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Deutsche Bank

22 April 2010

Near-Term Looks "Meaty"

Implications of Higher Protein Prices

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FITT Research

Fundamental, Industry, Thematic, Thought Leading
Deutsche Bank Company Research's Product Committee has deemed this work F.I.T.T. for investors seeking differentiated ideas. Here our Agribusiness/Protein and Restaurant teams take a collaborative approach in studying the issues surrounding the supply-demand balance in the protein industry and the impact of higher protein prices on meat producers/processors and restaurants.

Fundamental: supply-demand dynamics favorable for protein

Industry: what are the implications for the restaurant industry?

Thematic: stock implications

Thought Leading: comprehensive approach provides needed background

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Fundamental: supply-demand dynamics favorable for protein

Based on USDA estimates, a combination of lower production and a recovery in exports should lead to a 5.8% and 2.5% drop in domestic per capita pork and beef availability, respectively. Against this backdrop + considering a slight improvement in the economy and better foodservice demand at the margin, chicken per capita consumption is expected to grow 4.6%. With supply tight until at least late 2010/early 2011, higher demand should support protein prices.

Industry: what are the implications for the restaurant industry?

In light of this evolving fundamental outlook for proteins, we've looked at (1) the recent moves in the commodity costs that matter most to restaurants, (2) key commodity exposures across the group, (3) the latest commodity outlook for each company and (4) potential earnings risk/sensitivity. Our conclusion is that we do not see much commodity-related risk to restaurant profit forecasts in the near term, as most chains have already locked in major items for the balance of 2010 (w/ ground beef as a possible exception). However, we do see some risk to 2011 forecasts, as prices for most key commodities are significantly higher and consensus expectations call for higher EPS growth. Each 1% move in food costs impacts avg. restaurant EPS by 2-3% and margins by ~30bps.

Thematic: stock implications

We downgrade HRL to SELL on rapidly rising raw material costs and premium valuation, despite mgmt excellence and strong free cash flow generation. We remain positive on SFD on tight overall protein supply, a benign feed cost environment, improving demand (helped by the "breakfast wars"), and the potential for de-leveraging. The biological lag associated with hog production serves as insulation against rising production. We believe there is near-term upside in both SAFM and TSN owing to lower availability of competing meats, which should lead to retail and foodservice featuring of chicken this spring/summer. We raise estimates and price targets on SFD, TSN and SAFM. We remain positive on the restaurant group in the near-term, with Buy ratings on BKC, CMG, MCD, PNRA and RUTH. However, we believe the margin for error has diminished as valuations and expectations have moved higher. Given the recent strength in share prices, investors may begin to look for a good reason to trim positions. Rising commodity costs could emerge as a potential negative catalyst for the stocks.

Thought Leading: comprehensive approach provides needed background

Through a collaborative research process we have identified key secular themes across the protein and restaurant industries. The protein industry has been characterized by the typical boom and bust cycle. With breeding herds/flocks cut, production increases will take time. Restaurants are in the "sweet spot" of firming demand and benign input costs, but the latter may not last for long.

FITT Research

Top picks	
Smithfield Foods (SFD.N),USD20.04	Buy
Chipotle Mexican Grill, Inc (CMG.N),USD126.75	Buy

Companies featured	
Sanderson Farms (SAFM.OQ),USD57.82	Hold
Smithfield Foods (SFD.N),USD20.04	Buy
Tyson Foods (TSN.N),USD20.21	Hold
Burger King (BKC.N),USD21.47	Buy
McDonald's (MCD.N),USD70.36	Buy
YUM Brands, Inc. (YUM.N),USD43.11	Hold
Chipotle Mexican Grill, Inc (CMG.N),USD126.75	Buy
Darden Restaurants (DRI.N),USD47.40	Hold
Ruth's Hospitality Grp. (RUTH.OQ),USD5.75	Buy
Panera Bread Co (PNRA.OQ),USD85.16	Buy
Texas Roadhouse (TXRH.OQ),USD15.77	Hold
Hormel Foods (HRL.N),USD41.54	Sell
Archer-Daniels-Midland (ADM.N),USD28.77	Buy
Corn Products International (CPO.N),USD34.89	Hold

Ratings and estimates changes			
Hormel	SELL	from	HOLD
F2010E EPS	$2.63	from	$2.76
Smithfield			
F4Q10E EPS	($0.40)	from	($0.23)
F2011E EPS	$2.05	from	$1.63
Sanderson Farms			
F2010E EPS	$5.57	from	$4.49
Tyson			
F2010E EPS	$1.82	from	$1.41

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Executive Summary

Outlook – Protein

In our latest Monthly Mouthful (dated March 19th), we noted that protein fundamentals are strong owing to:

- Tight protein supplies;
- Low levels of inventory;
- An expected drop in protein production in 2010E (post a drop in 2009);
- A benign feed cost environment;
- Improved cash flow profiles leading to de-leveraging.

A new factor that enters the mix is a potential increase in demand. Since these are commodity products, a change in supply or demand, at the margin, drives price. Recent indications of a pick-up in demand from foodservice distributors and at other foodservice establishments, as well as retail sales data for the foodservice category, are positive for pricing.

The tight protein environment combined with a benign feed cost and improved demand environments bode well for integrated protein producers. We have favored the hog sector owing to the biological lag involved in increasing the breeding herd and thus production (at least a two year lag between when a sow is born and its offspring is brought to slaughter). This process takes about 9 months for chicken. However, we believe that near-term upside continues to exist for the chicken producers.

Hormel: We are downgrading Hormel to a SELL from a HOLD and reducing our price target to $37 from $41. We believe Hormel's management is at the top of the industry and acknowledge that free cash flow generation is strong. However, there is near-term downside owing to the sharp run-up in pork cutout prices and a tightening hog supply, in our view. While we ultimately believe the company will recover higher input costs, it will take time to accomplish this and margins are likely getting squeezed as raw materials increase. The divisions most at risk from higher pork prices are Refrigerated (36% of segment income) and Grocery (29% of segment income).

We reduce our F2010E (end Oct) EPS to $2.63 from $2.76 (excluding items), at the low end of management's guidance of $2.63-$2.73. We reduce our F2Q10E (end April) EPS to $0.63 from $0.66. We assume lower margins in Refrigerated, slightly lower margins in Grocery, but higher margins in Jennie-O as the turkey industry has improved. Assuming a multiple in line with the packaged food group of about 15x, applied to our C2010E EPS estimate of $2.48, we derive our price target of $37. Our DCF model that uses a 9.5% WACC (determined via CAPM: 0.8x beta, 4% risk free rate, 12% expected return), assuming LT growth in sales of 3-4%, operating profit 5-6% and EPS 7-8% suggests a price target of $40. Our Incremental Value Creation Coefficient (IVCC), which measures the present value of changes in future economic profit relative to the peer group through regression analysis suggests a price target of $33. Taken together, we arrive at our $37 price target.

Smithfield: We are reducing our F2010E (end Apr) EPS to (0.40) from ($0.23). Our F4Q10E (end April) is now $0.17, down from $0.33 on tighter assumed profits in Packaged Meats owing to the run-up in pork prices, as well as lower profits in Fresh Pork as packer margins were narrow at times during the quarter. We also ran through a mark to market loss in F4Q owing to hog hedges. Turning to F2011E, we raise our EPS estimate to $2.05 from $1.63.

The primary change stems from better Hog Production Group earnings owing to higher hog futures and more benign feed costs. Specifically, we assume Hog Production profits per head of $13. We continue to assume Fresh Pork profits of $0.02/lb, equating to an operating margin of 2.8%, helped by the closure of Sioux City. We assume Packaged Meats profits of $0.12/lb, or a 7.0% operating margin. Finally, we incorporate management's interest rate guidance for F2011E of $255 million, but note that building free cash flow should allow for a higher level of debt reduction and, thus, lower interest burden. In terms of valuation, we raise our price target to $24 from $22 and retain our Buy rating.

Sanderson Farms: We are raising our F2010E (end Oct) EPS estimate to $5.57 from $4.49. We incorporate higher chicken prices for boneless breast and tenders, lower prices for wings and assume a $0.40/lb price for leg quarters for F3Q10 (end July), which may prove conservative. As Sanderson has little business tied to fixed pricing, it is leveraged to the spot market. We model in corn futures past April, as Sanderson indicated it had not priced any corn past April, as of March 29th. We did not alter our soybean meal cost assumption, as the company noted it was hedged on soybean meal through fiscal year end. We also reduced our fixed costs per lb. assumption owing to improved operating leverage with Waco (its most efficient plant) operating at capacity. We do not adjust for any impact from China as we believe product is working its way indirectly into the market. Our F2011E (end Oct) EPS is $5.98, up 7.5% YoY. For F2Q10E (end April), we raise our EPS estimate to $1.26 from $1.12. In terms of valuation, we raise our price target to $65 from $51 and retain our HOLD rating

Tyson: We raise our F2010E (end Sep) EPS to $1.82 from $1.41 and our F2011E EPS to $1.98 from $1.56. We assume higher profits in Beef and Chicken, but temper our outlook for Pork and Prepared Foods. Specifically, for Prepared Foods, our regression using fresh 72% combo prices yields a profit slightly above break-even for fiscal 2Q10E (end March). We incorporate this in our model, but note it may prove conservative. For F2Q10E (end March), we adjust our EPS estimate to $0.37 from $0.36. We raise our price target to $22 from $16 and retain our HOLD rating.

Outlook – Restaurants

While we remain positive on the restaurant group broadly, with Buy ratings on BKC, CMG, MCD, PNRA and RUTH, we believe the margin for error has diminished as valuations and expectations have moved higher. Given the recent strength in share prices, investors may begin to look for a good reason to trim positions. We believe rising commodity costs, particularly proteins, may emerge as a potential negative catalyst for the stocks later in 2010 and into 2011.

We are beginning to see higher prices across certain food commodities, especially major proteins (beef, chicken, pork). These three proteins in aggregate represent ~30-40% of total food costs for most restaurants. In this report, we have taken a detailed look at how higher food prices may impact the restaurant segment. We've analyzed (1) the recent moves in the commodity costs that matter most to restaurants, (2) key commodity exposures across the group, (3) the latest commodity outlook for each company and (4) the potential earnings risk/sensitivity from higher commodity costs.

Our main conclusion is that we do not see much commodity-related risk to restaurant earnings forecasts in the very near term, as most chains have already locked in major items for the balance of calendar 2010. Plus, improving demand trends may trump input cost concerns in the near term. Looking out a bit further, we do see some risk to 2011 earnings forecasts for the group as prices for most major commodities are well above the levels seen in mid-to-late 2009, which is when many contracts were likely signed. We also expect higher labor and health care costs and the likely need to reinvest in assets/operations/products to begin to put some upward pressure on overall sector operating costs in the future. This means the near-term outsized improvements in margins/profitability may be short-lived and that margin assumptions further out carry some risk, particularly against the backdrop of surging stock prices and valuations.

- Each 1% change in food costs impacts annual EPS by 2-3% for the average restaurant chain and margins by ~30bps.
- Restaurant companies expect ~1% food cost deflation in FY10, on average. If this were to rise to just +2% in FY11, the earnings pressure could be 7-8% (before factoring in menu pricing) and ~90bps of pressure on margins.
- Current consensus forecasts call for a 50-60bps improvement in industry-wide margins in FY11, on top of +50-60bps in FY10 and +60-70bps in FY09. Consensus forecasts also assume an acceleration in industry-wide EPS growth to +17% in FY11 from +10% in FY10.

Valuation

Protein: We employ a variety of valuation methods for the protein and agribusiness sectors, including multiples analysis (P/E, EV/EBITDA and EV/sales), DCF models, and sum-of-the-parts models.

Restaurants: We use target valuation multiples (P/E, EV/EBITDA, rel. P/E, FCF yd) and DCFs to derive our price targets. We note that given recent strength in the stocks, restaurant industry P/E's have nearly recovered to the historical average of ~20x, while relative P/Es (~130%) are above the historical average (~105%). This suggests expectations are high across the group and that the risk of a negative turn in sentiment is rising.

Risks

Protein: Key risks include volatility in grain and energy markets, weather, trade barriers/political tensions, declining consumer confidence/wealth, and changes in input costs, such as grains.

Restaurants: Key risks include changes in consumer spending patterns, changes in input costs (especially food, labor, and rents), competitive activity (such as menu discounting and promotions), and potential food contamination and other health-related concerns.

Near-term looks meaty

In our latest Monthly Mouthful (dated March 19th), we noted that protein fundamentals are strong owing to:

- Tight protein supplies;
- Low levels of inventory;
- An expected drop in protein production in 2010E (post a drop in 2009);
- A benign feed cost environment;
- Improved cash flow profiles leading to de-leveraging.

A new factor that enters the mix is a potential increase in demand. Since these are commodity products, a change in supply or demand, at the margin, drives price. Recent indications of a pick-up in demand from foodservice distributors and at other foodservice establishments, as well as retail sales data for the foodservice category, are positive for pricing.

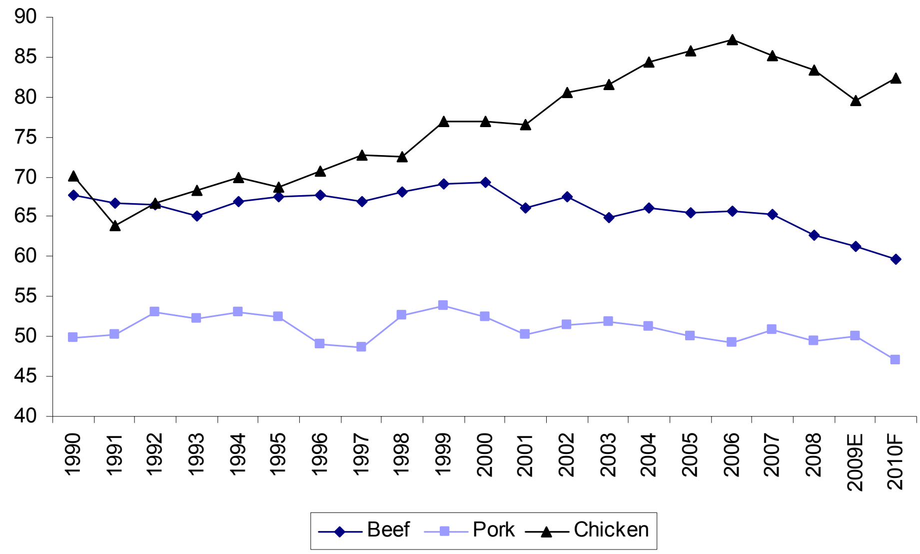
As shown in the figure below, per capita availability of beef and pork are expected to fall in 2010. Specifically for pork, the USDA forecasts:

- 3% drop in production
- 5.7% increase in exports
- 0.7% increase in imports

For beef, the USDA forecasts:

- 1% drop in production
- 9.7% increase in exports
- 1.2% increase in imports

Figure 1: Per capita domestic protein availability



Source: Deutsche Bank, USDA

Taken together, this leads to a 5% drop in domestic pork availability (or a 5.8% decline on a per capita basis) and a 1.5% decline in domestic beef availability (or 2.5% on a per capita basis). Chicken is the only protein that should be more available on the domestic market vs. last year and thus consumption is expected to increase.

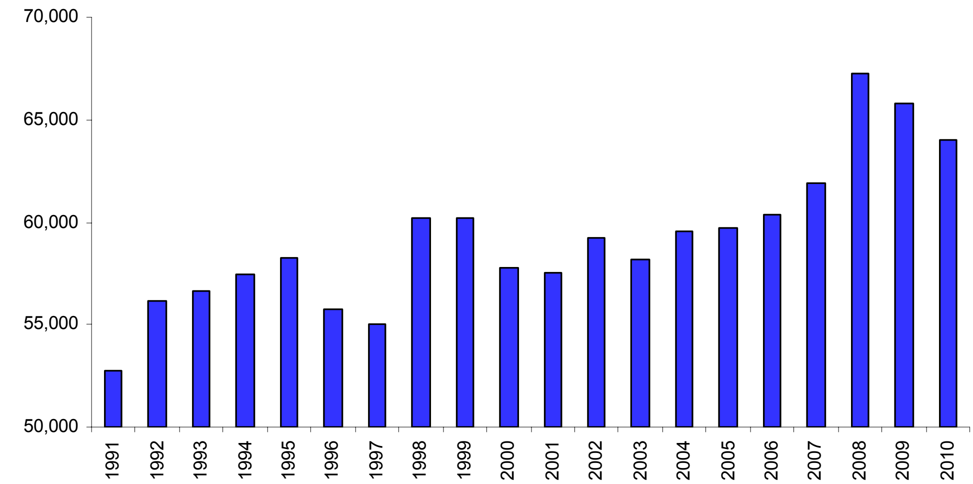
We have already started to see signs of overall demand improvement with the recovery in the broader economic as pointed out in U.S. Census' recently released monthly retail sales data, reporting a sequential increase of 1.6% in March (above the consensus calling for +1.2%). Retail sales for "food services & drinking places" category (a proxy for restaurant sales) were up 0.3% and 3.0% on a sequential and YoY basis, respectively. According to DB's Restaurant analyst, Jason West, this translates into a 1.3% YoY increase in sales for 1Q10, compared to +0.1% in 4Q09, -0.6% in 3Q09, +1.2% in 2Q09 and +1.2% in 1Q09. West indicates that this data suggests industry SSS accelerated in 1Q10 vs. 4Q09, with particular strength as the quarter closed out.

The tight protein environment combined with a benign feed cost and improved demand environments bode well for integrated protein producers. We have favored the hog sector owing to the biological lag involved in increasing the breeding herd and thus production (at least a two year lag between when a sow is born and its offspring is brought to slaughter). This process takes about 9 months for chicken.

Pork supply comes in tighter than expected

We remain positive on Smithfield Foods with "normalized" earnings brought forward owing to data released in the Quarterly Hogs & Pigs report in March, as well as an apparent recovery in export demand. Specifically, USDA's estimate of the number hogs and pigs on U.S. farms at the start of March was down 2.8% YoY (see figure below).

Figure 2: All hogs & pigs supply (thous head)

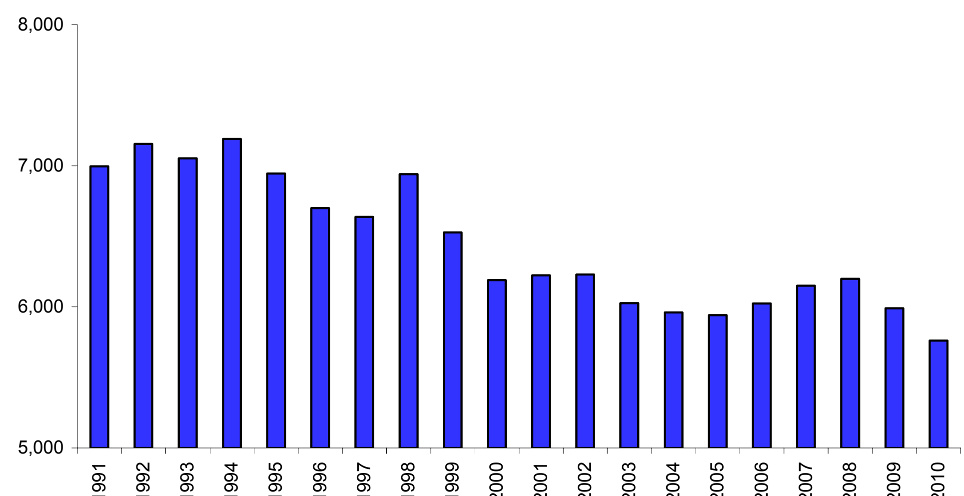


Source: Deutsche Bank, USDA

Contrary to talk in the market, the breeding herd on March 1st was 1.5% smaller than on December 1, 2009, indicating contraction, despite improving economics.

Importantly, the U.S. breeding herd was down 3.9% YoY (above the trade estimate for a 2.6% decline), as shown in the figure below. This was down 7.6% from the December 2007 high. Contrary to talk in the market, the breeding herd on March 1st was 1.5% smaller than on December 1, 2009, indicating contraction, despite improving economics. In terms of the quarterly progression, 2Q10 hog slaughter is expected to fall 1.5-2.0%, with 3Q10 hog slaughter down 3.5%. Finally, 4Q10 hog slaughter looks to be down almost 3%.

Figure 3: U.S hog breeding herd (thous head)

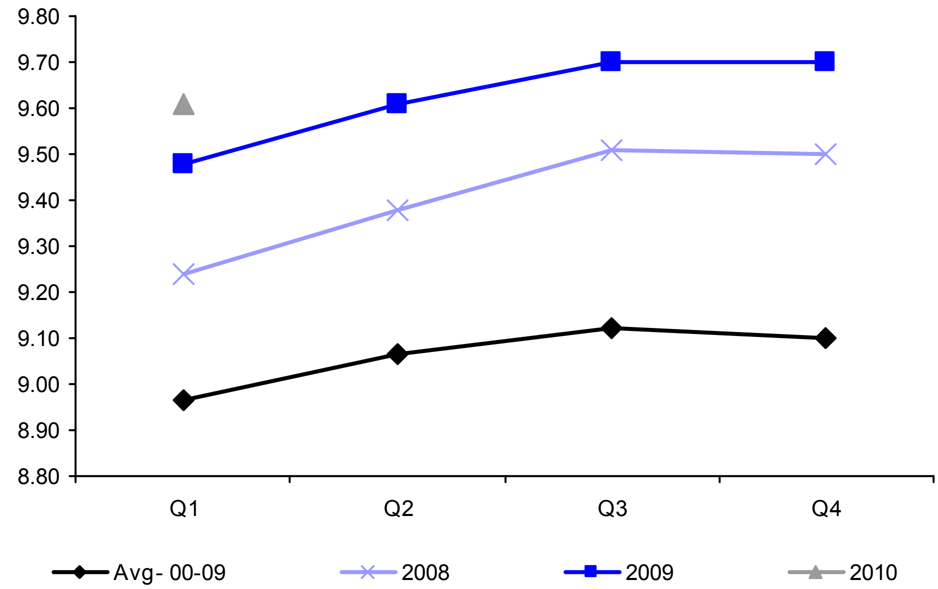


Source: Deutsche Bank, USDA

Another positive in the report was that the improvement in pigs per litter appears to be moderating.

Another positive in the report was that the improvement in pigs per litter appears to be moderating. Pigs per litter averaged 9.61 head during the Dec-Feb quarter, up 1.4% YoY, but down 0.9% sequentially. Productivity might decline even more owing to poor corn quality, which leads to a further tightening in the hog supply.

Figure 4: Yr to Yr comps, quarterly average pigs per litter



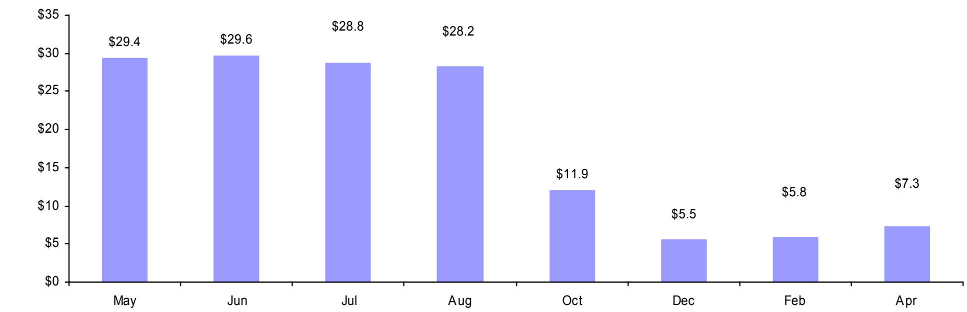
Source: Deutsche Bank, USDA

At the same time that supply has tightened, the USDA calls for a 5.7% recovery in pork exports as countries such as Russia and China have recently re-opened since banning U.S. pork post the H1N1 outbreak last spring.

In addition to a recovery in export demand, we believe domestic demand is strong. In fact domestic demand is the primary driver of domestic pork prices currently. We believe this is partially attributable to a focus on breakfast menus by foodservice operators. Specifically, Subway has announced a breakfast offering, while Jack in the Box upgraded its breakfast menu. Also, CKE Restaurant's Hardee's just added double "loaded biscuit 'n' gravy with egg and sausage to its morning menu. Most recently is Burger King's debut of the brunch menu in test markets.

The tighter supply + improved domestic demand dynamic has led to stronger hog prices. Against the backdrop of benign feed costs, forward profitability for hog producers has improved dramatically. The forward curve points to $18/ head of hog raising profitability. Prior to changes today, we had estimated $6.50-$7.00/head for F2011E (end April) for Smithfield.

Figure 5: Future hog raising operating profit per head



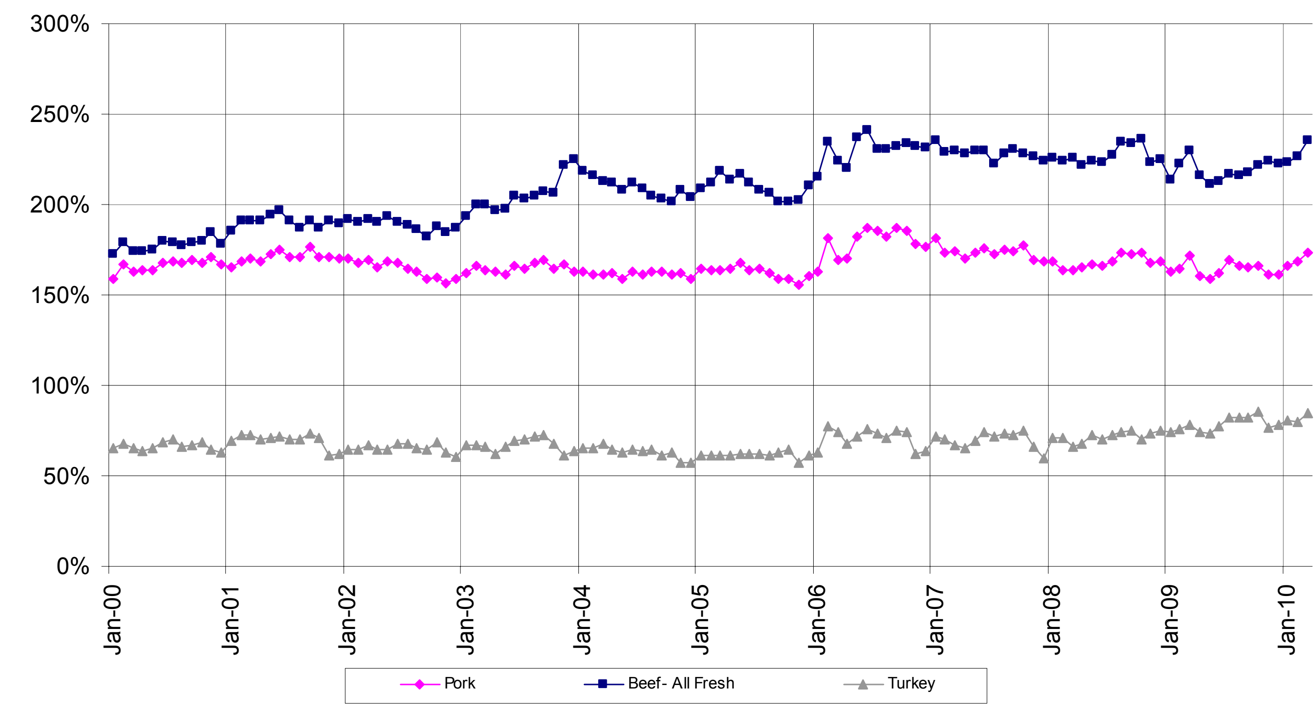
Source: Deutsche Bank, USDA

Upside to chicken

Since the start of this year, prices of competing meats have trended up relative to chicken.

While we believe that the hog complex is attractive, we also believe chicken has near-term upside. A limited supply of alternative meats leading to higher prices makes chicken more attractive on a relative basis. The figure below shows retail prices of the other proteins relative to chicken. Since the start of this year, prices of competing meats have trended up relative to chicken. Specifically, pork prices are up 36% YoY, beef prices are 15% higher YoY.

Figure 6: Retail meat prices as a % of broiler prices

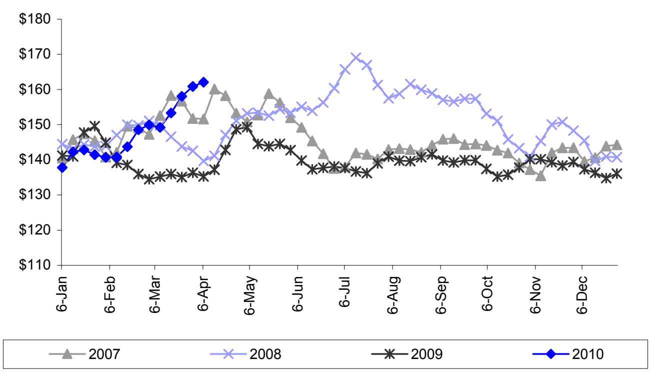


Source: Deutsche Bank, USDA

Why are ground beef prices so high?

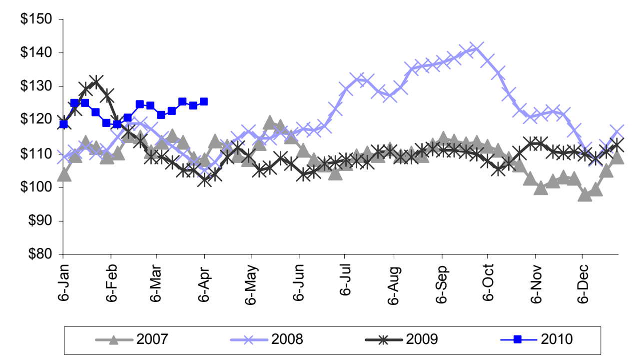
As shown below, beef prices are at record highs. We also show the price of the composite beef primal chuck cut, as a proxy for ground beef prices. Demand for low priced protein items (such as hamburgers) during the economic downturn has led to higher prices for manufacturing grade beef. We note that "burger wars" in the foodservice sector is partly responsible for this higher demand. Additionally, lower carcass weights YoY due to severe weather conditions experienced during the winter has resulted in less trim availability. Finally, imports of manufacturing grade beef are sharply lower YoY.

Figure 7: Yr to Yr comps, beef cutout ($/cwt)



Source: Deutsche Bank, USDA

Figure 8: Yr to Yr comps, primal chuck ($/cwt)

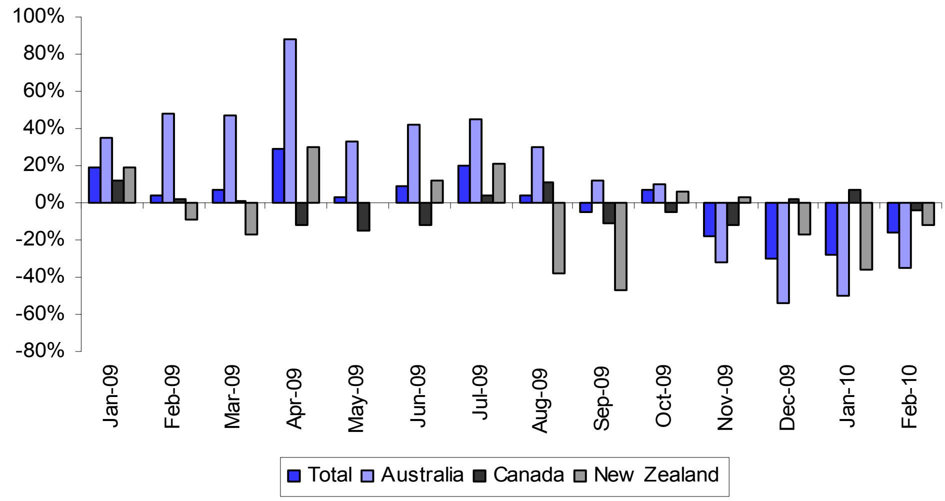


Source: Deutsche Bank, USDA

On the slaughter front, total cows slaughter YTD are running at last year's levels. Specifically, beef cow slaughter is up 7.6% YTD vs. last year driven by increased cow imports from Canada. However, this has been roughly offset by a decline in dairy cow slaughter (down 7% YTD) as we are comparing against a time when the first of three dairy cow buyout programs was in progress last year. Sources indicate that total cow slaughter should decline seasonally in the summer. Additionally, better pasture conditions for beef cattle, strong calf prices and the absence of any dairy herd buyout announcement should result in lower supplies, favoring grinding beef prices this summer.

Importantly, smaller supplies of imported beef have also led to higher ground beef prices. Specifically, Australian imports were down 35.2% in February (the latest data available) after falling 49.7% in January, on a YoY basis. This is driven by a stronger Australian dollar and improved conditions in Australia post several years of drought, prompting a rebuild of the herd. Australia accounted for 30% of U.S. beef imports in 2009. Beef imports from New Zealand and Uruguay are also down double-digits YTD.

Figure 9: YoY change in monthly beef and veal imports ('000 lbs)

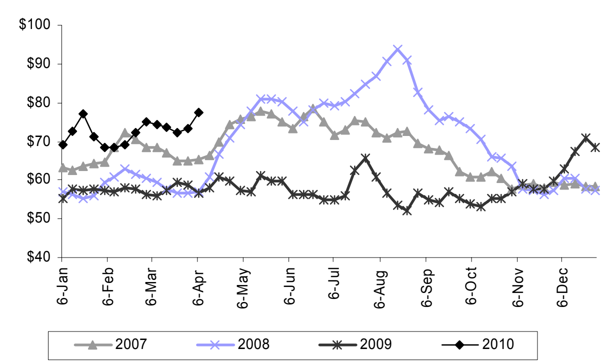


Source: Deutsche Bank, USDA

With higher ground beef and pork prices, we expect retailers to feature chicken during grilling season this year.

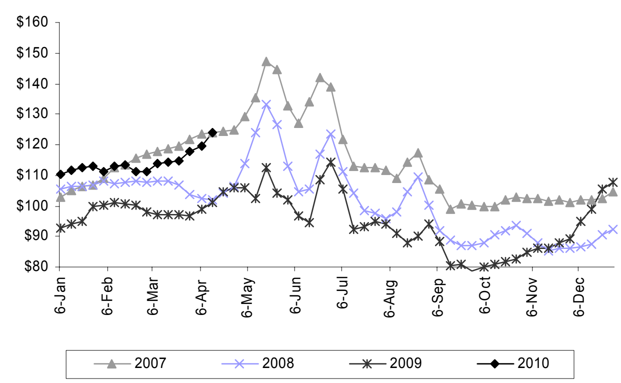
With higher ground beef and pork prices, we expect retailers to feature chicken during grilling season this year. We believe early indications point for solid chicken ads during Memorial Day. Fourth of July should be similar. Recall that last year, pork dominated Fourth of July featuring owing to low prices, post the H1N1 outbreak. This year, higher pork prices/lower domestic availability should favor chicken features. Below, we show the composite pork cutout, as well as the price of spareribs, an important summer grilling item.

Figure 10: Yr to Yr comps, pork cutout ($/cwt)



Source: Deutsche Bank, USDA

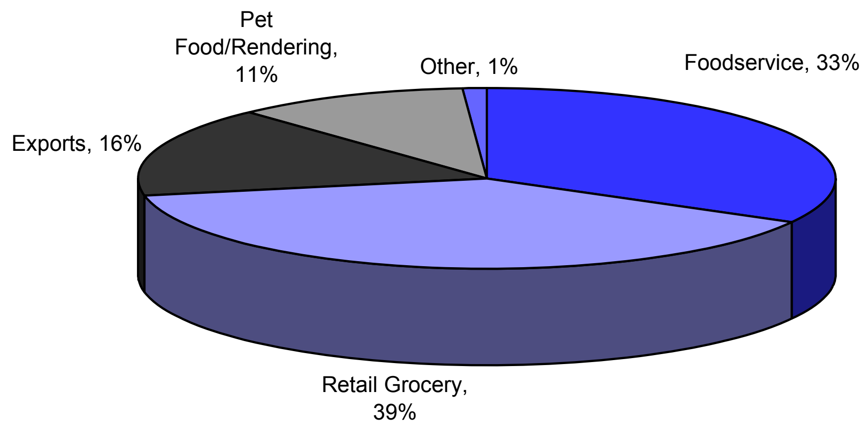
Figure 11: Yr to Yr comps, spareribs ($/cwt)



Source: Deutsche Bank, USDA

Additionally, given higher ground beef prices, foodservice operators at a recent industry conference pointed to higher chicken promotions this summer.

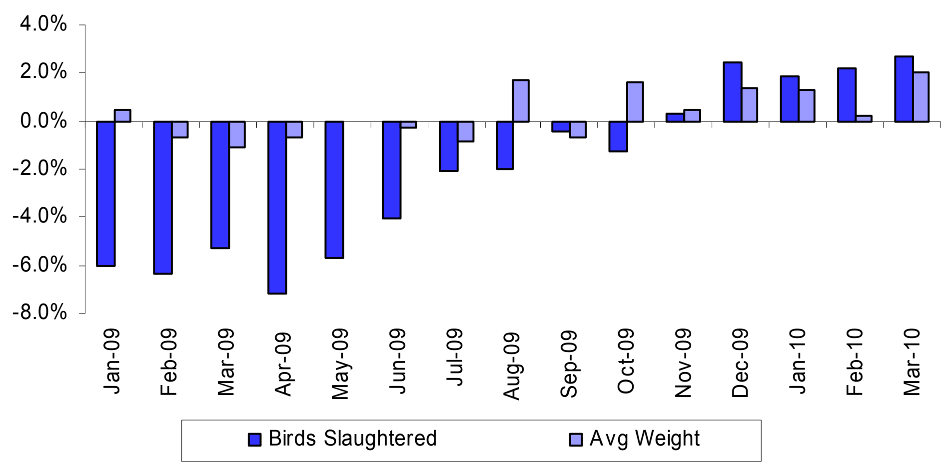
Figure 12: U.S. Broiler Marketing Channels, 2010E



Source: Deutsche Bank, EMI Analytics, National Chicken Council

With feed costs the single biggest determinant of production decisions, we have been concerned that producers would increase production, leading to flat or weaker prices. As shown below, producers have already begun to increase production by increasing weights (including a shift to bigger birds), as well as heads slaughtered. Specifically, based on weekly slaughter data from the USDA, we calculate live pounds processed are up 3.8% YTD (through April 10th).

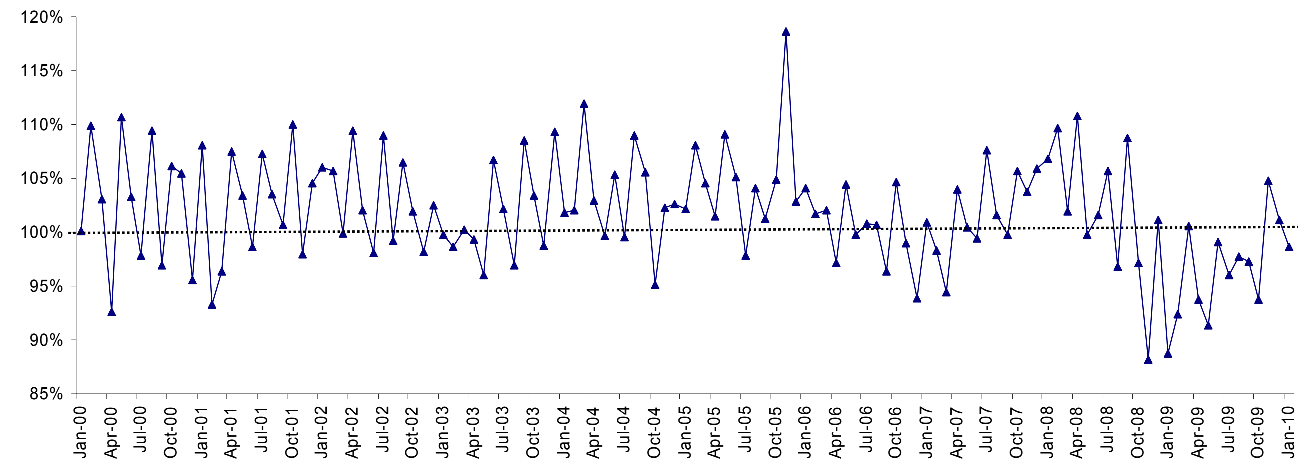
Figure 13: YoY change in heads slaughtered and average bird weight



Source: Deutsche Bank, USDA

Though production has been increasing, it remains low vs. history. This is partly due to constraints by low levels of hatching eggs as liquidation occurred at the breeder level. Additionally, some players are reportedly having difficulty in obtaining financing to expand. Additionally, monthly broiler hatchability is down YoY vs. a record year in 2009, though still is at solid levels. Specifically, a decline in hatchability from 84% to 83% represents about 2 million chicks/week, out of a weekly placement of about 205 million eggs. The decline in hatchability is due to producers holding hens longer (to an older age) in order to squeeze more production out of the animals, until the broiler hatchery supply flock is rebuilt and hatching egg availability improves.

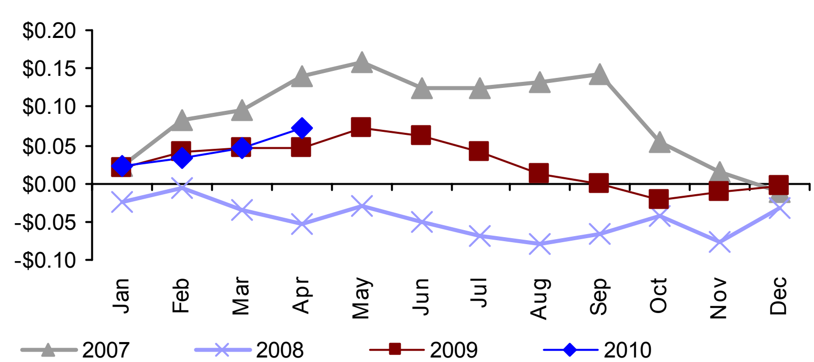
Figure 14: Monthly read to cook chicken production, YoY change



Source: Deutsche Bank, USDA

With improved profitability (see figure below) and more hatching eggs available, sources expect production to pick up. Sources varied in their expectation for timing of higher production. Some contacts suggested that 1Q11 will see higher production hit and result in lower profitability. Others claim that production will not be back to 2008 levels until the end of 2011. We assume production increases will take hold at some point in 2011, thus changing economics. However, intermediate term trends appear strong heading into the grilling season owing to current tight production levels across all major proteins.

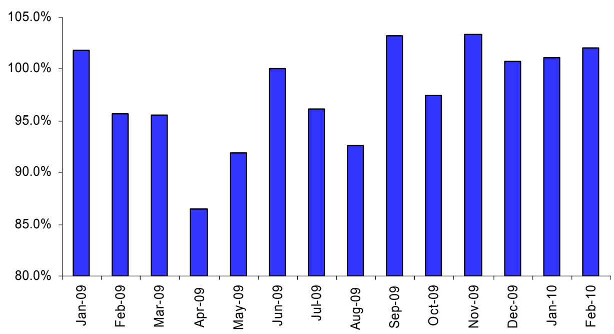
Figure 15: Chicken operating profit ($/lb)



Source: Deutsche Bank, USDA, WSJ, National Chicken Council
Note: April data through April 19th

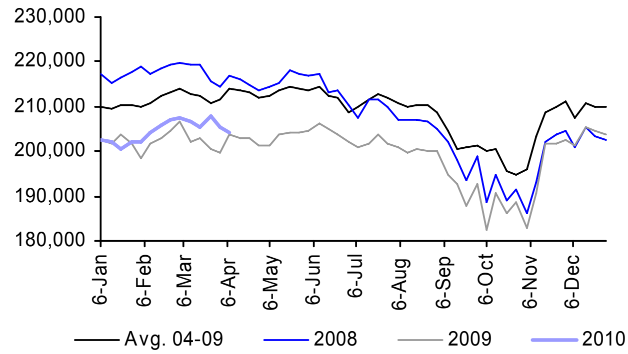
As shown below, pullet placements have increased in every month (on a YoY basis) since September, with the exception of October (see Figure 16). Those hatching eggs are starting to become available now. This has not yet been reflected in weekly eggs set data, which points to continued constraints. All in, it appears chicken production should increase about 4% this year. In 2011, production looks set to grow another 4-4.5%.

Figure 16: Pullets placed (YoY change)



Source: Deutsche Bank, USDA

Figure 17: Eggs set (thousand)



Source: Deutsche Bank, USDA

The Russian risk

The Russian market still remains closed to U.S. chicken, despite numerous indications that a settlement was "close." It is encouraging to see Urner Barry take up leg quarter prices $0.01/lb to $0.36 this week, despite the trade issue with Russia. Leg quarters clearly built in cold storage inventory in Feb (+21% YoY, +7% sequentially). Additionally, sources indicate that product is at Baltic ports, waiting to be unloaded. Hence, a continuation of the trade dispute with Russia is a risk to higher prices and improved profitability in the future.

However, at last week's conference, sources indicated that outer Russian cities that rely on U.S. dark meat are low on stocks. Prices increased 7% (at the wholesale level) in Russia over the last 2 weeks (notwithstanding the fact that consumption was low owing to Orthodox Easter). This appears to be leading to political pressure to settle with the U.S.

Sources out of Russia point to a potential cut in the total poultry quota by 50,000 MT. The U.S. may be cut by 150,000 MT from our current 600,000 MT allocation. For perspective, the U.S. allocation was 750,000 MT in 2009 and, by our estimates, the U.S. shipped about 734,000 MT to Russia last year. A step from 734,000 to 450,000 is no doubt negative. However, if we annualize February shipments to Russia, we calculate shipments of 126,000 MT. As a result, a resolution leading to the ability to ship 450,000 MT would be an improvement from current conditions. Our sources believe that as soon as Russia opens, leg quarter prices should reach $0.40/lb +.

Ratings & estimate changes

Hormel

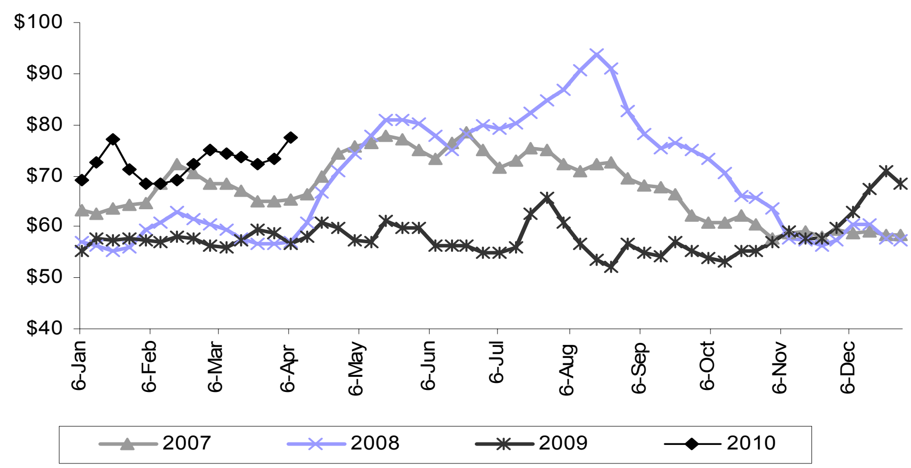
We are downgrading Hormel to a SELL from a HOLD and are reducing our price target to $37 from $41. We believe Hormel's management is at the top of the industry and acknowledge that free cash flow generation is strong. However, we believe there is near-term downside owing to the sharp run-up in pork cutout prices recently. While we ultimately believe the company will recover higher input costs, it will take time to accomplish this and margins are likely getting squeezed as raw materials increase. Another possible risk is the recent run-up in manufacturing beef owing to lower beef imports, as noted above. This ingredient is used in Hormel's Grocery division in items like stews and chili. However, inventory levels of finished product may insulate the company somewhat from this.

The divisions most at risk from higher pork prices are Refrigerated (36% of segment income) and Grocery (29% of segment income). Tougher comparisons in items like Spam may also pose a challenge as the incremental shift from convenience to value items by consumers dissipates.

We reduce our F2010E (end Oct) EPS to $2.63 (excluding items), at the low end of management's guidance of $2.63-$2.73. We reduce our F2Q10E (end April) EPS to $0.63 from $0.66. We assume lower margins in Refrigerated, slightly lower margins in Grocery, but higher margins in Jennie-O as the turkey industry has improved. Assuming a multiple in line with the packaged food group of about 15x, applied to our C2010E EPS estimate of $2.48, we derive our price target of $37. Our DCF model that uses a 9.5% WACC (determined via CAPM: 0.8x beta, 4% risk free rate, 12% expected return), assuming LT growth in sales of 3-4%, operating profit 5-6% and EPS 7-8% suggests a price target of $40. Our Incremental Value Creation Coefficient (IVCC), which measures the present value of changes in future economic profit relative to the peer group through regression analysis suggests a price target of $33. Taken together, we arrive at our $37 price target.

Risks to the upside include a greater degree of price realization in Grocery and Refrigerated than we currently forecast, a sudden drop in pork prices, a significant and sudden drop in corn prices, and higher than expected increase in turkey pricing.

Figure 18: Yr to Yr comps, pork cutout ($/cwt)



Source: Deutsche Bank, USDA

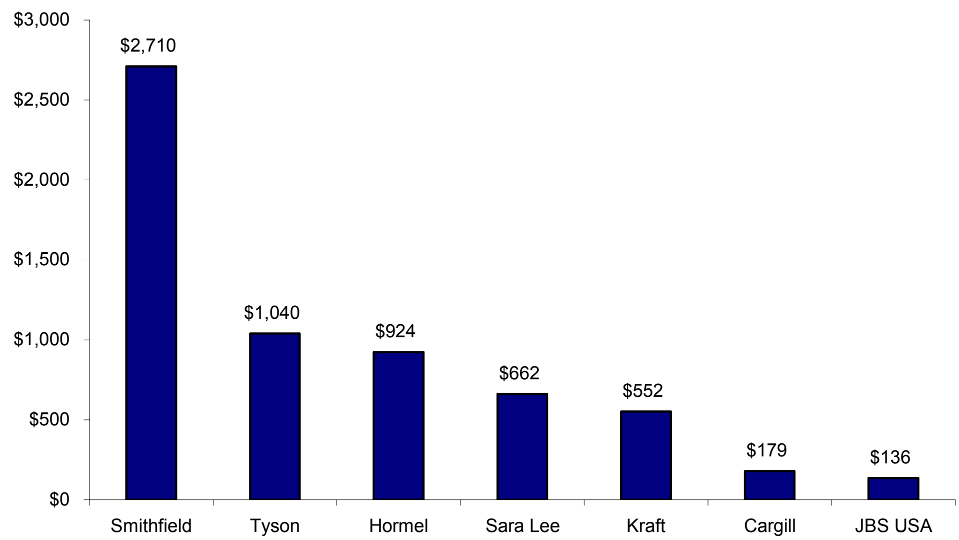
Smithfield

We are reducing our F2010E (end Apr) EPS to (0.40) from ($0.23). Our F4Q10E (end April) is now $0.17, down from $0.33 on tighter assumed profits in Packaged Meats owing to the run-up in pork prices, as well as lower profits in Fresh Pork as packer margins were narrow at times during the quarter. While we continue to include a $1/cwt impact in F4Q10E in assumed raising costs for the Hog Production Group, owing to costs associated with corn quality/vomitoxins, we also ran through a mark to market loss in F4Q owing to hog hedges.

Turning to F2011E, we raise our EPS estimate to $2.05 from $1.63. The primary change stems from better Hog Production Group earnings owing to higher hog futures and more benign feed costs. Specifically, we assume Hog Production profits per head of $13, less than the $18/head derived from the futures curves, but in line with what we can derive from management's presentation this week. We are modeling volume in line with company comments on the last conference call: 3% increase in Packaged Meats, 2.5% drop in slaughter volume and continue to model a 5% drop in HPG volume, owing to the impact of the company's sow liquidation efforts. We continue to assume Fresh Pork profits of $0.02/lb, equating to an operating margin of 2.8%, helped by the closure of Sioux City. We assume Packaged Meats profits of $0.12/lb, or a 7.0% operating margin. Finally, we incorporate management's interest rate guidance for F2011E of $255 million, but note that building free cash flow should allow for a higher level of debt reduction and, thus, lower interest burden.

As noted above, the introduction/expansion of breakfast menus by a variety of foodservice operators appears to be leading to better demand. Based on the figure below, Smithfield has the most leverage to this.

Figure 19: Foodservice pork sales ($, millions)



Source: Deutsche Bank, Smithfield Foods

In terms of valuation, we raise our price target to $24 from $22 and retain our Buy rating. Our DCF suggests a price target of $34. We assume 3-4% sales growth, 5-6% EBIT growth and 7% EPS growth. We utilize a 9.5% WACC (0.8x beta, 4% risk free rate, 12% required return). Assuming an 12x multiple on our C2010E EPS estimate of $1.87, we derive fair value of $22. Additionally, valuing Smithfield at 1.0x book value would suggest a price target of $17-$18. Taking an equally-weighted average, we derive our new price target of $24.

Risks include feed costs (corn, soybean meal), in terms of price, as well as quality, given the delayed, wet harvest this year; currency as a strengthening dollar relative to the currencies of importing nations may hurt exports; political risk/trade disputes; disease (which would adversely impact pork/protein consumption), execution risk, related to the restructuring program, and increased scrutiny by the current Administration regarding packer ownership of livestock and relating to industry concentration.

Sanderson Farms

As Sanderson has little business tied to fixed pricing, it is leveraged to the spot market.

We are raising our F2010E (end Oct) EPS estimate to $5.57 from $4.49. We incorporate higher chicken prices for boneless breast and tenders, lower prices for wings and assume a $0.40/lb price for leg quarters for F3Q10 (end July), which may prove conservative. As Sanderson has little business tied to fixed pricing, it is leveraged to the spot market. We model in corn futures past April, as Sanderson indicated it had not priced any corn past April, as of March 29th. We did not alter our soybean meal cost assumption, as the company noted it was hedged on soybean meal through fiscal year end. We also reduced our fixed costs per lb. assumption owing to improved operating leverage with Waco (its most efficient plant) operating at capacity. We do not adjust for any impact from China as we believe product is working its way indirectly into the market. Our F2011E (end Oct) EPS is $5.98, up 7.5% YoY. For F2Q10E (end April), we raise our EPS estimate to $1.26 from $1.12.

We also reduced our fixed costs per lb. assumption owing to improved operating leverage with Waco (its most efficient plant) operating at capacity.

In terms of valuation, we raise our price target to $65 from $51 and retain our HOLD rating. Our traditional DCF methodology (assuming 3-4% sales growth, 5% EBIT growth, 6-7% EPS growth) yields $68. We utilize a 9.5% WACC (0.9x beta, 4% risk free rate, 12% required return). Using our C2010 EPS of $6.17 and applying a 12x multiple, we derive a valuation of $74 per share. Historically, Sanderson Farms has traded at an average of 2.0x book value. Applying this average to current book value suggests a stock price of $55 per share. The historical period we observe for P/E and P/BV multiples begins in October 1995. We believe it is appropriate to use average multiples because this period captures peaks, troughs and normalized earnings periods. Averaging these methods, we derive our price target of $65.

Risks to the downside include a sudden and sharp rise in corn and soybean meal prices, a step down in domestic demand owing to economic weakness, and increased industry production. In addition, a stronger U.S. dollar and weaker international economies could limit export demand, thus further affecting chicken prices, particularly leg quarter values. We note imposition of Russian and Chinese policies to limit imports of U.S. chicken may have a negative impact on chicken prices. Upside risks include a sharp increase in chicken prices or a sudden and sharp fall in corn and soybean meal prices.

Tyson

We raise our F2010E (end Sep) EPS to $1.82 from $1.41 and our F2011E EPS to $1.98 from $1.56. We assume higher profits in Beef and Chicken, but temper our outlook for Pork and Prepared Foods. Specifically, for Prepared Foods, our regression using fresh 72% combo prices yields a profit slightly above break-even. We incorporate this in our model, but note it may prove conservative. For F2Q10E (end March), we adjust our EPS estimate to $0.37 from $0.36.

We raise our price target to $22 from $16 and retain our HOLD rating. Using our C2010E EPS of $1.86 and applying an 12x historical multiple, we derive $22-$23. Applying a historical ratio to book value of 1.3x, we derive $18. Our DCF metric (3% sales growth, 4-5% EBIT growth, 7-8% EPS growth, 10.5% WACC) yields $25. The historical period we observe for P/E and P/BV multiples begins in October 1995. We believe it is appropriate to use average multiples because this period captures peaks, troughs and normalized earnings periods. Taking a simple average, we derive our price target of $22.

Risks include trade barriers (particularly regarding Russian chicken and pork exports and Mexico regarding beef and pork), demand destruction owing to economic weakness, feed cost volatility, disease risk (H1N1, avian flu, BSE), and weather risk (as it relates to corn and soybean meal input costs). We also note that with nearly 100% ownership of Class B common stock (entitled to 10 votes per share), Don Tyson, via the Tyson Limited Partnership, holds 60%+ of the aggregate vote. Upside risks include lower than expected feed costs, another round of chicken industry production costs, sooner than expected recovery in demand owing to macro factors.

Implications for restaurants

Protein gain = restaurant pain?

Restaurants are enjoying a "goldilocks" state of affairs at the moment, with an environment characterized by improving demand and benign input costs. This sets up for a potential surge in profitability in coming quarters as sales perk up and costs stay low. (We believe companies will be slow to add back headcount and other expenses during the initial phase of demand recovery.) With this backdrop in place, restaurant stocks have been significantly outperforming, with the major restaurant names up 45% year-to-date (simple average) vs. a 7% increase in the S&P 500.

While we remain positive on the restaurant group, the margin for error has diminished given higher valuations

While we remain positive on the restaurant group broadly, with Buy ratings on BKC, CMG, MCD, PNRA and RUTH, we believe the margin for error has diminished as valuations and expectations have moved higher. Given the recent strength, investors may begin to look for a good reason to trim positions. We believe rising commodity costs may emerge as a potential negative catalyst for the stocks, particularly later in 2010 and into 2011. In other words, we do not expect the "goldilocks" backdrop to exist forever, as the downside of improving foodservice demand is usually higher commodity costs.

Proteins (beef, chicken, pork) represent ~30-40% of food costs for restaurant chains

We are beginning to see higher prices across certain food commodities, especially major proteins (beef, chicken, pork), which in aggregate represent ~30-40% of total food costs for most restaurants. In this report, we have taken a detailed look at how these higher prices may impact the restaurant segment. We've analyzed (1) the recent moves in the commodity costs that matter most to restaurants, (2) key commodity exposures across the group, (3) the latest commodity outlook for each company and (4) the potential earnings risk/sensitivity from higher commodity costs.

Our bottom line conclusion is that we do not see much commodity-related risk to restaurant earnings forecasts in the near term, as most chains have already locked in major items for the balance of calendar 2010. However, one exception here could be ground beef, which could put some near-term pressure on margins at certain hamburger QSR chains (particularly BKC and JACK).

Each 1% change in food costs impacts annual EPS by 2-3% for the average restaurant chain and margins by ~30bps.

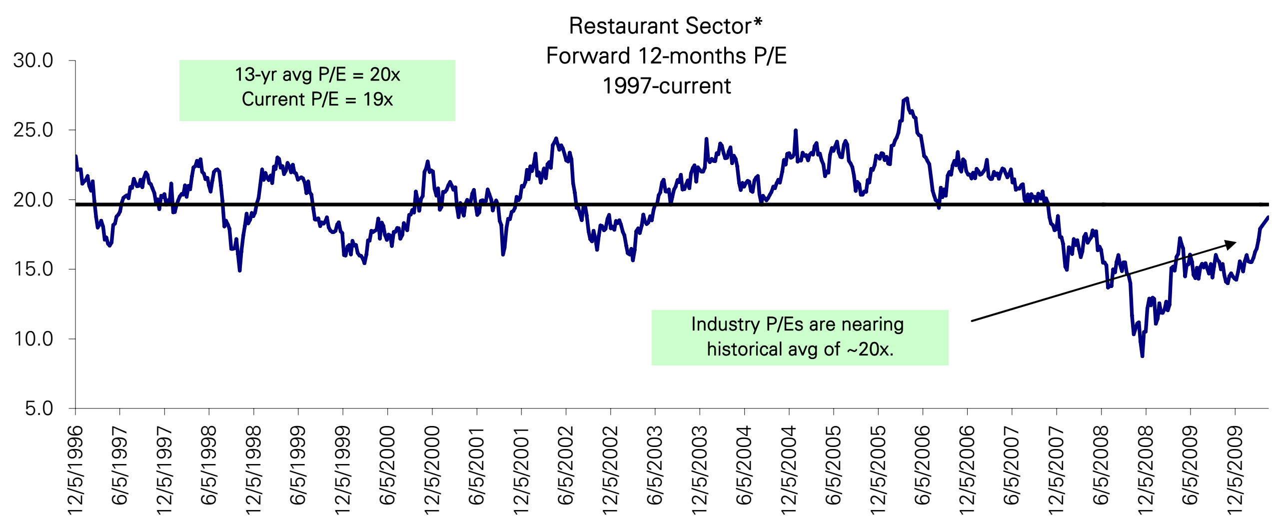
Looking out a bit further, we do see some risk to 2011 earnings forecasts for the group as prices for most major commodities are well above the levels seen in mid-to-late 2009, which is when many contracts were likely signed. Each 1% change in food costs impacts annual EPS by 2-3% for the average restaurant chain and margins by ~30bps. Restaurant companies expect ~1% food cost deflation in FY10. If this were to rise to just +2% in FY11, the earnings pressure could be 7-8% (before factoring in menu pricing).

We also expect higher labor and health care costs and the likely need to reinvest in assets/operations/products to begin to put some upward pressure on overall sector operating costs in the future. This means the near-term outsized improvements in margins/profitability may be short-lived and that margin assumptions further out carry some risk, particularly against the backdrop of surging stock prices and valuations. Current consensus forecasts call for a 50-60bps improvement in industry-wide margins in FY11, on top of +50-60bps in FY10 and +60-70bps in FY09. Consensus forecasts also assume an acceleration in industry-wide EPS growth to +17% in FY11 from +10% in FY10.

No estimate changes: For now, we are not adjusting estimates or ratings on our covered companies. However, we will continue to evaluate the impact of higher commodities as we move through the year, with a particular eye on pressure to 2011 margin forecasts.

Figures 20-21 summarize historical P/E and relative P/E valuations for the restaurant sector. We see that P/Es have nearly recovered to the historical average of ~20x while relative P/Es (~130%) are above the historical average (~105%). This suggests expectations are high across the group and that the risk of a negative turn in sentiment is rising.

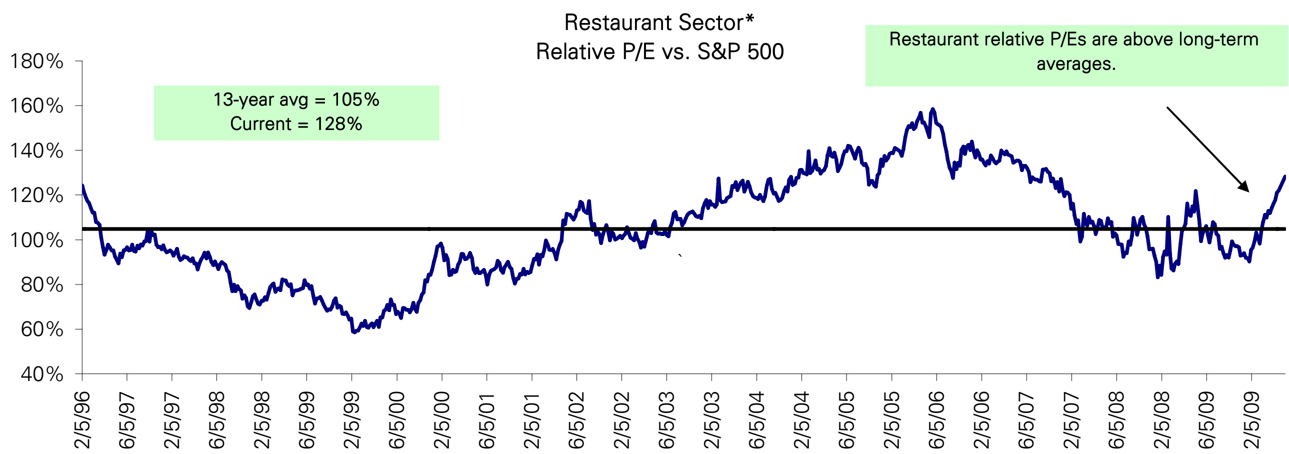
Figure 20: Restaurant industry P/Es have risen from ~14x in Nov '09 to ~19x currently



* Avg of 27 major restaurant chains.

Source: Deutsche Bank estimates, company information, Cap IQ

Figure 21: Restaurant industry relative P/Es are now well above long-term averages

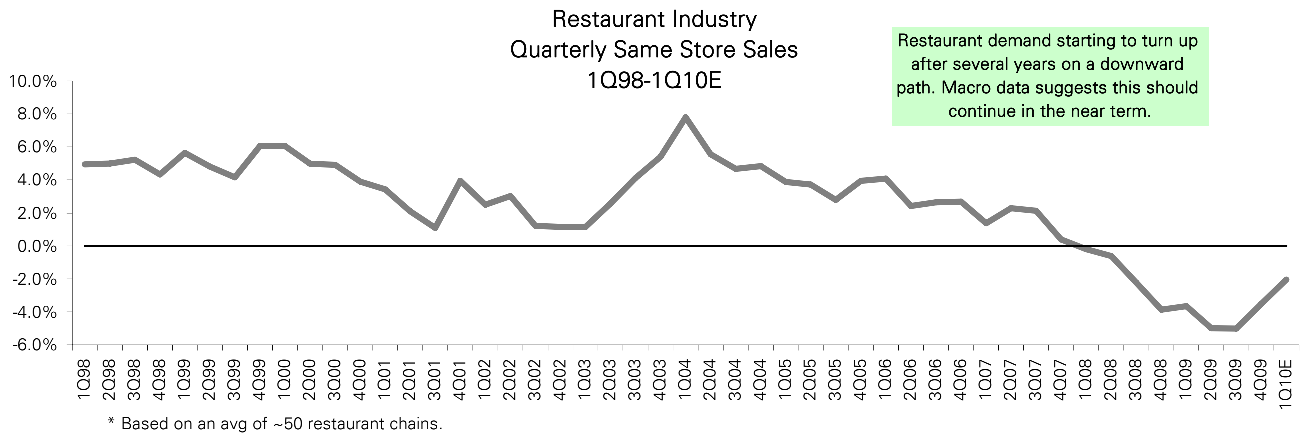


* Avg of 27 major restaurant chains.

Source: Deutsche Bank estimates, company information, Cap IQ

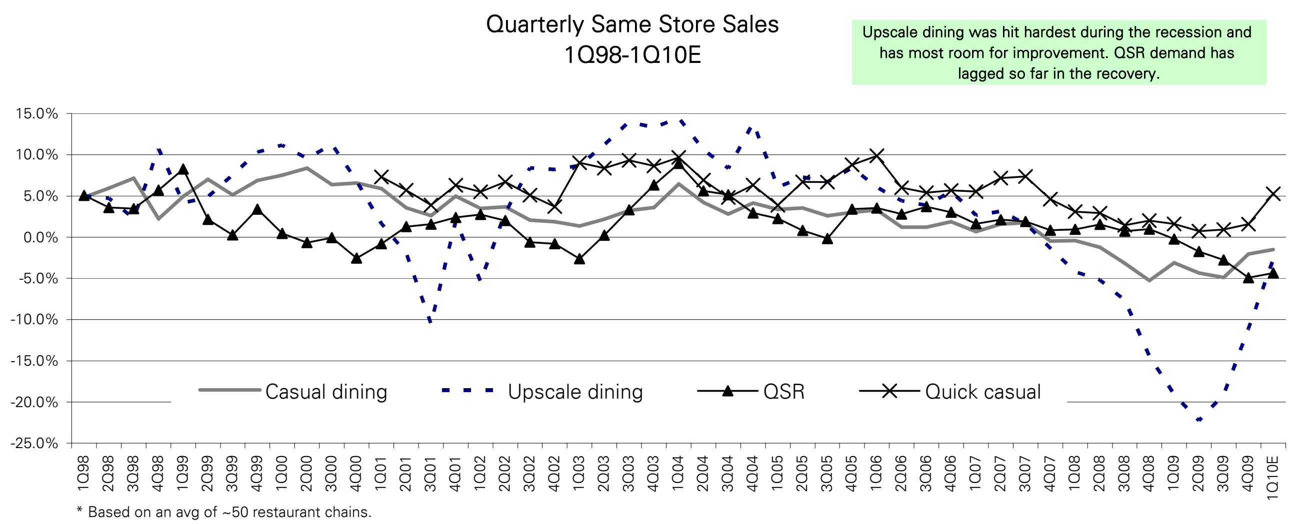
Demand recovery trumps margin concerns for now: While still in negative territory, comps for the sector appear to have bottomed in 3Q09. Industry sales conditions remain somewhat challenging given high unemployment and a general oversupply of restaurants. However, macro data suggests the improving demand trend is likely to continue in the near term. Combined with a favorable cost backdrop, in the near term, the fundamental outlook for restaurants remains positive for now. Figures 22-23 summarize the historical trend in aggregate same store sales across the restaurant group.

Figure 22: Restaurant industry same store sales are starting to turn higher



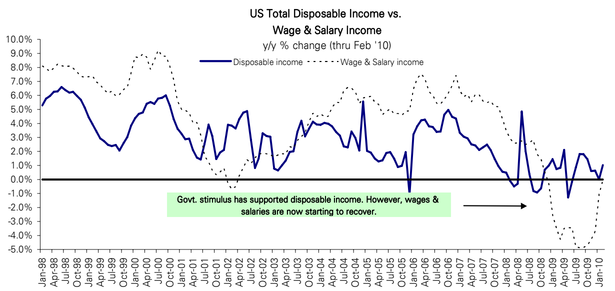
Source: Deutsche Bank estimates, company information

Figure 23: Sub-sector same store sales (1998-1Q10E)



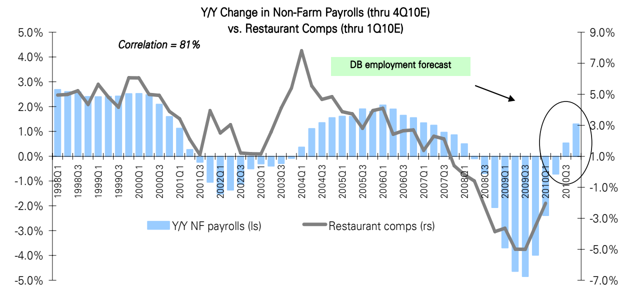
Source: Deutsche Bank estimates, company information

Figure 24: Improvements in key macro data point to…



Source: Deutsche Bank estimates, company information, BLS

Figure 25: …further improvement in same store sales



Source: Deutsche Bank estimates, company information, BLS

What's happening with commodities?

Figure 26 shows pricing trends for commodities that matter most to our restaurant coverage. We have also provided an estimate of 2010 prices for these commodities, based on a combination of futures prices, recent trends and/or DB's outlook.

While pricing trends for early-stage commodities, such as grains and oils, remain fairly benign, we have seen upward moves in many other areas, particularly proteins and dairy.

Proteins in total make up ~40-50% of the food bill for most chains, or 30-40% excluding seafood. So, each 10% move in protein prices would impact total food inflation by 4-5% (or 3-4% ex-seafood). Dairy makes up 8-10% of the food bill for most chains. Figure 27 summarizes the commodity mix for the major restaurant chains (where available).

Prices for most key protein items bottomed in late 2009. Below we summarize some of the recent trends in key items:

- **Live cattle:** Live cattle prices have risen ~20% YTD and are currently up 15% y/y. Current futures for 2H10 in the mid-90s compare to prices in the mid-80s for 2H09.
- **Ground beef:** Ground beef prices are currently in the $1.40/pound range (using a blend of 50s/90s). This is up 15% y/y and up 40% from the lows of ~$1.00/pound reached in Oct '09. Prices typically fall ~3% sequentially in June and also normally weaken in the Fall. Current prices and historical seasonal trends point to an average price of ~$1.33/pound for CY10, which would be up 16% versus 2009 and up ~20-25% in 2H10.
- **Choice beef (steak):** Choice beef prices are up ~25% from the lows in Oct '09 and are up ~10% y/y. This suggests that companies that locked in prices in late-09 for CY10 will likely see much higher prices when contracts are renewed for 2011.
- **Chicken breasts:** Boneless chicken breast prices have risen to $1.75/pound recently (according to the National Restaurant Association), up over 40% from the low-$1.20s levels in Oct '09. Prices are currently up ~15% y/y. Similar to choice beef, pricing chicken breasts in 2011 appears likely to be materially higher versus 2010.
- **Pork:** Pork belly (bacon) prices have risen to $0.95/pound recently, up 20% y/y and up 44% from the lows reached in Oct '09. However, bacon/pork tends to be a relatively small piece of the overall commodity basket for most restaurant chains.
- **Dairy:** Dairy prices were very weak in 2009, with milk down 35% and cheese down ~30%. Prices have reset to higher levels in 2010 and are likely to be up 10-20% this year, based on current trends and USDA forecasts.

Figure 26: Pricing trends for key restaurant commodities – protein prices have surged in recent months

Key input prices (commodities, gasoline, labor)

													y/y % change						
Grains & oils	2007	2008	1Q09	2Q09	3Q09	4Q09	2009	1Q10E*	2Q10E*	3Q10E*	4Q10E*	2010E*	2009	1Q10E*	2Q10E*	3Q10E*	4Q10E*	2010E*	Recent trends
Corn ($/bushel)	$3.48	$4.94	$3.60	$3.96	$3.16	$3.55	$3.57	$3.44	$3.55	$3.75	$3.80	$3.63	-28%	-5%	-10%	19%	7%	2%	recent price = $3.41; down 11% y/y
Wheat - Hard KC ($/bushel)	$6.74	$8.62	$6.12	$6.23	$4.91	$5.10	$5.59	$4.84	$4.80	$5.15	$5.30	$5.02	-35%	-21%	-23%	5%	4%	-10%	recent price = $4.84; down 15% y/y
Soybeans ($/bushel)	$8.11	$11.92	$9.25	$11.20	$10.59	$9.87	$10.23	$9.47	$9.65	$9.77	$9.60	$9.62	-14%	2%	-14%	-8%	-3%	-6%	recent price = $9.56; down 7.3% y/y
Soybean oil ($/lb.)	$0.35	$0.50	$0.30	$0.35	$0.32	$0.35	$0.33	$0.35	$0.37	$0.37	$0.37	$0.37	-33%	18%	7%	16%	5%	11%	recent price = $0.38; up 10% y/y
Rice ($/lb.)	$0.20	$0.35	$0.29	$0.26	$0.25	$0.25	$0.26	$0.26	$0.25	$0.25	$0.25	$0.25	-26%	-13%	-5%	0%	1%	-5%	recent price = $0.25; down 6% y/y
Produce																			
Tomatoes ($/case)	$12.42	$12.89	$8.25	$14.03	$9.19	$18.38	$12.46	$23.58	$26.00	$26.00	$26.00	$25.39	-3%	186%	85%	183%	41%	104%	recent price = $25.95; up 63% y/y
Potatoes ($/cwt.)	$5.42	$6.32	$6.63	$6.87	$4.89	$4.50	$5.72	$5.20	$5.20	$5.20	$5.20	$5.20	-10%	-22%	-24%	6%	16%	-9%	recent price = $7.90; up 11% y/y
Eggs (dozen, large)	$0.86	$1.20	$1.04	$0.87	$0.83	$1.08	$0.95	$1.16	$1.15	$1.15	$1.15	$1.15	-21%	12%	33%	38%	7%	21%	recent price = $1.06; down 13% y/y
Avocados (Hass, 48 ct.)	$30.62	$33.03	$25.44	$37.01	$45.29	$23.06	$32.70	$23.58	$29.61	$36.23	$23.06	$28.12	-1%	-7%	-20%	-20%	0%	-14%	recent price = $27; down 26% y/y
Protein																			
Live cattle (steer; $/lb.)	$0.92	$0.92	$0.83	$0.85	$0.82	$0.83	$0.83	$0.89	$0.99	$0.93	$0.96	$0.94	-10%	7%	17%	13%	16%	13%	recent price = $1.00; up 15% y/y
Beef (choice cut-out, $/cwt.)	$150	$154	$140	$144	$141	$139	$141	$146	$165	$165	$165	$160	-8%	4%	15%	17%	19%	14%	recent price = $167; up 9% y/y
Ground beef (90s/50s blend; $/lb.)	$1.11	$1.30	$1.20	$1.22	$1.11	$1.07	$1.15	$1.29	$1.40	$1.37	$1.27	$1.33	-12%	7%	15%	23%	19%	16%	recent price = $1.40; up 15% y/y
Prime beef (avg of 3 cuts; $/lb.)	$10.96	$8.88	$6.83	$7.03	$7.78	$7.66	$7.32	$7.37	$8.15	$8.15	$8.15	$7.95	-18%	8%	16%	5%	6%	9%	recent price = $8.28; up 23% y/y
Chicken breasts ($/lb.)	$1.61	$1.38	$1.37	$1.55	$1.47	$1.30	$1.42	$1.55	$1.82	$1.86	$1.52	$1.69	3%	13%	18%	27%	17%	19%	recent price = $1.76; up 16% y/y
Chicken wings ($/lb.)	$1.28	$1.09	$1.44	$1.39	$1.38	$1.57	$1.45	$1.68	$1.46	$1.43	$1.44	$1.50	32%	16%	5%	-3%	-8%	4%	recent price = $1.46; up 5% y/y
Chicken leg quarters ($/lb.)	$0.55	$0.61	$0.54	$0.63	$0.55	$0.48	$0.55	$0.50	$0.51	$0.52	$0.45	$0.50	-9%	-7%	-19%	-5%	-6%	-10%	recent price = $0.49; down 16% y/y
Pork belly (bacon) ($/1.25 lb.)	$0.90	$0.79	$0.75	$0.75	$0.72	$0.73	$0.74	$0.90	$1.00	$0.95	$0.95	$0.95	-6%	20%	33%	32%	31%	29%	recent price = $0.95; up 20% y/y
Pork tenderloin ($/lb.)	$2.38	$2.42	$2.20	$2.28	$2.34	$2.11	$2.23	$2.21	$2.21	$2.21	$2.21	$2.21	-8%	1%	-3%	-5%	5%	-1%	recent price = $2.22; up 2% y/y
Shrimp (16/20 ct.)	$5.35	$6.52	$5.56	$5.29	$5.00	$4.54	$5.10	$4.71	$5.00	$5.00	$5.00	$4.93	-22%	-15%	-5%	0%	10%	-3%	recent price = $5.10; down 6% y/y
Salmon (10-12 lb.)	$3.22	$3.26	$3.03	$3.49	$3.67	$3.21	$3.35	$3.38	$3.85	$3.85	$3.85	$3.73	3%	11%	10%	5%	20%	11%	recent price = $3.85; up 24% y/y
Snow crab legs (5-8 oz.)	$4.36	$4.40	$4.06	$3.35	$3.21	$3.29	$3.48	$3.61	$3.83	$3.83	$3.83	$3.77	-21%	-11%	14%	19%	16%	8%	recent price = $3.83; up 7% y/y
Dairy																			
Milk ($/cwt.)	$18.28	$17.81	$11.84	$10.50	$10.54	$13.27	$11.54	$14.59	$13.50	$14.00	$14.00	$14.02	-35%	23%	29%	33%	6%	22%	recent price = $13.22; up 28% y/y
Butter ($/lb.)	$1.37	$1.46	$1.13	$1.23	$1.22	$1.38	$1.24	$1.40	$1.50	$1.50	$1.50	$1.48	-15%	24%	22%	23%	9%	19%	recent price = $1.56; up 29% y/y
Cheese (40 lb. blocks; cents/lb.)	$176	$186	$118	$117	$125	$156	$129	$140	$145	$145	$145	$144	-31%	18%	24%	16%	-7%	11%	recent price = $1.43; up 22% y/y
Gas + labor																			
Gasoline (US avg; $/gallon)	$2.76	$3.22	$1.87	$2.31	$2.51	$2.56	$2.31	$2.68	$2.80	$2.80	$2.80	$2.77	-28%	43%	21%	12%	9%	20%	recent price = $2.83; up 40% y/y
Diesel (US avg; $/gallon)	$2.88	$3.80	$2.19	$2.34	$2.60	$2.74	$2.47	$2.85	$3.05	$3.05	$3.05	$3.00	-35%	31%	30%	17%	11%	22%	recent price = $3.07; up 38% y/y
Fed. min. wage (annual avg.; $/hr.)	$5.50	$6.20	$6.55	$6.55	$7.25	$7.25	$6.90	$7.25	$7.25	$7.25	$7.25	$7.25	11%	11%	11%	0%	0%	5%	will avg. $7.25 for '10; up 5%

USDA forecasts	2009	2010E*
Food inflation -- all food	1.8%	3.0%
Food inflation -- food away from home	3.5%	3.0%
Food inflation -- food at home	0.5%	3.0%

* Estimates based on a combination of futures prices, DB estimates and recent/historical trends.

Contracts are typically negotiated in the fall. Prices for proteins (including live cattle, beef, chicken breasts and bacon) have surged over the last several quarters. This points to potential upward pressure on restaurant food costs in 2H10 and/or 2011, as contracts roll off and are renewed.

Source: Deutsche Bank estimates, company information, American Restaurant Association

Figure 27: Food cost exposure by company (where available), as well as FY10 commodity inflation guidance and company restaurant mix

	Chicken	Beef	Pork	Seafood	Dairy/ cheese	Wheat/ bread	Produce ex-potatoes	Potatoes	Rice	Cooking oil	Soft drinks	Alcohol/ wine	Coffee	Paper/ packing	Freight/ Other	FY10 Commodity inflation	Company-operated restaurant %
QSR																	
Burger King	11%	20%	2%	-	8%	5%	5%	5%	-	-	14%	-	2%	9%	-	0.0%	12%
CKE Restaurants	9%	18%	7%	-	9%	5%	3%	9%	-	3%	12%	-	0%	11%	14%	NA	29%
Jack-in-the-Box	11%	20%	2%	-	2%	-	2%	8%	-	-	-	-	-	-	-	-1.0%	56%
McDonald's	15%	15%	1%	2%	8%	5%	5%	5%	-	-	15%	-	3%	10%	-	0.0%	21%
Sonic	10%	11%	-	-	12%	6%	-	-	-	-	-	-	-	-	-	-1.5%	20%
Wendy's/Arby's Group	15%	15%	-	-	8%	5%	-	-	-	-	-	-	-	-	-	2.5%	25%
YUM! Brands*	25%	15%	3%	3%	15%	13%	10%	3%	-	-	10%	-	-	11%	-	0.0%	23%
Pizza																	
Dominos	-	-	-	-	28%	-	-	-	-	-	-	-	-	-	-	NA	6%
Papa John's	-	-	-	-	38%	-	-	-	-	-	-	-	-	-	-	NA	18%
Quick casual																	
Panera	15%	5%	-	-	8%	10%	5%	-	-	-	15%	-	3%	-	-	-1.0%	100%
Chipotle	15%	10%	7%	-	10%	-	5%	-	3%	-	10%	2%	-	3%	-	0.0%	42%
Upscale dining																	
Morton's	-	36%	-	-	-	-	-	-	-	-	-	27%	-	-	-	NA	100%
McCormick & Schmick's	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	NA	100%
Ruth's Hospitality Group*	-	42%	-	12%	8%	-	-	-	-	-	2%	23%	-	-	-	-2.0%	43%
Casual dining																	
BJ's Restaurants	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.0%	99%
Brinker	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-1.0%	61%
Buffalo Wild Wings	43%	-	-	-	-	-	-	-	-	-	-	24%	-	-	-	NA	35%
California Pizza Kitchen	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1.0%	81%
CBRL Group	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-2.3%	100%
Cheesecake Factory	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.5%	100%
Darden	6%	14%	-	33%	7%	8%	-	-	4%	4%	-	-	-	-	-	-3.0%	98%
DinEquity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-1.0%	12%
P.F. Chang's	15%	15%	-	15%	-	-	15%	-	3%	5%	-	-	-	-	-	-1.0%	100%
Red Robin	14%	13%	-	3%	10%	9%	12%	11%	-	-	-	-	-	-	-	-2.3%	70%
Ruby Tuesday	5%	13%	-	16%	-	-	-	-	-	-	-	-	-	-	-	0.0%	75%
Texas Roadhouse	4%	46%	9%	0%	6%	2%	8%	2%	-	-	10%		-	-	-	-2.5%	78%
Coffee																	
Starbucks	-	-	-	-	8%	-	-	-	-	-	-	-	18%	-	37%	0.0%	53%
Average	14%	19%	4%	11%	12%	7%	7%	6%	3%	4%	11%	19%	5%	9%	25%	-0.6%	58%
Median	14%	15%	3%	8%	8%	6%	5%	5%	3%	4%	11%	24%	3%	10%	25%	-1.0%	56%

* Data for Ruth's Chris Steak House only. YUM for US only.

Source: Deutsche Bank estimates, company information

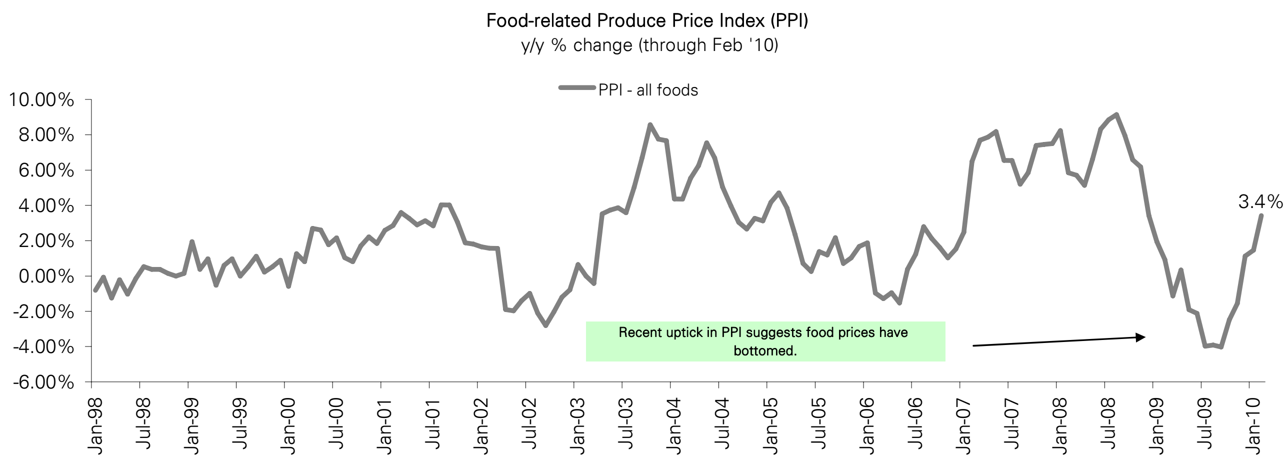
PPI also points to higher food costs ahead

PPI for food is at the highest level we've seen since Dec '08, suggesting some pipeline pressures are building in food commodities.

The producer price index (PPI) for food has continued its upward trend that started in Aug '09, rising +3.42% y/y in Feb '10, compared to +1.46% and +1.12% in Jan and Dec, respectively. This is the highest level of food PPI inflation we've seen since Dec '08 and suggests some pipeline pressures are building in food commodities. Despite the latest increases in PPI, many companies have maintained guidance of benign commodity costs for 2010 (discussed below), as most have locked in food costs for much of the year, thereby deferring food cost inflation until next year.

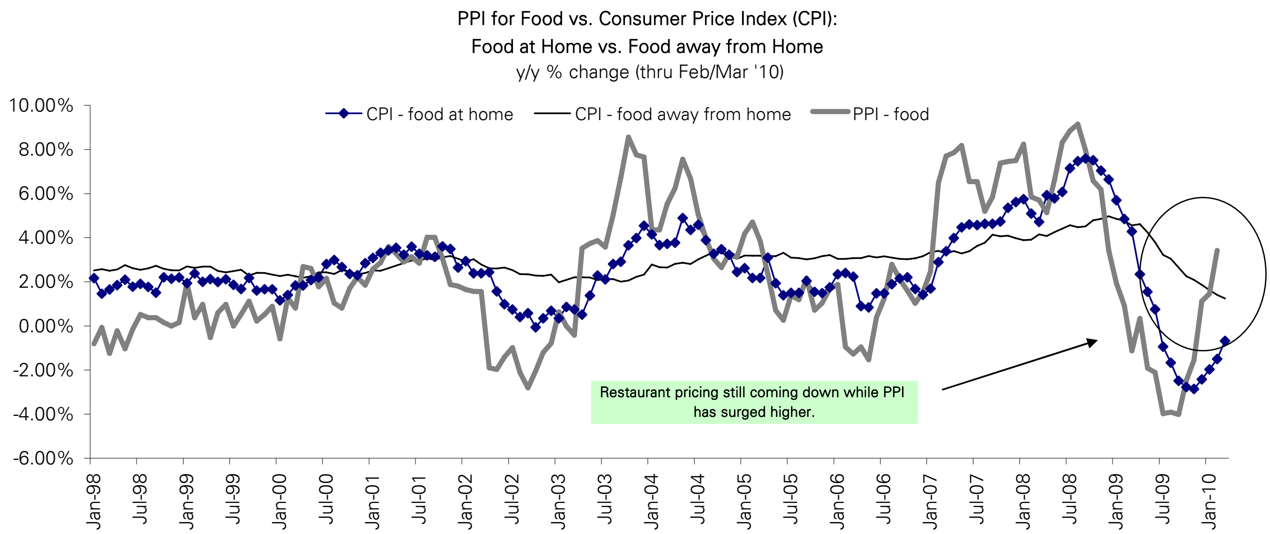
In contrast to the PPI trends, the CPI for "food away from home" continued to decelerate y/y in March, to +1.25% vs. +1.40% in Feb and +1.63% in Jan. This suggests a downward trend in pricing at restaurant chains continues and suggests some potential for margin pressure at restaurant chains in the future if commodity prices rise faster than menu prices.

Figure 28: PPI for food has moved higher since bottoming at -4% in Sept '09



Source: Deutsche Bank estimates, company information, BLS, freelunch.com

Figure 29: PPI for food now running above restaurant pricing (CPI for food away from home)



Source: Deutsche Bank estimates, company information, BLS, freelunch.com

What are the companies saying?

Most restaurant chains have good visibility on key commodities through yearend 2010 given forward purchase commitments (usually at fixed prices) and hedging practices.

Most restaurant chains have good visibility on key commodities through yearend 2010 given forward purchase commitments (usually at fixed prices) and hedging practices. We estimate that ~60% of overall food costs are locked in through FY10 for the sector, with some chains at nearly 100%. In addition, chicken, which tends to be the largest commodity exposure for most chains, is generally locked through the end of calendar 2010 under fixed-price contracts. However, with chicken representing ~15% of commodity costs for most chains, we expect this to become a more important issue to watch as contracts come up for renewal in late-10. As noted earlier, chicken breast prices are up ~40% from the late-09 levels, which is likely when many contracts were negotiated.

One area where we could see more near-term risk is ground beef. Higher ground beef prices are a potential headwind for hamburger fast food chains – exacerbated by the fact that most companies are unable hedge or lock in prices under forward contracts beyond a month or two. This means that ground beef costs typically float with the spot market for most fast food chains. However, we note that ground beef prices typically move seasonally lower in the summer, so one must be careful about extrapolating current prices for the rest of the year. Current prices and historical seasonal trends point to an average price of ~$1.33/pound, which would be up 16% for the full CY10 and up 20-25% in 2H10. We use a blend of 50s and 90s when calculating ground beef prices for the typical fast food chain.

Based on our analysis of company guidance, food costs are expected to be down ~1% on average for 2010.

Based on our analysis of company guidance, food costs are expected to be down ~1% on average for 2010 across the public restaurant chains, with a range of +2.5% to -3.0%. Most companies expect more favorable trends in 1H10, with less favorable trends in 2H10, as contracts gradually roll off and as certain less-hedged items, such as ground beef, are likely to be higher in 2H10.

Figure 30 summarizes commodity exposures for the major public restaurant companies, as well as the current outlook (primarily for 2010) with regard to inflation expectations and hedging status.

Figure 30: Restaurant industry – key commodity exposures and latest food cost outlook

	Key commodities (% of COGS)*	Food cost guidance/outlook*	Contracts/hedging status		Key commodities (% of COGS)*	Food cost guidance/outlook*	Contracts/hedging status
BJ's Restaurants	Chicken, beef, wheat, cheese	Food inflation of 1% in 2010. COGS of about 25% for 2010.	FY10: 85% commodities locked for 6 mos. or longer.	McDonald's	Ground beef (15%), Chicken (15%), Dairy (8%)	FY10: down 2-3% in US and down slightly in Europe	N/A
Brinker	Chicken, beef, cheese	Food costs favorable in FY10 and 1H FY11. Early indications on CY11 flattish.	About 50-60% of commodities contracted thru Dec '10. All items favorable except produce.	Morton's	Beef (36%)	N/A	20% of beef locked for 2010, approx. 10% lower than in 2009
Buffalo Wild Wings	Chicken	FYI0: No specific guidance on total food costs. Avg. wing price = $1.70 in 2009. YTD 2010 avg. = $1.65.	Wings are purchased on spot market.	P.F. Chang's	Beef (15%), chicken (15%), pork (15%), produce (15%)	FY10: Flat to down slightly, ex-produce. Produce generally flat currently.	N/A
Burger King	Ground beef (20%), Chicken (11%), Dairy (8%)	FY10: US food costs down 1H; up slightly 2H; flat to down slightly for full year.	Chicken contracted through YE10 (down 9%)	Panera	Chicken (15%), Wheat (10%), Dairy (8%)	Approx. 1% deflation in FY10.	FY10: ~60-65% contracted/hedged. ~80% hedged on wheat at $8.25 vs. $9.50 in '09.
California Pizza Kitchen	Cheese, wheat, chicken	FY10: 1% food inflation.	Have contracted 90% of all commodities for 6 mos. or longer. However, cheese not locked at all.	Papa John's	Cheese (38%)	N/A	Project cheese costs at $1.50-1.60 per lb.
CBRL Group	N/A	FY10: Food costs down 2.0-2.5%.	76% of commodity costs under contract for balance of FY10.	Red Robin	Chicken (14%), beef (13%), produce (12%), potatoes (11%)	FY10: 2.0-2.5% deflation.	Steak fries contracted at lower price than 2009.
Cheesecake Factory	N/A	FY10: Food cost inflation 0% to +1%. COGS slightly lower.	Locked on 60% of purchases for 2010.	Ruby Tuesday	Seafood (16%), beef (13%), chicken (5%)	FY10: Flattish food costs for FY10 and next 12 months.	Approx. 95% of commodities typically contrated 6-12 mos. Beef thru Dec '10. Seafood thru early Fall.
Chipotle	Chicken (15%), Beef (10%), Dairy (10%)	FY10: Up slightly, w/ deflation 1H and possible inflation 2H	FY10: Dairy unhedged. Rice, soy, tortillas contracted.	Ruth's Hospitality Grp.	Beef (42%), Seafood (12%), Dairy/butter (8%)	FY10: Beef expected to be down; dairy likely up.	FY10: 50% of beef locked at favorable prices. Dairy unhedged but do not expect much pressure
Darden	Seafood (33%), Beef (14%), Dairy/oil (11%), Pasta/bread (8%), Chicken (6%)	FY10: Food costs down 3%. FY11: Food costs flat to +0.8%.	100% locked on most key items thru FY10; 30-40% locked on key items for FY11	Sonic	Dairy/cheese (12%), beef (11%), chicken (10%)	FY10: Down slightly for the fiscal yr.	Most major items locked in for FY10.
DinEquity	N/A	FY10: Food costs flat to slightly favorable.	N/A	Starbucks	Coffee (18%), Dairy (8%)	FY10: flattish food costs; higher dairy offset by lower coffee	~25% of dairy exposure hedged; Forward purchase agreements for ~50% of coffee (DB est.)
Dominos	Cheese (28%), meat, boxes, wheat, sauce	FY10: Food basket likely up y/y in aggregate. Cheese/wheat up, chicken/pork flat, pulp down.	Expect cheese prices in $1.50-1.70 per lb. range.	Texas Roadhouse	Beef (46%), Produce (10%), Pork (9%)	FY10: Overall food costs down 2-3%; beef down MSD; pork down	Nearly 70% of overall food costs contracted for '10. 85% of beef, 100% pork, 50% chicken
Jack-in-the-Box	Beef (20%), chicken (11%), potatoes (8%)	FY10: Commodities down 1% (lower 1H, higher 2H); beef down 3%.	Beef 90s contracted thru April $1.30-1.38. Chicken thru Mar '12	Wendy's/Arby's Group	Beef, chicken, cheese, wheat	FY10: Up 2-3%, wtd. toward 2H.	N/A
McCormick & Schmick's	Seafood, beef	N/A	N/A	YUM! Brands	Chicken (25%), Beef (15%), Dairy/cheese (15%)	FY10: US and YRI 0%; China -1%. US: Chicken down; beef/cheese up	US: Chicken mostly hedged for '10

* Where available, based on a combination of company disclosures and DB estimates. YUM COGS data for US only.

Source: Deutsche Bank estimates, company information

What's the sensitivity to earnings?

We estimate that each 1% move in aggregate food costs impacts EPS for the average restaurant chain by 2-3% and restaurant/EBIT margins by ~30bps. This earnings sensitivity is higher for chains with a higher mix of company-owned restaurants.

Figure 31 summarizes the earnings and margin sensitivity to a 1% change in food costs for our covered companies. Not surprisingly, the fast food names are least sensitive to changes in food costs given a higher mix of franchised revenues.

Figure 31: Earnings/margin sensitivity to 1% change in food costs (before pricing)

	Impact from 1% move in food costs on...			
	Annual EPS ($)	Annual EPS (%)	Food & paper cost	EBIT margin
Burger King	$0.03	1.9%	30bps	20bps
McDonald's	$0.03	0.9%	30bps	30bps
YUM! Brands	$0.05	2.3%	30bps	25bps
Starbucks	$0.01	1.0%	10bps	10bps
Chipotle	$0.09	2.0%	30bps	30bps
Panera	$0.07	2.4%	30bps	30bps
Darden	$0.11	4.0%	30bps	30bps
Texas Roadhouse	$0.03	4.3%	40bps	40bps
Ruth's Hospitality Group	$0.04	11.0%	35bps	35bps
Average		2.4%	29bps	28bps

Source: Deutsche Bank estimates, company information

2011 forecasts could be the bigger concern

With food costs largely contracted for 2010, the primary area of concern would be around 2011 forecasts for the group, in our view.

With food costs largely contracted for 2010, the primary area of concern would be around 2011 forecasts for the group, in our view. Consensus forecasts assume a steady recovery in margins for the group in 2011, as well as an acceleration in revenue, EBITDA and EPS growth. This outlook, combined with higher valuations and stock prices, may not leave much room for hiccups, such a as surge in commodity costs.

In addition, we believe pricing power across the sector remains somewhat tenuous given a general oversupply of restaurants in certain segments of the industry (notably casual and upscale dining) and a still sluggish traffic environment. This raises the question of whether companies will be able to pass through higher commodity costs as easily as in the past.

Figure 32 summarizes historical and forecast EBITDA margins for the restaurant group through FY11E. Current consensus expectations call for a 50-60bps improvement in EBITDA margins in FY10 across the industry. With commodities still generally favorable for most companies this year and demand showing signs of improvement, we do NOT see significant risk to this outlook. However, FY11 consensus expectations call for a further 50-60bps improvement in industry margins. This outlook does appear to carry some risk if commodities remain at current levels or move higher.

What's the risk to earnings?: As noted earlier, aggregate expectations are for a 1% decline in food costs for FY10. If this swings to say +2% in FY11on higher protein/dairy/etc., that would imply ~90bps of incremental margin pressure across the group (or ~30bps for each 1% move in commodities), perhaps making the FY11 margin growth targets a challenge.

Looking at this from an earnings perspective, a 3% swing in food costs (i.e., from -1% in FY10 to +2% in FY11) could hurt earnings growth by 7-8% across the group in FY11 (or 2-3% for each 1% move in commodities). As shown in Figure 33, current consensus forecasts call for an acceleration in EPS growth in FY11, to ~17%, up from ~10% in FY10.

Figure 32: Restaurant industry EBITDA margin forecasts – rising food costs could pressure 2011 margins

	EBITDA MARGIN*								Y/Y CHANGE (IN BPS)						
Quick service	FY04	FY05	FY06	FY07	FY08	FY09	FY10E	FY11E	FY05	FY06	FY07	FY08	FY09	FY10E	FY11E
Burger King	10.8%	13.4%	16.9%	17.3%	18.3%	17.4%	17.3%	18.5%	252	354	43	101	-93	-9	116
CKE Restaurants	8.1%	9.4%	10.3%	9.9%	9.9%	10.6%	11.0%	10.6%	122	99	-41	2	61	42	-35
Jack in the Box	9.9%	9.7%	9.9%	10.9%	12.5%	11.0%	12.5%	13.6%	-14	18	101	156	-144	150	105
McDonald's	25.5%	26.4%	27.2%	29.7%	32.5%	35.4%	36.9%	38.4%	95	77	248	282	292	150	153
Sonic	26.0%	25.7%	24.9%	24.7%	24.2%	24.4%	25.0%	26.2%	-22	-85	-18	-50	16	59	125
YUM! Brands	17.5%	17.3%	18.2%	18.2%	17.8%	19.8%	21.2%	21.9%	-15	89	3	-42	200	136	76
QSR avg.	**16.3%**	**17.0%**	**17.9%**	**18.5%**	**19.2%**	**19.8%**	**20.6%**	**21.5%**	**70**	**92**	**56**	**75**	**55**	**88**	**90**
Quick casual															
Chipotle	5.9%	9.4%	11.7%	14.0%	13.3%	17.5%	17.6%	18.1%	347	229	229	-70	418	11	53
Panera Bread	18.1%	17.8%	16.3%	13.9%	14.2%	15.5%	16.4%	16.5%	-27	-152	-241	28	137	84	14
QC avg.	**12.0%**	**13.6%**	**14.0%**	**13.9%**	**13.7%**	**16.5%**	**17.0%**	**17.3%**	**160**	**38**	**-6**	**-21**	**277**	**47**	**33**
Casual dining															
BJ's Restaurants	9.0%	10.2%	9.6%	9.4%	9.0%	10.3%	11.0%	11.5%	120	-57	-16	-47	131	75	50
Buffalo Wild Wings	12.2%	12.7%	13.3%	12.9%	14.0%	14.3%	15.2%	15.5%	51	55	-38	104	31	96	28
Cheesecake Factory	13.7%	14.8%	12.2%	11.6%	10.1%	11.1%	11.7%	12.1%	108	-264	-58	-143	96	57	44
California Pizza Kitchen	12.6%	11.3%	10.8%	11.1%	9.7%	10.0%	9.9%	10.4%	-127	-45	24	-134	24	-5	42
Darden Restaurants	12.6%	13.0%	14.0%	13.9%	13.4%	13.0%	13.3%	13.7%	42	103	-11	-51	-44	31	47
Brinker International	13.5%	12.2%	12.9%	12.0%	11.0%	11.2%	11.5%	12.4%	-132	70	-86	-96	20	28	93
P.F. Chang's	10.7%	12.1%	10.5%	9.9%	10.1%	11.4%	11.7%	11.9%	146	-166	-57	22	127	37	13
Red Robin	14.5%	14.8%	13.5%	13.1%	11.4%	10.7%	10.4%	10.5%	26	-131	-43	-164	-69	-33	11
Ruby Tuesday	22.3%	20.4%	17.7%	16.4%	11.4%	11.8%	11.2%	12.3%	-192	-267	-130	-502	42	-63	110
Texas Roadhouse	13.7%	13.5%	12.7%	13.0%	11.3%	12.5%	13.0%	13.2%	-20	-81	29	-165	116	53	22
Casual dining avg.	**13.5%**	**13.5%**	**12.7%**	**12.3%**	**11.1%**	**11.6%**	**11.9%**	**12.4%**	**2**	**-78**	**-39**	**-118**	**48**	**27**	**46**
Upscale dining															
McCormick & Schmick's	7.3%	9.4%	9.7%	7.8%	6.1%	6.5%	6.9%	7.2%	203	29	-183	-170	41	34	30
Morton's	9.0%	8.9%	9.5%	8.1%	5.9%	5.2%	6.7%	7.0%	-4	51	-132	-222	-76	159	30
Ruth's Hospitality Group	15.5%	16.4%	15.6%	13.1%	9.7%	10.3%	10.7%	11.3%	91	-81	-255	-340	69	33	60
Upscale avg.	**10.6%**	**11.6%**	**11.6%**	**9.7%**	**7.2%**	**7.3%**	**8.1%**	**8.5%**	**97**	**0**	**-190**	**-244**	**11**	**75**	**40**
Industry avg.	**13.7%**	**14.2%**	**14.2%**	**13.9%**	**13.1%**	**13.8%**	**14.3%**	**14.9%**	**50**	**-7**	**-30**	**-72**	**67**	**53**	**56**

* All estimates from First Call except for DB covered companies. Excludes non-recurring items.

Forecasts assume steady margin recovery.

Source: Deutsche Bank estimates, company information, Cap IQ

Figure 33: Summary of restaurant industry growth expectations (based on DB and consensus forecasts)

		– SSS estimates* –			– Revenue Growth –			– EBITDA Y/Y growth –			– EPS est. –			– EPS Y/Y growth –		
QSR		FY09A	FY10E	FY11E	FY09A	FY10E	FY11E	FY09A	FY10E	FY11E	FY09A	FY10E	FY11E	FY09A	FY10E	FY11E
Burger King	BKC	1.2%	-2.8%	1.5%	3.4%	-1.3%	2.4%	-1.9%	-1.8%	9.3%	$1.41	$1.32	$1.50	2.2%	-6.3%	13.8%
CKE Restaurants	CKR	-3.9%	NA	NA	-4.2%	1.3%	9.5%	1.7%	5.4%	6.0%	$0.72	$0.78	$0.97	4.3%	8.3%	24.4%
Jack in the Box*	JACK	-1.2%	-6.5%	NA	-2.7%	-7.5%	-3.5%	-13.9%	5.0%	4.6%	$2.27	$1.95	$2.20	12.9%	-14.1%	12.8%
McDonald's	MCD	2.6%	3.0%	3.0%	-3.3%	1.7%	0.9%	5.4%	6.0%	5.1%	$3.98	$4.39	$4.73	8.4%	10.5%	7.7%
Sonic	SONC	-4.3%	-5.0%	NA	-10.7%	-22.3%	1.6%	-10.1%	-20.5%	6.7%	$0.72	$0.56	$0.70	-25.8%	-22.2%	25.0%
Wendy's /Arby's Group*	WEN	-1.6%	1.0%	NA	-2.2%	-2.6%	2.9%	15.9%	0.2%	10.6%	$0.17	$0.17	$0.24	21.4%	0.0%	41.2%
YUM! Brands	YUM	23.1%	6.3%	4.7%	-3.7%	3.9%	3.9%	7.1%	11.1%	7.7%	$2.17	$2.44	$2.75	13.3%	12.3%	12.7%
	AVG	**2.3%**	**-0.7%**	**3.1%**	**-3.3%**	**-3.8%**	**2.5%**	**0.6%**	**0.8%**	**7.1%**				**5.3%**	**-1.6%**	**19.6%**
PIZZA																
Domino's	DPZ	0.5%	2.0%	NA	-1.5%	3.1%	2.3%	2.2%	9.1%	3.4%	$0.87	$1.12	$1.24	16.0%	28.7%	10.7%
Papa John's	PZZA	0.0%	NA	NA	-2.3%	-0.6%	3.6%	2.4%	14.0%	6.2%	$1.50	$1.85	$2.10	-10.7%	23.3%	13.5%
	AVG	**0.3%**	**NA**	**NA**	**-1.9%**	**1.2%**	**3.0%**	**2.3%**	**11.6%**	**4.8%**				**2.6%**	**26.0%**	**12.1%**
QUICK CASUAL																
Chipotle Mexican Grill	CMG	2.2%	2.3%	2.3%	14.0%	13.3%	12.5%	49.9%	14.0%	16.0%	$3.95	$4.44	$5.29	67.5%	12.4%	19.1%
Panera Bread	PNRA	2.2%	6.9%	3.0%	4.2%	12.2%	10.5%	14.3%	18.3%	11.4%	$2.91	$3.49	$4.14	25.4%	19.9%	18.7%
	AVG	**2.2%**	**4.6%**	**2.6%**	**9.1%**	**12.8%**	**11.5%**	**32.1%**	**16.2%**	**13.7%**				**46.5%**	**16.2%**	**18.9%**
UPSCALE DINING																
Morton's	MRT	-20.0%	3.0%	NA	-20.7%	3.5%	4.6%	-30.9%	35.3%	17.2%	$0.10	$0.27	NA	-69.7%	NA	NA
McCormick & Schmick's	MSSR	-15.7%	NA	NA	-7.8%	-1.0%	5.3%	-1.7%	4.1%	16.1%	$0.32	$0.44	NA	-28.9%	37.5%	NA
Ruth's Hospitality Group*	RUTH	-19.3%	0.6%	4.0%	-12.5%	2.8%	4.7%	-6.2%	6.1%	10.6%	$0.42	$0.32	$0.37	20.1%	-23.9%	13.6%
	AVG	**-18.3%**	**1.8%**	**4.0%**	**-13.7%**	**1.8%**	**4.9%**	**-12.9%**	**15.2%**	**14.7%**				**-26.1%**	**6.8%**	**13.6%**
CASUAL DINING																
BJ's Restaurants	BJRI	-0.8%	2.0%	NA	14.1%	14.4%	16.3%	30.8%	22.7%	21.9%	$0.53	$0.65	$0.80	20.5%	22.6%	23.1%
Brinker International	EAT	-5.6%	-1.5%	NA	-14.5%	-11.6%	-4.3%	-12.9%	-9.4%	3.4%	$1.44	$1.41	$1.49	2.1%	-2.1%	5.7%
Buffalo Wild Wings	BWLD	3.1%	NA	NA	27.6%	17.0%	19.9%	30.4%	24.9%	22.1%	$1.69	$2.04	$2.50	24.3%	20.7%	22.5%
California Pizza Kitchen	CPKI	-6.6%	-1.0%	NA	-1.8%	-2.0%	6.3%	0.6%	-2.5%	10.8%	$0.77	$0.76	$0.90	13.2%	-1.3%	18.4%
CBRL Group	CBRL	-1.7%	0.3%	NA	-0.7%	1.1%	3.0%	-3.4%	13.5%	4.6%	$2.89	$3.51	$3.90	2.5%	21.5%	11.1%
Cheesecake Factory	CAKE	-2.6%	-0.5%	NA	-0.3%	1.9%	5.2%	9.2%	7.1%	9.1%	$1.07	$1.27	$1.46	27.4%	18.7%	15.0%
Darden Restaurants	DRI	-1.4%	-2.0%	1.7%	8.9%	-0.6%	5.1%	5.4%	1.8%	8.8%	$2.75	$2.95	$3.23	0.4%	7.3%	9.6%
DineEquity	DIN	-4.5%	-1.5%	NA	-12.4%	-4.3%	-10.3%	13.2%	-8.3%	-2.4%	NA	NA	NA	NA	NA	NA
P.F. Chang's*	PFCB	-6.7%	NA	NA	2.5%	0.6%	5.1%	15.4%	3.9%	6.3%	$1.87	$2.03	$2.30	29.0%	8.6%	13.3%
Red Robin	RRGB	-11.1%	2.9%	NA	-4.7%	5.7%	6.5%	-10.5%	2.4%	7.7%	$1.38	$1.31	$1.49	-23.8%	-5.1%	13.7%
Ruby Tuesday	RT	-7.9%	-1.5%	NA	-8.2%	-4.8%	0.3%	-4.8%	-9.9%	10.2%	$0.53	$0.66	$0.85	3.9%	24.5%	28.8%
Texas Roadhouse	TXRH	-2.8%	0.0%	2.5%	7.0%	4.0%	7.5%	18.0%	8.4%	9.3%	$0.67	$0.76	$0.84	26.6%	14.3%	10.9%
	AVG	**-4.1%**	**-0.3%**	**2.1%**	**1.5%**	**1.8%**	**5.1%**	**7.6%**	**4.5%**	**9.3%**				**11.5%**	**11.8%**	**15.6%**
COFFEE																
Starbucks	SBUX	-5.3%	3.6%	4.1%	-5.9%	4.5%	2.9%	0.4%	24.7%	14.4%	$0.80	$1.10	$1.34	12.7%	37.5%	21.8%
Industry averages		**-3.3%**	**0.4%**	**3.0%**	**-0.7%**	**1.1%**	**4.6%**	**6.0%**	**5.8%**	**9.2%**				**10.6%**	**10.2%**	**17.0%**

Revenue, EBITDA and EPS estimates from Capital IQ except for DB covered companies. Excludes non-recurring items. Same store sales estimates for non-covered companies based on company guidance.

*JACK: Same stores sales for Jack in the Box brand only; WEN: Wendy's only; RUTH: Ruth's Chris only; PFCB: P.F. Chang's only

Forecasts call for a strong recovery in EPS growth in FY11.

Source: Deutsche Bank estimates, company information, Cap IQ

We note that "food and paper costs" (i.e., COGS) are at multi-year lows across the restaurant industry currently.

We note that "food and paper costs" (i.e., COGS) are at multi-year lows across the restaurant industry currently. "Food and paper costs" for the restaurant industry finished FY09 at 28.9%, down from 29.6% in FY08. This compares to an average of 29.3% over the 2004-8 period. As shown in Figure 34, casual and upscale dining chains are currently furthest below the historical trend, with fast food chains actually slightly above the historical trend. This suggests many chains are enjoying food prices that are below historical levels and may not be sustainable over the long term, particularly within such a competitive industry.

Figure 34: Restaurant industry – food & paper costs as a % of sales

	Food & paper costs*						y/y change in bps				
	CY04	CY05	CY06	CY07	CY08	CY09	CY05	CY06	CY07	CY08	CY09
Quick service											
Burger King	NA	NA	30.3%	30.7%	32.0%	31.7%	NA	NA	36	134	-26
CKE Restaurants	29.8%	29.6%	28.8%	29.7%	29.7%	29.3%	-24	-76	85	2	-34
Jack in the Box	31.0%	31.8%	30.9%	32.4%	33.7%	31.7%	73	-84	146	133	-205
McDonald's	34.2%	34.0%	33.2%	33.0%	33.8%	33.5%	-17	-79	-20	77	-27
Sonic	26.5%	26.1%	25.8%	25.6%	26.9%	27.6%	-35	-29	-20	128	66
YUM! Brands	31.8%	31.4%	30.5%	31.0%	32.9%	31.9%	-34	-94	56	187	-100
QSR average	**30.6%**	**30.6%**	**29.9%**	**30.4%**	**31.5%**	**31.0%**	**-7**	**-65**	**47**	**110**	**-54**
Quick casual											
Chipotle	32.9%	32.4%	31.5%	31.9%	32.4%	30.7%	-53	-89	45	50	-174
Panera Bread	28.0%	28.6%	29.6%	30.4%	30.3%	29.3%	55	103	82	-13	-102
QC average	**30.5%**	**30.5%**	**30.5%**	**31.2%**	**31.4%**	**30.0%**	**1**	**7**	**64**	**19**	**-138**
Casual dining											
Applebee's**	26.5%	26.5%	26.7%	26.9%	26.9%	26.2%	-6	27	17	0	-70
BJ's Restaurants	26.0%	25.6%	25.7%	25.4%	25.2%	25.0%	-34	8	-28	-19	-28
Buffalo Wild Wings	33.8%	31.6%	30.8%	30.8%	29.8%	30.2%	-220	-81	-3	-93	38
Cheesecake Factory	26.5%	25.6%	25.4%	25.2%	25.9%	24.6%	-90	-27	-15	74	-133
California Pizza Kitchen	24.8%	25.0%	24.8%	24.7%	24.9%	23.6%	17	-17	-13	21	-123
Darden Restaurants***	30.2%	29.8%	29.1%	29.5%	29.5%	29.5%	-36	-71	38	-3	0
Brinker International	27.9%	28.3%	27.7%	28.0%	28.5%	28.0%	31	-59	31	53	-51
P.F. Chang's	28.4%	27.8%	27.4%	27.4%	27.2%	26.6%	-63	-41	8	-25	-60
Red Robin	23.8%	23.2%	22.6%	22.9%	23.8%	24.1%	-65	-57	29	90	25
Ruby Tuesday	25.8%	26.5%	26.7%	27.1%	27.4%	29.3%	74	16	48	31	184
Texas Roadhouse	34.9%	35.2%	35.1%	35.2%	35.4%	33.5%	36	-19	16	14	-187
Casual dining average	**28.1%**	**27.7%**	**27.4%**	**27.6%**	**27.7%**	**27.3%**	**-32**	**-29**	**12**	**13**	**-37**
Upscale dining											
McCormick & Schmick's	29.7%	29.3%	29.0%	29.1%	30.1%	29.4%	-41	-27	12	98	-67
Morton's	33.7%	33.1%	33.0%	33.1%	32.6%	30.5%	-62	-7	2	-51	-201
Ruth's Hospitality Group	33.7%	31.0%	32.2%	32.1%	32.4%	29.3%	-271	124	-11	32	-308
Upscale average	**32.4%**	**31.1%**	**31.4%**	**31.4%**	**31.7%**	**29.8%**	**-124**	**30**	**1**	**26**	**-192**
Restaurant industry average	**29.5%**	**29.2%**	**28.9%**	**29.2%**	**29.6%**	**28.9%**	**-36**	**-21**	**25**	**42**	**-72**

* Data based on calendar periods; adjusted for company's with non-December fiscal years.

** Applebee's is now owned by DinEquity. These figures represent Applebee's restaurant margin trends on a standalone basis, excluding IHOP.

*** Darden's margins are adjusted for mix shifts associated with the RARE acquisition.

Food & paper costs are at multi-year lows for restaurant chains.

Source: Deutsche Bank estimates, company information

Commentary and outlook for covered companies

Burger King (BKC: Buy)

As noted earlier, higher ground beef costs are a more near-term concern given that this product is typically purchased on the spot market. Ground beef represents ~20% of BKC's overall food basket and looks to be headed higher in coming months. Ground beef costs are up ~17% since BKC's F2Q10 conference call in early February. At that time, BKC was forecasting flattish food costs for FY10. This outlook is now looking a bit optimistic. The last time commodities costs spiked to a similar level for BKC (F2Q08-F2Q09), COGS rose ~200bps in the US & Canada segment. A similar increase in COGS this time around would cause our FY11 EPS estimate to fall to ~$1.38 from $1.50 currently, or ~8% downside. With BKC shares trading at just 14.6x our current forward-year EPS estimate, vs. over 19x for the restaurant industry, we believe some of this commodity risk is already priced into the stock. In addition, BKC has locked in chicken costs for CY10 at favorable prices (down 9%) helping to mitigate some of the pressure from higher ground beef prices this year. Overall, while we are concerned about the impact of rising ground beef costs, we believe BKC's discounted valuation and easy sales/margin compares will likely limit downside risk in the stock. Also, BKC's heavily franchised business model (~90% of the store base) helps to mitigate commodity risk as well.

Chipotle (CMG: Buy)

CMG has guided to a modest increase in food costs in 2010, with some deflation in 1H10. Higher chicken and beef prices more recently point to some inflationary pressure, particularly in 2011. However, we are reasonably confident that CMG has the ability to raise menu prices as necessary to combat higher commodity costs given strong brand positioning (average unit volumes ~70% higher than largest competitor). CMG has not raised menu prices since Dec '08.

Darden Restaurants (DRI: Hold)

Darden has guided to a 3% decline in food costs for FY10. Initial FY11 guidance calls for inflation of 0% to +0.8%. Given DRI's diverse restaurant concepts, the company has a fairly diverse product mix, with the heaviest weighting in seafood (~33% of COGS). Seafood costs that we track (shrimp, salmon, crab legs) have not moved up with other commodity costs recently, suggesting less risk to FY11 the commodity outlook for DRI at this time.

McDonald's (MCD: Buy)

MCD faces some risk related to higher ground beef costs. However, MCD has the lowest earnings sensitivity to commodity costs in the sector given the company's franchise + rental income driven model. Combined with strong buying power, less US exposure than most other restaurant chains and above-average pricing power, we do not expect commodities to be a major headwind for MCD in 2010 or 2011.

Panera (PNRA: Buy)

Panera has locked in the majority of key commodities for 2010 and expects the overall food basket to be down slightly this year. Looking to 2011, we believe higher chicken prices (~15% of food costs) could add some pressure to costs/margins. However, this could be partly offset by favorable wheat prices (~10% of food costs). PNRA has currently contracted wheat prices at $8.25/bushel in 2010. 2011 futures are currently in the $6.00 range, suggesting favorability next year as well. We also believe PNRA has some room to raise prices, as needed, given dominant brand positioning in the "bakery café" segment.

Ruth's Hospitality Group (RUTH: Buy)
RUTH clearly has considerable exposure to beef prices, with beef representing about 40% of COGS. RUTH's steaks are predominantly "prime" beef, which has moved higher in recent weeks, though not as much as other cuts. Prime beef prices are up ~5% versus Fall '09 levels and up 10% YTD. We believe RUTH has contracted ~50% of beef needs for 2010, minimizing risk of margin pressure in the near term. For 2011, we believe the potential for improving demand/traffic could be more important to stock sentiment than higher beef prices given the significant demand fall-off during the recession and generally low sales forecasts (we're modeling flattish comps for 2010).

Texas Roadhouse (TXRH: Hold)
Beef represents ~46% of TXRH's food basket. The company has contracted ~85% of 2010 supply at favorable y/y prices. However, we believe supply has not been contracted for 2011. Current "choice" beef prices are up 25% from the lows seen in Fall '09 and 12% above average prices for 2008-9. Clearly, any upward move in contracted choice beef prices for 2011 could have a major impact on TXRH restaurant margins, absent higher menu pricing.

YUM! Brands (YUM: Hold)
With chicken as YUM's most important food item in the US and globally, the company's commodity outlook is in good shape for 2010. YUM has guided to flat food costs in the US and YRI for 2010, with the China business expected to be down 1%. We believe YUM's chicken breast meat needs have been contracted for 2010 at favorable prices y/y in the US. Chicken-on-the-bone is typically purchased under cost-plus contracts. With grain prices generally benign, this portion of the commodity basket looks favorable as well. Looking to 2011, we believe YUM's chicken exposure could put some upward pressure on food costs. We are not as concerned by YUM's ground beef exposure (~15% of US COGS) given above-average flexibility on sourcing options.

Restaurant price targets and risks

Burger King (BKC: Buy) – $24 PT
Our $24 PT assumes ~16x our forward 12-months EPS forecast, in line with BKC's historical average P/E of 16x. We also assume ~8x our forward 12-months EBITDA forecast. We believe both of these are reasonable multiples for a company that may be emerging from a trough in its business and considering the reasonably stable and predictable nature of BKC's cash flows (given the heavy franchised mix of business). Our PT is also supported by a sum-of-the-parts model that assumes 6x company-operated EBITDA and 8.5x franchised EBITDA. At the current stock price, investors are only paying ~7.5x for BKC's franchised EBITDA (assuming the same 6x for the company-operated piece).

Risks
Slowing consumer traffic in the US, Europe or Latin America; rising input costs, particularly for ground beef, chicken and cheese, which are key input costs for Burger King; sharper pricing/promotions from competitors, which could hurt BKC's sales, market share and/or margins; a stronger US dollar.

McDonald's (MCD: Buy) – $76 PT
Our PT is based on a P/E of 17x forward-year EPS, which is near the midpoint of MCD's historical range of 13x-19x and a discount to the restaurant industry average of ~19x. While MCD has below-average unit growth potential (+1-2% worldwide) given the large installed base of restaurants, this is offset by above-average cash flow (highest dividend yield in the sector at 3.3%), improving returns on capital, market share gains, best-in-class operations and a largely franchise-driven income stream. Our price target assumes a slight premium to MCD's five-year average trading multiple of ~16x.

Risks

Slowing consumer traffic, particularly in the US or Europe, could negatively impact our sales forecast for MCD. The competitive environment remains challenging in the fast food industry, particularly in the US, as chains compete for foot traffic in a still-soft retail environment. MCD has significant exposure to foreign currencies (most notably the euro and the UK pound), which could cause volatility in sales and earnings due to both translation and transactional effects. As a food retailer, MCD also has exposure to input costs, such as food and labor, which can be volatile and can be impacted by factors outside of the company's control, such as global supply and demand, weather, and government-mandated minimum wage rates. MCD also faces the risk of food contamination, given its vast commodity supply chain, as well as other health/illness concerns.

YUM! Brands (YUM: Hold) – $41 PT

Our price target assumes an underlying P/E multiple of 16x forward 12-months EPS. Our forward-year multiple is consistent with our targeted valuation multiple for McDonald's given YUM's similar mix of US vs. international restaurants and similar long-term growth prospects (i.e., low-double digit EPS growth). Our price target is also supported by a sum-of-the-parts model, using blended forward-year EBITDA multiples of 7x for YUM's US business, 10x for YRI and 10x for China. These multiples are consistent with peer companies with similar business mix and growth profiles. With YUM shares currently trading at 16x our forward 12-months EPS forecast, we maintain a Hold rating.

Risks

Key downside risks include a stronger USD, slower Chinese consumer demand, and input cost volatility. YUM must also execute major strategic initiatives, such as China expansion and US refranchising, to meet our earnings and cash flow expectations. Upside risks include improved in US comps, weakness in the US dollar, or food price deflation.

Chipotle (CMG: Buy) – $150 PT (up from $135)

We have raised our price target on CMG in conjunction with our 1Q10 earnings recap report, which was also released today (4/22/10). Our price target is primarily driven by a DCF model, using 12% LT EBIT growth, 11-12% WACC (7% cost of debt, 2.9% risk free rate, 1.1x beta, 8% equity risk premium), and 8.0x terminal EBITDA multiple, up from 7.5x previously given potential upside to future earnings growth assumptions. Our PT implies a P/E ratio of 29x our forward 12-months EPS. This is a premium to sector averages given higher unit growth for CMG, as well as above-average unit-level returns and strong cash flow.

Risks

Key risks include: a "double dip" in macro-economic activity in the US, which is not assumed in our forecasts and could cause a shortfall on sales. Volatility in key cost inputs (such as food and energy) could also impact our profit outlook. In addition, CMG must continue to secure adequate real estate sites to execute on unit growth targets, a task that becomes more challenging as the company gets larger.

Panera (PNRA: Buy) – Maintain PT of $91

Our price target assumes 26x our forward 12-months EPS forecast, a premium to the restaurant industry (19x) given above-average unit growth at PNRA, best-in-class same store sales, high new unit returns, solid cash flow/balance sheet (5% FCF yield; no debt) and potential upside to our earnings forecasts. Our implied P/E falls to 23x when factoring in the ~$8/share in cash on PNRA's balance sheet.

Risks

Our outlook for Panera assumes improving traffic, despite a challenging macro-economic environment. There is a risk that consumers could continue to cut back on discretionary restaurant spending, particularly if unemployment stays high, causing Panera to fall short of our sales expectations. As a bakery café concept, Panera faces significant exposure to commodity prices, particularly wheat, which have been volatile in recent years. In addition, a challenging commercial real estate market could make it difficult for Panera to achieve its store opening targets.

Ruth's Hospitality Group (RUTH: Buy) – Maintain $7.00 PT

Our price target assumes ~9x our 2010 EBITDA estimate, up from 7.5x previously. We assume a slight premium to sector average EV/EBITDA multiples (~8.5x) given early signs of improvement in consumer/business spending, easing compares and substantial room for upside to current sales and margin forecasts.

DCF model: Our updated DCF model for RUTH also points to a fair value in the $7.00 per share range. Our DCF model is based on an 11% WACC (8% cost of debt, 3% risk-free rate, 8% equity risk premium, 3.1x beta, 45% debt capitalization) and a 6.5x terminal EBITDA multiple, consistent with peer group averages.

Risks

A slowdown in consumer spending could result in downside risks to our earnings forecast, which currently assumes some improvement in upcoming quarters. RUTH is also somewhat dependent on business-related spending, which could remain sluggish in light of the weak macro environment. RUTH's upscale dining model, involving premium food quality and service, makes it difficult to cut costs in a slowing sales environment, adding risk to margins. RUTH also faces exposure to volatility in food costs, particularly beef, which represents over 40% of RUTH's food costs.

Darden (DRI: Hold) – Maintain PT of $45

We assume a P/E multiple of 14x our forward 12-months EPS forecast. We assume a discount to DRI's historical average of ~15x given maturing core brands, low returns at Red Lobster and Longhorn, an oversupply of casual dining restaurants in the US, and weak consumer spending, which could limit future earnings growth rates. Our PT also embeds an EV/EBITDA multiple of ~7.5x, which we believe is consistent with peer companies with a similar growth profile.

Risks

Key risks for DRI include consumer spending, competition, and input costs. We expect consumer spending to remain under pressure given high unemployment, a weak housing market and stretched consumer balance sheets. However, our model assumes a modest improvement in traffic trends at DRI in coming quarters. If this does not occur, there could be downside risk to our estimates. Conversely, if the US economy recovers more quickly than expected and this leads to more robust traffic at casual dining restaurants, then our forecasts for DRI could be too low. In addition, weak same store sales and oversupply of restaurants in the casual dining sector may lead to heavy discounting by DRI's competitors, putting pressure on traffic and margins. Input costs, including for food and labor, have been volatile in recent years. DRI's 100% company-operated business model leaves the company more exposed than most peers to changes in these costs. DRI is particularly exposed to seafood prices (33% of food costs). To the extent these key input costs continue to be favorable, there is upside risk to our model.

Texas Roadhouse (TXRH: Hold) – Maintain PT of $14.50

Our PT is based on a multiple 18x our forward-year EPS forecast. We have assumed a discount to TXRH's historical average multiple in the low-20s given uncertain prospects for unit growth in the intermediate term, still negative same store sales trends and a challenging macro-economic and competitive environment.

Our price target is also supported by a discounted cash flow model using a 10-11% cost of capital (based on 7% cost of debt, 1.2x beta, 3% risk-free rate, 8% risk premium, 30% debt/capitalization), a 7x terminal EBITDA multiple (consistent with long-term industry averages), and a 10-year EBIT CAGR of ~8%.

Risks

Key risks include consumer spending, competition, and input costs. We expect consumer spending to remain under pressure given higher oil prices and a weak housing market. Our model assumes modest same store sales for TXRH, but there could be downside risk to store growth and same store sales if consumer spending weakens further. In addition, weak same store sales in the casual dining sector may lead to heavy discounting by TXRH's competitors, putting pressure on traffic or margins. Input costs, including for food and labor, have been rising. Our model assumes TXRH can manage these costs via traffic growth, menu pricing, and oversight of controllable costs. However, costs could rise further than expected and damage margins and profitability. TXRH is particularly exposed to beef prices given its positioning as a steakhouse concept. Beef represents nearly 50% of TXRH's cost of goods sold.

Figure 35: Restaurant industry valuation comparables

Restaurant Industry Comparables

Deutsche Bank

QSR	Ticker	FYE	4/21/2010 Stock price	Price target	Rating	Mkt cap (mm)	EPS estimates FY09A	EPS estimates FY10E	EPS estimates FY11E	P/E FY10E	P/E FY11E	P/E NTM*	LT growth	PEG	Rel. P/E	EV-to-EBITDA FY10E	EV-to-EBITDA FY11E	EV-to-EBITDA NTM*	Debt/ '09 EBITDA	Adj Debt/ '09 EBITDAR	Total restaurants	Company-operated %
Burger King	BKC	6	$21.48	$24.00	Buy	$2,938	$1.41	$1.32	$1.50	16.3x	14.3x	14.6x	13%	100%	99%	8.4x	7.7x	7.8x	1.9x	3.5x	11,925	12%
CKE Restaurants	CKR	1	$12.82	NA	NR	$706	$0.72	$0.78	$0.97	16.4x	13.2x	15.5x	16%	97%	105%	6.5x	6.1x	6.4x	2.3x	3.9x	3,103	29%
Jack in the Box	JACK	9	$24.60	NA	NR	$1,403	$2.27	$1.95	$2.20	12.6x	11.2x	11.7x	12%	94%	80%	6.3x	6.0x	6.1x	1.5x	4.3x	2,690	56%
McDonald's	MCD	12	$70.45	$76.00	Buy	$77,009	$3.98	$4.39	$4.73	16.0x	14.9x	15.3x	11%	139%	104%	10.0x	9.6x	9.9x	1.3x	2.4x	32,478	21%
Sonic	SONC	8	$12.51	NA	NR	$768	$0.72	$0.56	$0.70	22.3x	17.9x	19.1x	15%	126%	130%	9.7x	9.1x	9.3x	4.1x	4.5x	3,544	20%
Wendy's /Arby's Group	WEN	12	$5.44	NA	NR	$2,563	$0.17	$0.17	$0.24	32.0x	22.7x	28.1x	18%	NA	NA	8.1x	7.3x	7.8x	3.6x	4.8x	10,386	25%
YUM! Brands	YUM	12	$43.11	$41.00	Hold	$20,908	$2.17	$2.44	$2.75	17.7x	15.7x	17.0x	11%	136%	115%	10.0x	9.3x	9.9x	1.5x	3.0x	37,080	23%
									avg	**19.1x**	**15.7x**	**17.3x**	**14%**	**115%**	**105%**	**8.4x**	**7.9x**	**8.2x**	**2.3x**	**3.8x**	**101,206**	**26%**
PIZZA																						
Domino's	DPZ	12	$15.51	NA	NR	$897	$0.87	$1.12	$1.24	13.8x	12.5x	13.4x	10%	134%	91%	11.0x	10.6x	10.8x	8.0x	8.0x	8,999	6%
Papa John's	PZZA	12	$28.51	NA	NR	$789	$1.50	$1.85	$2.10	15.4x	13.6x	14.7x	10%	147%	100%	7.2x	6.7x	7.0x	0.9x	2.3x	3,469	18%
									avg	**14.6x**	**13.0x**	**14.1x**	**10%**	**141%**	**96%**	**9.1x**	**8.7x**	**8.9x**	**4.5x**	**5.1x**	**12,468**	**12%**
QUICK CASUAL																						
Chipotle Mexican Grill	CMG	12	$125.52	$150.00	Buy	$4,005	$3.95	$4.44	$5.29	28.3x	23.7x	24.6x	20%	125%	167%	12.5x	10.8x	11.9x	0.0x	2.1x	956	100%
Panera Bread	PNRA	12	$85.05	$91.00	Buy	$2,657	$2.91	$3.49	$4.14	24.4x	20.5x	23.7x	17%	137%	161%	9.7x	8.7x	9.5x	0.0x	2.2x	1,380	42%
										26.3x	**22.1x**	**24.1x**	**19%**	**131%**	**164%**	**11.1x**	**9.8x**	**10.7x**	**0.0x**	**2.1x**	**2,336**	**71%**
UPSCALE DINING																						
Morton's	MRT	12	$6.76	NA	NR	$107	$0.10	$0.28	$0.38	24.1x	17.8x	21.6x	12%	175%	147%	8.8x	7.5x	8.4x	4.6x	6.8x	89	100%
McCormick & Schmick's	MSSR	12	$10.61	NA	NR	$156	$0.32	$0.45	$0.59	23.6x	18.0x	21.4x	16%	134%	145%	6.7x	5.8x	6.3x	0.7x	4.7x	94	100%
Ruth's Hospitality Group	RUTH	12	$5.77	$7.00	Buy	$196	$0.42	$0.32	$0.37	17.9x	15.7x	17.1x	15%	122%	116%	7.8x	7.1x	7.6x	2.9x	5.0x	151	43%
									avg	**21.9x**	**17.2x**	**20.0x**	**14%**	**144%**	**136%**	**7.8x**	**6.8x**	**7.4x**	**2.7x**	**5.5x**	**334**	**81%**
CASUAL DINING																						
BJ's Restaurants	BJRI	12	$26.75	NA	NR	$730	$0.53	$0.66	$0.80	40.5x	33.4x	37.9x	24%	93%	257%	12.8x	NA	12.0x	0.1x	2.4x	92	99%
Brinker International	EAT	6	$20.40	NA	NR	$2,101	$1.44	$1.40	$1.48	14.6x	13.8x	13.9x	10%	137%	94%	7.0x	6.8x	6.8x	1.5x	3.2x	1,689	61%
Buffalo Wild Wings	BWLD	12	$49.89	NA	NR	$908	$1.69	$2.06	$2.51	24.2x	19.9x	22.6x	22%	102%	154%	9.1x	7.4x	8.4x	0.2x	1.9x	652	35%
California Pizza Kitchen	CPKI	12	$20.83	NA	NR	$506	$0.77	$0.77	$0.90	27.1x	23.1x	25.6x	14%	186%	173%	8.2x	7.4x	7.9x	0.6x	3.3x	253	81%
CBRL Group	CBRL	7	$52.34	NA	NR	$1,225	$2.89	$3.51	$3.90	14.9x	13.4x	13.8x	11%	127%	93%	7.9x	7.6x	7.6x	3.0x	3.7x	590	100%
Cheesecake Factory	CAKE	12	$29.03	NA	NR	$1,754	$1.07	$1.27	$1.46	22.9x	19.9x	21.8x	13%	167%	148%	9.3x	8.6x	9.1x	0.6x	3.3x	161	100%
Darden Restaurants	DRI	5	$47.40	$45.00	Hold	$6,717	$2.75	$2.95	$3.23	16.1x	14.7x	14.8x	10%	119%	100%	8.9x	8.2x	8.2x	1.9x	2.6x	1,803	98%
DineEquity	DIN	12	$44.74	NA	NR	$758	NM	NM	NM	NM	NM	NM	10%	NM	NM	8.1x	8.3x	8.2x	5.2x	5.8x	3,464	12%
P.F. Chang's	PFCB	12	$45.18	NA	NR	$1,041	$1.87	$2.03	$2.29	22.3x	19.7x	21.3x	15%	144%	145%	7.8x	7.4x	7.7x	1.1x	2.8x	363	100%
Red Robin	RRGB	12	$25.38	NA	NR	$395	$1.38	$1.32	$1.49	19.2x	17.0x	18.4x	14%	132%	125%	6.2x	5.8x	6.1x	2.2x	4.0x	439	70%
Ruby Tuesday	RT	5	$11.58	NA	NR	$735	$0.53	$0.66	$0.85	17.5x	13.6x	13.9x	11%	121%	94%	8.3x	7.5x	7.5x	2.5x	2.6x	901	75%
Texas Roadhouse	TXRH	12	$15.77	$14.50	Hold	$1,131	$0.67	$0.76	$0.84	20.7x	18.7x	20.0x	15%	134%	136%	9.3x	8.5x	9.0x	0.9x	1.8x	331	78%
									avg	**21.8x**	**18.8x**	**20.4x**	**14%**	**133%**	**138%**	**8.6x**	**7.6x**	**8.2x**	**1.6x**	**3.1x**	**10,738**	**76%**
COFFEE																						
Starbucks**	SBUX	9	$25.39	$30.00	Buy	$19,370	$0.80	$1.10	$1.34	23.1x	18.9x	20.5x	15%	132%	139%	10.2x	8.9x	9.4x	0.4x	2.9x	16,635	53%
						Restaurant industry				**20.9x**	**17.6x**	**19.3x**	**14%**	**130%**	**129%**	**8.7x**	**7.9x**	**8.4x**	**2.0x**	**3.6x**	**143,717**	**58%**
						S&P 500	**$58.47**	**$77.63**	**$90.75**	**15.6x**	**13.3x**	**14.7x**										

All estimates from Capital IQ consensus except for DB covered companies.

* NTM = next twelve months

** Marc Greenberg, CFA has lead coverage of Starbucks (SBUX)

Source: Deutsche Bank estimates, company information, Cap IQ

Deutsche Bank

Figure 36: US Agribusiness and Protein Valuations

Deutsche Bank

US Agribusiness and Protein Valuations

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4/21/2010

Targets and Recommendations / Fiscal Year EPS / Performance / Other

Company	FYE	Current Price	52-WK Range	Price Target	Curr Div Yield	Return vs. Target	Rating	US$ Market Cap (m)	US$ EV (m)	Free Float (%)	2008	2009		2010E	Absolute 1 Month	Absolute 3 Months	Absolute YTD	Total Debt/ Capital	Current Dividend
ARCHER DANIELS	Jun	$28.75	$33-23	$35	1.9%	21.7%	BUY	18,544	22,588	97.8	$2.82	$3.04	A	$3.08	-0.6%	-5.0%	-7.6%	34.7%	$0.56
CORN PRODUCTS	Dec	$35.15	$36-18	$30	1.6%	-14.7%	HOLD	2,664	3,033	99.1	$3.59	$2.00	A	$2.36	2.7%	20.8%	20.8%	24.4%	$0.56
HORMEL	Oct	$41.56	$43-29	$37	2.0%	-11.0%	SELL	5,626	5,526	51.7	$2.08	$2.51	A	$2.63	0.8%	8.2%	8.6%	13.7%	$0.84
SANDERSON FARMS	Oct	$58.22	$59-36	$65	1.0%	11.6%	HOLD	1,186	1,289	86.3	($0.54)	$3.99	A	$5.57	9.2%	24.0%	37.9%	18.9%	$0.60
SMITHFIELD	Apr	$20.51	$21-8	$24	0.0%	17.0%	BUY	3,405	6,007	86.5	$1.03	($1.41)	A	($0.40)	7.0%	23.8%	36.1%	50.9%	$0.00
TYSON	Sep	$20.19	$21-10	$22	0.8%	9.0%	HOLD	7,612	9,524	98.5	$0.35	$0.26	A	$1.82	13.3%	47.0%	63.6%	42.8%	$0.16
US Agri. & Protein		**$30.58**			**1.5%**			**48,156**	**61,885**		**$2.37**	**$1.72**		**$2.70**	**1.5%**	**5.0%**	**10.6%**		**$0.45**
S&P 500 Index	-	**$1,207**	**$1212-788**		**1.8%**														**$22.19**

Calendar Year Multiples / Fiscal Year Multiples & Yields

Company	P/E 2009	P/E 2010E	EV/EBITDA 2009	EV/EBITDA 2010E	EV/SALES 2009	EV/SALES 2010E	Price/Book Value 2009	Price/Book Value 2010E	Price/Tangible Book Value 2009	Price/Tangible Book Value 2010E	ROIC 2008	ROIC 2009	ROIC 2010E
ARCHER DANIELS	13.2	9.5	9.3	6.5	0.4	0.3	1.4	1.3	1.4	1.4	10.2%	9.5%	9.2%
CORN PRODUCTS	17.6	14.9	7.5	7.0	0.8	0.8	1.6	1.5	1.8	1.7	7.3%	4.1%	4.5%
HORMEL	15.2	16.8	7.9	8.3	0.8	0.8	2.7	2.8	4.1	4.4	9.3%	11.5%	12.2%
SANDERSON FARMS	11.5	9.4	6.1	4.7	0.7	0.7	2.8	1.9	2.8	1.9	-2.8%	14.2%	16.3%
SMITHFIELD	NA	11.0	27.3	6.6	0.5	0.5	1.1	1.2	2.1	2.1	4.9%	-2.4%	2.5%
TYSON	20.5	10.8	6.9	4.9	0.4	0.3	1.7	1.5	3.3	2.7	2.8%	4.8%	7.9%
US Agri. & Protein	**19.2**	**10.5**	**10.2**	**6.0**	**0.4**	**0.4**	**1.4**	**1.4**	**1.7**	**1.6**			
S&P 500 Index	**19.3**	**15.2**											

Calendar Year Forecasts

Company	Revenue 2008	Revenue 2009	Revenue 2010E	EBITDA 2008	EBITDA 2009	EBITDA 2010E	EBIT 2008	EBIT 2009	EBIT 2010E	EPS 2008	EPS 2009	EPS 2010E	DPS 2008	DPS 2009	DPS 2010E	Net Interest Cover 2008	Net Interest Cover 2009	Net Interest Cover 2010E
ARCHER DANIELS	78,325	62,208	68,446	4,298	2,441	3,471	3,559	1,633	2,591	$3.91	$2.17	$3.04	$0.52	$0.56	$0.60	6.78	4.25	7.06
CORN PRODUCTS	3,944	3,672	3,703	574	403	433	446	273	302	$3.59	$2.00	$2.36	$0.51	$0.60	$0.65	15.24	7.26	10.94
HORMEL	6,823	6,572	6,948	617	702	666	491	575	538	$2.04	$2.73	$2.48	$0.71	$0.76	$0.82	17.06	21.21	18.93
SANDERSON FARMS	1,750	1,821	1,892	10	212	274	(32)	169	228	($1.18)	$5.07	$6.17	$0.56	$0.57	$0.59	(3.32)	24.39	25.27
SMITHFIELD	12,506	11,143	12,256	295	220	908	18	(20)	666	($0.76)	($1.19)	$1.87	$0.00	$0.00	$0.00	1.50	0.87	3.41
TYSON	27,183	26,818	28,836	603	1,375	1,940	119	874	1,433	($0.07)	$0.98	$1.86	$0.16	$0.18	$0.19	0.56	2.81	4.75
US Agri. & Protein	**190,724**	**160,938**	**176,107**	**9,499**	**6,070**	**10,239**	**7,078**	**3,645**	**7,717**	**$2.56**	**$1.59**	**$2.90**	**$0.40**	**$0.43**	**$0.44**			

Company	Revenue Growth 2008	Revenue Growth 2009	Revenue Growth 2010E	EBITDA Growth 2008	EBITDA Growth 2009	EBITDA Growth 2010E	EBIT Growth 2008	EBIT Growth 2009	EBIT Growth 2010E	EPS Growth 2008	EPS Growth 2009	EPS Growth 2010E	DPS Growth 2008	DPS Growth 2009	DPS Growth 2010E	EBITDA Margin 2008	EBITDA Margin 2009	EBITDA Margin 2010E
ARCHER DANIELS	48.0%	-20.6%	10.0%	50.2%	-43.2%	42.2%	67.3%	-54.1%	58.7%	52.6%	-44.4%	39.9%	12.0%	8.7%	7.6%	5.5%	3.9%	5.1%
CORN PRODUCTS	16.3%	-6.9%	0.9%	24.2%	-29.9%	7.5%	32.3%	-38.9%	10.6%	41.7%	-44.3%	17.9%	34.2%	16.9%	9.9%	14.6%	11.0%	11.7%
HORMEL	8.1%	-3.7%	5.7%	-2.4%	13.8%	-5.1%	-2.9%	17.2%	-6.3%	-8.9%	33.8%	-9.2%	17.5%	7.1%	8.6%	9.0%	10.7%	9.6%
SANDERSON FARMS	13.3%	4.0%	3.9%	-93.8%	1938.1%	29.0%	-123.0%	NM	34.7%	-127.4%	-528.5%	21.6%	12.0%	1.8%	2.7%	0.6%	11.7%	14.5%
SMITHFIELD	2.4%	-10.9%	10.0%	-57.9%	-25.4%	312.6%	-96.0%	NM	-3498.7%	-153.2%	55.9%	-257.2%	0.0%	0.0%	0.0%	2.4%	2.0%	7.4%
TYSON	0.3%	-1.3%	7.5%	-43.4%	128.0%	41.1%	-78.4%	634.5%	64.0%	-111.1%	-1427.8%	89.4%	0.0%	9.4%	9.3%	2.2%	5.1%	6.7%
US Agri. & Protein	**28.7%**	**-15.6%**	**9.4%**	**20.1%**	**-36.1%**	**68.7%**	**27.5%**	**-48.5%**	**111.7%**	**13.0%**	**-37.7%**	**82.4%**	**14.9%**	**9.0%**	**2.6%**	**5.0%**	**3.8%**	**5.8%**

Fiscal Year Forecasts

Company	Net Income 2008	Net Income 2009	Net Income 2010E	Dep. & Amort. 2008	Dep. & Amort. 2009	Dep. & Amort. 2010E	Capital Exp. 2008	Capital Exp. 2009	Capital Exp. 2010E	Working Capital 2008	Working Capital 2009	Working Capital 2010E	FCF 2008	FCF 2009	FCF 2010E	FCF Yield 2008	FCF Yield 2009	FCF Yield 2010E
ARCHER DANIELS	1,802	1,707	1,982	753	743	906	1,779	1,898	1,500	(5,608)	3,082	522	(4,960)	3,454	1,800	-26.7%	18.7%	9.7%
CORN PRODUCTS	267	47	178	128	130	131	219	146	188	(458)	274	(5)	(311)	442	117	-11.7%	16.7%	4.4%
HORMEL	286	343	351	126	127	128	126	92	138	(150)	168	(24)	126	546	318	2.2%	9.7%	5.7%
SANDERSON FARMS	(43)	82	121	42	43	45	49	25	138	(47)	16	(7)	(108)	132	45	-9.1%	11.0%	3.5%
SMITHFIELD	139	(243)	(63)	264	271	240	460	175	196	(430)	262	188	(400)	22	169	-14.5%	0.7%	5.2%
TYSON	86	(537)	689	493	496	500	425	368	600	(409)	432	(83)	(220)	(3)	480	-3.1%	-0.0%	6.3%
US Agri. & Protein	**3,723**	**1,703**	**4,476**										**(4,871)**	**3,961**	**3,217**	**-10.2%**	**8.2%**	**6.3%**

Miscellaneous data

Company	Total Debt	Total Cash	Net Debt	ROIC	WACC	EV Spread	Next Results	Release Date
ARCHER DANIELS	7,865	3,821	4,044	9.5%	9.2%	0.3%	F3Q10	04 May
CORN PRODUCTS	544	175	369	4.1%	9.3%	-5.3%	F1Q10	27 Apr
HORMEL	350	449	-99	11.5%	9.6%	1.9%	F2Q10	19 May
SANDERSON FARMS	104	1	103	14.2%	10.5%	3.6%	F2Q10	25 May
SMITHFIELD	3,004	402	2,602	-2.4%	7.1%	-9.5%	F4Q10	17 Jun
TYSON	3,416	1,504	1,912	4.8%	12.1%	-7.3%	F2Q10	10 May
US Agri. & Protein				**6.5%**	**10.0%**	**-3.5%**		

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TYSON	Ruth Ann Wiser	(479) 757-6712	ruth.ann.wisener@tyson.com

Source: Deutsche Bank estimates, company information, Cap IQ

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

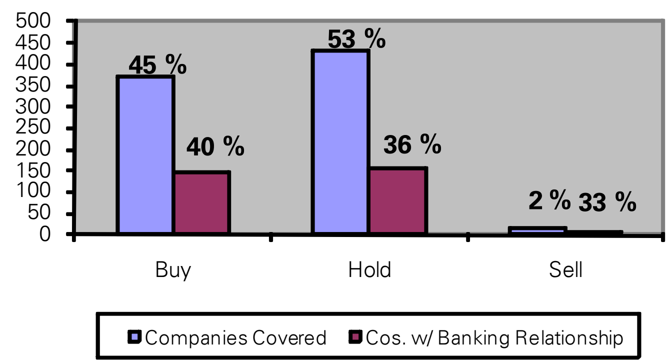
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. Christina McGlone/Jason West

Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.
Notes:
1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:
Buy: Expected total return (including dividends) of 10% or more over a 12-month period
Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



North American Universe

Regulatory Disclosures

1. Important Additional Conflict Disclosures

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2. Short-Term Trade Ideas

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