

My Largest Short Position: Wingstop

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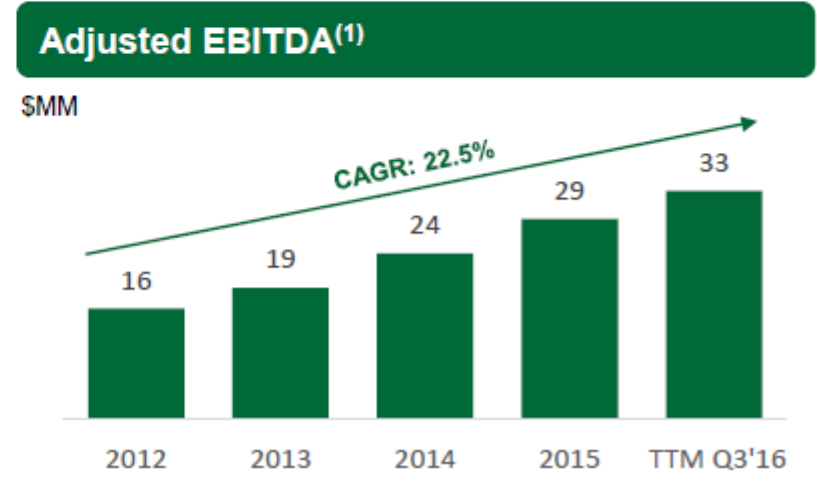
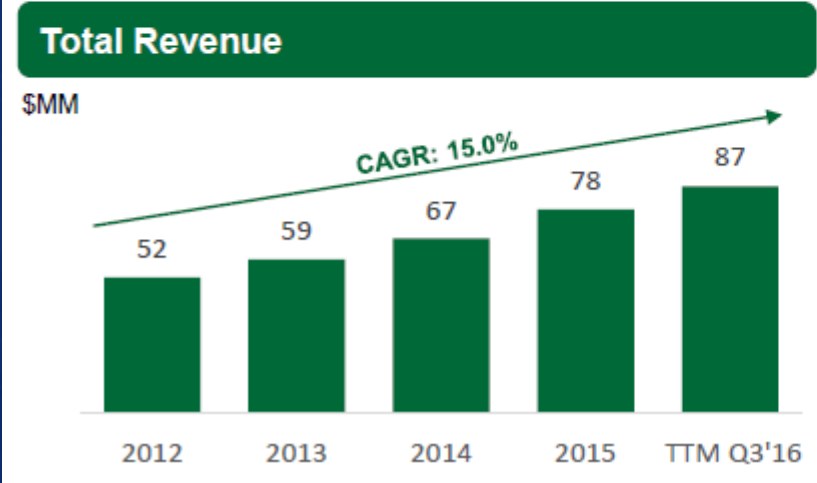
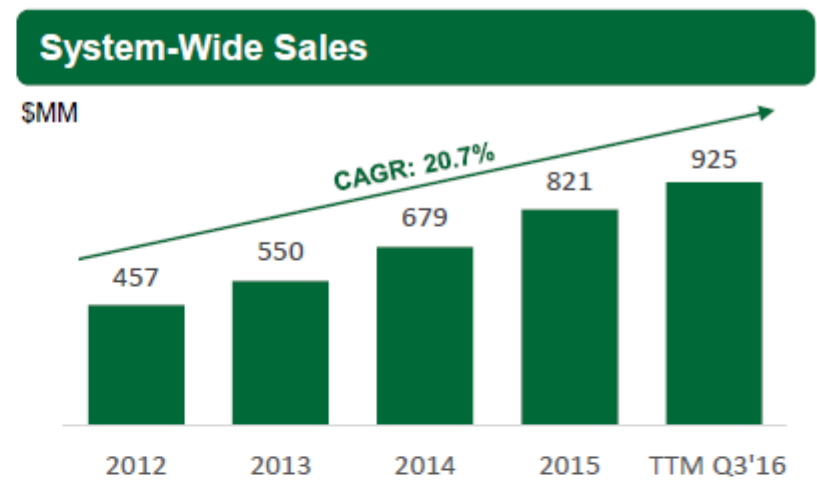
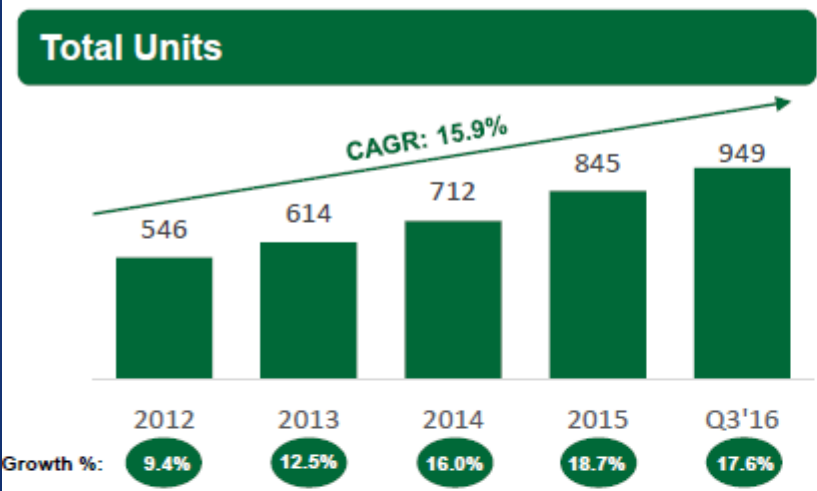
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- Wingstop is in the chicken wing restaurant franchise business
- Founded in 1994, it began franchising in 1997
- There are just over 1,000 Wingstop restaurants in 40 states (93% of units) and 6 countries, of which 98% are franchised
- 75% of revenues are take-away (vs. 16% at Buffalo Wild Wings)
- Like most franchise businesses, Wingstop has high margins and low capex, thus generating healthy free cash flow
- Market cap (at \$27.78): \$802m; cash: \$4m; debt: \$151m; EV: \$943m



Wingstop Is Growing Rapidly



Source: Wingstop investor presentation, 11/16.

Wingstop's Stock Is Down Slightly Since Its First Day Close After Its IPO in June 2015



Why Am I Short the Stock?

- 1) The valuation is absurd: 52x trailing EPS (43x NTM), 29x trailing EBITDA (24x NTM), and 11x trailing revenues (10x NTM)
- 2) Same store sales growth is decelerating
 - An estimated half of same store sales growth in recent years has been driven by price increases, which is likely unsustainable
- 3) There is little that is proprietary or unique about this business – these are chicken wing restaurants!
 - There are plenty of competitors, many much larger, with deeper pockets and better technology: head-to-head (BWW, Wing Street), other fast food chains (KFC, Domino's, Pizza Hut, Popeyes, Papa John's), and indirect (supermarkets selling ready-to-eat wings)
- 4) I doubt whether Wingstop can nearly triple the number of units in the U.S. to management's stated goal of 2,500
 - The market is much more competitive and may be becoming saturated
 - Roughly half of all chicken wing restaurants in the U.S. have been opened the last five years, a quarter in the last two years
 - Nearly 2/3 of Wingstops today are in two states, Texas (nearly 10% in Dallas alone) and California, so the business and brand are largely unproven elsewhere
- 5) After 22 years (including a dozen owned by two respected private equity firms) and growth to over 1,000 units, the company generated a mere \$91 million in revenues and \$15 million in net income in 2016

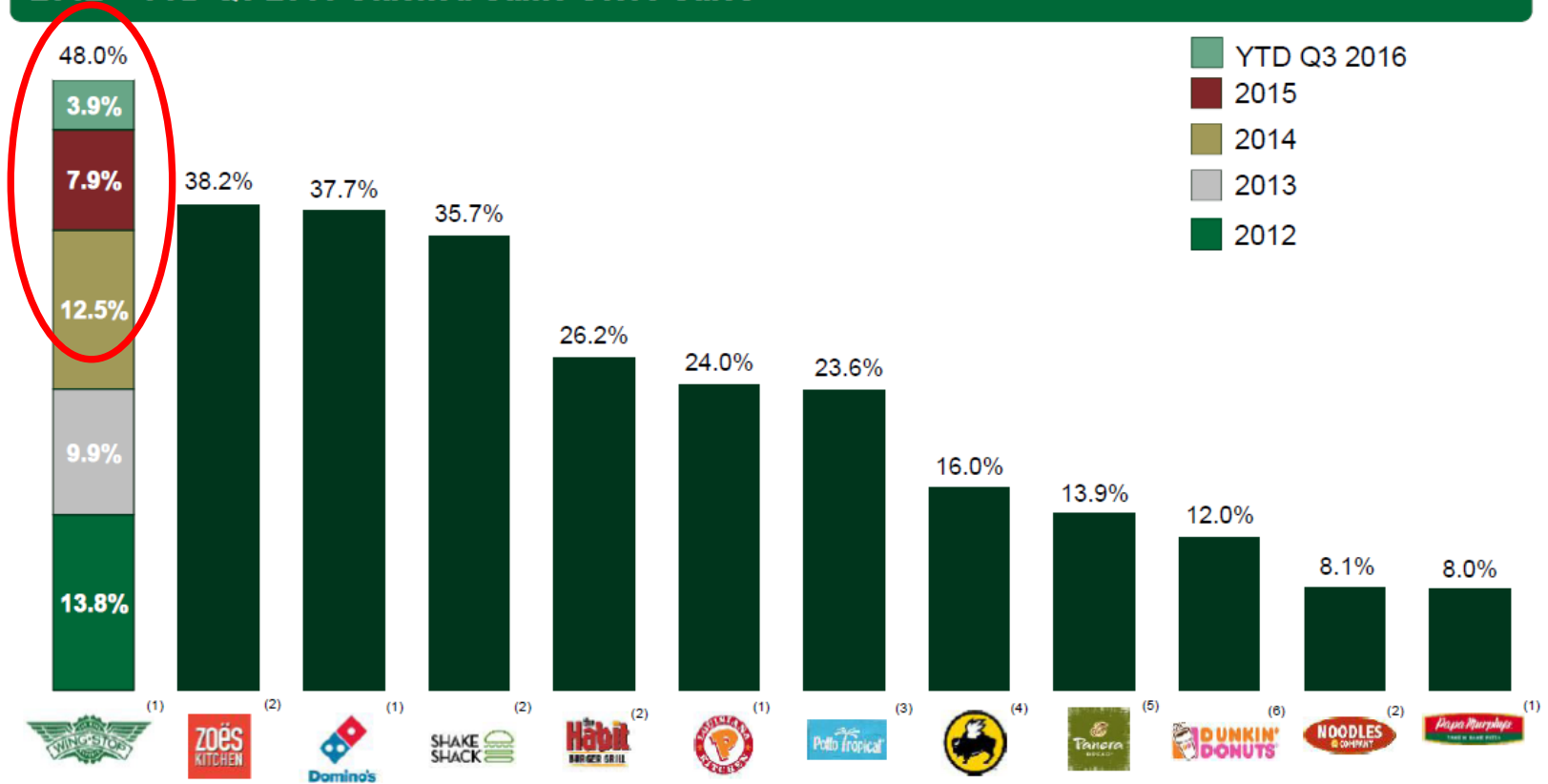
Wingstop's Investor Presentation Boasts of Phenomenal Same Store Sales Growth

But Note the Slowing Growth



AND INDUSTRY LEADING SSS

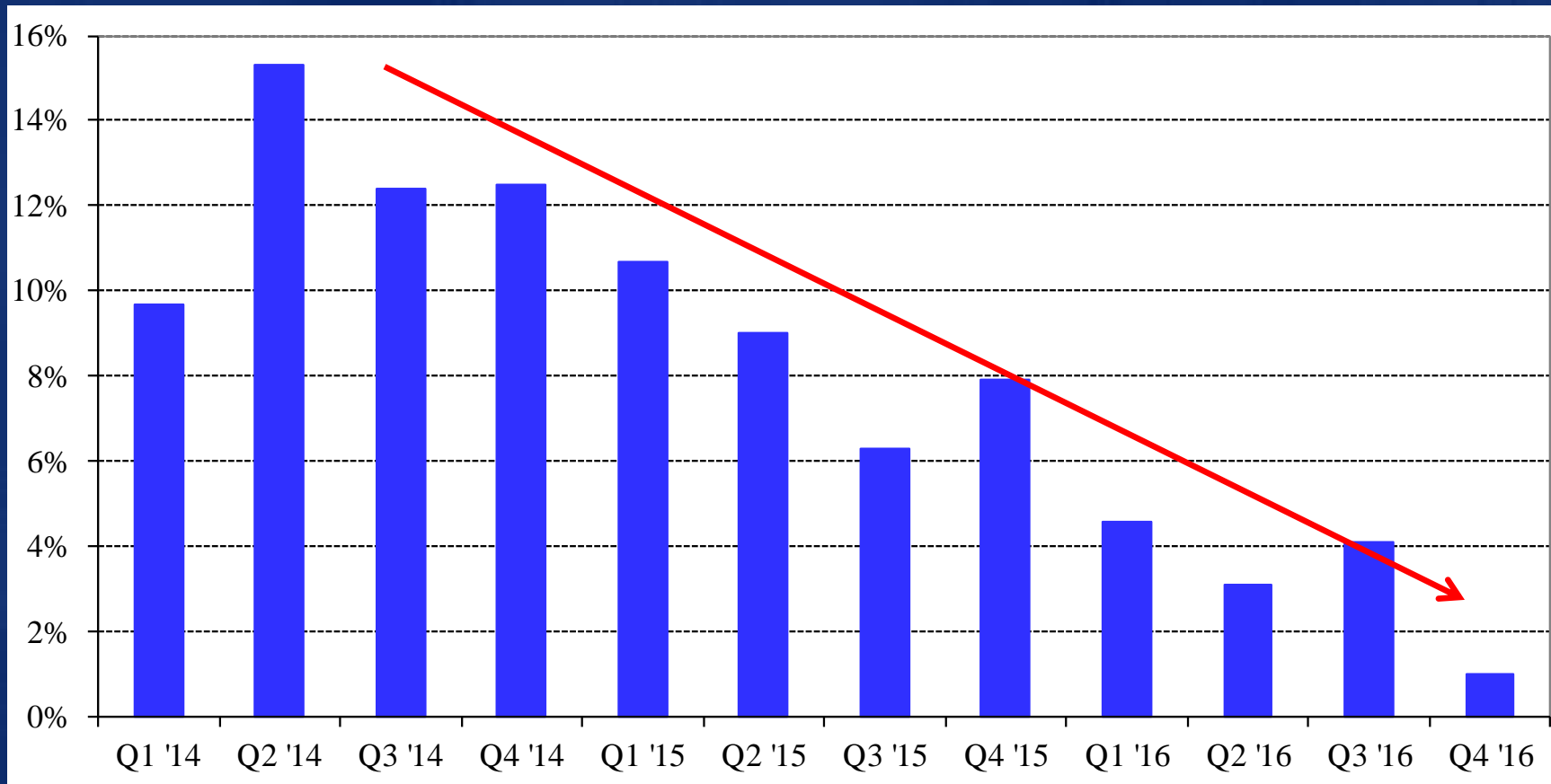
2012 – YTD Q3 2016 Stacked Same Store Sales



In Reality, Wingstop's Same Store Sales Growth Has Decelerated Significantly

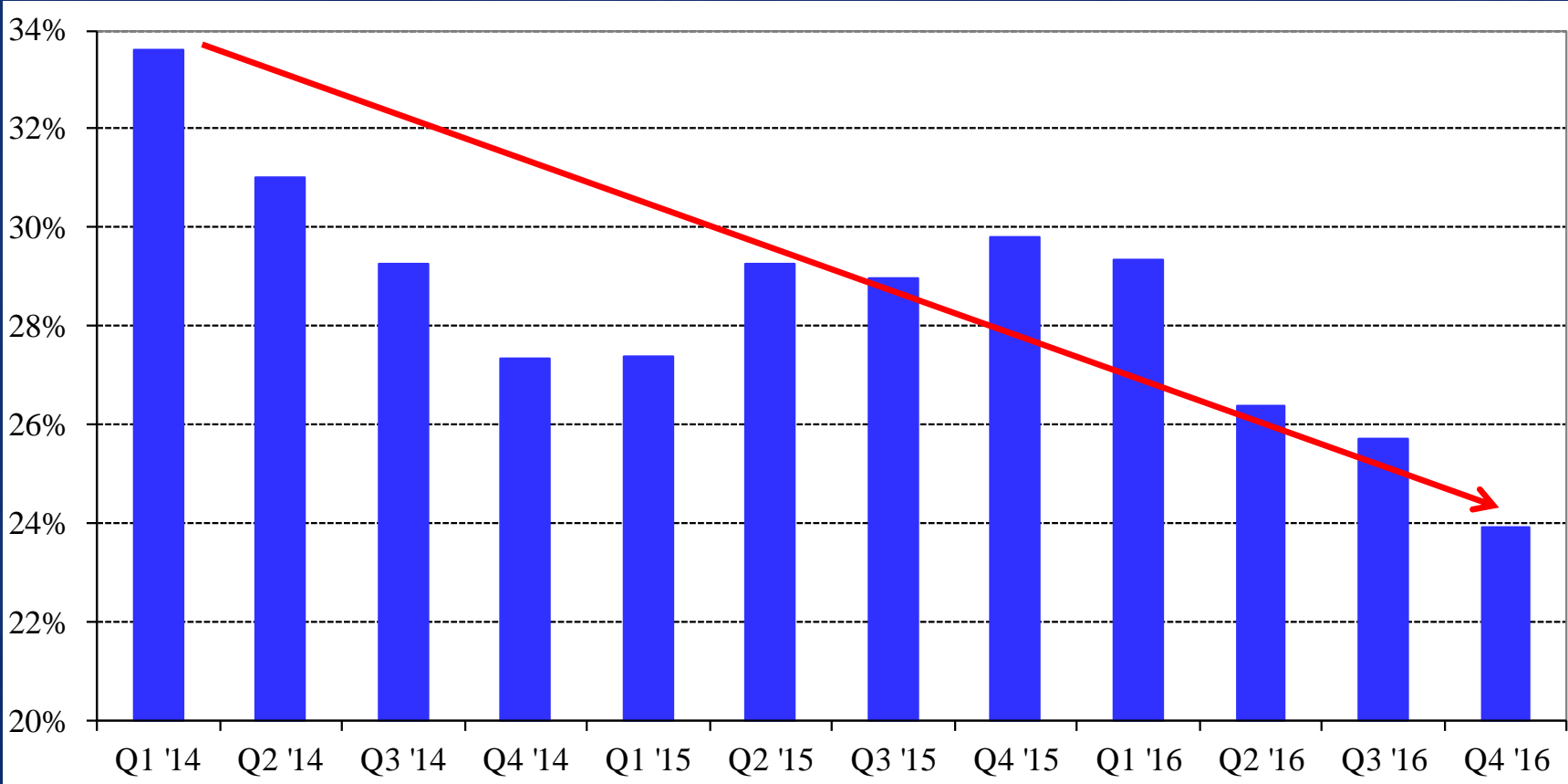
Despite Increasing the Pace of New Unit Growth

System-wide domestic same store sales growth



The Gross Margin of Wingstop's Company-Owned Stores Has Also Declined Significantly

Gross Margin of Company-Owned Stores



Note: Gross margin calculated as total cost of sales divided by company-owned restaurant sales

Wingstop's 2017 Guidance Indicates a Very Disappointing Year

- On the Q4 '16 conference call in early March, management said Q1 '17 comps are *negative* 2.6% so far *plus* the cost of wings are 10% higher YoY – meaning Wingstop could report unexpectedly weak sales, margins and profits in Q1
- Wingstop has issued the following guidance for 2017:
 - System wide unit growth of approximately 13% to 15%
 - Low single digit domestic same store sales growth
 - SG&A expenses of between \$34 million and \$35 million
 - Net income between \$18.5 million and \$18.8 million
 - Fully diluted EPS growth of 8% - 10%
 - Adjusted EBITDA growth of 13% - 15%
- This guidance implies *another ~300bps of margin decline*
- Summary: negative comps and plunging margins are totally inconsistent with a stock trading at such a rich valuation, so something have to give: either Wingstop's business metrics start to improve dramatically or the stock is likely to get cut in half (or more)
- I'm betting on the latter – and so was Roark Capital (see next slide)

Public Shareholders Are Wingstop's 4th Owners – and the Prior Owner Has Already Cashed Out Entirely

- Founded in 1994
- Acquired by Gemini Group in 2003
- Acquired by Roark Capital in 2010
- Taken public in 2015

Roark Capital specializes in franchise businesses and currently owns 16 quick/limited/full service restaurants chains. It typically holds for a decade or more.

But in the case of Wingstop, it rushed to dump its entire stake:

- Jun 2015 – IPO – 3.2m shares sold at \$19;
- Mar 2016 – Secondary – 6.3m shares sold at \$24;
- July 2016 – Special dividend of \$2.90/share, bringing debt to EBITDA to 5.2x;
- Aug 2016 – Secondary – 6m shares sold at \$29.25;
- Nov 2016 – Secondary – all of remaining 6.8m shares sold at \$26.28

Why the rush? My guess is that Roark saw a possible fad, oversaturation, and the signs of slowing growth, so wisely took the opportunity to cash out at an absurd valuation

Summary and Price Target

- Wingstop is an OK business at best – and there are major signs of deterioration (primarily weakening margins and SSS growth)
- Its business is largely undifferentiated and faces ferocious competition from all sides
- It has only proved that its business and brand work in two states, yet its valuation assumes that it can scale rapidly across the U.S. and abroad – a highly questionable proposition
- Given that the stock is currently priced for perfection, if I'm wrong, it has little upside – and if I'm right, look out below!
 - For example, look at Papa Murphy's (FRSH), a fresh pizza (take-away to cook at home) franchising business with 1,570 stores in 38 states and abroad: the stock went public ~\$10, soon soared to \$20+ -- and has now crashed to ~\$5
- A discounted cash flow analysis, even assuming favorable growth and margin increases for the next decade, yields a share price roughly half today's level
 - Even at that price, the stock would still be richly priced at more than 25x trailing EPS
- This is my largest short position at 3.1%
- There is plenty of borrow at negligible cost