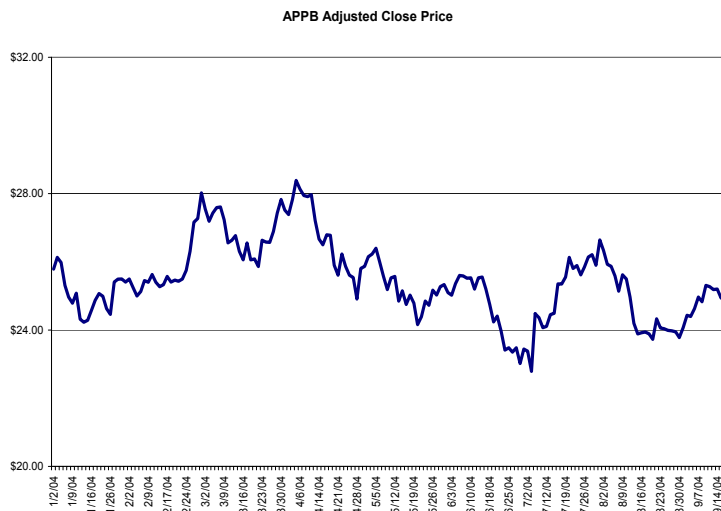




Applebee's International (APPB)



Rating

Target Price
Market Price

Hold

\$27.5
\$25.0

Trading Data

52-wk range	\$22.26 - \$28.55
Market cap.	\$2.03 Bill
Shares o/s	81.1 Mill
Avg. daily volume ('000)	706

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Highlights

- We project total sales increasing 8.5% annually for the next four years as Applebee's grows to an expected 2,300 units from a current level of 1,600. We expect the company to add around 100 units annually with about 70%-75% of the units franchised.
- Based on our DCF model that incorporates the growth rate previously mentioned, the stock is trading near intrinsic value. Our 12 month target price of \$27.5 is in line with current market valuation.
- The company is the industry leader in terms of profit margins and return on equity.

Please see the disclaimer at back of this report for important information

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Company Overview

Applebee's International, Inc. (APPB) with nearly 1,600 restaurants under the name "Applebee's Neighborhood Grill & Bar" is "the largest casual dining concept restaurant in America, in terms of number of restaurants and market share."¹ Applebee's restaurants are designed as neighborhood establishments offering a selection of moderately priced food and beverages items appealing to families and adults. They feature a selection of entrees, including beef, chicken, pork, seafood and pasta items, as well as appetizers, salads, sandwiches, and desserts. The average check in company-owned markets is \$10 to \$10.5. Alcoholic beverages accounted for 13.1% of 2003 company-owned restaurant sales.

The Company operates with a business model based on growth by franchising (around 80% of their restaurants) and complementing their operation with company operated restaurants. The Company defines its strategy as to strengthen the "Applebee's concept." Their expectation is that the system will have 2,300 restaurants in the United States.

Economic Environment

The casual dining segment is a fragmented industry that has been growing at a 10.7% CAGR since 1992. The top 100 restaurants have grown at an 11.8% CAGR during the same period. The most rapid growth period occurred during the early 1990s as many new concepts received funding, driving aggressive new unit growth. We expect the casual dining segment to continue benefiting from many of the trends that have driven growth thus far. Through October 2004, the S&P Restaurants Index was up 12.4% versus a 0.9% decrease for the S&P 500.

Sales drivers

Restaurant industry sales are driven by new unit growth and same-store sales, which depend of lifestyle trends, demographics, disposable income and personal consumption patterns.

Positive lifestyle trends. Americans are working longer hours than ever before, there are more dual-wage earner families, and single parent families. Less leisure time benefits restaurants against grocery sales.

Demographics help. The sector will benefit from the 82 million Americans considered Baby Boomers (aged 40-57) who are in their peak earning years and tend to be casual dining consumers.

Disposable income. Different factors that influence consumer's income such as unemployment rates, wage rate growth, cost of consumer expenditures (mostly gasoline and utilities), housing appreciations, and taxes influence restaurant sales growth.

¹ 10-K for FY 2003.

Revenues

Applebee's' total revenues are divided in three categories: company restaurant sales, franchise royalties and fees and other franchise income. During the past three years, company restaurant sales have represented over 87% of total revenues, while franchise royalties and fees and other franchise income have represented 12% and less than 1% on average, respectively.

Comparable restaurant sales at company restaurants increased by 5.2% in 2003, due primarily to increases in guest traffic and in the average guest check. The Company estimates that approximately 1.5% of the increase resulted from price increases and the To Go initiative. Additionally, the implementation of the "Carside To Go" program² grew from 5% of sales in 2002 to 7.1% in 2003.

Expenses

Applebee's has effectively used savings from efficiencies and scale to offer low prices in the casual dining segment. During the past four years Applebee's has consistently achieved savings in its food costs. In this period many of the top managers were put in place by CEO Lloyd Hill. Even as portion sizes were increased, food costs as percentage of total sales decreased. The Company mandates quality standards for all products used in the restaurants, and maintains a limited list of approved suppliers from which they and their franchisees must select. They have negotiated purchasing agreements with most of their suppliers which result in volume discounts for them and their franchisees. Applebee's is also implementing a multi-year supply management initiative started in 2001 which will potentially assist them in reducing inventory and distribution costs.

Cost of sales as % of revenues

	2003	2002	2001
Food and Beverage	26.0%	26.6%	27.0%
Labor	32.7%	32.9%	32.1%
Direct and Occupancy	25.0%	25.1%	25.3%
Pre-opening expense	0.2%	0.3%	0.3%
Total cost of sales	83.9%	84.9%	84.7%

Source: company's 10K

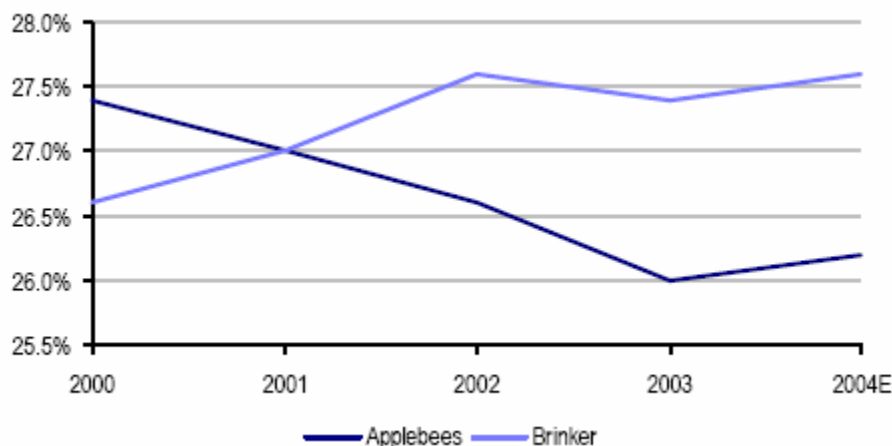
Food and beverage costs decreased from 26.6% in 2002 to 26% in 2003 due primarily to menu price increases and operational improvements resulting from supply chain management initiatives.

² Carry out program in implementation.

Labor costs decrease was due to lower hourly costs due to higher sales volume at company restaurants and was partially offset by higher costs related to the addition of dedicated To Go hourly labor during the second half of 2003 and higher workers' compensation costs.

Direct and occupancy decreased thanks to lower rent expense and depreciation expense, as percentage of sales, and was partially offset by higher insurance costs and higher packaging costs related to the To Go initiative.

Food costs as percentage of total sales



Source: Company reports and UBS estimates.

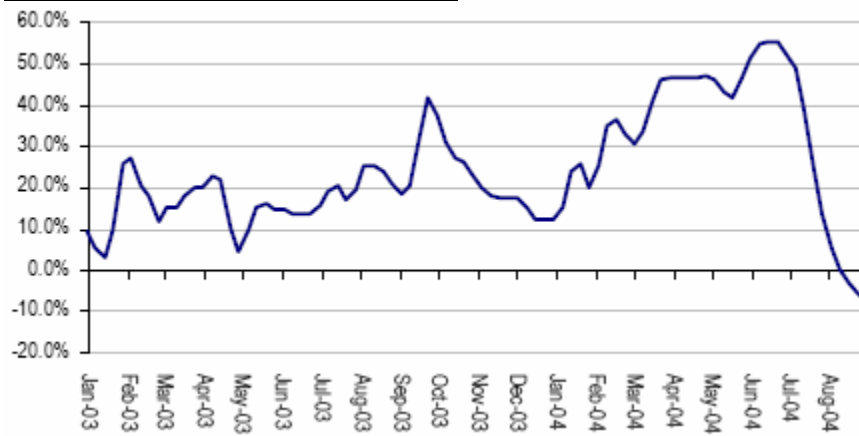
This efficient management of costs allows them to earn higher margins than competitors what translates into higher return on equity.

Company	ROE	Pre tax margin
BOBE	12.1%	9.3%
EAT	14.2%	6.4%
RYAN	14.7%	9.3%
CEC	18.2%	17.7%
CHUX	8.0%	4.1%
OSI	17.0%	9.6%
STAR	6.5%	6.7%
RARE	13.0%	9.2%
CAKE	13.8%	11.5%
LNK	7.8%	5.2%
DRI		
Average	12.5%	8.9%
Applebee's	20.4%	14.8%

Source: S&P report on Applebee's, November 9, 2004.

Over the past few months prices for chicken and some beef cuts have gone down. Chicken prices are down 30% since May highs and below 2003 levels.

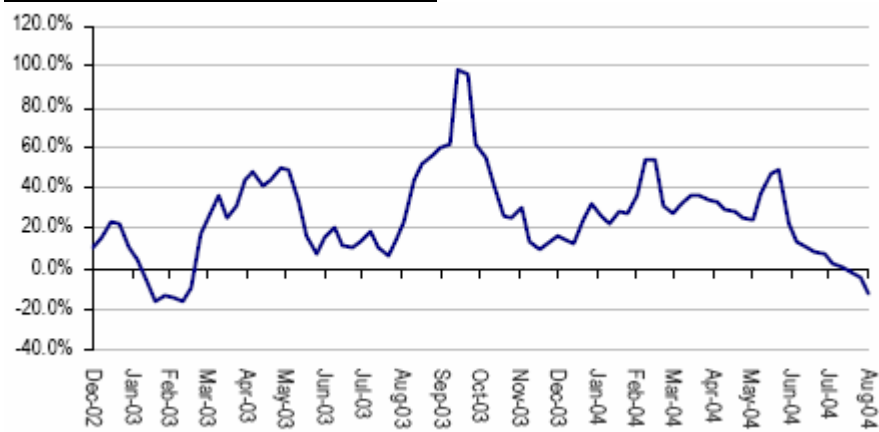
Chicken food costs - YoY % change



Source: Umer Barry.

Steak prices are down around 46% since May highs.

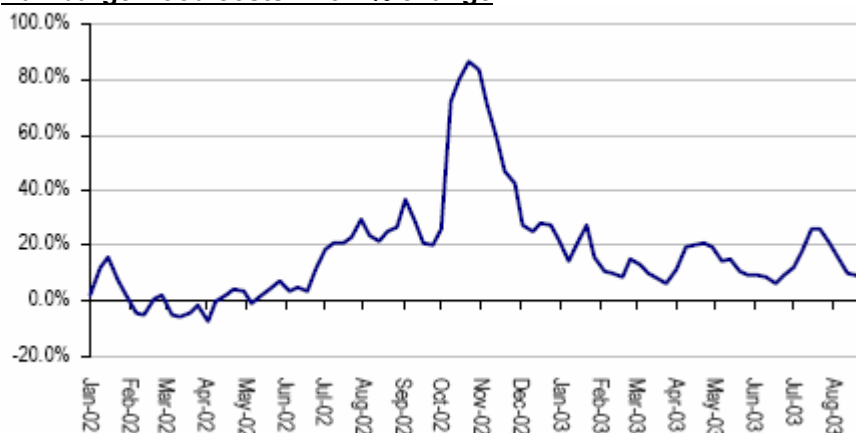
Sirloin food costs - YoY % change



Source: Umer Barry.

Hamburger prices are still above year ago levels.

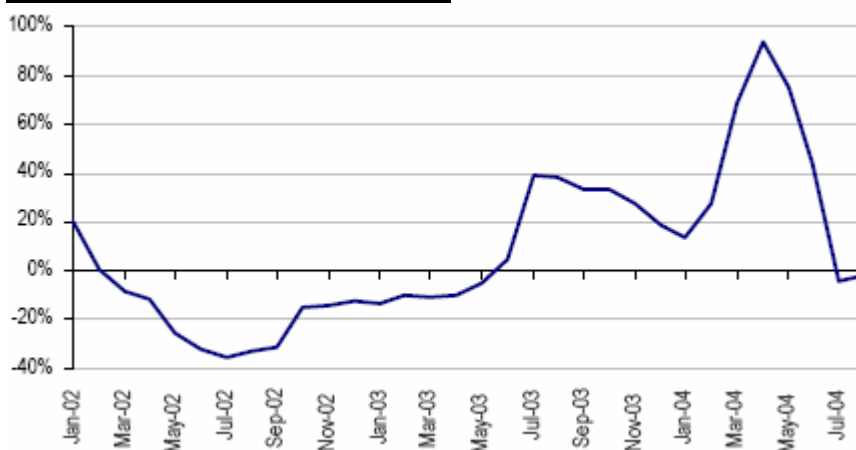
Hamburger food costs - YoY % change



Source: Umer Barry.

Cheese costs are down 27% compared to April highs.

Cheese food costs - YoY % change



Source: Umer Barry.

With the cost of commodities coming down in real basis, we will see a real increase in gross margins in all the companies of the sector; however, for our valuation, we considered that in the long term the company would operate with cost of goods sold in similar percentages than in the past³.

³ Please refer to the "Valuation" section for further details.

Valuation

DCF analysis

Our DCF model gives a price of **\$27.5**, slightly above current market price.

Revenue Projections

To project future revenues we decided to start by testing how accurate had management projections been in the past. This would give us a sense of how reliable these projections are. Table 1 summarizes our findings for the past four years.

Table 1

	2000	2001	2002	2003
<u>Management projections</u>				
Franchisees	90-100	80-90	80-90	70-80
Company owned	26	25	25	25
Total Change	116-126	105-115	105-115	95-105
<u>Change in # restaurants</u>				
Franchisees	95	81	78	65
Company owned	23	25	26	24
Total Change	118	106	104	89

Source: 10K for years 2000, 2001, 2002, 2003

In general, management's projections had been a good indicator of the number of new restaurants the company opened in following years. Today management forecasts say that a few years from now (they do not specify how many) there will be a total of 2,300 Applebee's restaurants in the United States. We think that goal is achievable. Compared with the number of restaurants other firms operate, with 2,300 units Applebee's will be in the upper end of the range (all other comparable companies not shown in this table operate less than 500 restaurants).

<u>Comparable companies restaurants</u>					
	<u>CKE Restaurants</u>	<u>Denny's</u>	<u>Friendly</u>	<u>Brinker</u>	<u>Outback Steak.</u>
Number of restaurants	3,225	1,600	540	975	825

Sustainable growth rate is the rate at which a firm can grow while keeping its profitability and financial policies unchanged. A firm's return on equity and its dividend payout policy determine the pool of funds available for growth. Therefore, the sustainable

growth rate provides a benchmark against which a firm's growth plans can be evaluated. Applebee's sustainable growth rate is around 19.6% (see appendix 1 for detailed calculations).

As of December of 2003 there were 1,585 Applebee's restaurants, 1,202 franchised and 383 owned by the company. We expect that the company will continue its growth strategy of opening around 100 restaurants per year over the following four years, and then reduce the growth rate to reach the projected number of 2,300 restaurants.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Change in #restaurants	104	100	100	100	80	80	80	25	25	25
Franchisees	74	75	75	75	60	60	60	20	20	20
Company owned	30	25	25	25	20	20	20	5	5	5
Total #restaurants	1,689	1,789	1,889	1,989	2,069	2,149	2,229	2,254	2,279	2,304

In order to check how sensitive the stock price was to the growth rate of the number of restaurants we calculated the stock price assuming that the increase was 100 for years 2008, 2009 and 2010. We found that, keeping other things constant, the stock price would increase only by around \$0.10 – \$0.15.

We calculated revenues per restaurant to determine how much would total revenues increase when opening new units.

Annual sales per restaurant (000)

	1999	2000	2001	2002	2003
Franchise	80.39	84.65	86.16	89.71	91.38
Company owned	2,277.69	2,124.26	2,100.38	2,029.74	2,264.12
Sales per restaurant	2,358.07	2,208.91	2,186.54	2,119.45	2,355.50

In our projections we used \$80.39 for new franchised restaurants and \$2,029.74 for new company owned restaurants. Had we used average annual sales (\$86.46 and \$2,159.24) the stock price would have been around \$0.60 higher.

In terms of same store sales growth we did not find any evidence that would lead us to think that restaurants will become more efficient in some way that would allow them to grow faster. We assumed that GDP growth rate of 3% would be adequate. This is consistent with the average same store sales growth for the past 10 years of 3.5%.

Overall we are projecting an average total revenue growth rate of 8.5% for the next four years decreasing to 3.7% in year 10.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Company restaurants sales	956,477	1,037,924	1,121,815	1,208,223	1,286,672	1,367,475	1,450,702	1,504,773	1,560,467	1,617,832
Growth	10.3%	8.5%	8.1%	7.7%	6.5%	6.3%	6.1%	3.7%	3.7%	3.7%
Franchise royalties and fees	119,077	128,678	138,568	148,754	158,040	167,605	177,456	184,388	191,527	198,881
Growth	8.4%	8.1%	7.7%	7.4%	6.2%	6.1%	5.9%	3.9%	3.9%	3.8%
Other franchise income	13,410	13,678	13,952	14,231	14,515	14,806	15,102	15,404	15,712	16,026
Growth	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
NET SALES	1,088,963	1,180,281	1,274,335	1,371,208	1,459,228	1,549,886	1,643,260	1,704,565	1,767,707	1,832,739
Growth	10.0%	8.4%	8.0%	7.6%	6.4%	6.2%	6.0%	3.7%	3.7%	3.7%

Given that the stock price is sensitive to changes in same store sales growth rate and to size of Cost of Good Sold as percentage of total revenues we ran a sensitivity analysis using these two variables.

		COGS / Revenues		
		73.3%	73.8%	74.4%
<u>Same Store Sales growth</u>	1.5%	\$ 25.01	\$ 23.06	\$ 20.73
	3.0%	\$ 29.66	\$ 27.48	\$ 24.86
	4.0%	\$ 33.07	\$ 30.72	\$ 27.90

Historically COGS has been between 73.3% - 74.4% of total revenues and our analysis on expenses (see Expenses section) leads us to believe that in the future costs will be closer to the lower end of that range. As we said previously we feel comfortable assuming a same store sales growth rate of 3% so our DCF price would be \$27.5.

P/E Valuation

We did two valuations based on P/E ratios, the first one was based on the average of a set of comparable companies⁴ and the second one was based on the historical P/E ratio observed by Applebee's. Overall, P/E valuation shows that the company is **fairly valued** in the market.

Comparable companies P/Es

Company	P/E
BOBE	13.6
EAT	26.7
RYAN	13.0
CEC	18.9
CHUX	19.9
OSI	18.7
STAR	21.8
RARE	21.6
CAKE	41.0
LNK	14.5
DRI	19.3
Average	20.8

Applebee's	19.3
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In terms of comparable companies PE Applebee's appears to be slightly undervalued.

Historic P/Es

This valuation is based on the idea that a company has intrinsic characteristics that provides its growth and returns perspectives. Since those characteristics are assumed constant, then the P/E multiple at which it trades should remain constant too. Therefore, if the historic average is above the current P/E of Applebee's, that would reflect that the company is undervalued and should be bought or sold otherwise.

Using historic P/Es for Applebee's since January 1999, we obtained an average multiple of 17.4X. The current multiple for the company is 19.3X, therefore, under this criterion, the company is overvalued.

Overall, P/E valuation shows that the company is fairly valued in the market.

⁴ See appendix for explanation of how we determined which were best comparable companies and their business description.

Testing the strategy

In order to verify that this type of valuation provides a meaningful indication of whether the stock should be sold or bought, we collected information on the monthly P/Es of the comparables since January 1999. With these values, we calculated the average P/E and compared it to the one observed for Applebee's at that time. If Applebee's was trading below the average, we concluded that the stock should be bought and kept for a 12 month period (the horizon of our recommendation,) otherwise, the stock should be sold short for the same period.

The conclusion was that this strategy would result in a 1.15% average monthly return with a standard deviation of 10.45%⁵. This result can be compared with the 1.30% average monthly return we would have obtained by holding a portfolio of restaurants comparable to Applebee's (the standard deviation for this return would have been 6.01%).

⁵ Appendix 4. includes the investment strategy simulation and the mean and standard deviation of the returns.

Appendixes

Appendix 1: Sustainable growth rate calculation

	1999	2000	2001	2002	2003
ROA	12.3%	13.4%	12.9%	14.7%	14.5%
Financial Leverage	1.74	1.67	1.54	1.44	1.40
ROE = ROA*Financial Leverage	21.3%	22.4%	19.8%	21.1%	20.4%
Net Interest expense after tax	6,921	5,955	4,772	1,388	6,743
NOPAT	61,119	69,116	69,173	84,415	100,301
Operating WC	(45,626)	(54,176)	(52,451)	(60,902)	(80,412)
Net long term assets	405,382	416,770	432,412	496,535	557,379
Net Debt	105,883	80,876	54,778	43,052	17,235
Net Assets	359,756	362,594	379,961	435,633	476,967
Net Capital	359,756	362,594	379,961	435,633	476,967
Effective interest rate after tax	6.5%	7.4%	8.7%	3.2%	39.1%
NOPAT margin	9.1%	10.0%	9.3%	10.2%	10.1%
Asset turnover	186.1%	190.3%	195.9%	190.4%	207.6%
Operating ROA	17.0%	19.1%	18.2%	19.4%	21.0%
Spread	10.5%	11.7%	9.5%	16.2%	-18.1%
Net Financial Leverage	41.7%	28.7%	16.8%	11.0%	3.7%
ROE = Operating ROA + Spread*Net fin lev	21.3%	22.4%	19.8%	21.1%	20.4%
Total dividends paid	2,659	2,662	2,779	3,010	3,323
Dividend payout ratio	4.9%	4.2%	4.3%	3.6%	3.6%
Sustainable growth rate	20.3%	21.5%	18.9%	20.4%	19.6%
ROE*(1-Dividend payout ratio)					

Appendix 2 DCF Model

	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
EBITA	164,433	178,222	192,425	207,052	220,343	234,033	248,132	257,389	266,924	276,744
Taxes on EBITA	(60,929)	(66,038)	(71,301)	(76,721)	(81,646)	(86,718)	(91,943)	(95,373)	(98,906)	(102,544)
NOPLAT	103,504	112,184	121,124	130,331	138,698	147,314	156,190	162,017	168,018	174,199
Depreciation	61,663	67,371	73,280	78,686	84,282	90,075	96,071	101,543	107,207	113,070
WCR	(11,761)	4,699	4,864	4,450	4,606	4,768	4,936	4,504	4,662	4,826
Capex	(209,629)	(119,932)	(127,687)	(128,464)	(135,809)	(143,411)	(151,280)	(151,925)	(159,358)	(167,052)
FCF	(56,223)	64,322	71,581	85,003	91,778	98,747	105,916	116,138	120,529	125,043
PV FCF	437,045	19%								
Continuing Value	1,812,211	81%								
PV Firm	2,249,256									
Value of Debt	20,862									
PV Equity	2,228,394									
Shares outstanding	81,100									
Stock price	\$ 27.48									
Current price	\$ 24.99									
WACC	9.9%									
Growth	3.0%									

Assumptions for WACC calculation

Risk free rate	4.2%
D/E	5.0%
Beta	0.81
Cost of debt	4.4%
Tax rate	36.0%
Market premium	7.4%

Appendix 3 Comparables search

To determine the set of comparables that we used for the valuation with P/Es, we used the following methodology using the Hoover's database:

1. We did a search for Applebee's International and in the section "Pro Tools" we specified the following criteria:
 - a. That the company is US based
 - b. That it is a public company
 - c. Sales between 500 and 1500 MM
 - d. Casual dining segment

This search resulted in 14 companies out of which one has Applebee's.
2. We reviewed the "Comparables" section in Hoover's and obtained 3 companies under the category "Top Competitors" but one was eliminated because it was not a public

As a result we obtained the following set of comparable companies:

- CKE Restaurants (CKR)
- Bob Evans Farms (BOBE)
- Landry's restaurants (LNY)
- Ruby Tuesday (RI)
- Denny's Corporation (DNY)
- Ryan's Restaurants Group (RYAN)
- The Cheesecake Factory (CAKE)
- O'Charley's (CHUX)
- RARE Hospitality International (RARE)
- CEC Entertainment (CEC)
- Lone Star Steakhouse & Saloon (STAR)
- Friendly Ice Cream Corp (FRN)
- P.F. Chang's China Bistro (PFCB)
- Brinker (EAT)
- Outback Steakhouse (OSI)

Business descriptions⁶

- CKE Restaurants (CKR): Selling fast food is the M.O. of CKE Restaurants. The company is a leading operator of quick-service food chains with about 3,225 locations. Its restaurants include Carl's Jr. and Hardee's, two leading brands in the hamburger business, and La Salsa Fresh Mexican Grill, an up-and-coming player in the fast-casual Mexican restaurant segment. CKE also owns Green Burrito, a small fast-food Mexican chain. Many of the company's restaurants are located in California and other western states; its Hardee's outlets operate primarily in the Midwest and Southeast. CKE owns and operates more than a third of its restaurants; the rest are operated by franchisees.
- Bob Evans Farms (BOBE): Bob Evans Farms brings home the bacon and serves it at your table. The company is well-known for its meat and pork products served at more than 560 family-style restaurants. Popular for its breakfast menu, the chain also serves traditional American fare for lunch and dinner. The company's Bob Evans and Owens Restaurant locations operate in about two dozen states. In July 2004 the company acquired the 80-store casual-dining Mimi's Cafe chain for \$182 million. In addition to its restaurants, Bob Evans sells its Bob Evans and Owens Country Sausage brand meat products through grocery stores, along with Bob Evans branded frozen dinners. It also markets its food products to institutional and food service customers.
- Landry's restaurants (LNY): Landry's restaurant empire stretches from the surf to the turf. The #2 casual-dining operator specializing in seafood (behind Darden's Red Lobster chain), Landry's Restaurants operates more than 280 restaurants under a number of brands specializing in seafood and steaks. Its some 140 Joe's Crab Shack locations offer seafood and crab specialties amid an interior decked out with an eclectic collection of seashore flotsam, while its Chart House and Saltgrass Steak House units feature a wide range of red meat options. Other concepts include Rainforest Cafe (Amazon-themed casual dining), Charley's Crab, and its signature Landry's Seafood House. Chairman and CEO Tilman Fertitta owns more than 21% of the company.
- Ruby Tuesday (RI): Ruby Tuesday puts ribs under the thumbs of hungry street fighting men. The company, which takes its name from a Rolling Stones song, operates and franchises more than 700 casual-dining restaurants in about 40 states. The full-service eateries offer a varied selection of American and ethnic menu items, including fajitas, pasta, ribs, seafood, and steak. Other items include appetizers, burgers, and desserts. More than 475 Ruby Tuesday locations are company-owned; most of its franchised units are jointly-owned partnerships in which Ruby Tuesday has a minority stake. The company also has a small but growing number of international franchises.
- Denny's Corporation (DNY): Feel like getting slammed for breakfast? The home of the Grand Slam Breakfast, Denny's (formerly Advantica Restaurant Group) is the leading full-service, family-style restaurant chain in the US, with more than 1,600 of its signature eateries located across the country. Its family-

⁶ All the short business descriptions were taken from Hoover's

style restaurants are typically open 24 hours a day, 7 days a week, and serve breakfast, lunch, and dinner. The menu features a variety of breakfast items along with such standard fare as hamburgers, steaks, salads, and desserts. The company owns and operates more than a third of its restaurants; the rest are franchised or operate under licensing agreements.

- Ryan's Restaurants Group (RYAN): Whoever this Ryan is, he sure must like beef. Ryan's Restaurant Group operates and franchises about 350 of its signature restaurants primarily in the Midwest and Southeastern US. Its family-oriented eateries offer a variety of steaks, as well as chicken, seafood, and burgers. The chain is known for its Mega Bar buffet, which features salad items, soups, cheeses, hot meats, vegetables, hot rolls, and fresh-baked cookies and other desserts, all served from self-service islands scattered throughout the dining area. The company's sole franchisee is Family Steak Houses of Florida, which operates about 20 locations in the Sunshine State.
- The Cheesecake Factory (CAKE): The Cheesecake Factory's vast 19-page menu is perhaps the most baroque document in the restaurant industry. The company operates more than 70 casual-dining restaurants that offer some 200 menu items ranging from sandwiches and salads to steaks and seafood. The highlight of the menu, of course, is cheesecake, which comes in about 40 varieties, including Chocolate Tuxedo Cream and Kahlua Cocoa Coffee. Each unit sports a unique design, but all are characterized by over-the-top opulence and Las Vegas-style glitz. In addition to its flagship concept, the company operates three Grand Lux Cafes, licenses three limited-service bakery cafes, and sells its cheesecakes to grocery stores and food-service facilities.
- O'Charley's (CHUX): You won't find mulligan stew at O'Charley's, but you can find plenty of other menu items to choose from. The company operates more than 215 of its namesake casual-dining restaurants in more than a dozen states across the southeastern and midwestern US. Its eateries feature moderately priced menu items such as steak, chicken, pasta, and seafood. O'Charley's also runs six Stoney River Legendary Steaks locations offering more-upscale dining. In addition, the company owns Ninety Nine Restaurant and Pub, a chain of nearly 90 casual-dining spots located primarily in New England.
- RARE Hospitality International (RARE): RARE Hospitality International can satisfy that meat-and-potatoes kind of guy (or gal). It owns and operates more than 230 casual-dining restaurants that specialize in steak and beef dishes. Its flagship LongHorn Steakhouse chain offers steak, seafood, and chicken dishes in a casual setting designed to imitate the look and feel of a Texas roadhouse. There are more than 190 LongHorn Steakhouses in 23 states, primarily in the Midwest and the southeastern US, as well as three franchised units in Puerto Rico. The company also owns more than 25 Bugaboo Creek Steak House restaurants and 17 upscale eateries called The Capital Grille
- CEC Entertainment (CEC): Don't let the mouse mascot fool you: This amusement kingdom is founded on the power of pizza. CEC Entertainment operates and franchises the Chuck E. Cheese's chain of pizza parlors. The restaurants, which are especially popular for birthday parties, feature dining-room entertainment provided by robotic characters, arcade games, and other activities targeting

families with young children. The menu includes a variety of pizzas, sandwiches, salads, and desserts. CEC Entertainment owns more than 430 of the pizza and fun joints in more than 40 states and Canada; there are about 50 franchised units.

- Lone Star Steakhouse & Saloon (STAR): Lone Star Steakhouse & Saloon's steak house formats range in price from affordable to holy cow! The company owns and operates about 250 of its namesake casual-dining restaurants that offer mesquite-grilled steaks, ribs, chicken, and fish in nearly 40 US states. Patrons are also treated to surroundings appointed by Texas paraphernalia, neon beer signs, and country music. In addition Lone Star Steakhouse operates 20 Texas Land & Cattle Steak House restaurants (bought out of bankruptcy in 2004), 15 upscale Sullivan's Steakhouses, five Del Frisco's Double Eagle Steak Houses, and a single mid-priced Italian restaurant known as Frankie's.
- Friendly Ice Cream Corp (FRN): Screaming ice cream lovers can soothe their pipes at Friendly Ice Cream. The company owns nearly 380 Friendly's family-style restaurants in 16 states, many of them in the Northeast, and franchises about 160 others, mostly in mid-Atlantic and northeastern states. Friendly is known for its desserts, but the restaurants also serve breakfast, lunch, and dinner -- mostly general fare such as sandwiches, salads, and burgers. The company also makes ice cream and other frozen treats that are distributed through some 4,500 supermarkets and other retail sites. Well-known items include Fribble shakes, the Royal Banana Split Sundae, and Wattamelon Roll desserts
- P.F. Chang's China Bistro (PFCB): The ancient Chinese secret behind P.F. Chang's success is upscale American service. P.F. Chang's China Bistro owns and operates about 100 full-service bistro restaurants in some 30 states offering lunch and dinner menus inspired by five culinary regions of China. The chain's locations offer stylish dining areas, display kitchens, and narrative murals based on ancient Chinese designs. Specialties include Chicken in Soothing Lettuce Wrap and Szechwan-style Long Beans as well as a variety of other dishes made with chicken, beef, seafood, vegetables, and noodles. The company also owns and operates more than 30 limited service Pei Wei Asian Diners in the southwestern US.

Top competitors

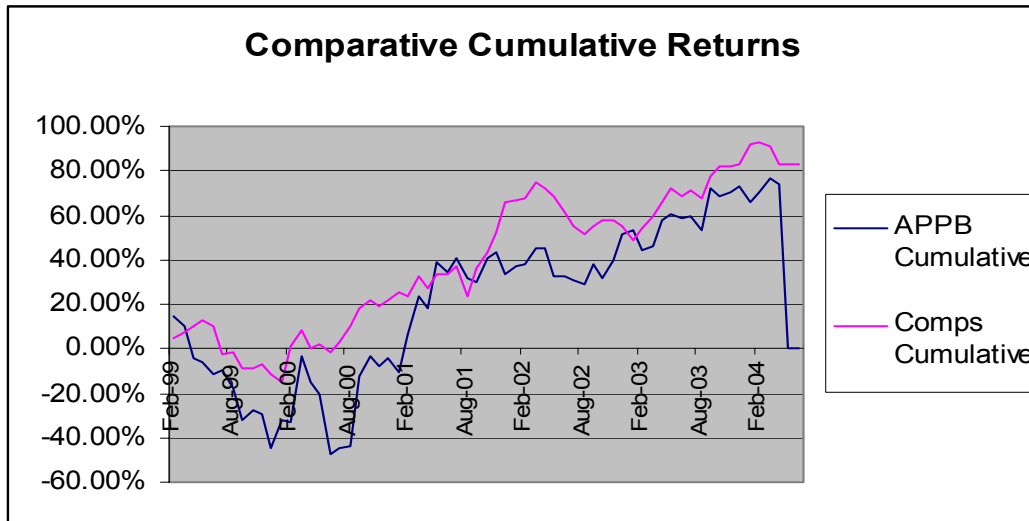
- Brinker (EAT): Brinker International, owner and operator of the Chili's Grill & Bar chain, is one hot player in the restaurant industry. Brinker is the #2 casual-dining restaurant operator (behind Darden). Chili's, with more than 975 locations, trails only Applebee's as the largest full-service chain. The restaurants offer southwestern-style dishes, such as fajitas, margarita grilled chicken, and its popular baby back ribs. In addition to Chili's, Brinker operates the Italian-themed Romano's Macaroni Grill and the Mexican-flavored On The Border Mexican Grill & Cantina. Its smaller, emerging chains include Maggiano's Little Italy, Rockfish Seafood Grill (43%-owned), and Corner Bakery Cafe.
- Outback Steakhouse (OSI): Peel back the layers of this bloomin' restaurateur, and you'll find more than a steakhouse. Outback Steakhouse is the #3 operator of

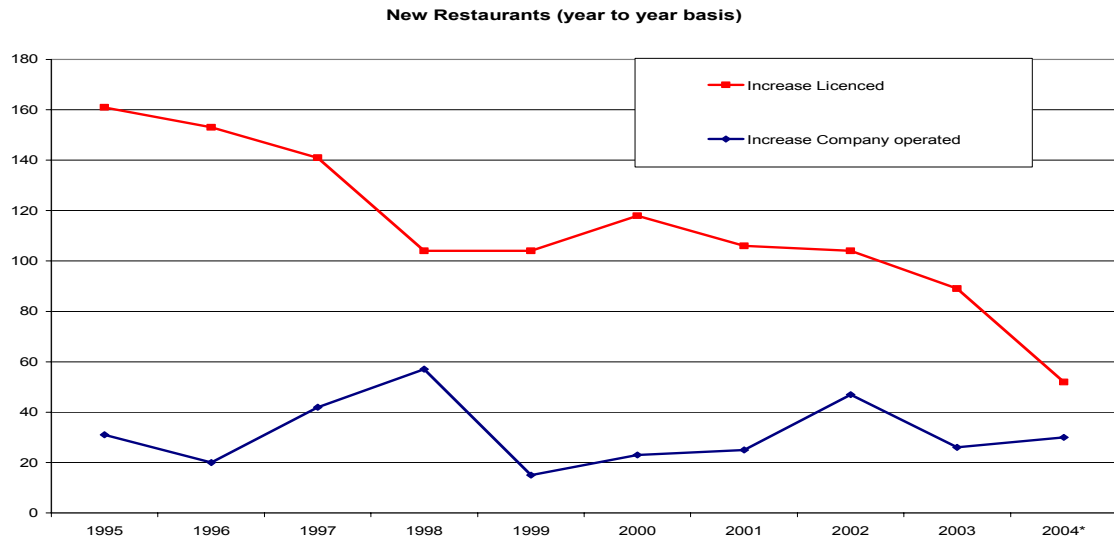
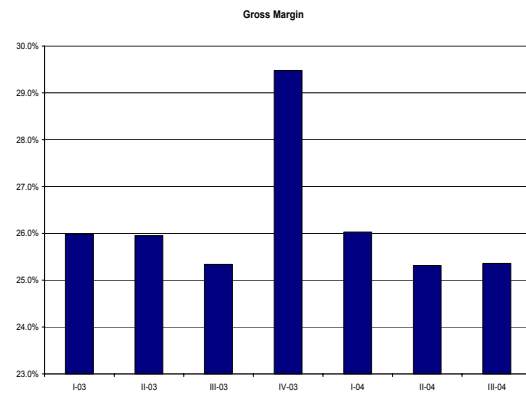
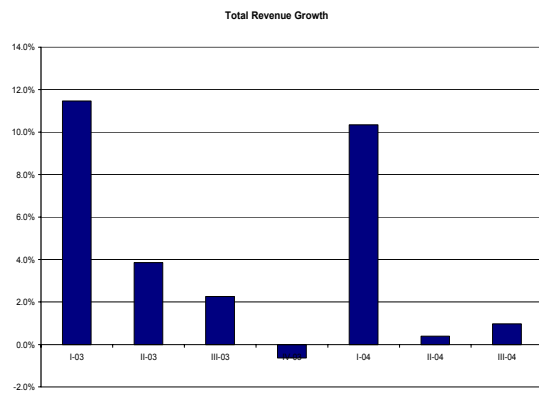
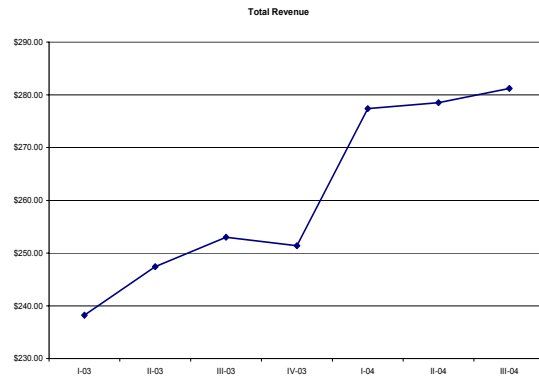
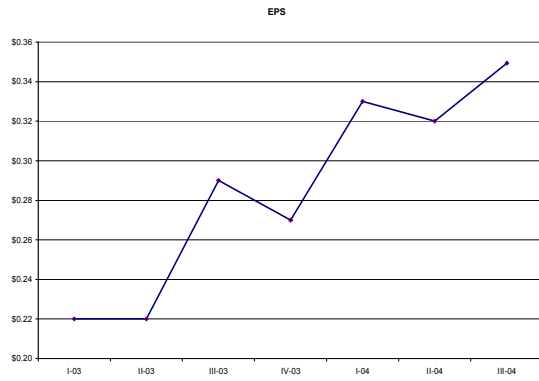
casual-dining spots (behind Darden Restaurants and Brinker International), with more than 1,000 locations in the US and 20 other countries. Its 825-unit signature concept offers steak, chicken, and seafood served in an Australian-themed atmosphere. Outback also operates nearly 150 Carrabba's Italian Grill restaurants, which offer pasta, chicken, and seafood dishes. Other concepts include Fleming's Prime Steakhouse and Bonefish Grill. The company owns about 80% of its locations.

Appendix 4 Investment strategy simulation

Date	Average P/E	Average Comps Price	1M Return	Annualized	APPB P/E	APPB Price	Long/Short	1M Return	Annualized
31-Jan-99	19.8786	13.3621	5.19%	83.52%	13.0992	6.4815	L	18.57%	672.26%
28-Feb-99	19.8563	14.0556	-0.50%	-5.87%	15.5319	7.6852	L	-4.34%	-41.26%
31-Mar-99	14.7202	13.9849	2.44%	33.58%	16.2185	7.3519	S	-4.03%	-38.96%
30-Apr-99	15.8623	14.3264	2.62%	36.41%	16.8722	7.6481	S	-14.29%	-84.27%
31-May-99	15.9754	14.7019	3.13%	44.68%	19.2825	8.7407	S	-2.12%	-22.66%
30-Jun-99	16.0482	15.1615	-3.13%	-31.69%	18.8271	8.9259	S	-4.98%	-45.82%
31-Jul-99	15.5308	14.6875	-12.28%	-79.25%	19.7645	9.3704	S	1.78%	23.56%
31-Aug-99	13.6222	12.8837	1.03%	13.06%	19.4130	9.2037	S	-8.45%	-65.34%
30-Sep-99	24.1695	13.0161	-7.30%	-59.71%	19.9351	9.9815	L	-14.47%	-84.68%
31-Oct-99	23.6742	12.0665	-0.06%	-0.68%	17.0502	8.5370	L	4.56%	70.67%
30-Nov-99	25.1530	12.0596	2.29%	31.21%	17.8269	8.9259	L	-2.07%	-22.24%
31-Dec-99	22.7386	12.3357	-4.83%	-44.78%	15.4457	8.7407	L	-15.04%	-85.86%
31-Jan-00	20.9775	11.7401	-3.69%	-36.35%	13.1223	7.4259	L	12.34%	304.21%
29-Feb-00	20.6319	11.3063	16.41%	519.30%	14.7422	8.3426	L	-0.11%	-1.32%
31-Mar-00	18.5583	13.1617	6.62%	115.71%	12.6685	8.3333	L	29.56%	2136.00%
30-Apr-00	20.5336	14.0325	-7.34%	-59.96%	16.4127	10.7963	L	-12.01%	-78.45%
31-May-00	18.7764	13.0020	1.30%	16.80%	14.4421	9.5000	L	-5.46%	-49.01%
30-Jun-00	17.3094	13.1714	-3.10%	-31.50%	12.9547	8.9815	L	-26.80%	-97.63%
31-Jul-00	16.7100	12.7626	4.14%	62.69%	9.4823	6.5741	L	2.25%	30.66%
31-Aug-00	17.1138	13.2909	6.94%	123.75%	9.6960	6.7222	L	1.38%	17.84%
30-Sep-00	15.5764	14.2135	8.73%	172.91%	9.5835	6.8148	L	31.32%	2529.59%
31-Oct-00	17.2940	15.4539	3.41%	49.52%	12.5848	8.9491	L	9.26%	189.43%
30-Nov-00	17.5210	15.9807	-2.56%	-26.71%	13.7502	9.7778	L	-4.73%	-44.13%
31-Dec-00	15.8916	15.5722	1.94%	25.90%	12.9914	9.3148	L	3.78%	56.04%
31-Jan-01	16.6877	15.8740	4.10%	61.89%	13.4821	9.6667	L	-6.13%	-53.19%
28-Feb-01	16.8704	16.5242	-1.52%	-16.77%	12.6556	9.0741	L	16.53%	527.02%
31-Mar-01	15.9101	16.2734	9.04%	182.43%	14.0501	10.5741	L	17.41%	586.08%
30-Apr-01	17.3967	17.7440	-5.67%	-50.33%	16.4959	12.4148	L	-5.06%	-46.37%
31-May-01	16.7124	16.7388	6.51%	113.19%	15.6613	11.7867	L	20.66%	852.61%
30-Jun-01	19.0813	17.8288	-0.74%	-8.56%	18.2149	14.2222	L	-5.31%	-48.06%
31-Jul-01	18.7887	17.6964	4.05%	61.08%	17.2473	13.4667	L	6.60%	115.34%
31-Aug-01	19.5545	18.4136	-13.23%	-81.79%	18.3857	14.3556	L	-8.67%	-66.32%
30-Sep-01	15.3333	15.9769	12.03%	290.79%	16.2992	13.1111	S	-2.03%	-21.85%
31-Oct-01	17.2513	17.8987	7.80%	146.31%	16.6308	13.3778	L	10.76%	241.03%
30-Nov-01	18.5141	19.2950	8.83%	176.09%	18.4209	14.8178	L	2.58%	35.75%
31-Dec-01	18.6305	20.9990	13.68%	365.77%	19.3212	15.2000	S	-10.09%	-72.09%
31-Jan-02	21.1727	23.8715	0.41%	5.09%	21.2703	16.7333	S	4.17%	63.27%
28-Feb-02	21.2343	23.9706	0.74%	9.25%	20.3833	16.0356	L	0.61%	7.57%
31-Mar-02	20.5561	24.1480	7.73%	144.40%	19.6222	16.1333	L	7.55%	139.46%
30-Apr-02	22.1372	26.0149	-2.61%	-27.21%	21.1033	17.3511	L	-0.08%	-0.92%
31-May-02	21.2835	25.3355	-3.56%	-35.25%	21.0871	17.3378	L	-12.48%	-79.81%
30-Jun-02	19.3322	24.4343	-7.58%	-61.17%	17.4627	15.1733	L	-0.22%	-2.60%
31-Jul-02	20.1718	22.5821	-5.96%	-52.19%	17.4243	15.1400	L	-2.20%	-23.44%
31-Aug-02	19.2489	21.2352	-4.31%	-41.08%	17.0407	14.8067	L	-1.31%	-14.59%
30-Sep-02	16.6881	20.3196	3.70%	54.65%	15.9621	14.6133	L	8.53%	167.08%
31-Oct-02	16.9112	21.0714	3.20%	45.88%	17.3239	15.8600	S	-5.93%	-51.96%
30-Nov-02	17.5119	21.7450	0.00%	-0.04%	18.3506	16.8000	S	7.97%	151.04%
31-Dec-02	16.9040	21.7443	-3.40%	-34.00%	15.5650	15.4607	L	12.11%	294.32%
31-Jan-03	16.2138	21.0044	-5.92%	-51.90%	17.4502	17.3333	S	1.38%	17.94%
28-Feb-03	15.3553	19.7614	5.49%	89.92%	17.2086	17.0933	S	-9.36%	-69.25%
31-Mar-03	16.0304	20.8465	5.25%	84.88%	17.7474	18.6933	S	2.25%	30.56%
30-Apr-03	18.4539	21.9419	6.17%	105.16%	17.3486	18.2733	L	11.86%	283.67%
31-May-03	19.7568	23.2960	6.13%	104.22%	19.4057	20.4400	L	2.51%	34.67%
30-Jun-03	20.1232	24.7243	-3.24%	-32.62%	20.1474	20.9533	S	-1.50%	-16.54%
31-Jul-03	22.7546	23.9241	2.42%	33.30%	20.4487	21.2667	L	0.75%	9.41%
31-Aug-03	23.3186	24.5040	-2.90%	-29.79%	20.6026	21.4267	L	-6.83%	-57.20%
30-Sep-03	22.6886	23.7924	9.72%	204.49%	19.1957	20.9867	L	19.16%	719.12%
31-Oct-03	18.5805	26.1057	4.60%	71.59%	22.8726	25.0067	S	-3.17%	-32.08%
30-Nov-03	19.5846	27.3071	-0.63%	-7.36%	23.5983	25.8000	S	1.36%	17.59%
31-Dec-03	19.0729	27.1338	1.07%	13.65%	23.2774	26.2267	S	3.13%	44.69%
31-Jan-04	19.1194	27.4248	9.50%	197.13%	22.5496	25.4067	S	-7.35%	-59.98%
29-Feb-04	20.7717	30.0300	0.48%	5.92%	24.2064	27.2733	S	4.20%	63.79%
31-Mar-04	22.6915	30.1743	-1.50%	-16.59%	23.1904	27.5200	S	5.98%	100.84%
30-Apr-04	N/A	29.7214	-8.20%	-64.16%	21.8028	25.8733	L	-2.34%	-24.78%
31-May-04	N/A	27.2857		0.00%	21.2915	25.2667	L	N/A	N/A
30-Jun-04	N/A	N/A		0	N/A			N/A	N/A

STRATEGY SUMMARY	
Average 1M return	1.15%
St. Dev 1M	10.45%
Average 1M return Comps	1.30%
St. Dev 1M	6.01%





Sources:

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