Brinker International

Corporate Ratings: B1 / BB-

Unsecured Debt Ratings: B3 / B

We hold a **positive** view on Brinker International ("Brinker") and its 3.875% Senior Unsecured Notes with maturity in May 2023. The company owns, operates, and franchises three restaurant concepts: Chili's Grill & Bar, Maggiano's Little Italy, and It's Just Wings (virtual concept exclusively) across 27 different countries, but with a large concentration in the United States.

Brinker demonstrates a healthy financial profile with solid drivers for revenue and EBITDA growth, prudently managed CAPEX including sufficient growth capex, and adequate liquidity, providing investors with confidence of the company's ability to meet its debt obligations.

The company's underperformance against the overall industry on certain credit metrics suggests some weakness to its credit profile. However, with Brinker's growth initiatives and continued improvement in foot traffic (with the easing of COVID-19 restrictions), we are confident that the company's credit metrics will lead to improvement in the company's credit rating.

We view the likelihood of a credit rating upgrade, along with improving financial performance, as strong rationale that Brinker will be able to refinance its obligations and pay out its unsecured loan that is due in 2023.

RECOMMENDATION:

BUY

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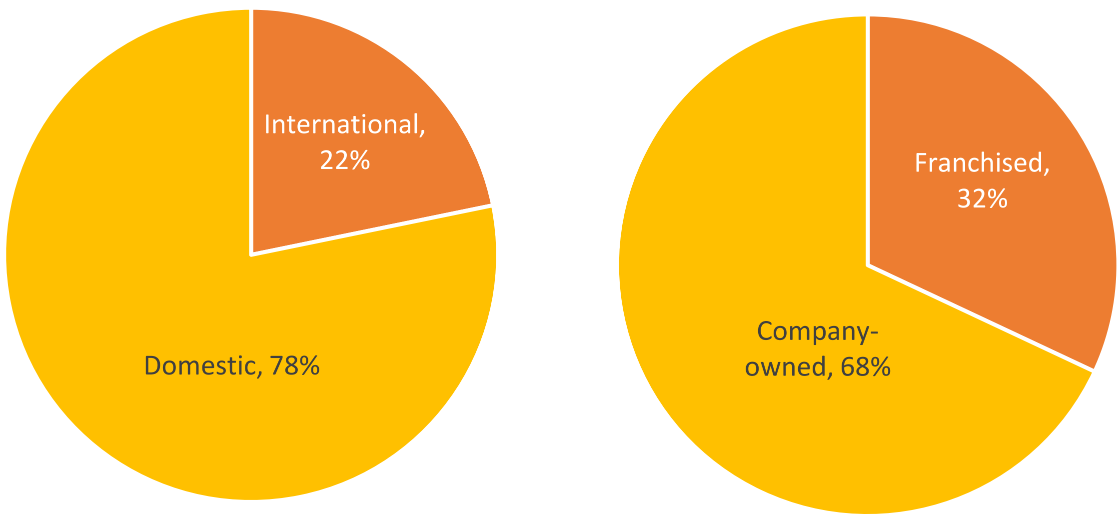
Company Overview

Introduction

Brinker International Inc. (“Brinker”; ticker “EAT”) owns/operates and franchises two brick-and-mortar restaurant brands: Chili’s Grill & Bar (“Chili’s”), a casual dining brand that is the flagship brand of the company, and Maggiano’s Little Italy (“Maggiano’s”), a full-service, polished casual brand. In June 2020, Brinker launched its first virtual (domestic) brand, It’s Just Wings, which includes restaurant-like menu offerings that are only available for purchase digitally. The company comprises 1,648 total physical locations of Chili’s and Maggiano’s across 28 countries, of which roughly two thirds are company-owned locations and one third is franchised, and of which roughly three quarters are domestically located, and one quarter is international.

Exhibit 1: Store Count by Ownership and Geography

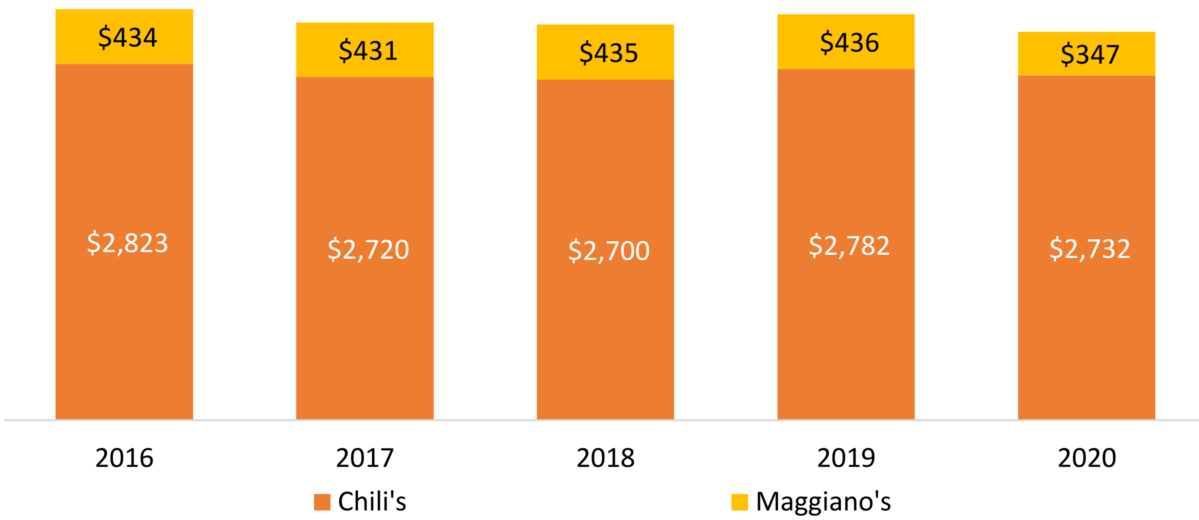


Source: Company Filings

Revenue Performance

There are 1,594 total locations of Chili’s and 54 total locations of Maggiano’s, and a breakdown of company revenues segmented by brand reflects this. In the five years from 2016 to 2020, the revenue mix is very consistent with Chili’s generating on average 87% of revenues while Maggiano’s generating on average 13% of revenues. The revenues for It’s Just Wings are included in those of Chili’s and Maggiano’s, contributing incrementally to the physical brands’ revenues as It’s Just Wings leverages the physical brands’ excess kitchen capacity.

Exhibit 22: Revenue by Brand



Source: Company Filings

Company-owned locations account for 98.2% of revenues while franchised locations account for just 1.8% of revenues. Below are performance metrics for company-owned locations of Chili's and Maggiano's as of FY2021. This trend of a predominantly company-ownership model is expected to continue in to the future. In the past several years, management has been focused on reallocating domestic brands towards more company ownership. Although the total number of stores has been relatively steady in the past five years, the mix has shifted from about 60% company-owned to 69% as the company believes it can improve operations and profitability of the locations it owns. The table below shows that company-owned Chili's locations outperform franchised Chili's locations in terms of revenue. Brinker does not provide profitability values segmented by ownership.

Exhibit 33: Chili's Revenue Growth by Ownership

	Q3/18	Q4/18	Q1/19	Q2/19	Q3/19
Company-owned	-0.40%	0.60%	2.00%	2.90%	2.90%
Franchised	-2.20%	-1.40%	-0.20%	-0.80%	-0.20%

Source: Company Filings

Exhibit 44: Brinker Company-Owned Metrics[1]

	Chili's	Maggiano's
Number of company-owned locations	1,069	52
Entrée price range	$8.00 to $19.69	$8.50 to $41.99
Average net sales per location	$2.9M	$5.2M
Average revenue per meal	$15.50 / guest	$25.78 / guest
Food and non-alcoholic beverage % sales	90.70%	89.20%

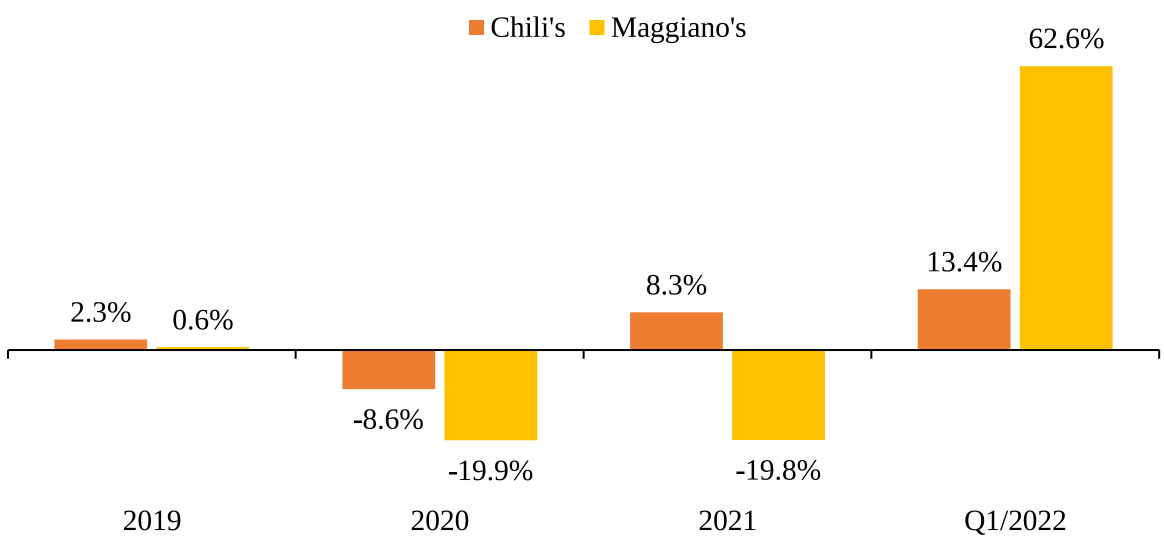
[1] Values for It's Just Wings are not shown as there are no physical locations and the digital brands operating results are included in those of Chili's and Maggiano's.

Source: Company Filings

Impact of COVID-19 Pandemic and Outlook

Brinker's performance was materially impacted by the COVID-19 pandemic because of dining closures and restrictions, and changes in consumer dining behavior, which limited guest traffic and thus, revenues. Comparable restaurant sales for Chili's were -8.6% in 2020 but returned to positive in 2021 and in 2022Q1, driven by a combination of relaxing COVID-19 restrictions and a ramp up in offsite revenues via web, mobile and third-party ordering. Comparable restaurant sales for Maggiano's were -19.9% and -19.8% for 2020 and 2021, respectively, but has sharply improved in 2022Q1 (+62.6%). The reason for this difference in performance is that Maggiano's focuses on special occasion events, large parties, and family style dining, which took place much less frequently (if at all) during the pandemic. Overall, we expect Brinker to continue increasing revenues contingent on continued relaxing of COVID-19 restrictions along with a boost from its ongoing strategic initiatives that eliminate the company's reliance on foot traffic and in-person dining.

Exhibit 55: Comparable Restaurant Sales by Brand[1]



[1] Values are for company-owned locations only. Values for franchised locations are not shared by management. The company also restated comparable sales for 2019-Q1/2022 only, so past years' data is not in the same format nor is it comparable.

Source: Company Filings

Growth Initiatives

Looking ahead, Brinker is well positioned to outperform its peers in the industry because of three reasons: 1) its existing and ongoing investment in virtual brands such as It's Just Wings, which leverage excess kitchen capacity and add an additional stream of revenue, 2) its focus on offsite business via its mobile app (launched in 2019), web ordering, and its partnership with third party delivery company, DoorDash, and 3) its targeted, data-driven marketing spend which focuses on customized experiences and offers based on past guest purchase behavior.

- It's Just Wings earned 170M in revenues in 2021 and has the strongest repeat customer rate (61.0%) of its peers; the company plans to continue testing and launching new digital brands as a growth strategy
- Multi-channel sales have increased traffic-driven share gains – from 2019 to 2021, offsite business has grown 273%
- With the relaunch of My Chili's Rewards program, the company expects to deliver customized service that can help it develop a competitive advantage

Credit Profile

Brinker is a non-investment grade company with a corporate credit rating of B1 and BB- from Moody's and S&P, respectively. Its Senior Unsecured debt, which we will discuss in more detail below, is rated B3 and B from Moody's and S&P, respectively. These credit ratings were given by Moody's with the expectation that overall credit metrics for the company to improve along with earnings, while maintaining strong liquidity, and following a prudent policy towards dividends and share repurchases. S&P provides its ratings with the expectation that the company will achieve below 4.0x leverage and above 4.0x EBITDA interest coverage, given that the company has been able to improve sales and margins coming out of the pandemic.

Exhibit 66: Brinker Restaurant Credit Rating

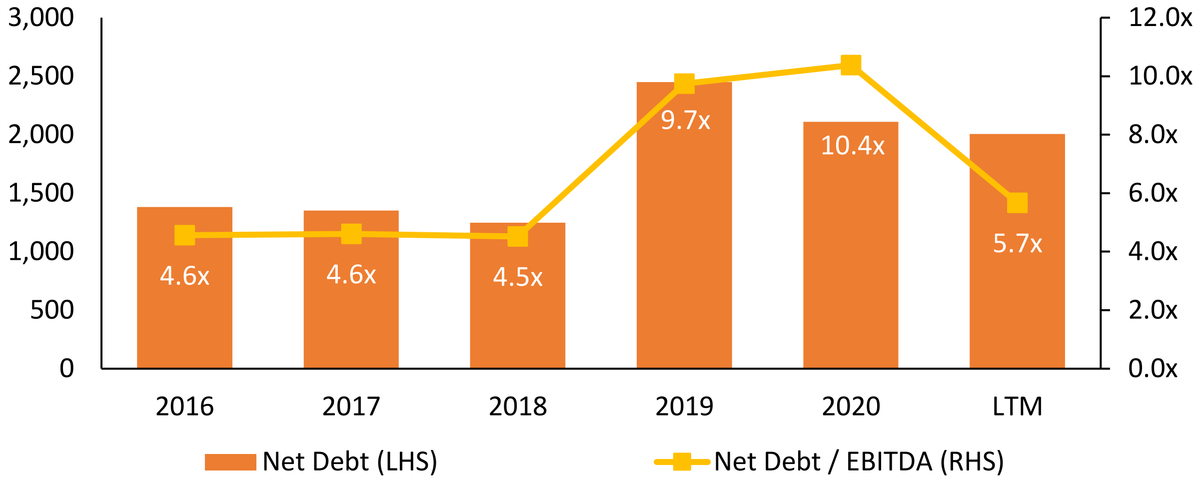
Ratings Summary

	Moody's	S&P
Corporate	B1	BB-
Unsecured	B3	B
Outlook	Positive	Stable
Last commented	21-May-2021	18-May-2021

Source: Moody's, S&P

The company currently has $2.2B in Total Debt and $2.1B in Net Debt, and a Net Debt / EBITDA of 5.67x, which is more debt and leverage than the company has had historically due to the impacts of ongoing pandemic. However, the company has made significant improvements in the last twelve months, benefiting from increased guest traffic and loosening of dining restrictions. Note: 2019 values for Net Debt and Net Debt / EBITDA increased in 2019 due to accounting changes that incorporate leasing assets onto the balance sheet.

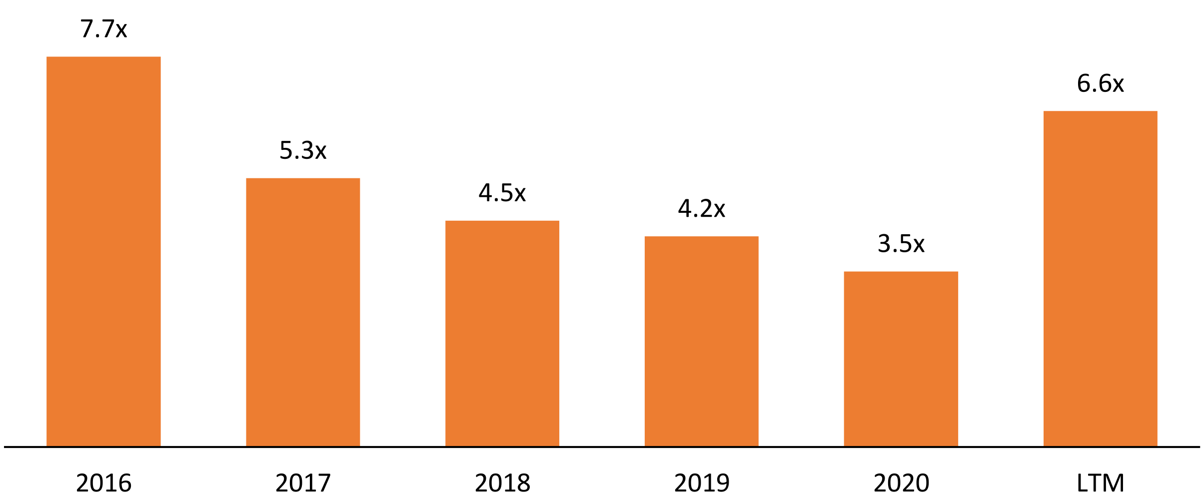
Exhibit 77: Net Debt and Net Debt / EBITDA



Source: Company Filings

Brinker's Interest Coverage Ratio (calculated as EBITDA / Interest Expense) has steadily declined since 2016, but has improved significantly in the last twelve months. Brinker had taken on debt starting in 2016 to purchase 116 locations of Chili's from a franchisee and took on more debt to weather the pandemic.

Exhibit 88: Interest Coverage Ratio



Source: Company Filings

Company Financials & Projections

Overview

In this report, we will examine Brinker's 3.875% Senior Unsecured Notes due in May 2023. However, we first evaluate the financials of the company in this section to better understand the business context and performance of the company, how cash flow is generated, and how the company manages liquidity.

This analysis takes account of Revenues and Expenses to evaluate near-term obligations and how the company's operations can pay for them. Moreover, this analysis examines Capital Expenditure and Net Working Capital to evaluate how the company is reinvesting in its business and maintaining sufficient liquidity. Such reinvestment is necessary to sustain cash flows from operations and long-term EBITDA.

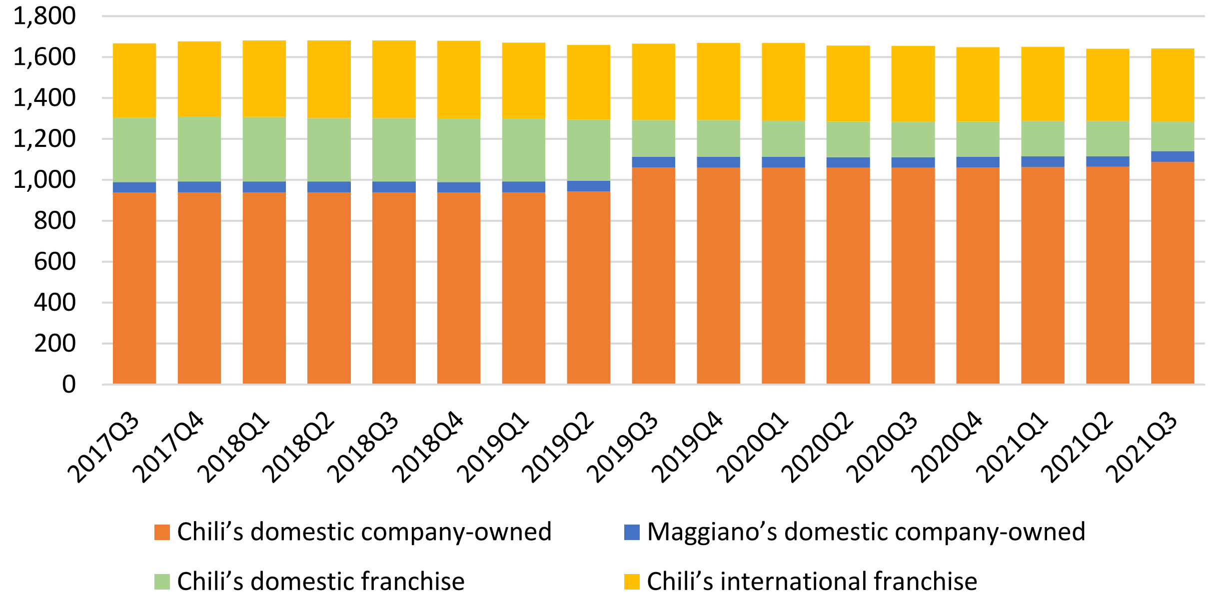
Revenue

Revenues are segmented between company sales (stores owned and operated by Brinker) and Franchise sales. Consistently, 98.0% or more of total revenues come from company sales. Approximately 69.0% of total stores are company owned and operated, and this number is trending upward.

In the past few years, Brinker has been acquiring domestic (not international) Chili's franchise restaurants and bringing them under Brinker operation. For example, in October 2021, Brinker acquired 36 Chili's restaurants in the US Midwest and Northeast for $55 million. As more franchise stores continue to be acquired, total sales will increase as company-owned locations generate more revenue ($2.9M per company-owned location vs. $2.6M per franchised location), ceteris paribus.

The figure below demonstrates how store count has remained steady in recent history at about 1,650 stores and how the mix of company owned vs. franchise stores has shifted towards the former, providing one driver of top line growth.

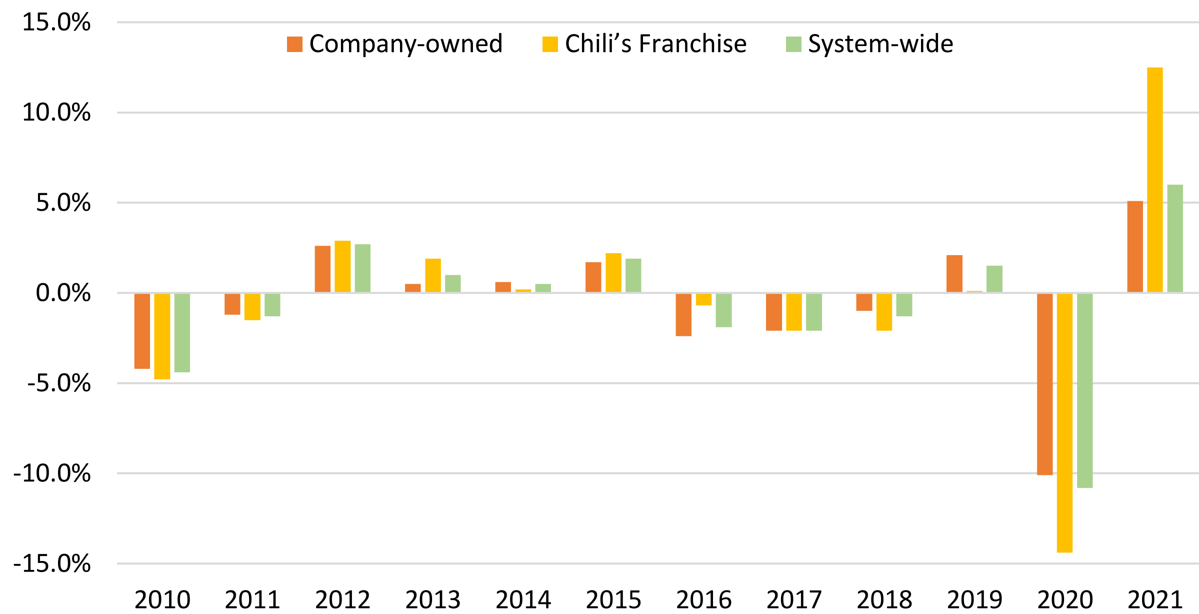
Exhibit 99: Brinker Store Count



Source: Own analysis, Brinker 10-Qs

Another driver of top line growth is growth in comparable restaurant sales. Brinker's sales are negatively impacted by macroeconomic shocks that influence customers' willingness to eat out at restaurants. This is evident in 2010 and 2020, years in which the American economy, where most sales are generated for Brinker, were in recession.

Exhibit 1010: Same-Store Sales (Current vs. Previous Fiscal Year)



Source: Own analysis, Brinker 10-Ks

In periods of greater calm, such as the period from 2011 to 2019, same-store sales seem to oscillate between positive and negative. The average same-store sales percentage for that period was 1.0%. Notably, this was a period of strong growth in the US economy. The next few years following the pandemic are less certain to be a period of strong growth, given the pandemic may linger and curb customer interest in eating out at restaurants.

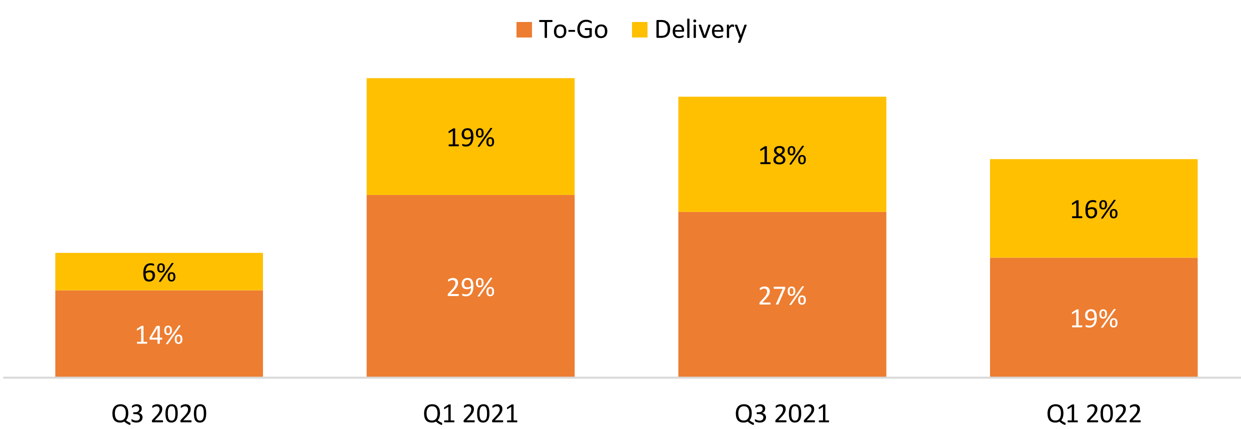
Although the macroeconomic outlook is uncertain and may have headwinds given significant uncertainty regarding the ongoing pandemic, we view several favorable factors for sales growth in the near term:

First, Brinker has initiated the virtual brand It's Just Wings that utilizes excess kitchen capacity of its Chili's and Maggiano's restaurants. Using more kitchen capacity increases sales and better effectively manages inventory.

Second, Brinker is advancing its digital and online offerings. For several years, Chili's restaurants have used digital technology on iPads within restaurants for ordering, paying, playing games, and more. In 2019, Brinker launched a mobile app. More recently, Brinker partnered exclusively with DoorDash in Fiscal Q4 2019.

The figure below demonstrates the extent to which off-premise sales have blossomed for Brinker during the pandemic. In the first fiscal quarter of 2021 (i.e., the third calendar quarter of 2020), off-premise sales comprised nearly half of all sales. During the pandemic, another phenomenon of off-premise sales is the increasing share of delivery relative to to-go purchases. From the third fiscal quarter of 2020 (i.e., the first calendar quarter of 2020) to the first fiscal quarter of 2022, the share of delivery sales has steadily increased from 30 to 45% of total off-premise sales. This is notable given that delivery sales are subject to more substantial fees than are to-go sales. We expect off-premise sales to drop further from the roughly 35.0% in Q1/2022 as guest habits return to in-person dining (pending pandemic recovery and restriction easing). However, we expect it to level off higher than the 20.0% rate in Q3/2020 (pre-pandemic) since we believe guest habits will include more off-premise dining than pre-COVID and the company is putting a lot of effort into growing this revenue stream. Taking this together, we estimate off-premise sales to level off somewhere between 25% and 30%.

Exhibit 1111: Off-Premise Sales as Percent of Total Sales at Chili's Restaurants



Source: Own analysis, Brinker 10-Qs

For Total Revenues for the company, we forecast a 1.00% growth for the next five years for Chili's and Maggiano's, which make up what we call the "Base Revenues" and add it to our forecast of revenue growth for It's Just Wings, the company's digital brand that is growing much more rapidly. Details of our calculations for It's Just Wings and our Total Revenues forecast is discussed in the EBITDA section below.

COGS and SG&A

COGS have historically been very consistent, averaging 82.5% and ranging from 80.2% to 85.0% from fiscal years 2006 to 2019. COGS are a substantial expense to Brinker because the majority of its businesses are company-owned and operated. Gross margins are thus relatively thin in the range of about 15-20% in the past decade.

The three most significant expenses are food and beverage expenses, restaurant labor, and restaurant expenses. Both expenses for food & beverage and restaurant labor have maintained very consistent percentages relative to sales since 2017. The figure below shows these three categories of COGS and their quarterly trends in the past several years. The start of each fiscal year (beginning in the third calendar quarter) tends to see higher costs in the form of general restaurant expenses, but otherwise COGS as a percent of sales have been stable.

Exhibit 1212: COGS as % of Sales

Source: Own analysis, Brinker 10-Qs

Looking forward, we expect COGS to temporarily increase as a share of sales due to industry-wide labor shortages and supply chain-related inflationary pressures on ingredients. The entire restaurants industry faces these pressures, so we expect increasing costs will be reflected broadly in increased menu prices. This trend of increasing prices would have an impact on aggregate demand for eating out, which is reflected in modestly declining revenue growth in the next several years in our financial projections.

We view the burgeoning business of It's Just Wings as a force that can dampen inflationary pressures on Brinker. It's Just Wings has lower COGS relative to other business lines given that it is a digital brand and shares many resources (i.e., labor, equipment, facilities) with existing business lines. We thus expect COGS as a percent of sales to be relatively elevated in the near term but not surpass its historical average of 85% given the growing proportion of It's Just Wings as a share of overall business at Brinker.

SG&A expenses for Brinker have been remarkably consistent in the past 16 years, ranging from 4.3 to 6.4 percent of sales. In the past several years, SG&A as a percent of sales has gravitated towards 5%. We use an average of the past five years to project future SG&A expenses.

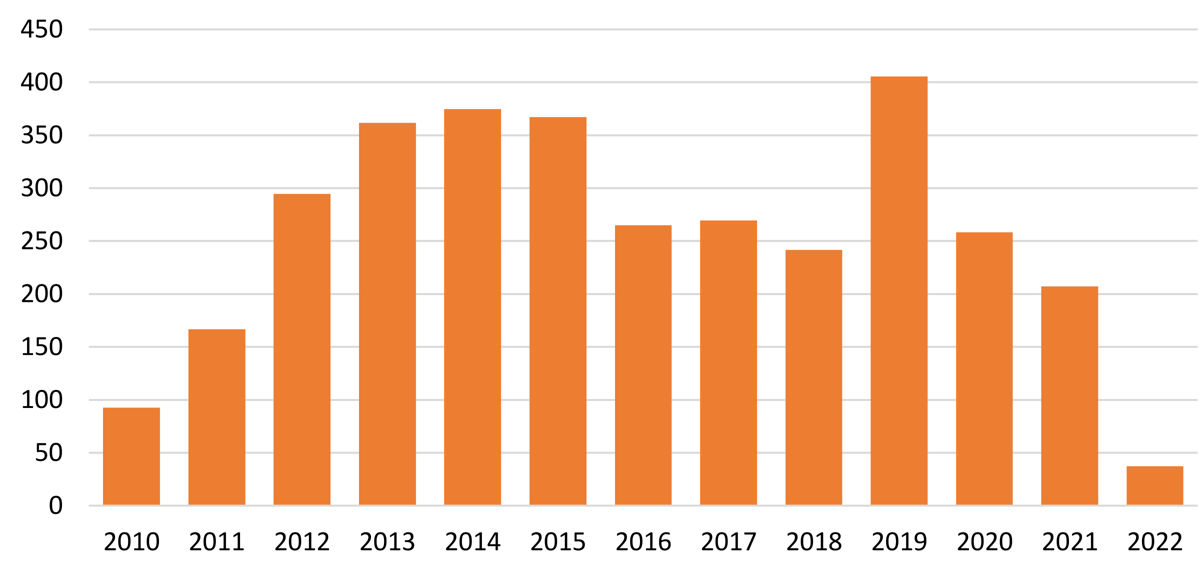
Capital Expenditure

Brinker uses its cash flows from operations to finance capital expenditures, pay dividends, and repurchase outstanding shares. Such capital expenditures include restaurant remodels, restaurant maintenance, and new restaurant construction.

Brinker regularly spends in excess of $200 million per year on capital expenditures. There is no immediate reason for concern about the small figure for the first fiscal quarter of 2022. It is very common for Brinker to escalate spending on capital expenditures throughout the fiscal year. Aggregating data for the fiscal period 2010-22, we observe that 10% of capex is spent in the first quarter, 19% in the second, 29% in the third, and 42% in the fourth. It appears as though management is reinvesting adequately in the business in order to continue generating sustained EBITDA levels. As of August 2021, management indicated to investors that it expects to spend between $155 million and $165 million on capital expenditures.

Growth capex has consistently made up approximately four tenths of total capex in the past decade. We estimate growth capex as the difference in net PP&E in the current and prior period plus depreciation & amortization in the current period. This gives us an approximation for the increase in fixed assets that can drive future growth. In the period from 2011 to 2018, growth capex averaged $118 million per annum, which was 41% of total capex. We exclude 2019 to today due to anomalies in data that are attributed to significant purchases of franchise businesses and the coronavirus pandemic. We see growth capex as a healthy share of total capex and a positive sign that Brinker is reinvesting in its business to achieve future growth.

Exhibit 1313: Capital Expenditures ($ Millions)

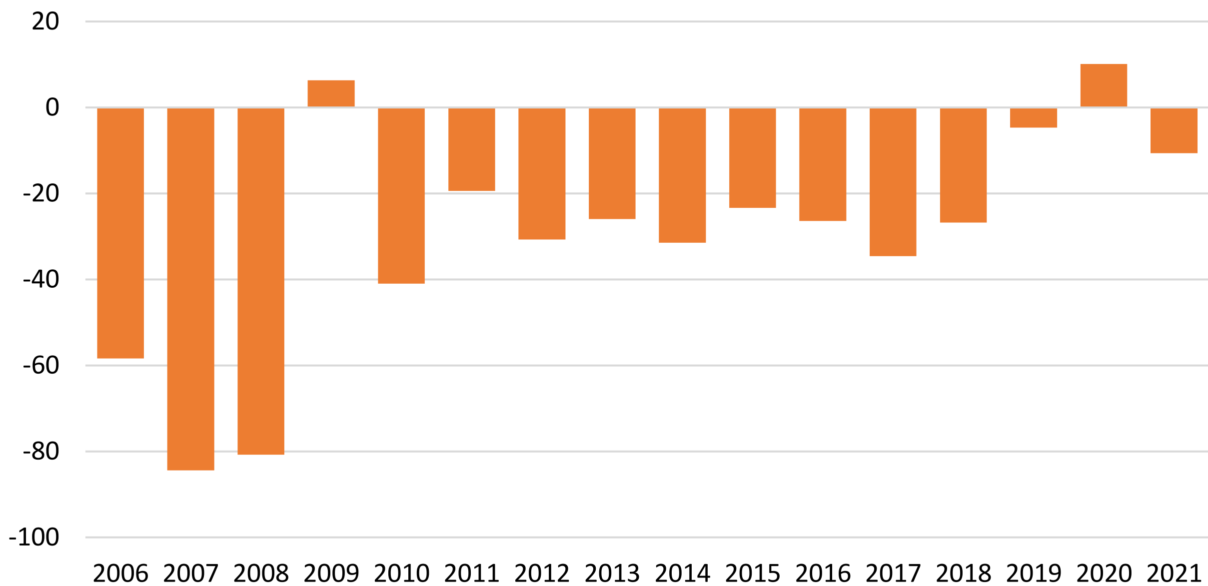


Source: Own analysis, Compustat

Trade Working Capital

Trade working capital is a measure of liquidity and ability to meet short-term commitments. Trade working capital is calculated here as the sum of accounts receivable and inventory less accounts payable. In the past decade, Brinker has operated with a trade working capital deficit.

Exhibit 1414: Trade Working Capital ($ Millions)



Source: Own analysis, Compustat

The fact that Brinker generally has larger current liabilities than current assets informs some of the company's decisions for using cash. Recently in October 2021, for example, Brinker purchased the restaurants of several dozen domestic Chili's franchises. To fund this $55 million acquisition, Brinker tapped into its revolving credit facility rather than using cash from operations.

While this reliance on credit markets for liquidity can be viewed as a negative mark against the firm's credit worthiness, this trade working capital deficit is also common for the industry where restaurants receive payment from guests right away but are extended credit from suppliers. For Brinker, an average deficit of roughly $25M is a relatively small amount so we do not believe this to be a concern with respect to the company's credit profile.

EBITDA

Putting this altogether, for our Total EBITDA forecast, we used the revenue contribution and EBITDA margin of It's Just Wings to approximate the profitability of Chili's and Maggiano's by working backwards. Our forecast is shown in the table below and we used the following calculations:

- Since we know that It's Just Wings made $170M in revenues with a 30.0% EBITDA margin, we calculated the remainder of the revenues to be attributable to Chili's and Maggiano's. Next, using the 30.0% EBITDA margin for It's Just Wings, we could calculate its EBITDA contribution ($51M for 2021).

- The remainder of the company's EBITDA ($352M-$51M=$301M) is attributable to Chili's and Maggiano's so we took 301M and divided it by Chili's and Maggiano's revenue contribution of $3,168M to get these brands' EBITDA margin, which is roughly 9.5%.
- Management is pursuing aggressive growth of It's Just Wings, with a goal of doubling revenues in three years, which we believe is possible given the fast growth that the brand has already achieved. We reflected this in our revenue forecast for the digital brand for 2022, 2023, and 2024, and then drop the growth rate to match the rest of the company (Chili's and Maggiano's) assuming that it will be significantly more difficult to continue growing so rapidly after It's Just Wings becomes sizeable.
- Additionally, we projected a 1.0% growth rate for Chili's and Maggiano's based on our discussion in the Revenue section above. We also forecast the EBITDA margin for these two brands to increase from the current 9.5% to 12.0% in 2025, as we expect the company will be able to get back to its historical average (which is quite consistent) with these two brands.

Overall, with the addition and growth of It's Just Wings, Total EBITDA margin is forecasted to improve to 13.7% in 2025. Our forecast also is roughly in line with management guidance of 8.0-10.0% EBITDA growth (our CAGR is 9.2%), which we believe is reasonable barring additional waves of dining restrictions and assuming that It's Just Wings can continue its growth.

Exhibit 1515: Revenue & EBITDA Build-up

	2021A	2022E	2023E	2024E	2025E	CAGR
Base Revenue (Chili's, Maggiano's)	3,168	3,199	3,231	3,264	3,296	1.0%
Base EBITDA	301	336	355	375	396	7.1%
Base EBITDA %	9.5%	10.5%	11.0%	11.5%	12.0%	
It's Just Wings Revenue	170	228	287	347	350	19.8%
It's Just Wings EBITDA	51	69	86	104	105	19.8%
It's Just Wings EBITDA %	30.0%	30.0%	30.0%	30.0%	30.0%	
Total Revenue	3,338	3,428	3,519	3,611	3,647	2.2%
Total EBITDA	352	404	442	479	501	9.2%
Total EBITDA Growth	55.2%	14.9%	9.2%	8.5%	4.4%	
Total EBITDA %	10.5%	11.8%	12.6%	13.3%	13.7%	

Source: Own analysis, Compustat

Independent of other analysis, we believe that Brinker has a healthy financial profile, and our assessment is that the company has and will continue to have the ability to pay off its debt obligations. This is enabled by its growing Revenues and EBITDA, slightly declining COGS, stable SG&A, and adequate CAPEX to generate sustained growth in EBITDA, as well as fair management of its Trade Working Capital.

Debt

The majority of Brinker's obligations are held in long-term debt. The most important facets of Brinker's debt include a secured revolving credit facility of $251.3 million with coupon of 1.875% and maturity in August 2026, a senior unsecured loan of $300 million with coupon of 3.875% and maturity in May 2023, and a senior unsecured loan of $350 million with coupon of $5.000% and maturity in October 2024.

Exhibit 1616: Debt Structure ($M, as of December 21, 2021)

Debt Capitalization	
Short Term Debt	**23.4**
Current Portion of LTD	23.4
Long Term Debt	**898.3**
Revolving Credit	**251.3**
Sec. Rev. Facility	251.3
Term Loans	
Notes/Bonds	**650.0**
Senior Unsec.	650.0
Other	**-3.0**
Adjustments	-3.0
Long Term Debt, Less Current Portion	**874.9**
Long Term Debt	898.3
Current Portion of LTD	-23.4
Total Debt	**$898.3**

Source: FactSet Debt Capital Structure

Given the quick succession of obligations due in 2023 and 2024, capital markets will view the refinancing of these debts in tandem. Brinker faces the risk of inability to refinance its debt, but we believe that this risk is low. As we demonstrate in the next section ("Credit Ratio Analysis"), we expect ratings agencies to increase the credit rating of Brinker in the near term. Improvement in credit ratings will increase the willingness of capital markets to participate in debt refinancing.

During an analyst call in October 2021, EVP & CFO Joseph Taylor stated that Brinker would look to reduce debt. We interpret this as a plan to reduce the face value of debt refinanced in 2023. Capital markets would interpret refinancing a smaller value than $650 million favorably.

Capital market participants will also want to see that free cash flow is sufficient to meet obligations and wind down debts into the future. We observe the ratio of free cash flow to net debt as a means for approximating Brinker's ability to meet and reduce debt moving forward. In the several fiscal years preceding the coronavirus pandemic, this ratio fluctuated between 3% and 9% from 2015 to 2018. Brinker experienced negative free cash flows in fiscal 2019 and 2020, but it regained positive free cash flows in fiscal 2021. We estimate this ratio to be 9% in fiscal-year 2022, given cash flows from operations of $339 million, capital expenditure of $160 million as per management's estimates in August 2021, and net debt held constant from fiscal year 2021. A 9% ratio of free cash flow to net debt is healthy and would be viewed as sufficient to refinance obligations moving forward.

Credit Ratio Analysis

For further credit analysis, we compare Brinker with the overall restaurant industry on key credit metrics in the table below. Notably, we observe that the company's Net Debt / EBITDA ratio leapt high in fiscal year 2020, just as it did across the entire restaurant industry. A reduction in EBITDA and a steep increase in debt led to a significant increase in Net Debt to EBITDA. This ratio has improved considerably for Brinker in the last twelve months, but it is not yet at its pre-pandemic level.

The ratio of EBITDA to Interest Expense has rebounded in the last twelve months to levels seen prior to the pandemic. This is the case for both Brinker and the restaurant industry at large. It is favorable for Brinker that its cash flows from operations are able to service the company's interest payments at a ratio of 6.6x in the last twelve months.

An upgrade in Brinker's credit rating would be favorable to its bond pricing. We view that Brinker will earn a credit rating upgrade in the near term ahead of its debt refinancing. Amid initial fears of the coronavirus outbreak, Brinker received credit rating downgrades. Given economic shutdowns and restaurant patron slowdowns, S&P Global and Moody's downgraded the local currency LT credit rating of Brinker in March and May 2020.

Despite strong brand awareness, scale, and technology initiatives, the credit agencies viewed Brinker and the restaurant industry as at higher risk for default due to the credit shock across the sector. Specifically, Moody's stated in May 2020 that it expected Brinker's debt to EBITDA ratio to be 6.5x and EBITDA to interest expense ratio to be 1.2x at the end of fiscal 2021 (i.e., the quarter ending June 2021).

Credit ratios have far surpassed these expectations that were set in May 2020. Net debt to EBITDA was 5.4x at fiscal year-end 2021. EBITDA to interest expense was significantly higher, and still rising, at 6.3x. With credit ratios improving relative to expectations, we believe that ratings agencies will upgrade the credit rating of Brinker.

In 2021, Brinker has already seen modest improvement in its credit rating. S&P Global upgraded the local currency LT credit rating of Brinker from B+ to BB- in May 2021, citing stable outlook. We anticipate ratings agencies to further upgrade Brinker's credit given stabilizing and improving financial outlook for the business as indicated by management guidance and recent improvements.

Exhibit 1717: Credit Ratio Comparison

($M)	Brinker International B1 Positive				Restaurant Industry N/A			
	FYE 19	FYE 20	FYE 21	LTM	FYE 19	FYE 20	FYE 21	LTM
Revenue	3,218	3,079	3,338	3,474	165,399	152,961	159,540	153,547
EBITDA	382	227	352	354	33,355	25,537	32,584	34,323
Net Debt	1,193	2,226	1,901	2,006	119,068	144,936	137,250	114,498
Total Debt	1,216	2,400	2,044	2,170	132,185	167,304	160,537	137,817
Cash & Cash Equivalents	13	44	24	31	13,117	22,368	23,287	23,320
Ratios								
Net Debt / EBITDA	3.1x	9.8x	5.4x	5.7x	3.6x	5.7x	4.2x	3.3x
Cash Flow / Total Debt	0.3x	0.1x	0.1x	0.0x	0.2x	0.2x	0.2x	0.2x
EBITDA / Interest Expense	6.2x	3.8x	6.3x	6.6x	7.9x	5.8x	6.8x	8.0x
Total Debt / Total Assets	1.0x	1.0x	0.9x	0.9x	0.7x	0.8x	0.7x	0.8x
Total Debt / Equity	-1.6x	-5.0x	-6.7x	-6.7x	47.1x	-36.6x	23.9x	-264.8x

Source: Company Financials, Moody's

Bond Evaluation

Brinker has one Senior Unsecured bond due May 2023 that is rated B3 by Moody's and B by S&P (non-investment grade), the details of which are in the table below.

Exhibit 1818: Senior Unsecured Notes

Bond Issue	Amount ($M)	Coupon	LGD	Maturity	At issue Date	At issue Price	Current (3-Dec-21) Price	Current (3-Dec-21) YTW%
3.875% Senior Unsecured Notes due 2023	300	3.875	92%	May-23	Oct-13	99.90	102.69	1.97%

Source: Bloomberg, Moody's

In order to determine whether an investor should purchase this bond, we calculated the probability of default (PD) using the hazard formula (also known as hazard rate or average default intensity):

$$\bar{\lambda} = s/(1\text{-R})$$

- where $\bar{\lambda}$ is the hazard rate per year
- s is the spread of the corporate bond yield over the risk-free rate
- R is the expected recovery rate

We used the G-Spread (the yield spread over the interpolated government bond yield) from Bloomberg of 1.563% for s and 8.00% for our recovery rate, R, given that Moody's loss given default (LGD) rate is 92.0%.

$$\bar{\lambda} = s/(1\text{-R}) = 0.01563/(1-0.08) = 0.0169565 \text{ or } 1.70\%$$

This resulted in a 1.70% default probability for Brinker's' 3.875% Senior Unsecured Notes.

Next, we looked at the historical average rates of default for single B rated bonds to confirm whether 1.70% is reasonable. The average historical default rate for S&P single B corporate bonds in the period from 1981 to 2020 is 4.19%, which is significantly higher than the 1.70% calculated for Brinker's bond. However, observing the average default rates by year for single B for the last five years, we observe an average default rate of 2.15%, which makes the 1.70% default rate for the Brinker bond seem more reasonable.

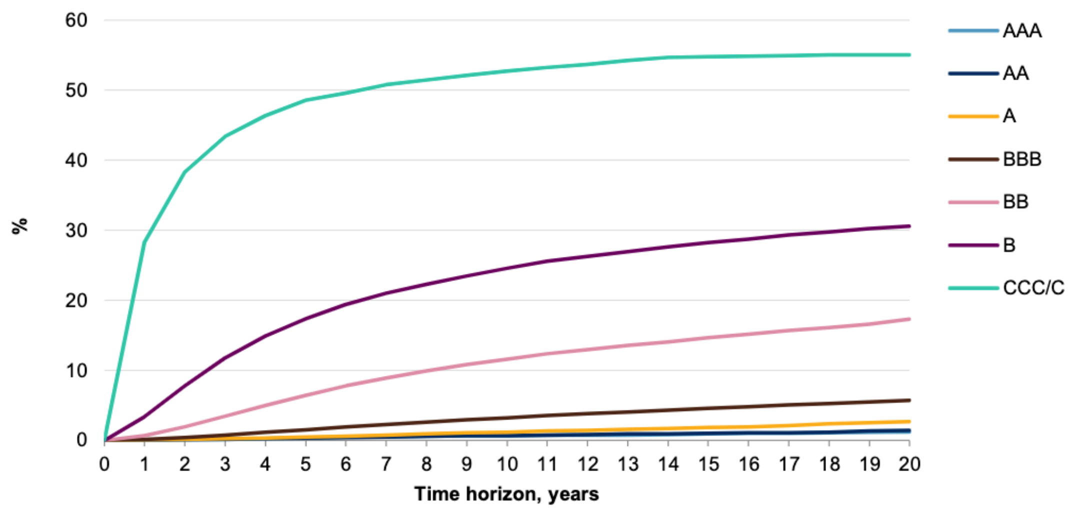
Exhibit 1919: Global Corporate Default Rates by Year

	AAA	AA	A	BBB	BB	B	CCC/C
2016	0.00	0.00	0.00	0.06	0.47	3.76	33.17
2017	0.00	0.00	0.00	0.00	0.08	1.00	26.56
2018	0.00	0.00	0.00	0.00	0.00	0.99	27.18
2019	0.00	0.00	0.00	0.11	0.00	1.49	29.76
2020	0.00	0.00	0.00	0.00	0.93	3.52	47.48

Source: S&P Global Ratings

Next, we wanted to take into consideration the maturity of the Brinker bond, which matures in May 2023 or roughly 17 months or 1.42 years from today. Observing the average cumulative default rates based on timeframe, we see that a single B bond with roughly 1.5 years remaining has a default rate of just under 5.00%, which is also higher than the 1.70% probability of default calculated for the Brinker bond. Our assessment overall is that while the bond is rated single B, it has a better (lower) probability of default than the average single B bond, so it appears that bondholders are getting a good return for the risk that they are taking holding this bond. Therefore, we give this bond a positive rating.

Exhibit 2020: Global Corporate Average Cumulative Default Rates by Rating (1981-2020)



Source: S&P Global Ratings

Lastly, as noted earlier in this report, our favorable view of this bond overall hinges on the company's ability to refinance both this bond and its Senior Unsecured bond due October 2024. We believe the company will be able to do so based on management's guidance regarding paying down debt, Brinker's recent track record of improving credit metrics, our forecast which shows continued improving credit metrics for the next several years, and improved credit ratings as a result.

Appendix

	2012A	2013A	2014A	2015A	2016A	2017A	2018A	2019A	2020A	2021A	*2022F*	*2023F*	*2024F*	*2025F*
INCOME STATEMENT														
Revenue	2,827	2,846	2,909	3,002	3,257	3,151	3,135	3,218	3,079	3,338	3,428	3,519	3,611	3,647
COGS	2,311	2,306	2,350	2,408	2,639	2,584	2,589	2,695	2,670	2,835	2,914	2,991	3,069	3,100
SG&A	151	143	140	137	142	142	156	172	162	143	168	172	177	179
Other expenses	4	6	39	-1	1	8	8	-31	19	9	3	2	0	10
EBITDA	361	391	380	459	475	416	383	382	227	352	343	354	364	359
D&A	125	131	136	145	156	158	153	149	162	150	167	170	174	177
EBIT	236	259	244	313	319	258	229	233	65	201	176	184	190	181
Interest Expense	27	29	28	29	33	50	59	62	60	56	58	49	49	49
Income Tax	58	67	62	88	86	58	44	17	-20	14	4	4	4	4
Net Income (Loss)	151	163	154	197	201	151	126	155	24	132	115	131	137	129
Revenue Growth	2.4%	0.7%	2.2%	3.2%	8.5%	-3.3%	-0.5%	2.6%	-4.3%	8.4%	2.7%	2.7%	2.6%	1.0%
COGS % of Revenue	81.8%	81.0%	80.8%	80.2%	81.0%	82.0%	82.6%	83.7%	86.7%	84.9%	85.0%	85.0%	85.0%	85.0%
SG&A % of Revenue	5.3%	5.0%	4.8%	4.6%	4.4%	4.5%	5.0%	5.3%	5.3%	4.3%	4.9%	4.9%	4.9%	4.9%
Other expenses % of Revenue	0.1%	0.2%	1.3%	0.0%	0.0%	0.3%	0.2%	-1.0%	0.6%	0.3%	0.1%	0.0%	0.0%	0.3%
EBITDA Margin	12.8%	13.7%	13.1%	15.3%	14.6%	13.2%	12.2%	11.9%	7.4%	10.5%	10.0%	10.1%	10.1%	9.8%
D&A % of Revenue	4.4%	4.6%	4.7%	4.8%	4.8%	5.0%	4.9%	4.6%	5.3%	4.5%	4.9%	4.8%	4.8%	4.9%
EBIT Margin	8.3%	9.1%	8.4%	10.4%	9.8%	8.2%	7.3%	7.3%	2.1%	6.0%	5.1%	5.2%	5.3%	5.0%
Interest Expense % of Total Debt	4.9%	4.3%	3.5%	3.2%	3.1%	4.1%	4.2%	4.6%	3.4%	2.7%	3.0%	3.0%	3.0%	3.0%
Income Tax % Pre-tax profit	27.6%	29.1%	28.8%	30.8%	29.9%	27.7%	26.0%	9.8%	N/A	9.4%	14.5%	14.5%	14.5%	14.5%
Net Income Margin	5.3%	5.7%	5.3%	6.6%	6.2%	4.8%	4.0%	4.8%	0.8%	3.9%	3.4%	3.7%	3.8%	3.5%

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