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Applebee's readies for new unit growth

It was an achievement against all odds: Over the past five years, during a crippling economic downturn, the company that is now DineEquity Inc. bought the Applebee's Neighborhood Grill & Bar chain for $2 billion and set out to sell roughly 475 company restaurants.

The goal — to become an almost entirely franchised chain, similar to sister brand IHOP — was accomplished at the end of 2012.

The company also rolled out a comprehensive remodel program, asking franchisees to invest between $200,000 and $225,000 per restaurant in a badly needed reimaging of the brand. About 66 percent of the system has been revamped, and the remainder is expected to be done by the end of 2014.

Now, the Glendale, Calif.-based company is turning to a new challenge: Applebee's domestic development.

"When we made the acquisition, we were very clear at the time that for the first couple of years, we actually didn't anticipate any development because we wanted the franchisees to focus on the remodel," DineEquity chief executive Julia Stewart said during an Oct. 29 call with analysts. "It probably took a little longer for us to build up that pipeline than we anticipated." When asked whether Applebee's unit growth would reaccelerate, however, Stewart said, "I think your assumptions are fair going forward."

And with a growing number of restaurant chains in the midst of similar comprehensive refranchising plans, eyes will be on Applebee's – the nation's largest casual-dining chain – to see how it fares.

Poised for the push Reigniting that growth will not be easy. With the casual-dining sector still weakened by the sputtering economic recovery and the increasingly competitive landscape, the return to new growth has come more slowly than Stewart expected.

In October, the company downgraded its expectations for new openings this year, saying franchisees will open between 25 to 30 new units in 2013, as opposed to the 40 to 50 previously projected.

“We were a little aggressive in that first year on getting back into the business mode, so we revised guidance downward,” said Stewart in an interview with Nation’s Restaurant News a few days after the conference call. “Since 2010, when we began the remodel process, franchisees have been building about 24 to 34 restaurants a year, so it’s not as if they’ve stopped developing. But certainly development has slowed.”

Considering closures along the way, however, the chain has added a net of only 10 locations over the past five years. Applebee’s ended 2008 with 1,875 domestic locations, growing to 1,885 by the end of 2012.

Of course, franchisees have been busy with other projects in the ongoing effort to make the brand more relevant.

The company has streamlined and almost completely overhauled the menu, changing or upgrading 90 percent of dishes. Applebee’s has also made a big push into late night, and this year launched a partnership with ESPN Zone to enhance Applebee’s bar areas as the neighborhood gathering spot for sports watchers.

More recently, the Kansas City, Mo.-based chain announced the planned roll out of touch-screen tablets that will give guests the opportunity to order and pay at the table – a move designed to help attract technology-loving Millennials.

And franchisees have been largely devoting available capital to the remodel, which was a high priority, said Stewart.

“The average franchisee owns about 50 restaurants, and they’re spending a fair amount of capital to remodel,” she said. “Applebee’s had never really had a major meaningful exterior remodel, and we really wanted that focus.”

Shifting gears

With the end of the remodel period in sight, now the opportunity is to pick up the pace of growth, she said. Over the next few years, the company would like to see the domestic system reach at least 2,000 units, which is a modest goal — and one the chain has neared before when it ended 2007 with 1,976 units.

In a move to generate excitement about future possibilities, the company is testing a new prototype model that Stewart calls “an evolution of the remodel.”

Saying details will be revealed next year, the new model is designed to offer franchisees flexibility to incorporate various operational and service aspects that are also being tested or are in the works – such as the tabletop tablets, or previously announced tests of fast-casual-style express service at lunch. The prototype is also being designed as a less expensive investment, said Stewart.

“There are a lot of things that the new prototype can flex in and flex out,” she said. “We feel good about it, and certainly the early evaluation and feedback has been very positive.” Franchise attorney Michael Daigle with Cheng Cohen LLC in Chicago said the notion of a flexible growth vehicle is a smart next step.

“Typically, when you get to a point where the franchisee base has reached capacity, or operators are comfortable with the number of units they have, they’ll either look for a new brand, or look for a new territory or a new model,” he said.

In recent years, existing Applebee’s operators that have been growing their size have done so largely by acquisition. The refranchising efforts allowed both existing and new operators to pick up company locations, and, in some cases, franchisees bought out other franchisees.

In October, for example, franchise operator Thomas & King Inc. announced an agreement to sell 80 Applebee’s in Kentucky and Arizona to RMH Franchise Corp. Terms were not disclosed, but the deal will more than double RMH’s count to 140 units. In August, Doherty Enterprises Inc. acquired 38 Applebee’s in Georgia and Florida from Gator Apple LLC, bringing Doherty’s count to about 100. Last year Argonne Capital Group LLC doubled its holdings by picking up 50 Applebee’s from seller Casual Restaurants Concepts Inc. and CRC II LLC. The deal also included development rights in the Florida cities of Tampa and Orlando.

To some extent, such M&A activity has delayed new growth as development plans are extended while the transactions come to fruition.

And they have shrunk Applebee’s’ franchisee base, placing the burden of growth on a smaller number of groups.

When Applebee’s was acquired in 2007, the company worked with 43 franchise operators, each operating about 20 restaurants on average. Now, Applebee’s has 37 franchise operators, each with about 50 restaurants on average.

Some see that as a positive, especially for a brand undergoing so much change.

“Having fewer franchisees can help a franchisor execute faster and better,” said Agustin Carcoba, president and chief executive of franchise lender GE Capital, Franchise Finance, or GEFF, based in Scottsdale, Ariz. “When you have a more fragmented system, it’s difficult to execute. And today, [being] nimble wins.” Stewart sees the resulting crop of franchisees as “financially sophisticated and savvy,” giving the brand a distinct advantage.

“Their capital capability and their infrastructure capability is very positive,” said Stewart. “As you can see, we’ve remodeled an entire system in less than four years. The franchise agreement calls for six years and they basically did it in four, and that has everything to do with their capability.”

Franchisee fueled

The largest of the bunch by far is Apple American Group, based in San Francisco, which owns about 450 Applebee’s restaurants.

Greg Flynn, Apple American’s chair and chief executive, said his group will open 13 new Applebee’s this year – almost half of all new units planned for the system. Among them is a 12,000-square-foot flagship in a high-volume location on San Francisco’s Fisherman’s Wharf, which opened earlier this year.

Flynn is planning another 16 new openings in 2014, along with completing the final 70 remodels for his system – an investment that has cost about $85 million over three years, but is money well spent, said Flynn. “We’ll see the return for many years on that investment.” Some franchise advisors see risks associated with particularly large operators within a system.

“The bigger the franchisee, the more power they’ll be able to wield,” said Daigle. “If a large franchisee that represents, say, 10 to 20 percent of a system decides they’re not playing along, your system is more likely to be impacted.” Before DineEquity bought the chain, that was a concern. Previous owners limited Flynn’s group to ownership of no more than 11 percent of the system.

That limit disappeared under the current ownership. Apple American this year was named the chain’s franchise operator of the year.

Said Flynn, “They are very rightly judging franchisees by what they can do, rather than what they are.” Meanwhile, Flynn has diversified his holdings. Last year, he became a Taco Bell franchisee, creating a second division under the Flynn Restaurant Group called Bell American Group.

With both casual-dining and quick-service brands in his portfolio and sales that have surpassed $1 billion, now the franchise operator is looking for a third concept in the fast-casual space – yet to be determined.

Still, Flynn is a passionate believer in Applebee’s and the future of “sit-down dining with liquor” in general.

“There are challenges within our business, but we are very well positioned to compete,” he said. “I’m certainly putting my money where my mouth is.” While Applebee’s revitalization is still a work in progress, the brand has outperformed its peers in recent quarters, according to data from performance tracking firm Knapp Track.

For the third quarter, Applebee’s same-store sales decline of 0.4 percent beat the segment decline of 2.4 percent, according to Knapp Track.

And Applebee’s annual comparable-store sales have been positive since 2010, despite a few negative quarters.

Stewart said the work the company has been doing over the past five years has helped the brand maintain its No. 1 position in casual dining, and the strategy is to stay there.

“There’s only three ways to grow market share: You build new restaurants; you have advertising gains or share of voice; or you have organic growth,” she said. “Our goal is to be doing all three.”

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