Miller, CEO	0.8	1.2%	Y	03/14/17

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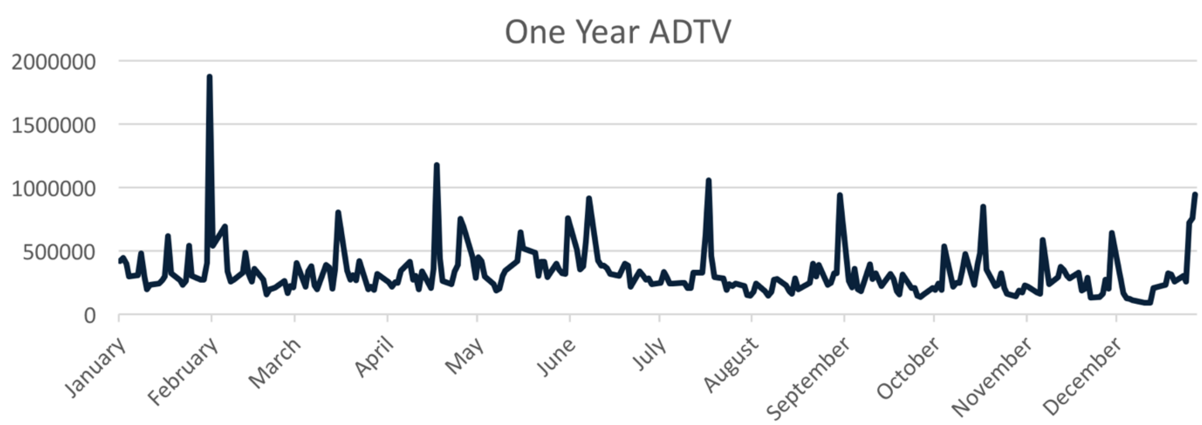
Liquidity



Source: Company Website

The firm's shares trade with a yearly average daily trade volume of roughly 330K (Info gathered Mar 12 2017-18). We can interepet the high liquidity-based on the 65M shares outstanding and trading history being good for the investor, because it indicates that the security is more popular among investors and less volatile than its peers. Hence, the DENN security presents little liquidity risk for investors. In the graph seen above, potential catalysts for most of the spikes in ADTV can be attributed to the release of company annual and quarterly earnings reports.

Valuation

Comparable Company Analysis

For our comparable analysis, we decided to pick companies that have similar offerings in the casual dining industry. Denny's direct competition in the full-service category includes a collection of national and regional chains, as well as thousands of independent operators. To narrow down our list, we selected peers with similar menu offerings and customer segments to Denny's. These seven companies are also exposed to the same economic headwinds, as they all compete in the same industry and geographic regions.

Restaurant Brands International. (QSR)

Restaurant Brands International Inc. owns, operates, and franchises quick service restaurants under the Tim Hortons and Burger King brand names.

Starbucks Corporation. (SBUX)

Starbucks Corporation owns the Starbucks brand and operates as a roaster, marketer, and retailer of coffee worldwide.

Yum! Brands. (YUM)

YUM! Brands, Inc operates and franchises quick service fast food restaurants. The company operates three main restaurants: KFC, Pizza Hut, and Taco Bell.

McDonald's. (MCD)

McDonald's Corporation operates and franchises McDonald's restaurants. Their restaurants offer various food products and drinks, but the brand is known for their all-day breakfast and burgers.

DineEquity Inc. (DIN)

DineEquity, Inc operates full-service restaurants in the United States and internationally. It owns and operates two restaurant concepts, Applebee's and International House of Pancakes (IHOP).

Dunkin' Brands Group. (DNKN)

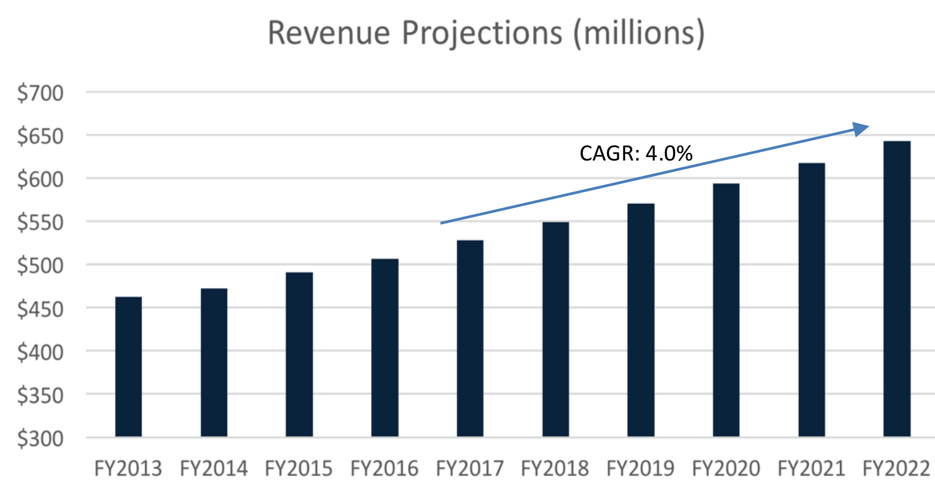
Dunkin' Brands Group, Inc., operates, franchises, and licenses quick service restaurants under the Dunkin Donuts and Baskin-Robbins brands.

Jack in the Box. (JACK)

Jack in the Box Inc. operates and franchises Jack in the Box quick-service restaurants and Qdoba Mexican Eats fast-casual restaurants.

Discounted Cash Flow Assumptions

Revenue Forecasts



We drove company revenues via segment growth rate, using company restaurant sales and franchise/license revenue. Company restaurant sales forecasts were based on the anticipated expansion into non-traditional locations and untapped domestic and international locations, along with an increase in sales through the revamped online platform. Accordingly, we anticipate a growth rate of 5% for company restaurant sales, while taking all these factors into consideration. Franchise and license revenue forecasts used similar rationale to company restaurants, but they also included the implementation of brand-revitalization strategies, as many franchise locations still need to be remodeled. Accordingly, we normalized this growth rate to be 1% while taking into consideration low royalty/advertising fees and the anticipated acquisition of various franchisee restaurants, which would result in revenues being displayed under company restaurant revenues.

Over the last 8 years, the opening and closing of new restaurants has remained at equilibrium, which means the company hasn't significantly increased the total number of systemwide Denny's restaurants (see graph under Business Overview). We anticipate management continuing this direction for the foreseeable future, so it will take a timeline of 5-10 years before the company begins to aggressively expand into new locations. As a result, we expect future revenue growth coming from a significant increase in same-store sales at both company and franchised/licensed restaurants. Accordingly, we anticipate an approximate 4% annual increase in same-store sales from 2019-2022, utilizing management's guidance along with forecasts for an annual revenue growth of 4%.

Cost Forecasts

Cost forecasts for 2018-2022, were based on an anticipated 40-50 new restaurant openings in both domestic and international locations. We believe the company will continue to open new locations at an 2% growth rate, as margins have remained fairly consistent throughout the last couple of years. However, using management's guidance we anticipate overall net restaurant growth remain flat due to the closing of numerous restaurants. Accordingly, COGS were anticipated to remain flat at 60%, SG&A at 12.5%, and OPEX at 0.5%. As a result of these assumptions, over our forecast period, we have projected an EBITDA margin of 27%.

Capital Expenditures

Capital expenditures (CAPEX) were forecasted by accounting for restaurant remodelling and expansion of both domestic and international locations. The estimated total investment to open and operate a Denny's franchise ranges from $1.2 million to $2.6 million and we have reflected these costs in our model. Over the past several years, however, stores have been opening and closing at a steady rate so we also anticipate costs remaining fairly steady. Because of the company's franchise/licensing model, there aren't large costs associated with the opening of new locations. Furthermore, we believe remodeling costs will remain steady for 2018-19, but taper off in future years as 80% of the system is anticipated to be remodelled by the end of 2018. The costs of online expansion are mostly sunk, as an established partnership with the meal-delivery service Olo means the company doesn't need to invest in delivery vehicles or face other miscellaneous costs. After considering all these factors, we set CAPEX growth rate to remain flat at a steady rate of 15%.

WACC

We calculated the weighted average cost of capital for Denny's to be 9.2%. We assumed a pre-tax cost of debt to be 2.5%, using Bloomberg, cost of equity based on the 8% average 10-year S&P 500 market return, risk-free rate of 2.3% utilizing a five-year US Treasury yield, and a levered beta of 1.5 taken from Bloomberg. We have also included a sensitivity analysis to show the effect of changing WACC and growth rates on our target share price.

Effective Tax Rate

With the adoption of the new US corporate tax code management anticipates a new income tax rate of 21% which we've reflected in our DCF model.

Recommendation

Denny's has been showing strong potential, through new revenue segments, successful brand-revitalization strategies, and a renewed focus on expanding to new locations both domestically and abroad. We are confident in management's strategic direction; however, the company lacks a unique value proposition. Management indicates their current value proposition is quality, 24-hour service to consumers of all incomes and backgrounds, whether they be at home or in the comfort of a newly remodelled diner. In an industry with an ever-increasing threat of disruption, however, we believe this proposition doesn't successfully differentiate the company from competitors, whether they be meal kits, fast-food/casual, or other full-service restaurants.

We believe changes to the menu and atmosphere, along with a new online platform will catalyze the company's growth resulting in increased revenues through an increase in same-store sales. In addition, the continued expansion into key domestic and international locations will continue to increase Denny's system-wide revenues. Furthermore, Denny's has launched a new share repurchase program, with an aggregate consideration of 197 million shares of common stock open to repurchases from Q4 2017 onwards. The program, however, gives the impression management believes the corporation does not have many profitable opportunities for growth. We believe this capital allocated for the share repurchase program is misplaced, as net restaurant growth has remained flat over the past several years and more capital should be allocated towards expanding into new locations.

To determine a share price, we used a 50/50 weighting for the comparable company's analysis and DCF, because we felt it was important to consider the company's peers in an industry with a high level of competition. Using this method, we arrived at a target price of $16, which is 1% lower than the current share price of $16.15. We believe Denny's is a great company with an established market presence and experienced management team, but the current price is not cheap. However, the company would be an attractive investment opportunity if the share price drops below $13.

Under management's strategic direction, we believe that the Denny's brand will continue to grow but due to their current valuation, we recommend a **HOLD** rating.

Risks

Location Risks for Restaurants

The success of Denny's franchised and licensed restaurants can be heavily affected by location. It is important to keep in mind that current locations may not continue to be attractive as demographic patterns within the region may change. It is also possible that the economic conditions where restaurants are located could decline in the future, which could potentially result in reduced sales at those locations.

Changing Consumer Preferences

Denny's needs to consistently evolve their menu to keep up with changes in consumer tastes and preferences. It is also important to keep geographic tastes in consideration when revising menus for locations. College campuses and locations beside the inter-state have very different demographics. It is important to have a menu that appeals to the needs of all target demographics.

Franchise Risk

Lack of established internal communication channels in franchised restaurants leads to difficulty communicating with managers, due to the independent nature of these restaurants. In turn, managers have difficulty implementing new menu changes, maintaining quality of food, training staff, and changing customer service policies.

Consumer Spending

When economic conditions are favourable, consumers are more likely to spend money eating out at restaurants, as opposed to cooking at home, conversely, during a recession, consumers are more likely to eat at home and restaurant sales will decrease.

Appendix 1 – Income Statement

	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Income Statement										
Revenue	**462.6**	**472.3**	**491.3**	**506.9**	**529.2**	**550.1**	**572.0**	**594.9**	**618.9**	**644.1**
COGS	283.6	288.8	294.4	302.1	**324.7**	**330.0**	343.2	356.9	371.4	386.5
Gross profit	**179.0**	**183.5**	**196.9**	**204.9**	**204.5**	**220.0**	**228.8**	**238.0**	**247.6**	**257.6**
Cost of franchise and license revenue	46.109	44.761	43.345	40.8	39.3	**41.3**	42.9	44.6	46.4	48.3
SG&A	56.835	58.907	66.602	68.0	66.4	**71.5**	74.4	77.3	80.5	83.7
OPEX	7.071	1.27	2.366	26.9	4.3	**2.8**	2.9	3.0	3.1	3.2
EBITDA	**69.0**	**78.5**	**84.6**	**69.2**	**94.4**	**104.5**	**108.7**	**113.0**	**117.6**	**122.4**
D&A	21.5	21.2	21.5	22.2	**23.7**	**24.7**	25.1	24.5	24.0	23.5
EBIT	**47.5**	**57.3**	**63.2**	**47.0**	**70.7**	**79.8**	**83.6**	**88.5**	**93.6**	**98.9**
Interest expense	10.3	9.2	9.3	12.2	**15.6**	**17.0**	17.0	17.0	17.0	17.0
Other expenses (income)	1.1	(0.6)	0.1	(1.1)	**(1.7)**	**-**				
EBT	**36.1**	**48.8**	**53.7**	**35.9**	**56.8**	**62.7**	**66.6**	**71.5**	**76.5**	**81.8**
Income taxes	11.5	16.0	17.8	16.5	**17.2**	**13.2**	14.0	15.0	16.1	17.2
Net income	**24.6**	**32.7**	**36.0**	**19.4**	**39.6**	**49.6**	**52.6**	**56.5**	**60.5**	**64.6**
Shares outstanding, basic	90.8	86.3	82.6	75.3	68.1	68.1	68.1	68.1	68.1	68.1
Shares outstanding, diluted	92.9	88.4	84.7	77.2	70.4	70.4	70.4	70.4	70.4	70.4
Earnings per share, basic	**$ 0.27**	**$ 0.38**	**$ 0.44**	**$ 0.26**	**$ 0.58**	**$ 0.73**	**$ 0.77**	**$ 0.83**	**$ 0.89**	**$ 0.95**
Earnings per share, diluted	**$ 0.26**	**$ 0.37**	**$ 0.42**	**$ 0.25**	**$ 0.56**	**$ 0.70**	**$ 0.75**	**$ 0.80**	**$ 0.86**	**$ 0.92**

Appendix 2 – Cash Flow Statement

	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Cash Flow Statement										
Operating activities										
Net Income	24.6	32.7	36.0	19.4	39.6	49.6	52.6	56.5	60.5	64.6
Depreciation and amortization	21.5	21.2	21.5	22.2	23.7	24.7	25.1	24.5	24.0	23.5
Operating, net	7.1	1.3	2.4	26.9	4.3	-				
Amortization of deferred financing costs	0.5	0.5	0.5	0.6	0.6	-				
Early extinguishments of debt and leases	2.2	(0.0)	0.2	(0.0)	0.1	-				
Change in interest rate caps	0.0	(0.0)	-	-	-	-				
Deferred income tax expense mlp	9.1	13.2	14.0	8.8	10.3	-				
Reversal of tax valuation allowance	(0.4)	(0.3)	(0.1)	0.1	0.2	-				
Share-based compensation	4.9	5.8	6.6	7.6	8.5	-				
Cash flow before working capital	**69.4**	**74.4**	**81.1**	**85.7**	**87.4**	**74.3**	**77.7**	**81.0**	**84.5**	**88.2**
Cash flow from operating activities	**57.0**	**74.9**	**80.6**	**71.2**	**78.3**	**69.7**	**77.2**	**80.6**	**84.1**	**87.8**
Cash used in investing activities	**(16.5)**	**(21.3)**	**(32.7)**	**(32.7)**	**(27.1)**	**(27.7)**	**(22.0)**	**(21.6)**	**(21.2)**	**(20.8)**
Cash from financing activities	**(51.2)**	**(53.5)**	**(49.3)**	**(37.6)**	**(48.7)**	**-**	**-**	**-**	**-**	**-**
FX effect	-	-	-	-		-				
Net change in cash	**(10.6)**	**0.1**	**(1.4)**	**0.9**	**2.4**	**41.9**	**55.2**	**59.1**	**62.9**	**67.0**
Beginning cash balance	**13.6**	**2.9**	**3.1**	**1.7**	**2.6**	**5.0**	**46.9**	**102.1**	**161.1**	**224.1**
Ending cash balance	**2.9**	**3.1**	**1.7**	**2.6**	**5.0**	**46.9**	**102.1**	**161.1**	**224.1**	**291.1**

Appendix 3 – Balance Sheet

	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Balance Sheet										
Current assets										
Cash and cash equivalents	2.9	3.1	1.7	2.6	5.0	46.9	102.1	161.1	224.1	291.1
Accounts receivable	17.3	18.1	16.6	19.8	21.4	18.6	18.9	19.6	20.4	21.3
Inventories	2.9	3.0	3.1	3.0	3.1	3.4	3.4	3.6	3.7	3.9
Prepaid and other current assets	7.4	7.7	14.1	9.4	11.8	6.8	7.2	7.5	7.8	8.1
Current deferred income taxes	23.3	24.3	-	-	-	-	-	-	-	-
Assets held for sale	-	-	0.9	1.0	-	-	-	-	-	-
Total current assets	**53.8**	**56.1**	**36.4**	**35.9**	**41.3**	**75.6**	**131.6**	**191.8**	**256.0**	**324.3**
Total non-current assets	**242.0**	**233.8**	**260.6**	**270.2**	**282.5**	**285.5**	**282.4**	**279.5**	**276.6**	**273.9**
Total assets	**295.8**	**289.9**	**297.0**	**306.2**	**323.8**	**361.1**	**414.0**	**471.3**	**532.7**	**598.2**
Total current liabilities	**74.1**	**80.4**	**101.6**	**93.4**	**94.9**	**82.7**	**83.0**	**83.8**	**84.7**	**85.6**
Total non-current liabilities	**213.3**	**207.9**	**256.1**	**283.9**	**326.2**	**326.2**	**326.2**	**326.2**	**326.2**	**326.2**
Total liabilities	**287.3**	**288.3**	**357.6**	**377.3**	**421.1**	**408.9**	**409.2**	**410.1**	**410.9**	**411.8**
Shareholders' equity										
Common stock	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Additional paid-in capital	567.5	571.7	565.4	578.0	594.2	594.2	594.2	594.2	594.2	594.2
Retained earnings (accumulated deficit)	(470.9)	(438.2)	(402.2)	(382.8)	(334.7)	(285.1)	(232.5)	(176.0)	(115.6)	(50.9)
Treasury stock	(72.3)	(108.3)	(201.0)	(265.9)	(355.6)	(355.6)	(355.6)	(355.6)	(355.6)	(355.6)
Accumulated other comprehensive income (loss)	(16.8)	(24.6)	(23.8)	(1.4)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
Total shareholders' equity	**8.4**	**1.6**	**(60.6)**	**(71.1)**	**(97.4)**	**(47.8)**	**4.8**	**61.3**	**121.7**	**186.4**
Non-controlling interest					-	-	-	-	-	-
Total equity	**8.4**	**1.6**	**(60.6)**	**(71.1)**	**(97.4)**	**(47.8)**	**4.8**	**61.3**	**121.7**	**186.4**

Appendix 4 – WACC Calculations and Sensitivity Analysis

Cost of Equity	
Risk-free rate	2.3%
Expected market return	8.0%
Market risk premium	5.8%
Beta	1.55
Cost of equity	**11.2%**

Cost of Debt	
Pre-tax cost of debt	2.5%
Effective tax rate	35.0%
Cost of debt	**1.6%**

WACC	
Market value of equity	1,071.4
Total outstanding debt	265.1
Total capitalization	1,336.5
Cost of equity	11.2%
Cost of debt	1.6%
WACC	**9.3%**

	WACC				
Perpetuity Growth Rate	10.20%	9.70%	9.20%	8.70%	8.20%
1.00%	$ 7.40	$ 8.03	$ 8.72	$ 9.51	$ 10.40
1.50%	$ 7.85	$ 8.53	$ 9.31	$ 10.18	$ 11.19
2.00%	$ 8.35	$ 9.11	$ 9.97	$ 10.96	$ 12.10
2.50%	$ 8.91	$ 9.76	$ 10.73	$ 11.86	$ 13.18
3.00%	$ 9.55	$ 10.51	$ 11.62	$ 12.91	$ 14.46

	WACC				
Terminal EV/EBITDA Multiple	10.20%	9.70%	9.20%	8.70%	8.20%
13.0 x	$ 16.18	$ 16.49	$ 16.80	$ 17.13	$ 17.45
14.0 x	$ 17.45	$ 17.78	$ 18.12	$ 18.46	$ 18.81
15.0 x	$ 18.72	$ 19.07	$ 19.43	$ 19.79	$ 20.16
16.0 x	$ 19.99	$ 20.36	$ 20.74	$ 21.12	$ 21.51
17.0 x	$ 21.27	$ 21.65	$ 22.05	$ 22.45	$ 22.87

Appendix 5 – Discounted Cash Flow Analysis

Free Cash Flow										
EBIT	47.5	57.3	63.2	47.0	70.7	79.8	83.6	88.5	93.6	98.9
Less: Tax expense	(16.6)	(20.1)	(22.1)	(16.4)	(24.7)	(27.9)	(29.3)	(31.0)	(32.8)	(34.6)
Add: Depreciation and amortization	21.5	21.2	21.5	22.2	23.7	24.7	25.1	24.5	24.0	23.5
Less: Capital expenditures	(16.8)	(22.1)	(27.0)	(19.7)	(18.8)	(19.7)	(20.0)	(19.6)	(19.2)	(18.8)
Less: Change in net working capital	(12.4)	0.5	(0.4)	(14.5)	(9.1)	(4.6)	(0.5)	(0.4)	(0.4)	(0.4)
Unlevered free cash flow	**23.2**	**36.9**	**35.1**	**18.5**	**41.7**	**52.2**	**58.9**	**62.1**	**65.3**	**68.6**
Discount factor					0.25	2.71	2.86	2.98	3.16	3.40
Present value of unlevered free cash flow					**24.4**	**28.1**	**45.7**	**47.7**	**49.3**	**50.8**

Exit Multiple Method		
Terminal EV/EBITDA multiple		**15.0 x**
PV sum of unlevered FCF		246.1
PV of terminal value		1,358.5
Enterprise value		**1,604.6**
Add: Cash		1.7
Less: Debt		265.1
Less: Other EV adjustments		-
Equity value		**1,341.2**
Shares outstanding		69.2
Implied share price	**$**	**19.38**

Current price	$	15.48
Implied price	**$**	**19.38**
Total return		**25.2%**

Perpetuity Growth Method		
Perpetuity growth rate		**2.0%**
PV sum of unlevered FCF		246.1
PV of terminal value		698.9
Enterprise value		**945.0**
Add: Cash		1.7
Less: Debt		265.1
Less: Other EV adjustments		-
Equity value		**681.5**
Shares outstanding		69.2
Implied share price	**$**	**9.85**

Current price	$	15.48
Implied price	**$**	**9.85**
Total return		**-36.4%**

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Appendix 6 – Comparable Companies Analysis

				EV/EBITDA Multiple			P/E Multiple		
Company	**Ticker**	**Equity Value**	**Enterprise Value**	**NTM EV/EBITDA**	**2019E EV/EBITDA**	**2020E EV/EBITDA**	**NTM P/E**	**2019E P/E**	**2020E P/E**
Restaurant Brands International	QSR	30,230.8	43,742.9	20.6 x	18.8 x	17.3 x	31.6 x	24.0 x	21.3 x
Starbucks Corporation	SBUX	84,813.1	86,345.3	14.4 x	12.9 x	11.6 x	25.3 x	22.1 x	19.6 x
Yum! Brands	YUM	27,917.1	36,788.1	18.0 x	17.7 x	16.9 x	29.5 x	25.8 x	22.3 x
McDonald's	MCD	138,752.7	164,699.9	15.9 x	15.9 x	15.0 x	26.7 x	24.5 x	22.4 x
DineEquity INC	DIN	926.3	2,224.5	10.5 x	10.9 x	10.2 x	12.4 x	12.5 x	10.1 x
Dunkin' Brands Group Inc	DNKN	5,815.3	7,969.2	16.4 x	16.1 x	15.2 x	26.6 x	24.0 x	21.2 x
Jack in the Box Inc	JACK	2,893.0	4,030.7	12.7 x	12.8 x	11.2 x	21.8 x	19.1 x	17.7 x
Denny's	**DENN**	**979.5**	**1,273.3**	**12.5 x**	**12.1 x**	**11.7 x**	**25.0 x**	**24.2 x**	**20.0 x**
Median				**15.9 x**	**15.9 x**	**15.0 x**	**26.6 x**	**24.0 x**	**21.2 x**
Mean				**15.5 x**	**15.0 x**	**13.9 x**	**24.8 x**	**21.7 x**	**19.2 x**
High				**20.6 x**	**18.8 x**	**17.3 x**	**31.6 x**	**25.8 x**	**22.4 x**
Low				**10.5 x**	**10.9 x**	**10.2 x**	**12.4 x**	**12.5 x**	**10.1 x**

	EV/EBITDA Implied Price			P/E Implied Price		
Median	$ 20.35	$ 21.14	$ 20.55	$ 15.97	$ 14.86	$ 15.89
Mean	**$ 19.70**	**$ 19.76**	**$ 18.76**	**$ 14.90**	**$ 13.46**	**$ 14.42**
High	$ 27.70	$ 25.84	$ 24.49	$ 18.96	$ 16.00	$ 16.80
Low	$ 11.91	$ 13.06	$ 12.61	$ 7.46	$ 7.73	$ 7.61

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