



ALPHA  **CHALLENGE**
Kenan-Flagler Business School
The University of North Carolina

November 20th, 2015



Company: Sonic Corp. (NASDAQ SONC)

Action: Long

Price Target: \$34.00

Students: Peiheng Xu, Devon Pennington, Elise Radolf



Long: SONC – Company Overview



Domestic Drive-in Leader

Market Value	
Stock Price (November 15, 2015)	\$27.83
Shares Outstanding	49.8
Market Cap	\$1,385.4
Plus: Debt	462.5
Less: Cash	27.2
Enterprise Value	\$1,820.6

Financial Data	
2015 Revenue	\$606.1M
2015 EPS	\$1.20
2015 Gross Margins	40%
2015 EBITDA Margins	27%
2015 Net Margins	10%

Current Valuation (Consensus)	
FY 2016 P/E	21x
FY 2016 EV/EBITDA	10.3x

Price Target	
<i>FY 2016 Price Target</i>	\$34
<i>Upside</i>	26%

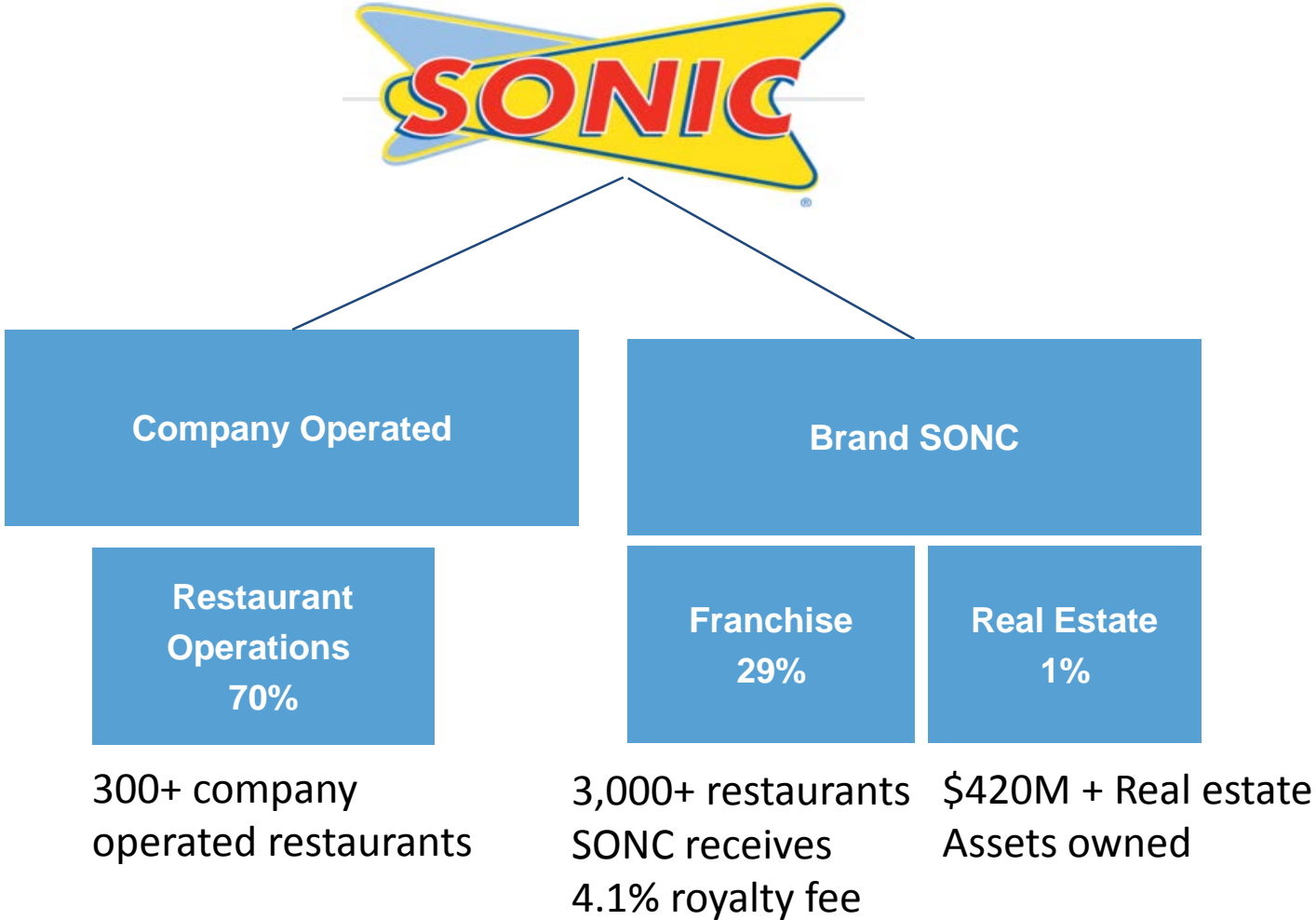


- Largest drive-in chain with ~3,500 locations.
- 90% Franchised.
- Primarily in the Southern US.

- Highly differentiated and customizable menu of food and specialty flavor drinks.
- 40% of product mix is drinks.
- Most diverse menu in QSR.

SONC – Company Overview

Corporate Structure



Opportunity: Improving Unit Economics

Intelligent Management

- Customizable drinks with superior margins
- Strategic restructuring will reach AUV target faster
- Aggressive share buyback to return value to shareholders

Strategic Restructuring

- Relocate stores to boost comparative same store sales
- Increase marketing ROI to build brand equity

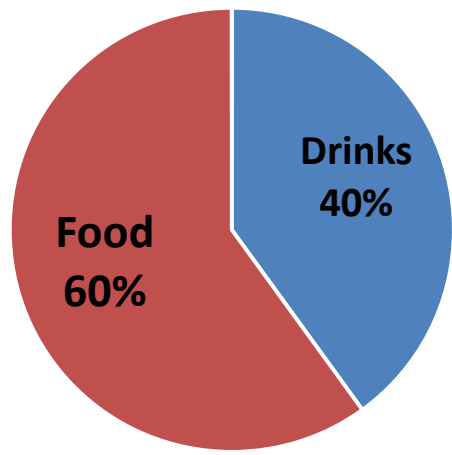
Technological Innovation

- Benefits of POPS/POS are underappreciated
- Growth cycle stage similar to previous QSR tech initiatives



Superior Management with a Smart Strategy

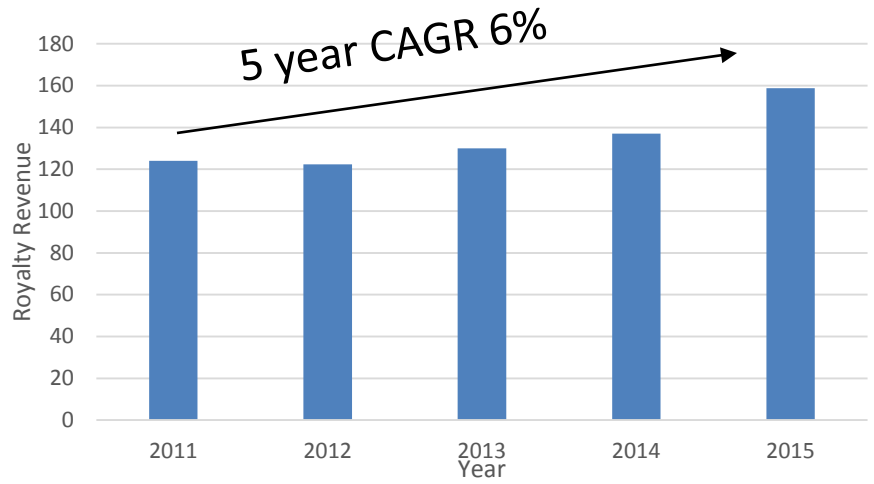
Better Product Segmentation



Better product mix than Peers

- Superior margins on drinks
- Better meal time mix leads to repeat customers
- Partnered with Coca Cola

Franchise Royalty Revenue



90% franchising mix with room to grow

- Stability of cash flows due to royalty fees
- Advertising and cap ex financed by franchisees
- Royalty rates are graduated based on revenue



SONC – Long Thesis #1...Continued

Sonic will outperform 2020 target of \$1,500 AUV.

6 months ahead of target

Improving Unit Economics

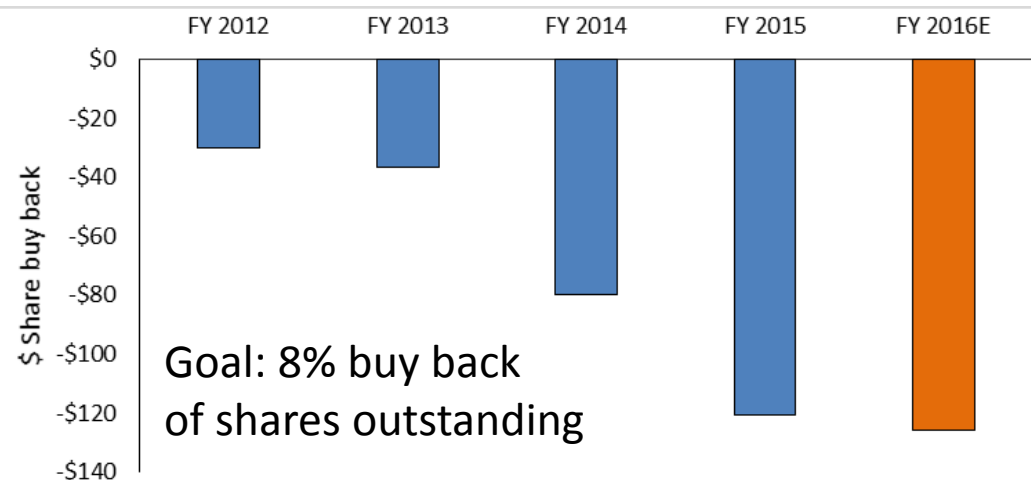
- Relocate stores to achieve 20-30% additional revenue per store
- Grow store margins to 17%-18% through technology initiatives

System AUV

	2015A	2020E	2020NEW
	5% sss	3% sss	4% sss
Number Company stores	387	368	368
Company Revenue	436	534	572
Company AUV	\$ 1.1	\$ 1.5	\$ 1.6
Number franchisee stores	3,139	3,300	3,300
Franchisee Revenue	\$ 3,931	\$ 4,949	\$ 5,181
Franchisee AUV	\$ 1.3	\$ 1.5	\$ 1.6
System Wide AUV	\$ 1.2	\$ 1.5	\$ 1.6

Share Buy Back Plan

- Aggressive stock repurchase plan
- Approved for \$146 million in 2016



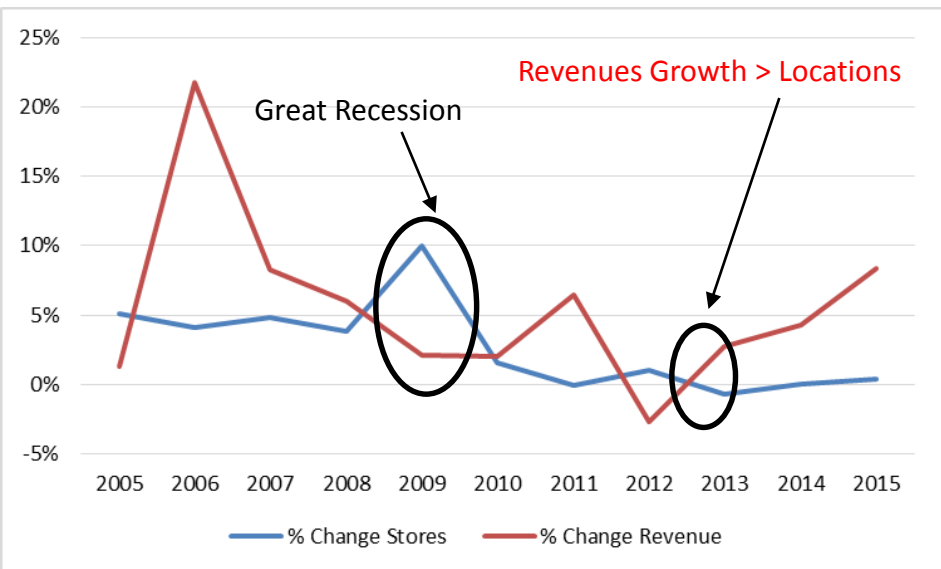


SONC – Long Thesis #2

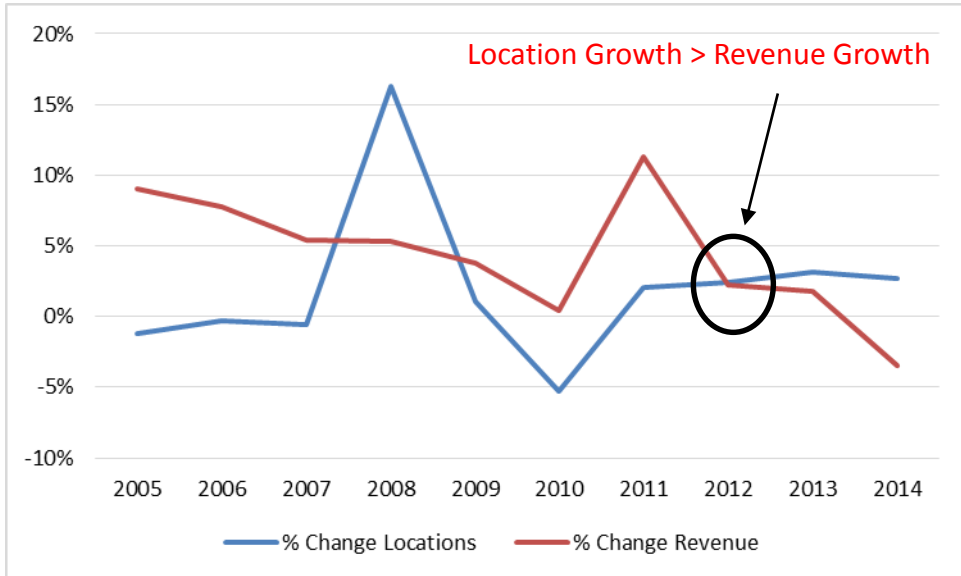


Smarter than its Peers – Lessons Learned

SONC Stays Lean



Peers Haven't Learned



Peers include: WEN, MCD, PLKI

Why slow expansion?

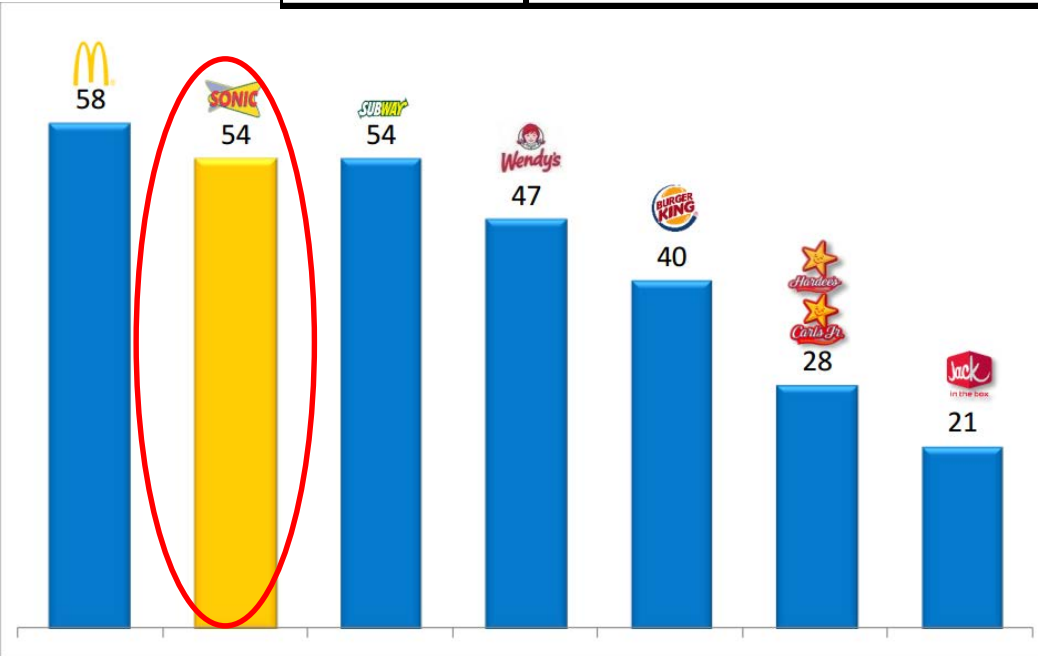
- Relocate and refurbish underperforming stores
- Flexible during declining sales
- Can easily pivot to changes in consumer preferences



SONC – Long Thesis #2...Continued

Higher efficiency in Marketing Expenditure

(\$millions)	Awareness			
	Ad Dollars	% Sales	Level	\$/Ranking Unit
WEN	\$ 73	4%	47	\$ 1.6
MCD	\$ 99	1%	58	\$ 1.7
JACK	\$ 42	3%	21	\$ 2.0
SONC	\$ 22	4%	54	\$ 0.4



Higher ROI on marketing expenditures

- Growing brand awareness to build customer loyalty
- Increase current market share from same store sales

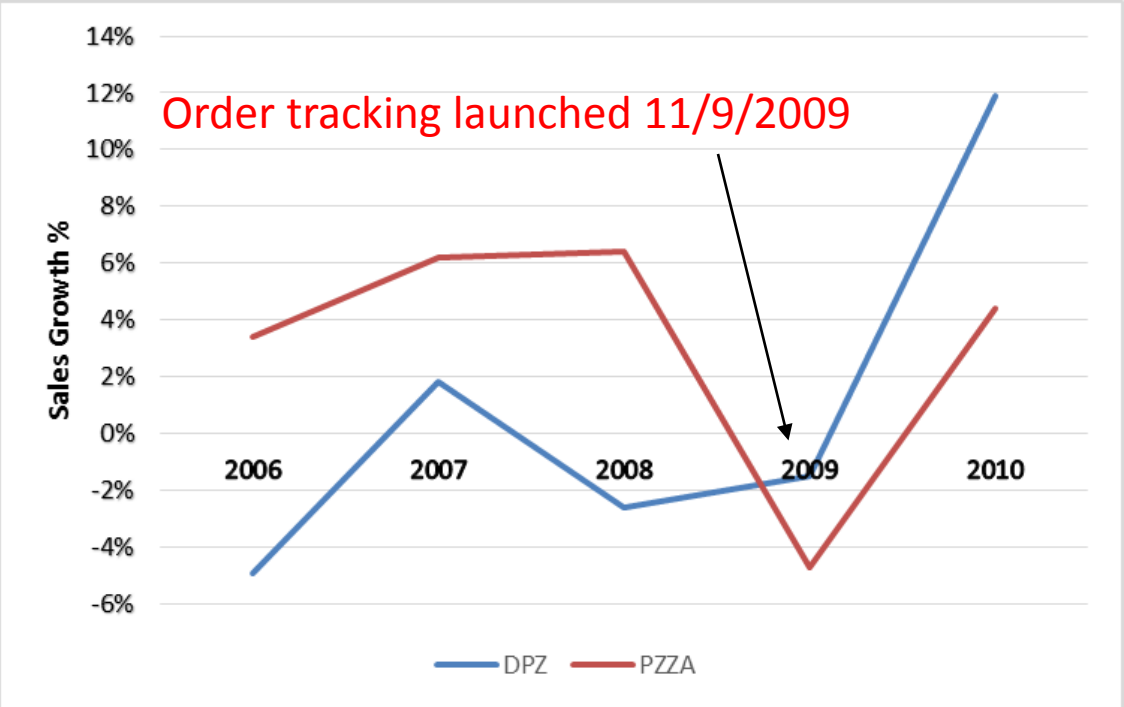


SONC – Long Thesis #3



Tech Innovation Transforms the Ordering Process

The Domino Effect



- Significant increase in 2010 sales due to DPZ mobile app
- POPS/POS will drive same store sales in 2016
- Will add 2-5%+ to same store comparable sales

SONC: POPS and POS



Financial Summary

Terminal	
DC Inputs	
Assumed Terminal Growth Rate	2%
WACC	8%
Implied Enterprise Value	\$2,199
Less Debt:	(410)
Implied Equity Value	\$1,789
Diluted Shares Outstanding	52.5
Implied Value Per Share	\$34
Implied P/E (2016)	24x
Implied EV/EBITDA (2016)	12x

Price upside

26%

Exit Multiple	
Multiple Inputs	
Exit EBITDA	244
Exit Multiple	9x
Implied Enterprise Value	\$2,196
Less: Net Debt	(410)
Implied Equity Value:	\$1,786
Diluted Shares Outstanding	52.5
Implied Value Per Share	\$34
Implied P/E (2016)	24x
Implied EV/EBITDA (2016)	12x

Price upside

26%

Bear Case (\$25) Delayed deployment of POPS	Base Case (\$34) Relocations and POPS deployment	Bull Case (\$38) Failed transition
Implied upside: (7%)	Implied upside: 26%	Implied upside: 41%
Key Assumptions: <ul style="list-style-type: none"> Limited store relocations 2% same store sales growth Delayed launch of POPS/POS will cause flat gross margins 	Key Assumptions: <ul style="list-style-type: none"> 3% same store sales growth including relocations 3% sales growth from deployment of POPS 100bps improvement in gross margins due to POS cost savings 	Key Assumptions: <ul style="list-style-type: none"> AUV targets met 1 year ahead of target Higher than expected commitment of new stores by franchisees Continued store expansion in North East and California

SONC – Valuation

Financial Summary

	Market Cap	% Franchised	P/E NTM	EV/EBITDA	P/E TTM
Sonic	1,528	89%	21x	10x	23x
Dunkin Donuts	5,830	100%	19x	13x	24x
PopEyes	1,356	97%	25x	14x	29x
Jack in the Box Inc.	2,867	74%	21x	11x	26x
Wendy's	3,393	85%	26x	12x	44x
Papa Johns	2,210	84%	25x	14x	32x
Domino's Pizza	5,550	97%	27x	16x	32x
Average			23x	13x	29x
QSR Average					25x

Historical P/E



Risks and Mitigation

Risk	Potential Harm	Mitigating Force
<p><u>Minimum wage rate increase</u> (Increase from \$7/hr to \$12/hr)</p>	<p>HIGH</p>	<ul style="list-style-type: none"> Automation of menu to minimize impact
<p><u>Successful Implementation of POPS/POS drive in technology</u> (Drive store traffic and repeat customers)</p>	<p>Moderate</p>	<ul style="list-style-type: none"> Increase emphasis of social media and mobile presence to maximize customer experience and connection
<p><u>Store Concentration in Texas</u> (952 or 28% of stores in TX – decrease in disposable income of customers)</p>	<p>Low</p>	<ul style="list-style-type: none"> Promote limited times offers and and value items

SONC – Areas of Research

Steps Taken

- Call with Consumer Insights at SONC
- Call with sell-side analyst
- Call with buy side analyst
- Call with IR at SONC



Future Steps

- Call with Franchisee
- Call with suppliers
- Call with Competitor QSR





Long: SONC - Appendices

Output Summary

	2012	2013	2014	2015	2016E	2017E	2018E	2019E	2020E
<u>Number of Stores</u>									
System	3,556.0	3,522.0	3,518.0	3,526.1	3,550.5	3,575.1	3,595.3	3,656.0	3,717.9
YoY	-0.1%	-1.0%	-0.1%	0.2%	0.7%	0.7%	0.6%	1.7%	1.7%
Company	409.0	396.0	391.0	387.1	383.2	379.4	375.6	371.8	368.1
YoY	-8.3%	-3.2%	-1.3%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%
Franchise	3,147.0	3,126.0	3,127.0	3,139.0	3,167.3	3,195.8	3,219.7	3,284.1	3,349.8
YoY	1.0%	-0.7%	0.0%	0.4%	0.9%	0.9%	0.8%	2.0%	2.0%
<u>Segment</u>									
System									
Revenue	542	543	552	606	647	691	739	786	822
YoY	-0.8%	0.2%	1.8%	9.8%	6.7%	6.9%	6.9%	6.3%	4.7%
Company									
Revenue	404	402	405	436	463	492	524	553	575
YoY	0.5%	-0.5%	0.8%	7.6%	6.2%	6.3%	6.4%	5.5%	4.0%
Franchise									
Revenue	126	130	137	160	173	188	205	222	236
YoY	-4.5%	3.2%	5.4%	16.8%	8.3%	8.7%	8.7%	8.4%	6.5%
Franchise Store Revenue	3,386	3,480	3,627	3,931	4,175	4,434	4,700	4,982	5,181
YoY	-2.7%	2.8%	4.2%	8.4%	6.2%	6.2%	6.0%	6.0%	4.0%
Royalty Rate	3.7%	3.7%	3.8%	4.1%	4.2%	4.3%	4.4%	4.5%	4.6%
YoY	-1.8%	0.5%	1.1%	7.7%	2.0%	2.4%	2.5%	2.3%	2.4%
Total Revenue to Sonic									
Additional Revenue	11.3	10.3	9.9	10.2	10.4	10.6	10.8	11.1	11.3
	-4.6%	-8.8%	-4.1%	3.6%	2.0%	2.0%	2.0%	2.0%	2.0%

Balance Sheet

	2012	2013	2014	2015	2016E	2017E	2018E	2019E	2020E
Balance sheet									
Current Assets									
Cash and Cash Equivalents	53	78	36	27	28	23	46	73	107
Other Current Assets	55	63	60	58	55	55	55	57	59
Total Current Assets	107	141	96	85	83	79	102	130	166
Non Current Assets									
PP&E	443	400	442	421	422	418	414	409	404
Other Non Current Assets	113	120	113	113	113	113	113	113	113
Total Assets	681	661	651	620	618	610	628	653	683
Current Liabilities									
Accounts Payable	11	13	17	14	19	20	21	23	23
Other Current Liabilities	75	86	80	90	97	97	97	97	97
Total Current Liabilities	81	73	80	88	116	117	118	119	120
Non Current Liabilities									
Long-term Debt	482	467	437	428	458	508	508	478	448
Deferred Income Taxes	57	51	60	60	60	60	60	60	60
Total liabilities	622	583	588	603	633	684	685	656	627
Shareholders' Equity									
Common Stock - Par Value	9	17	18	18	18	18	18	18	18
Additional Paid in Capital	231	225	225	233	233	233	233	233	233
Retained Earnings	723	758	806	852	903	963	1,031	1,104	1,183
Treasury Stock	(895)	(907)	(965)	(1,068)	(1,168)	(1,288)	(1,338)	(1,358)	(1,378)
Total Shareholders Equity	59	77	63	17	(15)	(74)	(57)	(4)	56
Liabilities & Shareholders Equity	681	661	651	620	618	610	628	653	683

Income Statement

	2012	2013	2014	2015	2016E	2017E	2018E	2019E	2020E
<u>Income statement</u>									
Revenue	544	543	552	606	651	695	743	790	826
YoY	-0.4%	-0.2%	1.8%	9.7%	7.4%	6.8%	6.9%	6.2%	4.7%
- Stores	539	538	548	603	647	691	739	786	822
YoY	-0.7%	-0.2%	1.9%	10.0%	7.3%	6.9%	6.9%	6.3%	4.7%
- Others	5	5	4	3	4	4	4	4	4
YoY	45.2%	1.4%	-10.2%	-26.8%	27.7%	0.0%	0.0%	0.0%	0.0%
COGS	(258)	(257)	(342)	(364)	(385)	(407)	(433)	(456)	(474)
Gross profit	285	286	210	242	266	288	311	333	352
Gross margin	52.5%	52.6%	38.1%	40.0%	40.8%	41.4%	41.8%	42.2%	42.6%
SG&A	(77)	(78)	(69)	(79)	(85)	(87)	(89)	(96)	(101)
% of revenue	-14.2%	-14.3%	-12.6%	-13.1%	-13.1%	-12.5%	-12.0%	-12.2%	-12.2%
ER&D	(119)	(117)	(42)	(45)	(49)	(52)	(56)	(59)	(62)
% of revenue	-21.8%	-21.6%	-7.6%	-7.4%	-7.5%	-7.5%	-7.5%	-7.5%	-7.5%
EBIT	90	91	99	118	131	149	166	178	189
EBIT margin	16.5%	16.8%	17.9%	19.5%	20.2%	21.4%	22.3%	22.5%	22.9%
Investment Income	(31)	(29)	(25)	(25)	(25)	(25)	(25)	(25)	(25)
Others	(1)	(6)	(0)	(1)	(1)	(1)	(1)	(1)	(1)
PBT	58	56	74	92	105	123	140	152	163
Tax	(22)	(20)	(26)	(27)	(32)	(37)	(43)	(47)	(50)
Tax rate	-37.8%	-34.8%	-35.0%	-29.7%	-30.5%	-30.0%	-31.0%	-31.0%	-30.5%
Net Income	36	37	48	65	73	86	96	105	113
Adjusted Net Income	37	41	48	66	74	87	97	106	114
Net margin	6.7%	7.5%	8.7%	10.8%	11.4%	12.5%	13.1%	13.4%	13.8%

Cash Flow Statement

	2012	2013	2014	2015	2016E	2017E	2018E	2019E	2020E
<u>Cashflow statement</u>									
Operating Activities									
Net Income	36	37	48	64	73	86	96	105	113
Depreciation and Amortization	41	39	41	45	50	53	56	59	63
Stock Based Compensation Expense	4	4	4	4	0	0	0	0	0
Working capital change	(2)	7	1	12	15	1	1	(1)	(1)
Accounts Receivable	(3)	2	(6)	3					
Change in Accounts Payable	(1)	2	1	(1)					
Change in net operating assets	2	3	6	10					
Cash Flow from Operating Activities	95	88	104	136	138	140	154	163	175
				137					
Investing Activities									
Plant and Equipment Additions	(24)	(41)	(79)	(42)	(45)	(48)	(52)	(55)	(58)
Proceeds from Sale of Plant and Equi	10	33	2	14					
Other Assets	(10)	7	6	3					
Cash Flow from Investing Activities	(24)	(1)	(71)	(25)	(45)	(48)	(52)	(55)	(58)
Financing Activities									
Repayment of Long-term Debt	(15)	(190)	(10)	(90)	(70)	(50)	(50)	(50)	(50)
Proceeds from Borrowings on Credit	0	155	0	91	100	100	50	20	20
Repurchase of Common Stock	(30)	(37)	(80)	(121)	(126)	(100)	(50)	(20)	(20)
Cash Dividends Paid	0	0	0	(19)	(22)	(26)	(29)	(31)	(34)
Cash Flow from Financing Activities	(48)	(61)	(75)	(120)	(118)	(76)	(79)	(81)	(84)
Other Adjustments									
Cash Flow Net Changes in Cash	23	25	(42)	(9)	(25)	15	23	27	34

Discounted Cash Flow

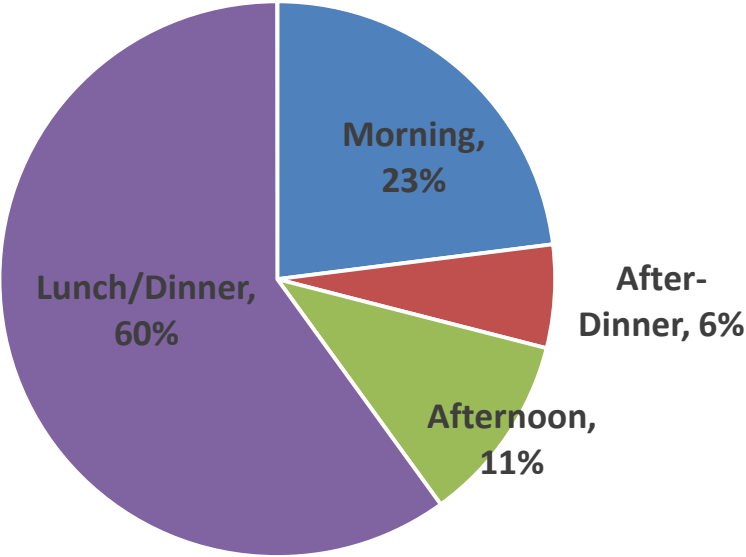
USD m	2015	2016E	2017E	2018E	2019E	2020E	Terminal Value
EBIT	118	131	149	166	178	189	
Less: Taxes	(27)	(32)	(37)	(43)	(47)	(50)	
Profit after tax	91	99	112	122	131	139	
Plus: D&A	45	50	53	56	59	63	
Less: CAPEX	(42)	(45)	(48)	(52)	(55)	(58)	
Change in WC	12	15	1	1	(1)	(1)	
Free cash flow	105	119	117	128	134	144	2,420
Discounted CF		119	109	110	107	106	1,650
NPV of EV	2,200						
Less: Net debt	410						
Equity Value	1,790						
Shares outstanding	53						
Price	34						
Risk free rate	2.2%						
Beta	1.1						
Market return	7.3%						
WACC	8%						
Terminal growth	2.0%						

Source: Company data

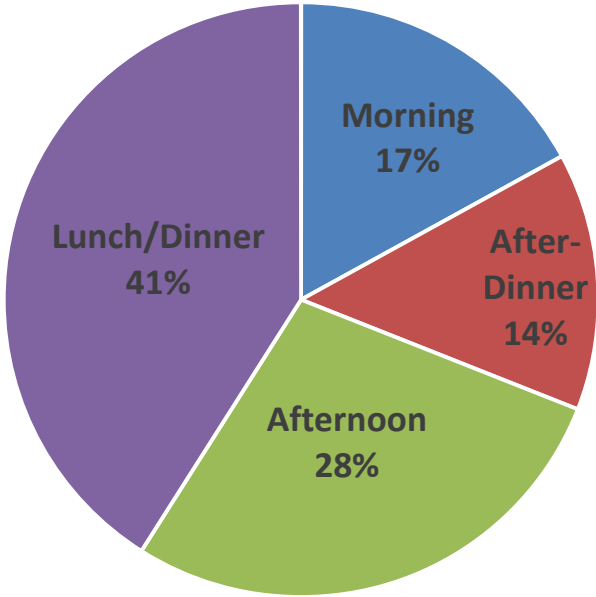
Product Offerings

Day Part Strategy

QSR



Sonic



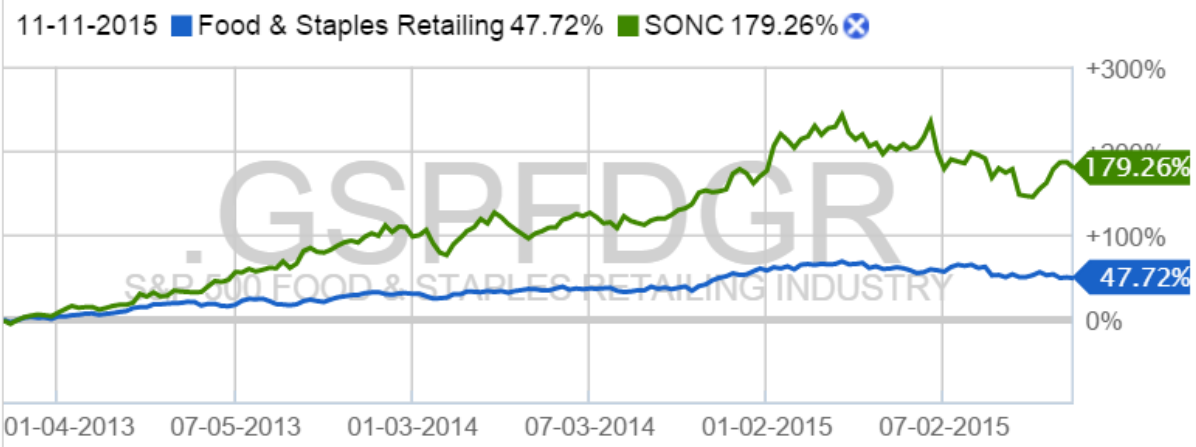
SONC – Company Overview

Key Statistics

Relative 5 year performance



Relative 3 year performance



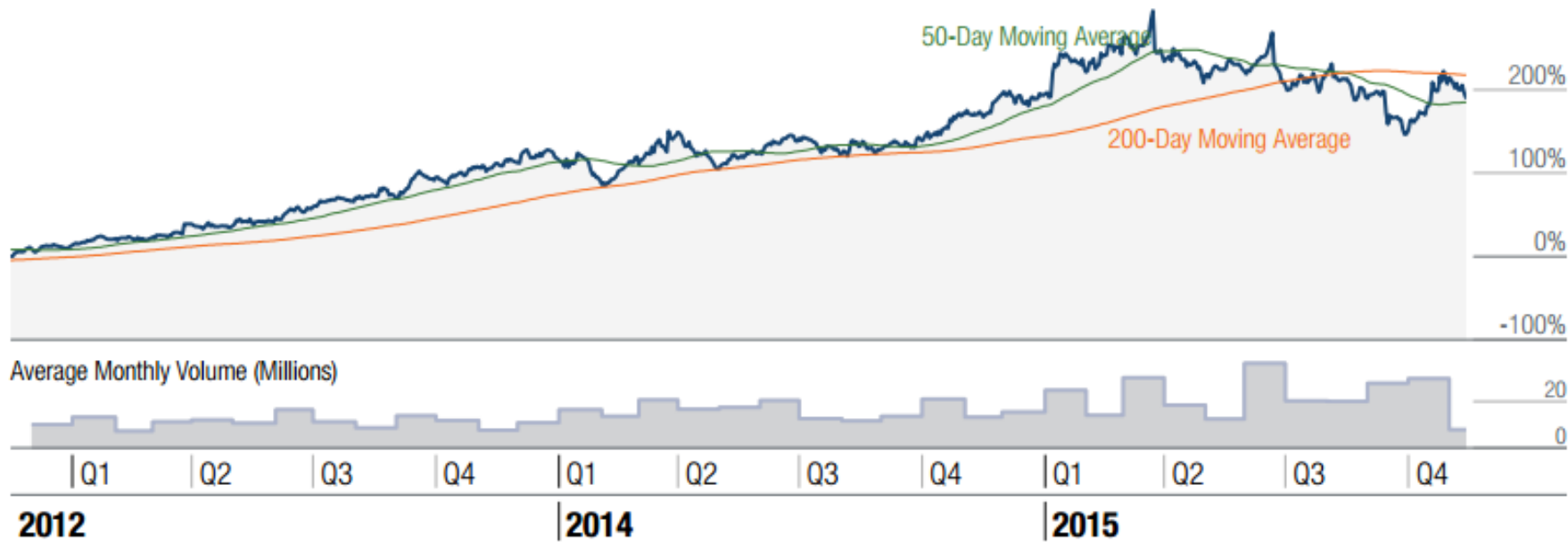
Key Statistics (Latest 4 Quarters)

EPS Growth	41.2%
EPS Growth 3 Year, annualized	0.0%
EPS Growth 5 Year, annualized	28.7%
Sales Growth	7.0%
Asset Turnover	1.0x
Inventory Turnover	95.2x
Receivables Turnover	18.4x
Effective Tax Rate	29.7%
Total Debt to Equity	1,951.8x
Interest Coverage	3.6x
Quick Ratio	0.9x
Current Ratio	1.1x
Payout Ratio	36.7%
Debt to Capital	0.9x

SONC – Company Overview

Stock Price Chart

3-Year Price Performance Data provided by Thomson Reuters DataScope



Trading Characteristics

52 Week High <small>3/24/2015</small>	\$36.73	Price Performance (% Change)	Volume
52 Week Low <small>9/30/2015</small>	\$22.72	4 Week	Average 10-Day
% Price Above/Below		3.4	1,013,876.1
20-Day Average	-4.7	13 Week	Average 90-Day
50-Day Average	2.0	-7.0	1,102,738.4
200-Day Average	-8.5	52 Week	Shares Outstanding
		6.1	49,779,000
		<small>1 Year Annualized as of 11/13/2015</small>	Shares Short
		Total Return	6,251,203
		+7.50%	Days to Cover
		Standard Deviation	4
		0.31	Short Interest % Change
		Beta	5.5
		0.91	<small>Short Interest data provided by NASDAQ, NYSE, etc.</small>

SONC – Company Overview

Sonic Fundamentals

Fundamentals	2007	2008	2009	2010	2011	2012	2013	2014	2015
Price/Earnings	24.0x	14.9x	14.1x	22.6x	29.9x	15.6x	24.9x	24.8x	22.5x
Price/Sales	1.7x	1.1x	1.0x	0.9x	1.1x	1.0x	1.7x	2.1x	2.3x
Price/Book Value	-12.5x	-13.7x	-163.6x	21.2x	11.1x	9.2x	11.6x	18.1x	79.1x
Price/Cash Flow	12.7x	7.9x	7.2x	7.4x	9.5x	7.3x	12.3x	13.1x	12.9x
Gross Margin	35.3%	34.6%	35.3%	35.6%	34.9%	35.4%	36.0%	37.4%	39.4%
Profit Margin	8.4%	7.5%	6.9%	3.8%	3.5%	6.6%	6.8%	8.7%	10.6%
Sales/Employee	\$2.2 M	\$2.1 M	\$2.1 M	\$43.2 Th	\$45.1 Th	\$47.2 Th	\$48.3 Th	\$51.4 Th	\$55.8 Th
Income/Employee	\$179.8 Th	\$157.5 Th	\$141.3 Th	\$1.7 Th	\$1.6 Th	\$3.1 Th	\$3.3 Th	\$4.5 Th	\$5.9 Th
Return on Equity	-60.1%	-94.1%	-1,158.4%	94.9%	37.2%	60.9%	47.4%	76.5%	369.9%
Return on Assets	8.5%	7.2%	5.8%	2.9%	2.8%	5.3%	5.6%	7.4%	10.4%
PEG (Historical Growth)	2.4x	2.4x	-5.2x	-0.8x	-0.9x	-1.6x	1.1x	0.6x	0.9x
Beta	0.4	1.1	1.2	1.5	1.5	1.4	1.4	1.6	1.1
Annual Dividend	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.09	\$0.27
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.3%

SONC – Company Overview

Market Comparables

Company Name (Ticker Symbol)	PE (11/10/15)	High P/E	Low P/E
Sonic (SONC)	23.2	30.6	18.9
DineEquity (DIN)	27.9	38.5	27.4
PopEyes Louisiana Kitchen (PLKI)	28.7	36.7	25.7
BJ's Restaurant (BJRI)	27	34.2	24.9
Dave and Busters (PLAY)	42.4	45.2	21.1
Shake Shack (SHAK)	n/a	-90.4	-36.1

Ticker	Firm	Market Cap (\$mm)	AUV Firm	O'Sales Prior FY	Total # of Locations	# of Franchises	% Franchised
SONC	Sonic Corp.	1,528	1.12	606.09	3,526.00	3,139.00	89%
JACK	Jack in the Box Inc.	2,867	1.51	1,484.13	2,888.00	2,147.00	74%
PZZA	Papa John's International, Inc.	2,923	1.10	1,598.15	4,663.00	3,928.00	84%
PLKI	Popeyes Louisiana Kitchen, Inc.	1,356	1.50	235.60	2,379.00	2,314.00	97%
WEN	Wendy's Company	3,393		2,061.06	6,515.00	5,558.00	85%

Ownership

Top 10 Institutional Holdings by Shares Held

Name	Reporting Date	Total Holdings ▼	Position Value	Outstanding Shares Owned
Vanguard Group, Inc. (The)	06/30/15	3.6M	\$101.0M	7.28%
BlackRock Fund Advisors	06/30/15	2.9M	\$80.8M	5.83%
Price (T.Rowe) Associates Inc	06/30/15	2.3M	\$64.3M	4.63%
Chilton Investment Company, LLC	06/30/15	2.3M	\$63.4M	4.57%
Bank of America Corporation	06/30/15	2.1M	\$58.1M	4.19%
Dimensional Fund Advisors LP	06/30/15	1.9M	\$51.7M	3.72%
Ranger Investment Management, LP	06/30/15	1.5M	\$41.9M	3.02%
Citigroup Inc.	06/30/15	1.4M	\$40.1M	2.89%
Invesco Ltd.	06/30/15	1.4M	\$38.0M	2.74%
Waddell & Reed Financial Inc.	06/30/15	1.4M	\$37.8M	2.72%



■ Institutional Stock Ownership	53.4%
■ Institutional Mutual Fund Ownership	46.4%
■ Mutual Fund Ownership	1.7%
■ Insider Ownership	4.5%
■ Other	-6.0%

SONC – Company Overview

Senior Management Team

