

Determinants of Valuation Ratios: The Restaurant Industry in 2011¹

The restaurant industry has always represented a prime example of a competitive industry. New innovations are easily observed and imitated, start-up costs are generally quite low, and the entry and exit of new players is frequent. Despite the intense competition, a wide range of valuation ratios are typically observed in the industry. The year 2011 was no exception. It was characterized by the following industry medians:

Industry Median ROE = 15 percent
Industry Median Consensus Analyst Forecast of Five-Year EPS Growth = 15 percent
Industry Median Price-to-Earnings Ratio = 20
Industry Median Market-to-Book Ratio = 3.8

The brief sketches of four restaurant companies on the following pages illustrate the variety of experiences within the industry.

REQUIRED

Based on the information provided for each of the following four companies, rank the companies as to whether you expect them to have a higher or lower market-to-book ratio and a higher or lower price-to-earnings ratio relative to the median firm in the industry.

Brinker International, Inc.

Brinker International, Inc. owns, develops, operates, and franchises various restaurant brands primarily in the United States. It operates the restaurants under the Chili's Grill & Bar and Maggiano's Little Italy brand names. As of August 29, 2011, the company owned, operated, and franchised 1,534 Chili's Grill & Bar restaurants and 45 Maggiano's Little Italy restaurants in 50 states, and Washington, D.C.; and held a minority investment in Romano's Macaroni Grill. Summary financial data are presented below:

Book Value of Equity/Share = \$4.72
2010 EPS = \$1.52
Consensus Analyst Forecast of 2011 EPS = \$1.70
Consensus Analyst Forecast of Five-Year EPS Growth = 12 percent

Benihana, Inc.

Benihana Inc. operates Benihana teppanyaki-style Japanese restaurants in the United States. It also operates other Asian restaurant concepts that include RA Sushi and Haru. The company's Benihana teppanyaki restaurant offers fresh steak, chicken, and seafood; RA Sushi concept provides sushi and Pacific-Rim dishes; and Haru concept offers traditional Japanese and Japanese fusion dishes. It operates 63 Benihana

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restaurants, 25 RA Sushi restaurants, and 8 Haru restaurants, as well as 18 franchised Benihana restaurants in the United States, Latin America, and the Caribbean. The company was founded in 1964 and is based in Miami, Florida. Summary financial data are presented below:

Book Value of Equity/Share = \$9.59
2010 EPS = \$0.02
Consensus Analyst Forecast of 2011 EPS = \$0.37
Consensus Analyst Forecast of Five-Year EPS Growth = 20 percent

Chipotle Mexican Grill, Inc.

Chipotle Mexican Grill, Inc. develops and operates fast-casual, fresh Mexican food restaurants in the United States. It also operates restaurants in Toronto, Canada and in London, the United Kingdom. As of October 20, 2011, it operated 1,100 restaurants. Chipotle Mexican Grill, Inc. was founded in 1993 and is based in Denver, Colorado. Summary financial data are presented below:

Book Value of Equity/Share = \$31.92
2010 EPS = \$5.64
Consensus Analyst Forecast of 2011 EPS = \$6.82
Consensus Analyst Forecast of Five-Year EPS Growth = 22 percent

Ruby Tuesday, Inc.

Ruby Tuesday, Inc., together with its subsidiaries, develops, operates, and franchises casual dining restaurants in the United States, Puerto Rico, Guam, and internationally. The company operates its restaurants under the Ruby Tuesday brand, as well as owns and operates one Marlin & Ray's, one Truffles, and two Wok Hay casual dining restaurants. As of August 30, 2011, it owned and operated 746 Ruby Tuesday restaurants; and 43 domestic and 52 international franchisees operated restaurants. The company was founded in 1920 and is based in Maryville, Tennessee. Summary financial data are presented below:

Book Value of Equity/Share = \$9.27
2010 EPS = \$0.73
Consensus Analyst Forecast of 2011 EPS = \$0.65
Consensus Analyst Forecast of Five-Year EPS Growth = 11 percent