

2015 Restaurant Franchisee Profitability Reporting and Implications

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I've noted the reluctance of virtually all restaurant franchisors to report the profitability of franchised stores. But there are a few franchisors that do.

After watching fourth quarter and year-end results for 2015, Popeye's (NASDAQ:PLKI) and Domino's (NYSE:DPZ) continue to stand out in reporting franchise store level "profit," which is likely an EBITDA number. Both franchisors have done so for some time, three years now by my count.

The table below shows the trends.

Restaurant Franchisors Who Report Franchisee "Profitability"

Source: Company year-end earnings calls

Brand	2015 US Unit "Profitability"	Net US New Stores	Trend
Popeyes	\$340,000	+72	Up, from \$177,000
Domino's	\$120,000	+133	Up from \$80,000.

To its credit, Dunkin' Brands (NASDAQ:DNKN) typically reveals new year Dunkin' Donuts Western U.S. opening cohort (i.e., class) sales and simple unlevered (i.e., no debt service) cash on cash return. The McDonald's (NYSE:MCD) chief financial officer noted in March that the U.S. franchisee "cash flow" was **\$350,000** per store unit. As with Popeyes and Domino's, the \$350,000 is of course before many costs and expenses. McDonald's CEO reported franchisee numbers in 2013, when franchised stores reached **\$500,000**.

Despite the fact that store EBITDA is profit before everything—profit before taxes, franchisee overhead, debt service and future years capital spending (CAPEX), these are still important indicators.

There are two implications that can be easily seen.

1. The timing of the lack of franchisee visibility is unfortunate given the current state and municipal push for minimum wage increases

This week's minimum wage increases in California and New York were made without the general awareness of how marginal franchisee true cash flows could be, after allowing for brand royalties, rent margins, price discounting, capital expenditures and other fees. The policy makers and the politicians didn't have the data and have to be educated in any event. Most have only a very hazy understanding of the difference between the large franchisor corporations and franchisees, and most importantly, who pays for what. Some will say the wage increases would have happened anyway; but the small business advocacy game has to be played with all the cards in the deck. Franchisors can improve the odds with better disclosure.

2. The store economics for Domino's and Popeyes show that franchise unit growth follows the store profitability of a system's franchises

In other words, profitable franchises produce an environment for franchise expansion. Take for example, both Domino's and Popeyes. They were in the midst of a recent period of rising store level profitability. The profitability gains of their franchised restaurants encouraged and enabled future unit expansion, as both CEOs noted to analysts. Future franchisee unit growth was funded via retained profits and positive cash flow that franchisees accumulated. Why? Because almost every franchise loan requires injected franchisee capital, and because most franchisors target their own franchisees for expansion. That means profits for the franchised stores first, then franchise unit expansion, not the other way around.

History shows that massive increases in franchise store count without the average store being profitable bodes poorly for a franchise system in the restaurant industry.

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ABOUT JOHN A. GORDON



Public Profile

Chain restaurant earnings and economics expert John A. Gordon at Pacific Management Consulting Group provides analysis and management solutions to those who need to know about chain restaurant performance, yielding the right information at the right time.

Gordon focuses on restaurant strategy, operations and financial management topics, and has a 40-year background in restaurant operations and financial management staff roles. He is a Master Analyst of Financial Forensics (MAFF).

Pacific Management provides creative, detailed and effective insight, independent research and analysis that is free of conflicts of interest so that you get the unvarnished truth. The company provides chain restaurant earnings and economics analysis, research, expert consultant and witness support, creditor committee support, due diligence and other analytical investigations of restaurants.

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