

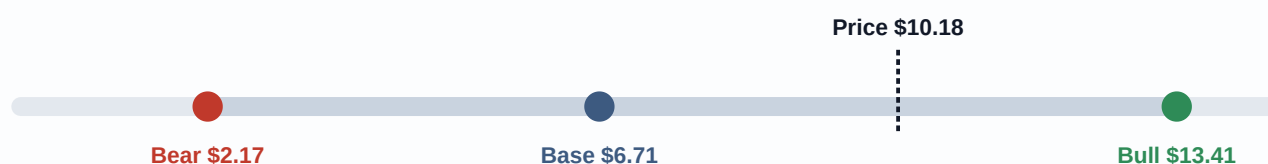
Initiated 2026-09-30 · Price \$10.18 (as of 2026-09-30 close, stockanalysis.com) · Mkt cap \$628mm · Consumer discretionary / full-service restaurants (daytime) · Model: verified

Rating: Hold — Conviction: Medium

First Watch trades at 8.85x lease-excluded FY2025 GAAP EBITDA, near its 52-week low, while growing units ~9% a year, but it is cheap for reasons. Traffic is negative (−0.4% in Q2), restaurant margin has fallen for a year (20.1% to 18.5%), free cash flow is negative, and the revolver is \$70mm drawn. The exit-multiple method sees about 30% upside if margins recover. The Gordon method sees none while growth capex exceeds EBITDA. Positive traffic should come before trusting the margin recovery.

Conviction tests (3a-v-c): T1 pass (base −38.1% at +1pp, −29.8% at −1pp; Hold at both) · T2 fail (Gordon alone \$0.00 → Sell; exit multiple alone +31.9% → Buy) · T3 pass · T4 pass

MODEL VALUE RANGE VS PRICE



Business overview

First Watch runs a daytime-only (7am–2:30pm) full-service breakfast, brunch and lunch chain. At 2026-06-28 it had 665 restaurants: 586 company-owned and 79 franchised. Nearly all revenue is company restaurant sales (\$351.5mm of Q2's \$354.7mm). Three variables drive earnings. The first is unit growth: 60–62 net system openings are guided for FY2026, 53–54 of them company-owned. The second is same-restaurant sales, which were +3.6% in FY2025 and +3.4% in Q2 2026, but on −0.4% traffic, with the rest from price and mix. The FY2026 guide is +1.5% to +3.0%. The third is restaurant-level margin (18.5% in FY2025 vs 20.1% in FY2024; 18.8% in Q2 2026), driven by food costs (−1.6% commodity deflation in Q2) and wages (+4.1%).

Competition

The breakfast daypart is fragmented. First Watch is the largest dedicated daytime chain. IHOP (Dine Brands) is the scaled value-priced competitor: its domestic comps rose 1.5% in Q2 2026, and management said it outperformed the industry on both sales and traffic for a third straight quarter. First Watch's +3.4% was mostly price, so IHOP is winning the traffic comparison right now. Private brunch chains Snooze and Another Broken Egg (AUV \$1.9mm per older trade press) compete for the premium weekend occasion, and Cracker Barrel at breakfast. Pressure would show first in traffic and then in the ability to take price, which is where the Q2 numbers already point. On one aggregator's lease-inclusive trailing EV/EBITDA, FWRG's 14.4x sits inside the peer range (DIN 11.0x, BJRI 12.7x, CBRL 17.8x), so the market gives it no growth premium.

Bull case

1. **Unit runway at ~9% a year** — 53–54 company openings a year on a 586 base, plus franchise acquisitions, compound revenue at 11–14%. Plays out if new units ramp to system AUVs and traffic turns positive (June did), with comps of +3–4%. *Model: rev_growth*
2. **Margin recovery** — commodity deflation and maturing 2024–25 openings lift restaurant margin back toward 20%, and G&A leverages on a faster-growing revenue base. GAAP EBITDA margin rises from 8.4% to ~11%. Plays out if egg and protein costs stay benign and wage inflation holds at the low end of 3.5–4.5%. *Model: ebitda_margin*
3. **Re-rating from a trough multiple** — at 8.85x GAAP EBITDA and 6.7x the adjusted guide, a return to positive traffic could restore a growth premium. Plays out if two quarters of positive traffic coincide with a raised guide. *Model: exit_ev_ebitda*

Bear case

1. **Price-led comps with negative traffic** — the SRS guide was raised only at the low end, from +1–3% to +1.5–3.0%, and Q2 traffic was still negative. Price is doing the work, and more price risks the traffic line. Plays out if traffic stays negative through FY2027 and the consumer trades down to IHOP-style value. *Model: rev_growth, ebitda_margin, exit_ev_ebitda*
2. **Growth that consumes cash** — FY2025 capex of \$156.9mm exceeded GAAP EBITDA of \$102.5mm, and the revolver went from undrawn to \$70mm. If returns disappoint, openings get cut, lowering growth and the multiple together. Plays out if FY2027 capex has to be funded by more revolver draws. *Model: rev_growth, capex_pct_rev*
3. **Operating and financial leverage** — \$294mm of funded debt (2.66x net GAAP EBITDA) sits on top of \$781mm of operating lease liabilities. The \$90mm swap at 4.16% expires 2026-10-06, so more of the floating debt reprices. Plays out if margins stay below FY2025 while the 10Y holds above 5%. *Model: ebitda_margin, wacc*

Valuation & balance sheet

Metric (definition)	Current	Own history (range or 5y avg)	Peers	Source, as-of
EV/EBITDA (model basis: mkt cap – cash + funded debt incl. finance leases; GAAP EBITDA, operating leases excluded)	8.85x FY2025 · 6.7x FY2026 adj. guide midpoint	n/a (unverified)	n/a on this basis	Model; 10-Q 2026-06-28
EV/EBITDA (aggregator, trailing, lease-inclusive)	14.4x	n/a (unverified)	CBRL 17.8x · DIN 11.0x · BJRI 12.7x	stockanalysis 2026-09-30
EV/Sales (aggregator, trailing)	1.27x	n/a (unverified)	CBRL 0.65x · DIN 2.16x · BJRI 1.14x	stockanalysis 2026-09-30
Forward P/E (consensus)	50.5x	n/a (unverified)	CBRL 25.3x · DIN 6.5x (distorted, depressed price) · BJRI 22.9x	stockanalysis 2026-09-30
FCF yield (TTM OCF – capex / mkt cap)	–3.3% (–\$20.9mm)	FY2025 capex \$156.9mm vs GAAP EBITDA \$102.5mm	n/a	stockanalysis; EDGAR

Model-implied value range (from `model-summary.json` ; generic module, Gordon-growth DCF and exit-EV/EBITDA DCF, midpoints): Bear \$2.17 · Base \$6.71 · Bull \$13.41 per share, i.e. implied returns of –78.7% / –34.1% / +31.8% vs \$10.18. *These ranges show how the bull and bear drivers translate into value; they are not price targets.* The midpoints sit below the price, which contradicts a Hold. I keep the call because the Gordon method floors at \$0.00 in Base: year-5 FCF still carries growth capex (8.5% of revenue vs 6.3% D&A) and is grown at 3% forever, undervaluing a concept whose capex would fall toward maintenance as growth slows. On a scratch copy with year-5 capex set to 5%, Base Gordon is \$11.79 and the midpoint \$12.98 (+27.5%). The exit-multiple method gives \$13.43 Base (+31.9%) and embeds a 9.0x exit, a ~2% re-rating from today's 8.85x same-basis multiple. The price sits between Base and Bull on the exit method, so what's priced in is roughly "no margin recovery." First Watch is a single brand, so I ran a tail sensitivity: revenue +10% in FY2026, then +2%, 0%, 0% and +1%, with EBITDA margin 6.0%, capex 5%, NWC –3%, a 6x exit and a 10.7% WACC. The bear midpoint falls to \$0.13.

Balance sheet: net leverage 2.66x FY2025 GAAP EBITDA (gross 2.86x), coverage 5.2x EBITDA/net interest. Liquidity: \$20.5mm cash plus ~\$55mm undrawn revolver (before letters of credit). Nearest maturity: term facilities (\$206.0mm) and revolver (\$70.0mm), both 2029-01-05. Unrated. Operating lease liabilities of \$781mm are excluded from EV because EBITDA is after rent.

Model note: verified: LibreOffice recalculation matched all 3,207 formula cells. Unverified inputs: none. Assumptions without basis: none. No scenario CHECKs. No EPS guide; Base Y1 GAAP EPS of \$0.13 is ~35% below the ~\$0.20 implied by consensus forward P/E, mainly because GAAP EBITDA is after ~\$18mm of SBC and other add-backs. The model omits landlord tenant-improvement allowances that run through operating cash flow. The 24% tax rate is a judgment. Historicals start in FY2023 (FY2023 is 53 weeks).

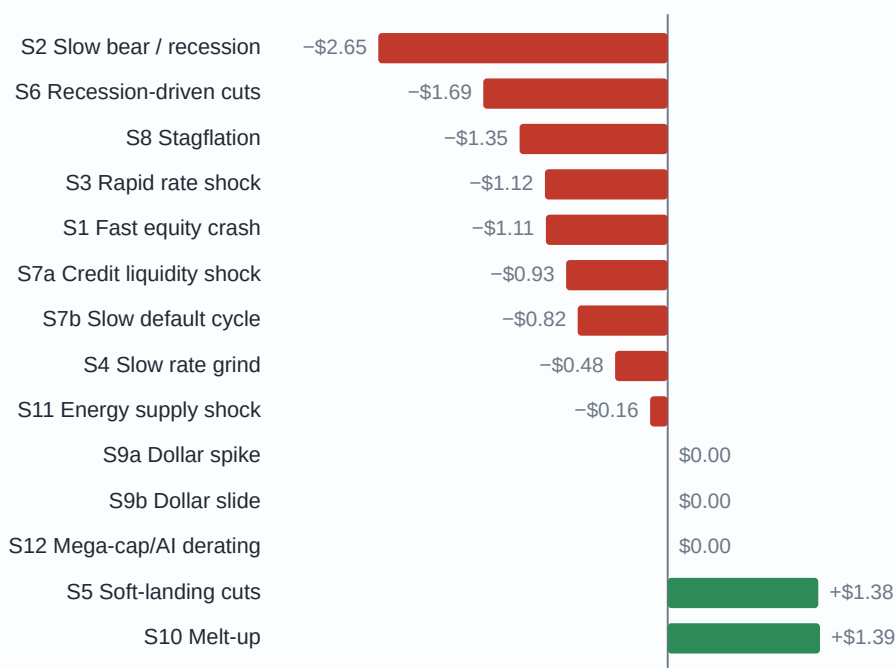
Scenario stress test

Reasoned from the bull/bear drivers above. The model column comes from the scenario overlays (Base case + shock).

Scenario	Effect	Mechanism	Magnitude	Model Δ value vs Base (\$/sh)
S1 Fast equity crash	–	Small cap, 10.7% short interest; multiple de-risks, no operating channel	Med	–\$1.11
S2 Slow bear / recession	–	~\$20 brunch check is discretionary: traffic falls, new units open under plan, labor and rent deleverage; transitory, so milder than the multi-year bear	High	–\$2.65
S3 Rapid rate shock	–	Floating term loan and revolver reprice as swaps roll off; discount rate and small-cap multiple compress	Med	–\$1.12
S4 Slow rate grind	–	Same channel, grinding	Low	–\$0.48
S5 Soft-landing cuts	+	Cheaper floating debt, lower discount rate, consumer relief	Med	+\$1.38
S6 Recession-driven cuts	–	Traffic loss outweighs lower rates on the floating debt	Med	–\$1.69
S7a Credit liquidity shock	–	No bonds before 2029, but a levered small cap with a drawn revolver de-rates in forced selling	Low	–\$0.93
S7b Slow default cycle	–	Tighter bank credit raises revolver cost; landlord and developer financing slows site deliveries	Low	–\$0.82
S8 Stagflation	–	Egg, pork, produce, coffee and 3.5–4.5% wage inflation against a consumer resisting more price	Med	–\$1.35
S9a Dollar spike	0	No material effect, not modeled (all US)	Low	\$0.00
S9b Dollar slide	0	No material effect, not modeled	Low	\$0.00
S10 Melt-up	+	Heavily shorted, 36% down over a year: covering and re-rating	Med	+\$1.39
S11 Energy supply shock	–	Gasoline squeezes discretionary spend; distribution and utility costs	Low	–\$0.16
S12 Mega-cap/AI derating	0	No material effect, not modeled: no AI linkage, already a low-multiple small cap	Low	\$0.00

S2 is ~58% of the Base – Bear gap: a recession is transitory, the bear case a multi-year plateau. **Currently active/on watch per the playbook:** S3 partially active (price leg met); S8, S10 and S11 on watch. S3 is the live one here, via the discount rate and the floating debt as the October swap rolls off.

MODEL VALUE CHANGE VS BASE, BY SCENARIO



What would change the call

Upgrades if: same-restaurant traffic turns positive for two consecutive quarters, restaurant-level margin holds $\geq 19\%$ for FY2026, and FY2027 openings are funded without further revolver draws. **Downgrades if:** traffic stays negative through Q4 2026, restaurant margin falls below 18%, FY2026 adjusted EBITDA misses the \$133–136mm guide, or net debt rises above $\sim 3\times$ GAAP EBITDA.

Watch items

- **W1:** Q3 same-restaurant traffic vs Q2's -0.4% (June positive) and SRS vs the $+1.5\%$ to $+3.0\%$ guide — Q3 release — $\sim 2026-11-03$ — *Model: rev_growth*
- **W2:** Restaurant-level margin vs FY2025's 18.5% and adjusted EBITDA vs the \$133–136mm guide — Q3 / Q4 releases — Nov 2026 / Feb 2027 — *Model: ebitda_margin*
- **W3:** Revolver balance (\$70mm at 2026-06-28) and FY2027 capex/openings guide — Q3 10-Q / Q4 release — Nov 2026 / Feb 2027 — *Model: capex_pct_rev*
- **W4:** Interest cost after the \$90mm 4.16% swap expires 2026-10-06 — Q4 10-K — Feb 2027 — *Model: none*

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Independent single-name research. Directional characterization, not a price target, execution instruction, or portfolio recommendation.