

# A Good Year

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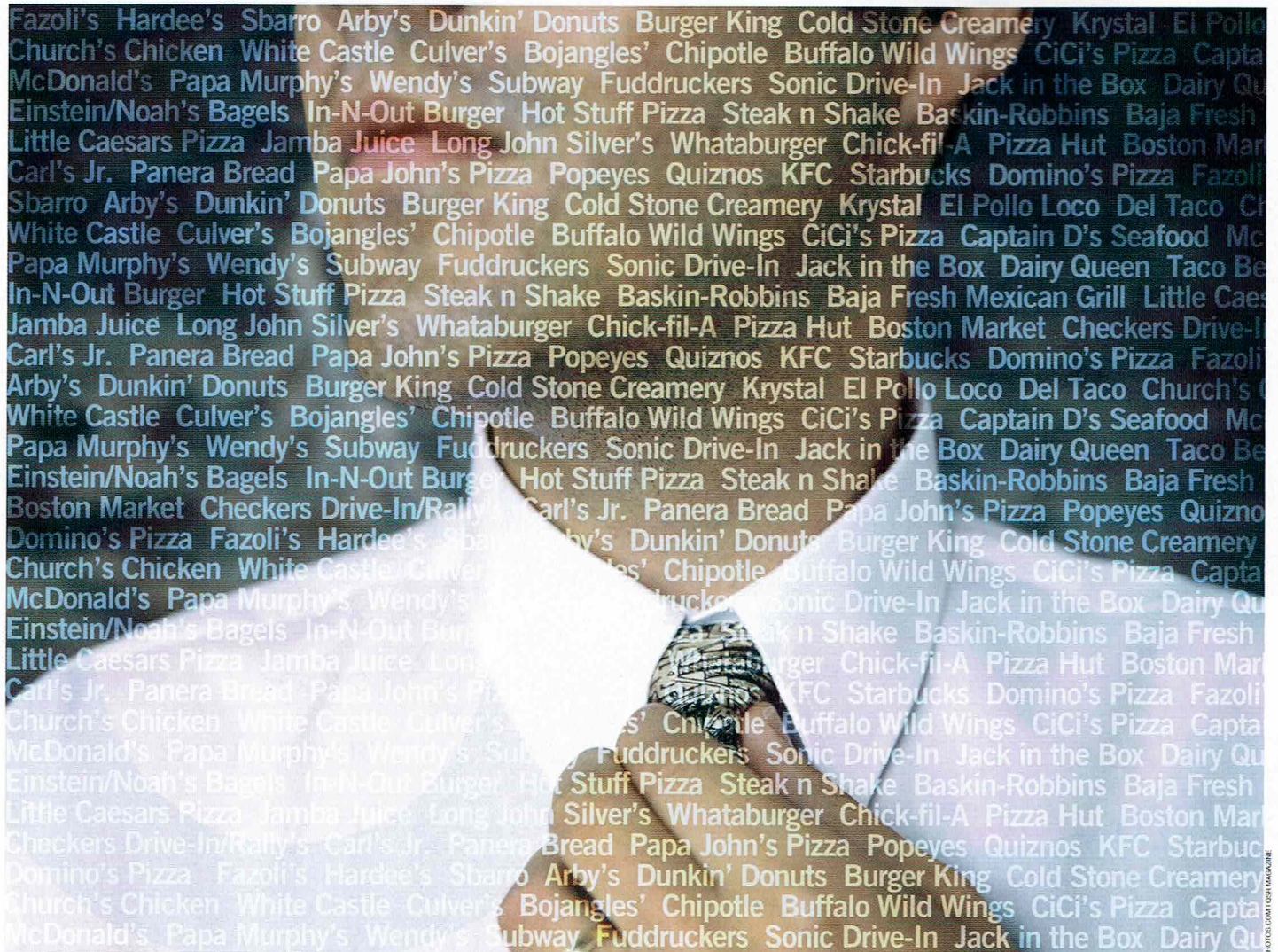


PHOTO: GUY WATKIN

**>>> The last several years in quick-serve have been nothing if not challenging. McDonald's, Burger King, and Wendy's have all taken turns struggling to attract customers.** The fast-casual movement

has added more choice to the segment and changed the menus at many a traditional quick-serve. The low-carb craze and the healthy choice movement have had R&D departments humming at full steam. It's nice to know, however, that for the most part, 2004 reflected positive results for all of those efforts.

According to the National Restaurant Association (NRA), the quick-service segment ratcheted \$128.2 billion in sales last year, an impressive increase of 5.9 percent. The segment's top chains gained 7.6 percent. Twenty-two of those companies appearing in the QSR 50 had double-digit systemwide sales increases while only four experienced declining figures. Last year, only 15 of the top 50 had

double digit increases and 10 had decreases. This was a good year.

Starting at the top, there is little doubt that McDonald's Corporation's Plan to Win is working. Almost three years ago, then-CEO Jim Cantalupo declared a battle plan to slow unit growth and focus on rebuilding existing stores. In 2004, the McDonald's U.S. system gained 10.3 percent in sales and 11.8 percent in annual unit volumes (AUV) on top of the 8.9 percent and 6.2 percent gains in 2003. That annual unit volume increase was the third largest of the QSR 50. At the same time, units grew by a paltry half percent last year. The world's largest restaurant chain showed everyone once again how they achieved that status.

As evident from January's announcement that the company is pursuing "strategic alternatives" for its Chipotle chain, McDonald's is still focused on Cantalupo's plan. Chipotle continues to show its Mexican fast-casual competitors how it's done with GE Commercial Finance, Franchise Finance (Geff) estimating [continued on page 46]

[continued from page 38] of over 40 percent growth in system sales and 34 percent growth in units in 2004, on top of sales growth of 38 and 31 percent the last two years. Chipotle had the highest jump on the QSR 50 from 45th last year to 34th this year. It is hard to imagine that McDonald's CEO Jim Skinner's phone hasn't been ringing off the hook from potential Chipotle suitors.

As analyst Mark Kalinowski predicted early last year, 2004 was the year that Wendy's took over the number two spot from the venerable Burger King. According to QSR 50 partner GEF, Wendy's edged out the King by \$12 million in systemwide sales. Even so, GE's estimates indicate no growth in annual unit volumes at Wendy's, and certainly the company struggled with negative or small same-store sales increases last year. It appears that Wendy's systemwide sales increase of 3.1 percent was largely due to a 3 percent increase in units.

One of the main problem areas at Wendy's corporate is the Baja Fresh chain. After systemwide sales growth at 40 and 26.5 percent and over 30 percent unit growth in 2002 and 2003, the once up-and-coming Baja Fresh slid 10 percent in sales last year and grew units by only 4 percent. Baja Fresh CEO Greg Dollarhyde was replaced with Panera Bread CFO Bill Moreton in April 2004. Moreton then left in April of this year and was replaced by Wendy's veteran and Cafe Express CEO Brion Grube. Baja Fresh is at 47 on the QSR 50, but with growing chains pushing in from the bottom, it is quite likely the Fresh Mex chain will fall out of the top 50 next year. Add to that this spring's "finger incident" in California and the rumors in May that buyers might be looking at Wendy's, and it is not a stretch to predict another, maybe an even more, challenging year at Wendy's.

Burger King, on the other hand, probably doesn't look as good in the QSR 50 listing as it actually was in 2004. Beginning in May, same-store sales increases were in the high single digits through year-end and even hit double digits in July and December. The introduction of new menu items such as the Angus Steak Burger and TenderCrisp Chicken Sandwiches, along with rather quirky advertising for both, seemed to elevate stores that really needed a boost. Burger King's decrease in systemwide sales is likely the effect of a continued decline in units as the weak are weeding themselves out. One must also take into account that 2004 brought in a new CEO, president, chief concept officer, chief financial officer, general counsel, and at least six other vice presidents or higher executives.

Burger chains hit a stride in 2004 despite the pressure from the healthy food advocates. Sonic continues its steady growth with units and AUVs of around 7 percent leading to systemwide sales growth of around 14 percent. CKE Restaurant's Carl's Jr. and Hardee's posted annual unit volume increases of 9.6 and 8.8 percent, respectively. Checkers Drive-Ins is doing something right with its existing stores with system sales growth of 18 percent and annual unit volume increasing 17.5. Bottom line: We still love our burgers and fries.

The struggle at KFC seems to have no end. KFC's 2004 system

sales were up a slight 2 percent but AUVs and unit growth were a little less than flat. The chain is doing quite well in China, but U.S. competitors Popeyes, Church's, and Bojangles' beat out the dominant KFC by adding 4.6, 4.7, and 11.6 percent, respectively, to their system sales. Parent company YUM! Brands has even taken KFC out of its much ballyhooed co-branding strategy. With Popeyes and Church's now under separate ownership, it's likely both will continue to make ground on KFC in the near future.

One thing that stands out on the QSR 50 this year is the terrific growth of the snack segment. Starbucks was up 38 percent in systemwide sales, 11 percent in AUVs, and more than 22 percent in unit counts. That follows two years of more than 20 percent sales growth in a time when coffee consumption in general is still waning.

In another case of an old-timer being reinvigorated, Dunkin' Donuts increased systemwide sales by 15 percent and units by almost eight. The company is now fully exploiting its role in the coffee market, and it appears Dunkin' Brands CEO Jon Luther and company are beginning to understand how to compete with Starbucks. Dunkin' has a lot of room to grow outside its native Northeast, so don't expect this old-timer to slow down anytime soon.

New to the QSR 50 this year are Jamba Juice and Cold Stone Creamery. Jamba Juice's 22.5 percent sales increase and, more importantly, 27 percent increase in AUVs might indicate it's taking advantage of the health consciousness thing. Hey, you've got to have something to drink with those burgers and fries.

Health consciousness only goes so far, or at least that's the impression one gets considering the big winner this year is Cold Stone Creamery. Units have grown by over 60 percent in each of the last two years. Systemwide sales were up 86 percent in 2004 on top of a 72.7 percent increase in 2003. In 1999, Cold Stone had 74 stores but the company reached unit number 1,000 in early May.

Buffalo Wild Wings seems to be putting its initial public offering proceeds to good use. System sales increased 40 percent off of unit growth of 25 percent and an AUV increase of almost 11 percent. Expect these figures to cool a bit in 2005 given the recent announcement that same-store sales increases would be slowing.

On the close-but-not-quite side, Jason's Deli is making a rapid claim for QSR 50 recognition. Sales were up 19 percent on a 10.5 percent AUV increase and 8 percent unit count increase. The company has been growing at impressive rates over the last several years, so expect Jason's to enter the big list next year.

Another impressive performer just outside the 50 is Cheyenne, Wyoming-based Taco John's. The chain has kept its unit base in check the last few years, increasing stores by only 1.7 percent in 2004 while it focused on improving operations, food, and marketing. Vice President of Marketing Brian Dixon says Taco John's has focused a lot of attention on drive-thru operations leading to both speed and accuracy improvements over the last two to three years. On the food side, the Grilled Burritos introduced last year led to double-digit same store sales increases for several months. The "Fresh Taste of West Mex" advertising campaign featuring Whiplash the Cowboy Mon-

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key has helped, too. The results of these efforts were a 15 percent increase in systemwide sales and an 11 percent increase in annual unit volumes.

On the other end of the spectrum, Schlotzsky's and Blimpie both fell from the QSR 50 with 19- and 10-percent sales declines, respectively. Schlotzsky's went through a battle in 2004 that led to the ouster of John and Jeff Wooley from executive management, the brief appointment of David Samuel Coats as interim CEO, a 20 percent reduction in corporate staff including most of the executive team, the closure of more than a dozen corporate stores, the filing of Chapter 11 bankruptcy protection, and finally the sale of all company assets to Bobby Cox Companies, Inc. this January. The chain started fresh in 2005 with Bobby Cox as chairman, Bob Barnes as president, and Ronny Jordan as chief financial officer. In a January press release, Barnes reported, "Everyone is enthusiastic about the tremendous opportunities ahead." Perhaps 2005 will be the year Schlotzsky's slows or halts the slide with a view toward growing again.

Blimpie is trying to get back on track as well. With Subway building on every corner in an admittedly self-cannibalizing strategy to win the world, Blimpie has found itself struggling for position, losing 10 percent in system sales in 2004 on top of 12 percent and 9 percent decreases the previous two years. There is a bright spot in the 2004 figures: AUVs increased 4 percent, according to GEF. Blimpie is moving its menu upscale by adding three new grilled ciabatta sandwiches. The goal is to bring Blimpie more in line with fast-casual fare while keeping the value price point.

The National Restaurant Association projects that the quick-service segment will grow at a somewhat slower pace of 4.7 percent to around \$134.2 billion in sales for 2005. That is about the same growth rate as in 2003. The NRA's survey of operators indicates that the existing unit focus is still in vogue considering remodeling, training, and technology upgrades all outrank unit expansion in projected capital expenditures. It worked last year for a lot of the traditional chains so don't be surprised to see it continue to pay off.

## The Next Fifteen

Rank	Chain	2004 Systemwide Sales (IN MILLIONS)	2004 Change In System Sales	2003 Systemwide Sales (IN MILLIONS)	Total Units
51	Jason's Deli	\$280.0	19.1%	\$235.0	136
52	Schlotzsky's Deli	\$265.0*	-19.0%	\$327.0	445
53	Hungry Howie's Pizza & Subs	\$247.0	8.8%	\$227.0	491
54	Auntie Anne's	\$236.2	0.1%	\$236.0	679
55	Taco John's	\$234.1	14.9%	\$203.8	411
56	Wienerschnitzel	\$230.1	4.6%	\$219.9	345
57	Blimpie Subs	\$225.0	-10.0%	\$250.0	1,407
58	Au Bon Pain	\$224.9	8.0%	\$208.3	202
59	Taco Cabana	\$216.1	11.2%	\$194.4	133
60	A&W Restaurants	\$200.0	0.0%	\$200.0	469
61	Corner Bakery	\$180.5	12.4%	\$160.6	86
62	Atlanta Bread Company	\$177.5	8.1%	\$164.2	166
63	Donatos Pizza	\$171.0	-2.3%	\$175.0	175
64	Togo's Eatery	\$167.0	-7.2%	\$180.0	420
65	Cinnabon	\$163.9	-3.4%	\$169.7	400

\* Includes figures estimated by GEF, Technomic, or QSR. DND = Did Not Disclose. SOURCE: GE Franchise Finance, Technomic Information Services, QSR

## Top 10 Fast-Casual Chains By Systemwide Sales

Rank	Chain	2004 Systemwide Sales (IN MILLIONS)	2004 Change In System Sales	Sales Per Unit (000s)	2004 Units
1	Panera Bread	\$1,241.2	27.1%	\$1,872.4	741
2	Buffalo Wild Wings	\$511.4	40.1%	\$1,909.0	306
3	Chipotle	\$480.0*	43.3%	\$1,200*	409
4	Fazoli's	\$370.1	-6.1%	\$983.0	375
5	Einstein/Noah's Bagels	\$345.0	-3.1%	\$776.0	506
6	Fuddruckers	\$340.3	15.7%	\$1,418.0	240
7	Baja Fresh Mexican Grill	\$305.0*	-10.3%	\$1,200.0*	295
8	Jason's Deli	\$280.0	19.1%	\$2,125.0	136
9	Au Bon Pain	\$224.9	8.0%	\$1,113.5	202
10	Corner Bakery	\$180.5	12.4%	\$1,842.0	86

\* Includes figures estimated by GEF, Technomic, or QSR. DND = Did Not Disclose. SOURCE: GE Franchise Finance, Technomic Information Services, QSR