Sonic Corp.

SONC: NASDAQ

Analyst: Matthew Schilling
Sector: Consumer Disc.

BUY

Price Target: $34.00

Key Statistics as of 11/19/2015

Market Price:	$28.36
Industry:	Leisure/Restaurants
Market Cap:	$1.4B
52-Week Range:	$22.72 - $36.73
Beta:	1.39

Thesis Points:

- Macroeconomic Tailwind for Restaurant Industry
- Same Store Sales Growth Mixed with Inorganic Growth is an Ideal Combination
- Competitive Advantage in Highly Competitive Market

Company Description:

Sonic Corporation is primarily a franchising corporation of drive in eateries. They currently have 3,526 locations in the United States and have been in business for over 60 years. They provide consumers with what is considered to be American classics, in hotdogs, burgers and fries. They have a variety of products that range from lunch to dessert and operate in 44 states across the United States.

Thesis

Sonic Corporation has the perfect economic tailwind brewing that will propel its revenue growth. GDP growth has stabilized, disposable income has increased and consumer confidence in the United States economy has increased. This situation will generate revenue in the form of more traffic in locations and more franchisees. In addition, they have seen consistent same store sales growth while exhibiting an ability to continue opening up new locations. This will continue to stabilize their revenue growth going forward. They currently operate in a highly saturated and competitive market but they have a unique advantage over their competitors in the fast food industry.

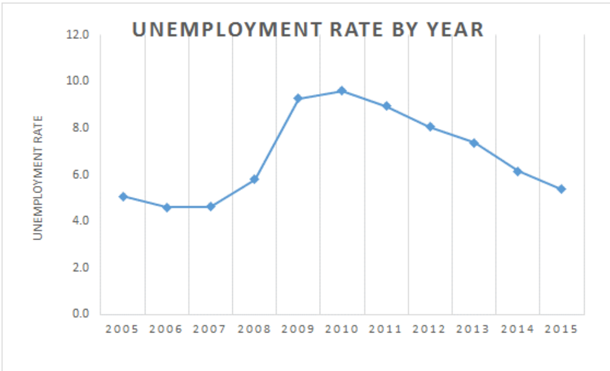
Macroeconomic Industry Tailwind

Over the past few years the perfect consumer spending storm has been brewing. Growth in GDP has resulted in more employment and higher wages for employees, increasing the amount of disposable income consumers have to spend. Since 2009, the United States has recovered greatly from economic recession from 2007 to 2009. The real growth rate in GDP has consistently stayed around 2% since 2009 and indications point to that number continuing to hover around the 2% growth rate.

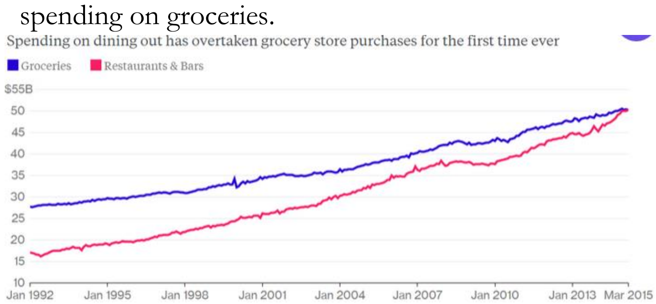
Date	US Real GDP Growth Rate
Sep 30, 2015	2.03%
Dec 31, 2014	2.47%
Dec 31, 2013	2.45%

GDP growth is a critical statistic in assessing the health of a country's economy. A healthy GDP leads to other positive macroeconomic factors such as, lower unemployment rates and higher amounts of disposable income.

The graph above shows the growth in average real disposable income between 2008 and 2015. Real disposable income has increased by approximately $1,000 since 2013 and will continue to increase into 2016. Such increases allow consumers to spend more money on leisurely items such as dinning out. Another crucial macroeconomic factor is the unemployment rate within the United States. In 2009, the tail end of the recession, unemployment more than doubled from where it was in 2007 (4.6% to 9.3%). Since 2009, the rate has gradually decreased, reaching the current September rate of 5.1%.



The more people that are employed, the more people there are to spend money on food in restaurant's. All of these macroeconomic factors have been improving over the past few years and caused spikes in consumer confidence. 2015 is the first time in United States history that spending on dinning out has surpassed spending on groceries.

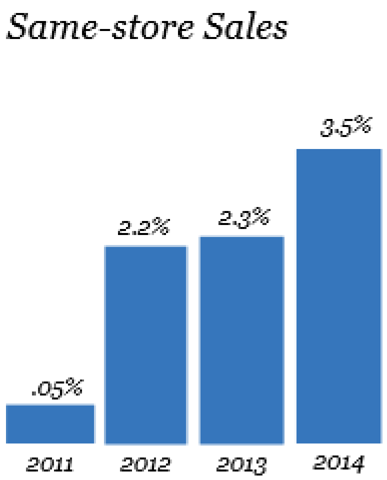


This trend hints that spending on dining out will continue to grow, leaving a revenue growth potential for Sonic. Confidence in the market has increased the amount of franchises that are opening every year.

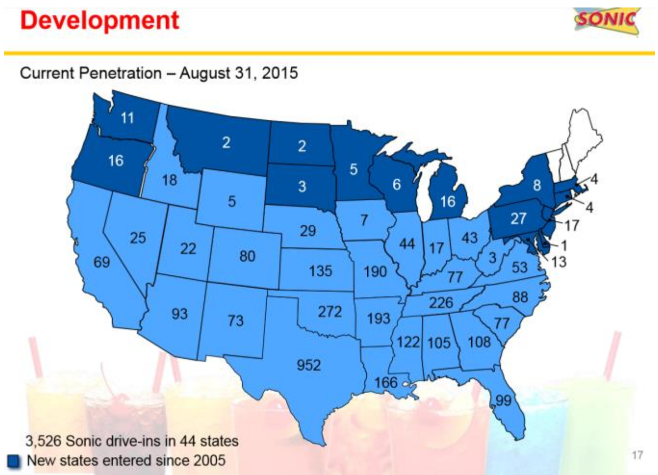
New store commitments have increased every year as a result of the positive macroeconomic outlook. This number is expected to increase further and provide Sonic with additional revenue growth in the future.

Same Store Sales Growth

For most fast food style restaurants, revenue growth can become dependent on new store sales growth. In the case of Sonic Corporation they experienced a mix of the two.



Same store sales growth within the fast food industry is an important factor in accessing a company's direction. Big companies like Panera and Chipotle have seen their same store sales growth drop significantly in the past few years. As for Sonic, their same store sales growth have been increasing much faster than competitors.



Sonic is still at in early stage in expansion with only 3,526 locations. Major consumer states, such as New York, only have 8 locations within the state. This leaves them a platform for future revenue growth through inorganic new stores growth. The combination of same store sales growth and inorganic growth will lead to consistent revenue growth every year.

Market Overview and Competitive Advantage

The fast food industry has become a highly competitive and crowded industry. Demographic switches have allowed more fast-casual restaurants to slide into positions of higher market share. This is where Sonic has an advantage. Sonic is the biggest drive in, old school style fast food player. They have the ability to play in the normal fast food game with their drive thru and seating area but have the same ambiance as fast-casual restaurants. Their unique operations and lesser penetration gives the company a competitive advantage.

Valuation

SONC is currently trading at $28.36 and after a conservative return on equity valuation approach, an intrinsic value of $32.16 has been calculated. Keeping the margins the same as they currently are and continuing to keep their operating costs proportionally constant. This added with a fast revenue decay projects a target price of $34. (Other projections are on the attached proforma)

Conclusion

I am recommending a buy on SONC due to multiple factors. There is an ideal macroeconomic tailwind that will propel Sonic's future revenues. With spending on eating out sky rocketing, Sonic will have more in store customers and franchisees. In addition, they have strong same store sales growth and an ability to continue inorganic new stores growth. They also have a competitive advantage in the fact of their unique style of operation. As a result of all three of those factors I expect a target price of $34 and recommend a buy.

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Sonic Corp.	SONC	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	1-y Return: 15.75%	NEUTRAL
		Matthew Schilling	$29.75	$32.16	$34.00	2%		

General Info	
Sector	Consumer Discretionary
Industry	Hotels, Restaurants and Leisure
Last Guidance	October 19, 2015
Next earnings date	NM
Market Data	
Enterprise value	$1,916.21
Market Capitalization	$1,480.94
Daily volume	0.85
Shares outstanding	49.78
Diluted shares outstanding	53.95
% shares held by institutions	98.94%
% shares held by insiders	4.41%
Short interest	14.13%
Days to cover short interest	6.02
52 week high	$36.73
52-week low	$22.72
5y Beta	1.39
6-month volatility	38.03%

Peers	Market Cap.
Dunkin' Brands Group, Inc.	$3,852.88
Fiesta Restaurant Group, Inc.	$996.89
Buffalo Wild Wings Inc.	$3,040.73
Bojangles', Inc.	$614.04
DineEquity, Inc.	$1,588.73
Denny's Corporation	$785.33
The Cheesecake Factory Incorporated	$2,225.53
Noodles & Company	$307.28
BJ's Restaurants, Inc.	$1,135.96
Chipotle Mexican Grill, Inc.	$17,922.21

Current Capital Structure	
Total debt/Common Equity (LTM)	0.39
Cost of Borrowing (LTM)	5.51%
Estimated Cost of new Borrowing	6.36%
Altman's Z	5.02
Estimated Debt Rating	CCC
Current levered Beta	0.85
LTM WACC	6.00%

Management

Professional	Title	Comp. FY2013	Comp. FY2014	Comp. FY2015
Hudson, J.	Chairman, Chief Executive Officer and Presid	$2,167,851	$2,470,294	$0
Budd, John	Chief Development & Strategy Officer and Se	$40,859	$928,099	$0
Miller, Craig	Chief Information Officer of Sonic Industries	$501,272	$867,665	$0
San Pedro, Claudia	Chief Financial Officer and Executive Vice Pre	$0	$0	$0
Britten, Michelle	Principal Accounting Officer, Vice President a	$0	$0	$0
Horsch, Corey	Vice President of Investor Relations and Trea	$0	$0	$0

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	0.00%	-2.38%	2.38%	1.37%
Last Quarter-1	0.50%	-1.81%	0.00%	0.70%
Last Quarter -2	1.28%	1.39%	8.33%	2.33%
Last Quarter -3	4.90%	9.23%	12.50%	2.20%
Last Quarter -4	2.10%	1.50%	0.00%	0.62%
Standard error	0.9%	2.1%	2.5%	1.10%

Standard Error of Revenues prediction	0.9%
Imputed Standard Error of Op. Cost prediction	1.9%
Imputed Standard Error of Non Op. Cost predictio	1.4%

Industry Outlook (Porter's Five Forces)

Bargaining Power of Suppliers (100th Percentile), Bargaining Power of Customers (100th Percentile), Intensity of Existing Rivalry (100th Percentile), Threat of Substitutes (100th Percentile), Threat of New Competition (100th Percentile), and Overall (100th

Proforma Assumptions

Convergence Assumptions

All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years

General Assumptions	
Money market rate (as of today)	0.32%
Risk-Free rate (long term estimate)	2.91%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	37.5%
Country Risk Premium	6.0%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$606.09
FY2016	5.0%	$636.39
FY2017	4.7%	$666.30
FY2018	4.5%	$696.29
FY2019	4.2%	$725.53
FY2020	3.9%	$753.83
FY2021	3.5%	$780.21
FY2022	3.3%	$805.96
FY2023	3.0%	$830.14
FY2024	3.0%	$855.04
FY2025	3.0%	$880.69
Continuing Period	3.0%	$907.11

Items' Forecast Assumptions

	Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year
Operating Cash/Rev.	2.66%	2.66%	0.0%
NWV/Rev.	0.00%	0.00%	0.0%
NPPE/Rev.	69.53%	69.53%	0.0%
Dpr/NPPE	10.68%	10.68%	0.0%
NET MARGIN	10.19%	10.19%	0.0%
Op. Exp./Rev.	72.40%	72.40%	0.0%
SBC/Rev.	0.58%	0.58%	0.0%
Rent Exp./Rev.	1.75%	1.75%	0.0%
R&D/Rev.	0.00%	0.00%	0.0%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	14.84%	14.84%	0.0%
ROE	-313%	-313.15%	0.00%
P/E	22.70x	22.70x	0.00x
P/BV	NA	NA	0.00x
Debt/Equity	39%	39%	0.0%
Unlevered beta	0.68	0.68	0.00
Dividends/REV	3%	3%	0.0%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Money market rate
Other claims on the firm's assets	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years
E&P expenses are not capitalized
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (5.82%, 6%, 6.18%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value σ(ε)	$0.09
1-year target price σ(ε)	$0.10

Valuation

Forecast Year	ROE	Ke	Common Equity	Implied Equity Value	Other Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share
LTM	-313.1%	8.0%	-$64.14	$1,702.01	$87.15	49.78	$31.73
FY2016	-106.2%	8.1%	-$25.45	$1,810.14	$86.31	49.78	$33.38
FY2017	-285.1%	9.7%	$23.77	$1,962.67	$85.68	49.78	$35.76
FY2018	322.7%	4.6%	$75.04	$2,026.76	$85.95	49.78	$36.42
FY2019	107.5%	6.5%	$128.69	$2,131.83	$5.27	49.78	$38.61
FY2020	65.7%	7.0%	$184.85	$2,252.20	$5.47	49.78	$40.21
FY2021	47.7%	7.2%	$243.48	$2,385.54	$5.66	49.78	$41.99
FY2022	37.6%	7.4%	$304.60	$2,531.90	$5.85	49.78	$43.94
FY2023	31.2%	7.6%	$368.11	$2,692.07	$6.03	49.78	$46.07
FY2024	26.7%	7.7%	$434.11	$2,867.10	$0.00	49.78	$48.39
FY2025	23.5%	7.8%	$502.70	$3,058.31	$0.00	49.78	$50.91
Continuing Period	-313.1%	8.0%	-$37.95				

Monte Carlo Simulation Results

The 3σ(ε)-adjusted intrinsic value is $32.16; the 3σ(ε)-adjusted target price is $34; and the analysts' median target price is $33.69

Sensitivity Analysis

Revenue growth variations account for 95.9% of total variance
Risk premium's variations account for 2.5% of total variance
Operating expenses' variations account for 1.4% of total variance
Continuing period growth variations account for 0.2% of total variance