• FAST AND FRIENDLY SERVICE • GREAT TASTING FOOD • EVERYBODY FEELS WELCOME • PART OF MY NEIGHBORHOOD • KIDS HAVE A GREAT TIME • EXCELLENT VALUE • IT'S ALWAYS FUN • RIBLETS, RIBLETS AND MORE RIBLETS • CASUAL AND COMFORTABLE • SO MANY CHOICES • DINNER'S LIKE AN ADVENTURE • I ALWAYS GET A BALLOON • PLENTY OF HEALTHY CHOICES • ALWAYS SOMETHING NEW • EVEN GRANDMA HAS FUN • SMILES ARE EVERYWHERE YOU LOOK • THE ONLY PLACE OUR KIDS WANT TO GO • WE'RE ALWAYS TREATED SPECIAL

Applebee's International, Inc.
1997 Annual Report

"Dear Applebee's"

Why America Loves Us
Neighborhood by Neighborhood

Applebee's International, Inc. 1997 Annual Report

The Most Fundamental Rule ...

of a successful business is deceptively simple – find out what your customers want and give it to them ... and do it better than anyone else. At Applebee's, we've elevated this concept into more than a competitive advantage – it's part of our culture. We ask our guests how we're doing and we really listen to what they tell us. We use sophisticated surveying techniques, plus the most basic barometer of customer satisfaction – when one of our servers asks a guest how everything was ... **over 200 million times every year.**

Stacy, the greeter at my neighborhood Applebee's, even knows my name.

I love Riblets!

It's cool that our team picture is on the wall.

My family eats at Applebee's every week.

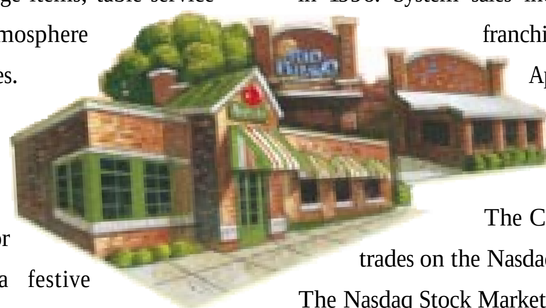
There's always something new and tempting on the menu — I can't wait to try them all!

Going to Rio Bravo is like a trip south of the border.

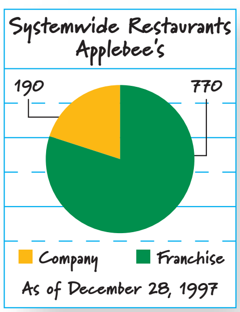
See How We're Growing

Applebee's International, Inc. is headquartered in Overland Park, Kansas, and develops, franchises and operates casual dining restaurants in 48 states and six international countries, under the Applebee's Neighborhood Grill & Bar® and Rio Bravo Cantina® brands.

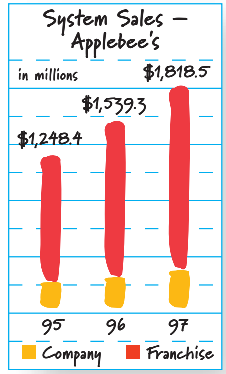
Each **Applebee's Neighborhood Grill & Bar** is designed as an attractive, friendly, neighborhood establishment featuring moderately priced, high-quality food and beverage items, table service and a comfortable atmosphere which appeals to all ages. **Rio Bravo Cantinas** are designed with distinctive Mexican architecture and interior decor which create a festive atmosphere reminiscent of an authentic Mexican border-town cantina.



At December 28, 1997, there were 960 Applebee's Neighborhood Grill & Bar restaurants, of which 770 were operated by franchisees and 190 were operated by the Company, and 55 Rio Bravo Cantina restaurants, of which 24 were operated by franchisees and 31 were operated by the Company. This compares with 1996 year-end totals of 819 Applebee's restaurants and 30 Rio Bravo Cantina restaurants.



Total annual system sales for the Applebee's concept reached approximately **$1.82 billion** in 1997, an increase of 18 percent from total system sales of approximately $1.54 billion in 1996. System sales include franchisee sales as reported to Applebee's International, as well as sales of Company Applebee's restaurants.



The Company's common stock trades on the Nasdaq National Market tier of The Nasdaq Stock Market under the symbol **APPB.**

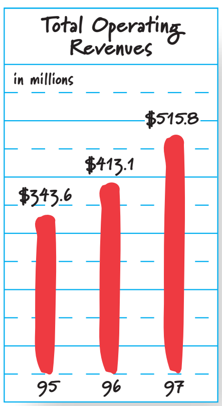
Contents

Dear Shareholders:

At Applebee's we've developed listening into an art form ... and strengthened it to a competitive advantage.

By listening to our guests in neighborhoods across America, Applebee's has grown into one of the most successful chains in the history of casual dining. Our vision is to transcend the dining category and build Applebee's into a brand recognized across all industries and respected around the world as a symbol for outstanding quality, value and service. Last year we made significant progress toward reaching that goal.

Fiscal 1997 marked a year of impressive achievement for Applebee's International, Inc. System sales for the Applebee's concept, which include both franchise and Company restaurant sales, climbed 18 percent over the prior year to $1.82 billion, while Company restaurant sales alone increased 26 percent to $452.2 million. Additionally, total operating revenues, which include Company restaurant sales and franchise income, were $515.8 million, up 25 percent from the year before. 1997 net earnings reached $45.1 million, or $1.44 per share on a basic basis and $1.43 per share on adiluted basis, an increase of 19 percent over the year before. While we are pleased with the growth in net earnings for 1997, we still could have done better. During the last six months, our earnings growth rate was slowed primarily due to higher-than-anticipated costs related to our comprehensive, far-reaching food and menu initiative, including increased labor costs due to minimum wage increases and tight labor markets.



Comparing restaurants open for at least 18 months, systemwide comparable sales for the Applebee's concept in 1997 increased 0.5 percent, while comparable sales for the Company's Applebee's restaurants increased 0.1 percent. Comparable sales for Company Rio Bravo Cantina restaurants, however, declined 1.6 percent for the year.

The driving goal of Applebee's International remains constant – to fortify its dominant brand strength and extend its undisputed leadership in casual dining. To accomplish that ambitious goal, we clearly detailed our basic business objectives in last year's letter to shareholders. Here is the progress we have made toward achieving our strategic objectives.

A critical objective is to expand the Applebee's concept, and we continue to make impressive headway in an increasingly competitive industry. During 1997, we added 145 new Applebee's restaurants for a year-end total of 960 units, including 190 Company and 770 franchise restaurants – a 17 percent increase over the prior year and the fourth consecutive year of opening over 140 restaurants. The pace of development remains strong with 27 sites under construction at year end and a pipeline filled with sites

A Personal Tribute

As Abe Gustin (on left) turns his full attention to his role as Chairman, I want to thank him for his leadership, wisdom and guidance. His ongoing counsel will continue to be an integral part of Applebee's strategy for success.

Abe J. Gustin, Jr.
Chairman of the Board

Lloyd L. Hill
Chief Executive Officer, President and Chief Operating Officer

Selected Financial Data

(in thousands, except per share amounts)	*Fiscal Year Ended* Dec. 28, 1997	Dec. 29, 1996	Dec. 31, 1995	Dec. 25, 1994	Dec. 26, 1993
Statement of Earnings Data:					
Company restaurant sales	$452,173	$358,990	$299,824	$222,445	$159,482
Franchise income	63,647	54,141	43,739	31,419	21,324
Total operating revenues	$515,820	$413,131	$343,563	$253,864	$180,806
Operating earnings	$ 71,283	$ 58,833	$ 45,712	$ 29,311	$ 19,677
Net earnings	$ 45,091	$ 38,014	$ 27,420	$ 17,823	$ 12,551
Basic net earnings per common share	$ 1.44	$ 1.22	$ 0.94	$ 0.64	$ 0.46
Diluted net earnings per common share	$ 1.43	$ 1.21	$ 0.92	$ 0.63	$ 0.45
Dividends per share	$ 0.08	$ 0.07	$ 0.06	$ 0.05	$ 0.04
Basic weighted average shares outstanding	31,401	31,188	29,319	27,970	27,543
Diluted weighted average shares outstanding	31,640	31,533	29,860	28,472	27,932
Balance Sheet Data *(at end of fiscal year)*:					
Total assets	$377,474	$314,111	$270,680	$180,014	$138,680
Long-term obligations, including current portion	$ 29,105	$ 25,843	$ 27,427	$ 38,697	$ 19,845
Stockholders' equity	$290,443	$244,764	$203,993	$108,788	$ 92,680

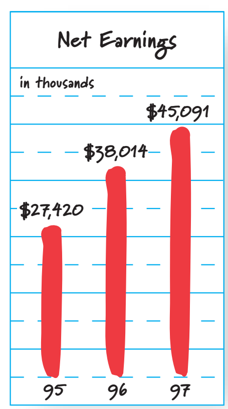
The table above sets forth for the periods and the dates indicated selected financial data of the Company. All amounts reflect the mergers with Pub Ventures of New England, Inc. and Innovative Restaurant Concepts, Inc., which were accounted for as poolings of interests. The fiscal year ended December 31, 1995 contained 53 weeks, and all other periods presented contained 52 weeks. The preceding should be read in conjunction with the Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Annual Report.

approved and awaiting development. We expect to open between 117 and 132 Applebee's restaurants in 1998, including 32 Company and 85 to 100 franchise units.

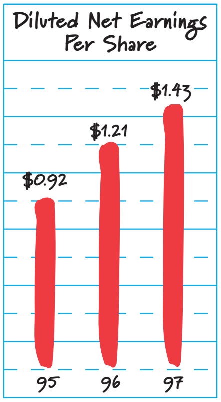
A second objective is to build our base of Company restaurants by acquiring sound franchise operations that meet our strategic and financial criteria. In the first half of 1997, we purchased the 11 Applebee's restaurants in the St. Louis metropolitan area, among the strongest markets in our system, and have since added four additional units to this market. Just prior to year-end 1997, we announced an agreement to acquire 32 Applebee's restaurants in Virginia from our largest franchisee as part of a plan we approved for them to exit the system as an Applebee's franchisee. We expect this transaction to be finalized in late March 1998. The Applebee's concept is well established in Virginia with a dominant market position, and this group of restaurants has consistently performed well and produced exceptional operating margins, guided by a strong management team. These two important acquisitions will add depth to our operations and will bring Company ownership to nearly one-fourth of the system total.

A third objective is to strengthen our leadership in the casual dining segment by continuously enhancing our concept. Beginning in April 1997, we rolled out a major new food and menu initiative, which was fully implemented systemwide by the end of November. This strategic program represents a significant investment in our long-term growth and success, and our guests have responded favorably to this important effort. In the short term, however, the associated costs for new plateware, training and restaurant labor hampered our financial results. The higher-than-anticipated labor expenses are expected to continue into the first half of 1998; however, we believe that the operating profitability of our Applebee's restaurants will subsequently return to more favorable levels later in 1998.

Another objective is to extend our lead over the competition in number of units, and in 1997 we solidly reinforced our position as the nation's largest single concept in the $38.5 billion casual dining segment in total number of units. At year end, we led our nearest bar-and-grill competitor by over 400 units and were larger than our two closest rivals combined. Our market share of the total casual dining segment increased to our highest reading ever – an estimated 5 percent overall and 18 percent of the bar-and-grill category. We have been increasing our market share at a rate of close to 20 percent per year, while maintaining average restaurant sales volumes of nearly



$2.1 million. And we served more than 200 million guests last year – an increase of approximately 30 million, based on a $280 million increase in system sales and our average guest check.



Also, we remain committed to our objective to develop Rio Bravo Cantina, our Mexican restaurant concept, as the Company's second growth vehicle. During 1997, we opened 26 new Rio Bravo Cantinas systemwide for a year-end total of 55 units, including 31 Company and 24 franchise restaurants. However, decelerating sales trends and somewhat-lower-than-expected profitability have caused us and our franchisees to refine our development plans for this year, and we now anticipate opening a total of approximately 18 to 20 Rio Bravo Cantina restaurants in 1998. During the past two years, we also converted a number of locations from other Mexican concepts to Rio Bravo, but the larger size and lack of marketplace acceptance generally have proven unsatisfactory. We continue to refine this concept and in March 1997 introduced a new, smaller 5,800-square-foot prototype which will enable entry into smaller markets with a lower unit investment expected to provide improved economic returns for our franchisees.

While our initial expectations for the development of the Rio Bravo Cantina concept have been tempered, we need to evaluate the evolution of this concept in relation to Applebee's historic development. We can look at Applebee's success today and easily forget that it did not occur overnight. Ten years ago, at the time Applebee's International, Inc. was formed in 1988, there were only 54 Applebee's restaurants, and it took four years to open the next 200 units. Then our restaurant development really began to accelerate as we opened over 700 Applebee's restaurants during the next five years. Just as we refined the Applebee's concept over a period of years, we are continuing to refine the Rio Bravo Cantina concept.

Another key objective is to extend Applebee's presence internationally. We continue our expansion overseas at a cautious pace, selectively seeking international franchisees with proven local operating expertise. During 1997, our franchisees opened seven new restaurants and added two new countries to our international roster. Currently, there are eight franchisee groups operating in six countries – Canada, Curacao, Germany, Greece, The Netherlands and Sweden. With casual dining rapidly growing in popularity overseas, we are actively targeting development of other major international markets.

To continue the successful pursuit of these business objectives, we are solidifying and strengthening our senior management team. In January 1998, Abe Gustin moved into his role as full-time Chairman.
In this capacity, he will continue to provide his leadership and broad experience as an entrepreneur, former franchisee and business executive to the Company.
In addition, we are adding new vitality and proven leadership in other key executive positions. We have appointed Stuart Waggoner, formerly Senior Vice President responsible for the Applebee's division, as President and CEO of the Rio Bravo Cantina division. In May 1997, Larry Cates joined as President of the International division, bringing 21 years of international experience to this vital growth area. In November 1997, Lou Kaucic joined as Senior Vice President of Human Resources with a 20-year background of senior-level human resources experience. We are also aggressively seeking a qualified individual to assume the role of President of the Applebee's division.

As we enter 1998, we will continue to focus on the sound strategies and core competencies that have led to our remarkable success. As we exceed two significant milestones – $2 billion in system sales and 1,000 restaurants – these same fundamentals will reinforce our dominant leadership of the casual dining segment. And as we reflect on our accomplishments, we recognize that our past and continuing success entails a series of unique and valued relationships – between franchisor and franchisee, between the home office and our executives in the field, between our restaurant managers and associates.

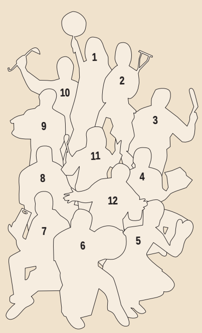
Most importantly, we realize that our ongoing success depends on building and fortifying the relationship with our guests – continually seeking their input, answering their needs and exceeding their expectations ... every day with every guest contact, in every restaurant, in every neighborhood.

LLOYD L. HILL

Chief Executive Officer, President
and Chief Operating Officer

March 1998

Applebee's restaurant employees, home office staff and executives enthusiastically share a common goal – to give our guests a compelling reason to keep coming back … again and again.



1. Jami Hoag, Applebee's greeter; **2.** Juvy Juan, Applebee's server; **3.** George Shadid, Executive Vice President and CFO; **4.** Lou Kaucic, Senior Vice President of Human Resources; **5.** Karen Lazowski, Director of Employee Relations; **6.** Antonio Rivera, Applebee's cook; **7.** Mike DiPardo, Applebee's server; **8.** Bob Martin, Executive Vice President of Marketing; **9.** Eric Brown, Applebee's cook; **10.** Steve Lumpkin, Senior Vice President of Strategic Development; **11.** Pam Brittendall, Product Development Manager; **12.** Lloyd Hill, CEO, President and COO.

Listening to Our Guests and Answering Their Needs

A leading industry report has stated that success in casual dining will depend on "concepts that satisfy consumers' needs for convenience, fun, family friendliness, health, variety and value." This prediction reads like a page out of the Applebee's strategic playbook. Meeting our guests' needs is the basic foundation of our concept. And to make certain we are delivering, we ask guests what they want and how we are doing.

Our most critical customer feedback mechanism takes place over 200 million times a year, in neighborhoods all across America, when an Applebee's server asks a guest, "How is everything?". With every guest contact, we have the opportunity to listen and to learn; with every guest we please, we have the chance to build and fortify a relationship. Beyond these invaluable interpersonal exchanges, we also employ a variety of sophisticated techniques to bolster customer satisfaction.

During 1996, we introduced the Customer Satisfaction Index, our front-line tool for measuring how effectively our restaurants are meeting guests' expectations. Each month, between 200 and 250 guests at every restaurant receive an incentive to contact our customer response call center and voice their opinions on 18 core operational and service areas. The responses – totaling 40,000 systemwide each month – reflect how our restaurants are performing on everything from friendliness to cleanliness, accuracy of the wait time to the speed of food delivery, and food temperature to taste. Using this tool, we can identify trends early and alert managers to potential problem areas.

For the second consecutive year, we conducted extensive consumer research during 1997, surveying 3,600 casual dining customers in 13 markets to learn what

"My friends and I always feel welcome at Applebee's. It's also a super place to celebrate another team victory."

Fast Guest Response

Advanced technology means faster response to guests and faster food preparation.

they thought of Applebee's and our competition. Reflecting our category leadership, Applebee's was the undisputed front-runner in "unaided awareness" – the ability of customers to recall a restaurant concept off the top of their heads. Overall, our awareness level was nearly twice that of our nearest casual dining competitors – and even higher in heavily developed markets. While it is certainly rewarding that Applebee's comes to mind with consumers, this indicator is especially important due to a positive correlation between unaided awareness and average unit volume in a given market.

As part of this survey, we also asked customers what were the most important attributes of the dining experience. Leading their collective list is high-quality, tasty food; prompt, responsive service; and a friendly, welcoming atmosphere. These opinions reinforce the consistent findings of our Customer Satisfaction Index where the critical issues with guests are food taste, overall cleanliness and visual appeal.

At Applebee's, we understand that technology can play an important role in meeting guests' needs. Our computer-based point-of-sale (POS) system is helping servers respond faster to our guests and speeding food preparation in the kitchen. Last year, this low-cost, easy-to-use system earned the Technology Innovation Award from the Food Service Technology Group. Another technological initiative, designed to work in conjunction with the POS system, is helping strengthen our customer service efforts while improving operational efficiency and increasing profitability. We have begun installing the initial sales forecasting and labor modules in Company and franchise units, giving managers a tool to more effectively manage labor costs.

Food, Service, Atmosphere

Applebee's scores high on the issues most important to guests.

Customer Satisfaction Index

Each month, we solicit opinions by telephone on restaurant performance, ranking the results according to the five customer-critical areas of the Apple Index.

Apple Index

Atmosphere
Performance
Personality
Lightning Speed
Excellent Food

Developing Service Performers Who Dazzle Our Guests

Learning what customers want and giving it to them is not nearly as easy as it sounds. To attract and keep guests, we must exceed their expectations with each visit, with each meal, with each contact. Most importantly, we realize that winning guest loyalty begins with earning employee loyalty.

People-Pleasing Performers

Applebee's hires service employees based on their personalities and attitudes.

Attracting, hiring and keeping good employees is the greatest challenge facing both our industry and our Company. As we compete aggressively for customers in the marketplace, we are competing just as aggressively for motivated employees. The numbers alone are daunting. According to a National Restaurant Association survey, the number of people employed in the foodservice industry will rise from 9.5 million today to 10.8 million by 2005. Including retirements, that means there will be 3.9 million new jobs to be filled – and that number does not include the effect of the industry's traditionally high turnover.

Applebee's has a distinct competitive advantage in the employment arena. Our leadership of the casual dining segment and strong brand equity give us an edge in attracting the best employees. We market ourselves to employees as much as to guests, using the strength of the Applebee's brand. If our marketing message conveys the fun and friendliness of Applebee's to guests, then potential employees should consider Applebee's as a fun and friendly place to work. Plus, current and former employees represent a sizeable group that can help influence others in making employment and dining choices.

To assist managers in recruiting top talent, last year we developed new hiring practices that are personality driven instead of the traditional skill-driven approach. By profiling the personality traits of 1,000 of our

Service Performers

Service performers enjoy the chance to perform, joining in song to help guests celebrate a birthday or special occasion.

most successful service performers, we singled out the behaviors and attitudes exhibited by superior workers. Next, we created a written interview procedure called Selecting Service Performers to help managers identify individuals who will fit into the Applebee's culture and will deliver the service level our guests expect. This program has proven extremely effective at predicting the probability of success for servers, hostesses and other workers who interact with our guests.

We are extending this successful personality-driven strategy to the selection of restaurant managers, as well. Our research clearly shows that hourly employee satisfaction is often linked to the direct supervisor and restaurant management practices.

The Difference Is Training

Training for all Applebee's and Rio Bravo Cantina employees involves food preparation, food serving and food tasting.

Employees place great importance on the relationship with their supervisor and on managers creating the proper working atmosphere. In addition, we have found a direct connection between a restaurant's performance and the longevity of its management team. The need to find managers who fit the Applebee's culture is critical, considering the numbers alone. With over 100 new Applebee's restaurants opening systemwide each year with as many as five managers each, together with normal yearly turnover, the Applebee's system needs to hire over 2,000 new managers each year.

The result of all these efforts will be a talented team of service-oriented employees and managers – and the ultimate beneficiaries will be our guests.

"As a mother, I can't say enough about the kid-friendly atmosphere at Applebee's … it makes our weekly visit a special event."

Giving Our Guests Concepts That Are Inviting and Friendly

The underlying strength and advantage of Applebee's are firmly rooted in the concept, properly executed. At the very core of our concept is great food at affordable prices delivered by service-minded people in a friendly, welcoming atmosphere. The theme of our new image campaign, unveiled in 1997, underscores this special appeal – "You Belong at Applebee's.®" We believe everyone belongs at Applebee's, and we make a tremendous effort to share that feeling.

Our proven model of market penetration relies on developing enough restaurants in a given market to be a competitive force. Heavy penetration enables us to market the concept more efficiently and economically – building higher levels of consumer awareness, increased frequency, customer satisfaction and, ultimately, greater market share. Applebee's consumer research indicates a clear link between our market penetration strategy and winning loyal guests. In highly penetrated markets, we have achieved high levels of consumer awareness and customer satisfaction, and in turn, high average unit volumes. Furthermore, research shows a direct relationship between availability and frequency – more restaurants in a market can increase the number of times people dine out.

Applebee's continues to build on its marketplace momentum, adding over 140 new restaurants annually in each of the last four years. Already the leader in the casual dining segment with 944 units at year end in all 48 continental states, we currently project eventual growth to approximately 1,500 domestic Applebee's restaurants within the United States. While pursuing that vision, we recognize the need to continue evolving our concept to keep it fresh and to meet the future demands of guests and the marketplace.

Last year, we introduced a new, smaller Applebee's prototype as a crucial initiative in our continuing market penetration. This prototype combines decreased square footage with increased seating efficiency and a larger waiting area, together with

"Thanks Applebee's. My birthday party was the best ever. We'll be back again next year ... and lots more times in between!"

Atmosphere Plus Energy

The smaller Rio Bravo Cantina prototype continues to capture the authentic flavor of a Mexican border-town cantina.

updated interior decor improvements and external design enhancements to underscore Applebee's image and identity. This new updated look is being incorporated into all new construction and future remodels.

As we continue building customer awareness, we are strengthening our marketing efforts for 1998 with an aggressive plan that includes more campaigns, new programs and new advertising – including a significant increase in our television exposure by doubling our national cable TV presence. A critical element of our intensified marketing is the extension of our successful family marketing efforts into a year-long, educationally focused program – recognizing that families with children represent a growing part of our business.

Our family marketing program has been significantly strengthened through several key strategic partnerships – Visa's® "Read Me a Story" program that supports the Reading Is Fundamental® literacy movement; the Discovery Kids Channel network of educational programming for kids; and the National Association of Basketball Coaches and their Coaches vs. Cancer fund-raising program that benefits child-oriented research and educational programs of the American Cancer Society.

The Company is spicing up the inviting appeal and friendliness of the Applebee's concept in a second growth vehicle with the continued development of its Rio Bravo Cantina restaurants. Rio Bravo is a festive casual dining concept that captures the atmosphere and energy of a Mexican border-town cantina. Beginning with the acquisition of 13 units in 1995, this concept has grown to a systemwide total of 55 restaurants at the close of 1997 with approximately 75 expected by the end of 1998. We recently introduced a new 5,800-square-foot prototype that will reduce the investment for franchisees, while still supporting strong unit volumes and profitability.

Updated Look Outside

Recent exterior design enhancements fortify Applebee's image and identity.

The Family Program

Applebee's family program includes key elements such as the "Read Me a Story" program supporting literacy and the Coaches vs. Cancer fund-raising effort.

Concentrating on Food and Value to Keep Our Guests Coming Back

By continually and carefully listening to our guests, we know that their overriding priority when dining out is appealing, appetizing food. To meet this requirement, we are continuously researching what consumers will want one or two years ahead – creating and refining new offerings in our test kitchens, seeking confirmation with focus group tasting panels and field testing before introducing our new menu systemwide. We constantly attempt to achieve that delicate balance between menu excitement, operational feasibility and acceptable profitability. While working to develop loyalty among guests who crave variety, we realize the need to also continually improve existing menu items.

Promoting Sensational Food

The highly successful "Skillet Sensations™" promotion is being expanded for 1998.

To meet guests' needs for quality and taste, we launched a major new food and menu initiative in early 1997. This proactive effort was designed to make our food and presentation more contemporary, to enhance our competitive positioning and to set the standard for the future of casual dining. By the end of November, we completed the rollout of this massive transition to most Applebee's restaurants in our system.

This long-term strategic program included enhanced food offerings and upgraded food specifications, additional menu item selections and side dish alternatives, and updated food presentations – right down to a new assortment of garnishes for added appeal.

To further enhance our presentation, we replaced all our plateware with new contemporary dishes that prominently feature the Applebee's logo. Although not designed to produce short-term results, our guests have been quick to respond favorably.

Food and Menu Initiative

New oversized white plateware, featuring the Applebee's logo, draws attention to the colorful appeal of our food offerings.

A new apple-shaped red wire basket enhances the presentation of appetizers and other menu items.

Enhanced Food, Presentation

In a major initiative during 1997, Applebee's enhanced its food selections and specifications, added new plateware and revamped its menus.

In addition to the various elements of the food and menu initiative, we are expanding our seasonal food-focused promotions for 1998. These campaigns feature proprietary food innovations that only Applebee's offers – from a sizzling update of our popular "Skillet Sensations" dishes to a variety of tempting "Pasta Creations" and more.

We expect positive acceptance to continue building as we refine various elements and guests are increasingly exposed to all the components. Clearly, our food and menu initiative represents a substantial investment in our long-term success and continued growth – and the full impact will be measured in years and the longevity of the Applebee's concept.

To complement and support the dramatic changes in our food and presentation, we updated our physical menu as well, making it just as fresh and contemporary. The new "Slice of Life" menu graphically captures the look and feel of an Applebee's restaurant with a cover design that reflects the food, atmosphere and unique neighborhood appeal of the Applebee's concept. Inside, the new menu combines bright graphics and an easy-to-read format to highlight our appetizers and salads, burgers and sandwiches, and other signature specialties.

"For folks on a fixed budget, Applebee's delivers great value along with great food. And the fun-filled atmosphere keeps us feeling young."

Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The Company's revenues are generated from two primary sources: Company restaurant sales (food and beverage sales) and franchise income consisting of franchise restaurant royalties (generally 4% of each franchise restaurant's monthly gross sales) and franchise fees (which typically range from $30,000 to $35,000 for each Applebee's restaurant opened and $40,000 for each Rio Bravo Cantina restaurant opened). Beverage sales include sales of alcoholic beverages, while non-alcoholic beverages are included in food sales. Certain expenses (food and beverage, labor, direct and occupancy costs, and pre-opening expenses) relate directly to Company restaurants, and other expenses (general and administrative and amortization expenses) relate to both Company restaurants and franchise operations.

The Company operates on a 52 or 53 week fiscal year ending on the last Sunday in December. The Company's fiscal years ended December 28, 1997 and December 29, 1996 contained 52 weeks, and the fiscal year ended December 31, 1995 contained 53 weeks, and are referred to hereafter as 1997, 1996 and 1995, respectively.

Acquisitions

On March 23, 1995, a wholly-owned subsidiary of the Company merged with and into Innovative Restaurant Concepts, Inc. ("IRC"), referred to herein as the "IRC Merger." As a result of the IRC Merger, IRC became a wholly-owned subsidiary of the Company. The IRC Merger was accounted for as a pooling of interests and, accordingly, the accompanying consolidated financial statements include the accounts and operations of the merged entities for all periods presented. At the time of the IRC Merger, IRC operated 17 restaurants, including 13 Rio Bravo Cantina restaurants, and four other specialty restaurants, comprised of Ray's on the River, two Green Hills Grille restaurants, and the Rio Bravo Grill.

The combined earnings of IRC included earnings of limited partnerships which were not taxable entities for federal and state income tax purposes. The accompanying consolidated statements of earnings reflect provisions for income taxes on a pro forma basis as if the Company had been liable for federal and state income taxes on the earnings of IRC's limited partnerships at statutory rates.

On April 3, 1995, the Company acquired the operations and assets of five franchise restaurants in the Philadelphia metropolitan area, referred to herein as the "Philadelphia Acquisition." The Philadelphia Acquisition was accounted for as a purchase and, accordingly, the results of operations of such restaurants have been reflected in the consolidated financial statements subsequent to the date of acquisition.

On April 14, 1997, the Company acquired the operations and assets of 11 franchise restaurants in the St. Louis metropolitan area, referred to herein as the "St. Louis Acquisition." The St. Louis Acquisition was accounted for as a purchase and, accordingly, the results of operations of such restaurants have been reflected in the consolidated financial statements subsequent to the date of acquisition.

On December 23, 1997, the Company entered into an agreement with Apple South, Inc. ("Apple South"), its largest franchisee, to acquire 31 Applebee's restaurants plus one restaurant under construction in the Virginia markets of Norfolk, Richmond, Roanoke and Charlottesville for approximately $93,400,000, subject to certain closing adjustments, referred to herein as the "Virginia Acquisition." The Virginia Acquisition is anticipated to close in late March 1998, subject to obtaining financing, operating licenses and third-party consents, and will be accounted for as a purchase.

Results of Operations

The following table sets forth, for the periods indicated, information derived from the Company's consolidated statements of earnings expressed as a percentage of total operating revenues, except where otherwise noted. Percentages may not add due to rounding.

	Fiscal Year Ended		
	Dec. 28, 1997	Dec. 29, 1996	Dec. 31, 1995
Revenues:			
Company restaurant sales	87.7%	86.9%	87.3%
Franchise income	12.3	13.1	12.7
Total operating revenues	100.0%	100.0%	100.0%
Cost of sales (as a percentage of Company restaurant sales):			
Food and beverage	27.5%	28.0%	28.3%
Labor	32.1	31.5	31.7
Direct and occupancy	25.3	24.4	24.1
Pre-opening expense	0.8	1.0	0.8
Total cost of sales	85.7%	84.9%	84.8%
General and administrative expenses	10.2%	10.6%	11.3%
Merger costs	—	—	0.5
Amortization of intangible assets	0.6	0.6	0.7
Loss on disposition of restaurants and equipment	0.2	0.8	0.2
Operating earnings	13.8	14.2	13.3
Other income (expense):			
Investment income	0.4	0.7	0.5
Interest expense	(0.3)	(0.4)	(0.7)
Other income	0.1	0.1	0.1
Total other income (expense)	0.1	0.5	(0.1)
Earnings before income taxes	13.9	14.7	13.2
Income taxes (including pro forma provision for income taxes)	5.2	5.5	5.2
Net earnings	8.7%	9.2%	8.0%

Fiscal Year Ended December 28, 1997 Compared With Fiscal Year Ended December 29, 1996

Company Restaurant Sales: Overall Company restaurant sales increased $93,183,000 (26%) from $358,990,000 in 1996 to $452,173,000 in 1997. Sales for Company Applebee's restaurants increased $69,350,000 (24%) from $285,093,000 in 1996 to $354,443,000 in 1997, due primarily to Company restaurant openings and sales from the 11 St. Louis restaurants acquired in April 1997. Sales for Company Rio Bravo Cantina restaurants were $59,523,000 and $83,295,000 in 1996 and 1997, respectively, and sales for the specialty restaurants were $14,374,000 and $14,435,000 in 1996 and 1997, respectively. The increase in sales for the Rio Bravo Cantina restaurants resulted primarily from Company restaurant openings.

Comparable restaurant sales at Company Applebee's restaurants increased by 0.1% in 1997. Weighted average weekly sales at Company Applebee's restaurants increased 2.0% from $40,366 in 1996 to $41,176 in 1997. Comparable restaurant sales and weighted average weekly sales at Company Applebee's restaurants in 1997 were positively affected by menu price increases. In addition, weighted average weekly sales in 1997 increased as a result of the sale of six lower than average volume restaurants in southern California in October 1996 and the purchase of 11 higher than average volume restaurants in St. Louis in April 1997. Excluding these restaurants, weighted average weekly sales decreased 0.2% in 1997.

Price increases were implemented during the fourth quarter of 1996 and the fourth quarter of 1997 for certain menu items. The Company does not expect significant comparable restaurant sales increases and may experience comparable restaurant sales decreases for the 1998 fiscal year for Company Applebee's restaurants, as many of its restaurants operate near sales capacity and various markets continue to experience competitive pressures. Although the Company's experience in developing markets indicates that the opening of multiple restaurants within a particular market results in increased market share, decreases in comparable restaurant sales may result.

Comparable restaurant sales for Company Rio Bravo Cantina restaurants decreased by 1.6% in 1997 due primarily to increased competition in the Atlanta market. Weighted average weekly sales (excluding one restaurant that is open for dinner only) decreased from $66,743 in 1996 to $60,946 in 1997. Weighted average weekly sales in 1997 were impacted by new restaurant openings in new markets, as well as the addition of a new smaller prototype restaurant. When entering new markets where the Company has not yet established a market presence, sales levels are expected to be lower than in the Georgia and Florida markets where the Company has a concentration of Rio Bravo Cantina restaurants and high customer awareness.

Franchise Income: Overall franchise income increased $9,506,000 (18%) from $54,141,000 in 1996 to $63,647,000 in 1997. This increase was due primarily to the increased number of franchise Applebee's and Rio Bravo Cantina restaurants operating during 1997 as compared to 1996. In addition, comparable restaurant sales for franchise Applebee's restaurants increased 0.6% in 1997. Such increases were partially offset by a decrease in weighted average weekly sales for franchise Applebee's restaurants of 0.9% in 1997.

Cost of Company Restaurant Sales: Food and beverage costs decreased from 28.0% in 1996 to 27.5% in 1997 due primarily to operational improvements, purchasing efficiencies resulting from the Company's rapid growth, and menu price increases. Such decreases were partially offset by an increase in food costs during the implementation of the Company's food and menu initiative. Beverage sales, as a percentage of Company restaurant sales, declined from 18.3% in 1996 to 17.8% in 1997 which had a negative impact on overall food and beverage costs, as a percentage of Company restaurant sales. Management believes that the reduction in beverage sales is due in part to the continuation of the overall trend toward increased awareness of responsible alcohol consumption.

Labor costs increased from 31.5% in 1996 to 32.1% in 1997. Such increases were due primarily to the adverse impact on restaurant labor costs during, and for a number of months following, the implementation of the Company's food and menu enhancement initiative in its Applebee's restaurants. The Company expects labor costs, as a percentage of sales, to continue to be impacted during the first half of the 1998 fiscal year as a result of this implementation. Increases in the minimum wage as well as the highly competitive nature of the restaurant industry continue to exert pressure on both hourly labor and management costs. An increase in the Federal minimum wage went into effect on October 1, 1996, and a second increase became effective on September 1, 1997. In addition, the 1997 fiscal year was negatively impacted by an increase in group medical insurance costs.

Direct and occupancy costs increased from 24.4% in 1996 to 25.3% in 1997. Such increases were due, in part, to the new plateware costs relating to the Company's food and menu enhancement initiative in its Applebee's restaurants. In addition, such increases were partially due to an increase in repairs and maintenance expense relating to maintenance contracts on restaurant point-of-sale systems as well as the aging of the Company's restaurants, higher depreciation expense associated with new restaurants, and increases in utility costs and property taxes.

General and Administrative Expenses: General and administrative expenses decreased from 10.6% in 1996 to 10.2% in 1997 due primarily to the absorption of general and administrative expenses over a larger revenue base as well as the additional leverage resulting from the St. Louis Acquisition. A portion of the decrease in 1997 was due to a decrease in executive bonuses. General and administrative expenses increased by $8,692,000 during 1997 compared to 1996 due primarily to the costs of additional personnel associated with the Company's development efforts and system-wide expansion, including costs related to the franchising and expansion of the Rio Bravo Cantina concept.

Loss on Disposition of Restaurants and Equipment: Loss on disposition of restaurants and equipment decreased from $3,318,000 in 1996 to $1,209,000 in 1997. In October 1996, the Company completed the sale of six of its eight Company owned Applebee's restaurants located in the San Bernardino and Riverside counties of southern California. The operations of the six restaurants and future restaurant development in the market area were assumed by an existing Applebee's franchisee. The sales price was $8,500,000 and a loss on the disposition of the properties of $75,000 was recorded in the third quarter of 1996. During the fourth quarter of 1996, the Company recognized a loss of $2,500,000 primarily relating to the intended disposition of the two remaining restaurants in the territory.

Investment Income: Investment income decreased in 1997 compared to 1996 primarily as a result of decreases in cash and cash equivalents and short-term investments due to capital expenditures and acquisitions.

Interest Expense: Interest expense increased in 1997 compared to 1996 primarily as a result of interest on capitalized leases associated with the St. Louis Acquisition.

Income Taxes: The effective income tax rate, as a percentage of earnings before income taxes, was 37.2% in 1997 compared to 37.4% in 1996. The decrease in the Company's overall effective tax rate in 1997 was due primarily to a reduction in state income taxes and an increase in credits resulting from FICA taxes on tips.

Fiscal Year Ended December 29, 1996 Compared With Fiscal Year Ended December 31, 1995

Company Restaurant Sales: Overall Company restaurant sales increased $59,166,000 (20%) from $299,824,000 in 1995 to $358,990,000 in 1996. Sales for Company Applebee's restaurants increased $47,743,000 (20%) from $237,350,000 in 1995 to $285,093,000 in 1996, due primarily to Company restaurant openings and sales from the five Philadelphia restaurants acquired in April 1995, as well as an increase in comparable restaurant sales. Sales for Company Rio Bravo Cantina restaurants were $48,135,000 and $59,523,000 in 1995 and 1996, respectively, and sales for the specialty restaurants were $14,339,000 and $14,374,000 in 1995 and 1996, respectively. The increase in sales for the Rio Bravo Cantina restaurants resulted primarily from Company restaurant openings and an increase in comparable restaurant sales.

Comparable restaurant sales at Company owned or operated Applebee's restaurants increased by 1.1% in 1996. Weighted average weekly sales at Company owned or operated Applebee's restaurants increased 1.0% from $39,977 in 1995 to $40,366 in 1996. The Company believes these increases were due, in part, to successful food-specific promotions backed by an increase in advertising spending, as a percentage of sales, in 1996. A menu price increase was implemented during the fourth quarter of 1996 for certain menu items. Although the Company's experience in developing markets indicates that the opening of multiple restaurants within a particular market results in increased market share, decreases in comparable restaurant sales may result.

Comparable restaurant sales for Company owned Rio Bravo Cantina restaurants increased by 3.9% in 1996. Weighted average weekly sales (excluding one restaurant that is open for dinner only) increased slightly from $66,158 in 1995 to $66,743 in 1996 and were impacted by the expected lower sales volumes at new restaurants.

Franchise Income: Overall franchise income increased $10,402,000 (24%) from $43,739,000 in 1995 to $54,141,000 in 1996. This increase was due primarily to the increased number of franchise Applebee's restaurants operating during 1996 as compared to 1995. The remaining increase in franchise income resulted primarily from franchise fees earned relating to the opening of the first nine franchise Rio Bravo Cantina restaurants during 1996. These increases were partially offset by decreases in weighted average weekly sales and comparable sales for franchise Applebee's restaurants which decreased 2.6% and 1.2%, respectively, in 1996.

Cost of Company Restaurant Sales: Food and beverage costs decreased from 28.3% in 1995 to 28.0% in 1996, due primarily to operational improvements, purchasing efficiencies resulting from the Company's rapid growth and early payment discounts, and the menu price increase implemented in the fourth quarter of 1996. In addition, the Company experienced an increase in food costs in the second quarter of 1995 as a result of winter flooding in California which caused shortages of certain produce items and a significant increase in related costs. Beverage sales, as a percentage of Company restaurant sales, declined from 18.9% in 1995 to 18.3% in 1996, which had a negative impact on overall food and beverage costs. Management believes that the reduction in beverage sales is due in part to the continuation of the overall trend toward increased awareness of responsible alcohol consumption.

Labor costs decreased from 31.7% in 1995 to 31.5% in 1996. Labor costs, as a percentage of sales, were positively affected by an overall reduction in workers' compensation costs due to favorable historical claims experience and improved hourly labor efficiency. Such decreases were partially offset by higher management costs in 1996. Overall labor costs continue to be adversely affected by the lower sales volumes in the southern California market.

Direct and occupancy costs increased from 24.1% in 1995 to 24.4% in 1996 due primarily to higher advertising expense and depreciation expense which were partially offset by lower rent expense. The southern California market continues to have a negative impact on overall direct and occupancy costs due to the absorption of such expenses, which are primarily fixed in nature, over a lower sales base in those markets.

Pre-opening expense increased from $2,234,000 in 1995 to $3,557,000 in 1996 due primarily to the opening of two additional Applebee's restaurants and one additional Rio Bravo Cantina restaurant in 1996 and costs incurred relating to the reopening of two Applebee's restaurants after being rebuilt. The Company also incurred higher pre-opening costs for each of the five Rio Bravo Cantina restaurants that were opened in 1996 as compared to those opened in 1995.

General and Administrative Expenses: General and administrative expenses decreased in 1996 to 10.6% from 11.3% in 1995, due primarily to the absorption of general and administrative expenses over a larger revenue base. General and administrative expenses increased by $5,134,000 during 1996 compared to 1995 due primarily to the costs of additional personnel associated with the Company's development efforts and system-wide expansion, including costs related to the franchising and expansion of the Rio Bravo Cantina concept.

Merger Costs: The Company incurred merger costs of $1,770,000 in 1995 relating to the IRC Merger. The impact of these costs on net earnings per common share was approximately $0.06 in 1995.

Loss on Disposition of Restaurants and Equipment: In October 1996, the Company completed the sale of six of its eight Company owned Applebee's restaurants located in the San Bernardino and Riverside counties of southern California. The operations of the six restaurants and future restaurant development in the market area were assumed by an existing Applebee's franchisee. The sales price was $8,500,000 and a loss on the disposition of the properties of $75,000 was recorded in the third quarter of 1996. During the fourth quarter of 1996, the Company recognized a loss of $2,500,000 primarily relating to the intended disposition of the two remaining restaurants in the territory.

During 1995, the Company recognized a loss of $615,000 relating to the planned disposition of two restaurants in 1996, including $275,000 relating to one restaurant managed under a purchase rights agreement. The Company continues to operate one restaurant under this agreement.

Investment Income: Investment income increased in 1996 compared to 1995 primarily as a result of increases in cash and cash equivalents and short-term investments resulting from the proceeds of the Company's stock offering in July 1995.

Interest Expense: Interest expense decreased in 1996 compared to 1995 primarily as a result of a decrease in interest related to the revolving credit facility incurred in 1995 and a decrease in long-term debt resulting from the payoff in August 1995 of the debt assumed in connection with the IRC Merger.

Income Taxes: The effective income tax rate, as a percentage of earnings before income taxes, was 37.4% in 1996 compared to 39.5% in 1995. Excluding non-deductible merger costs, the effective income tax rate would have been 38.0% in 1995. The remaining decrease in the Company's overall effective tax rate in 1996 was due primarily to a reduction in state income taxes.

Liquidity and Capital Resources

The Company's need for capital resources historically has resulted from, and for the foreseeable future is expected to relate primarily to, the construction and acquisition of restaurants. Such capital has been provided by public stock offerings, debt financing, and ongoing Company operations, including cash generated from Company and franchise operations, credit from trade suppliers, real estate lease financing, and landlord contributions to leasehold improvements. The Company has also used its common stock as consideration in the acquisition of restaurants. In addition, the Company assumed debt or issued new debt in connection with certain mergers and acquisitions.

Capital expenditures were $65,672,000 in 1996 and $128,155,000 in 1997 (which includes $36,150,000 related to the St. Louis Acquisition and $1,525,000 related to the purchase of the remaining 50% interest in a joint venture arrangement with the Company's franchisee in Nevada). The Company currently expects to open 32 Applebee's restaurants and 11 Rio Bravo Cantina restaurants in 1998. Capital expenditures in fiscal 1998 are expected to be between $85,000,000 and $90,000,000 (excluding $93,400,000 relating to the Virginia Acquisition), primarily for the development of new restaurants, refurbishments of and capital replacements for existing restaurants, and enhancements to information systems for the Company's restaurants and corporate office. The amount of actual capital expenditures will be dependent upon, among other things, the proportion of leased versus owned properties as the Company expects to continue to purchase a portion of its sites. In addition, if the Company opens more restaurants than it currently anticipates or acquires additional restaurants, its capital requirements will increase accordingly.

The Company has certain debt agreements containing various covenants and restrictions which, among other things, require the maintenance of a stipulated fixed charge coverage ratio and minimum consolidated net worth, as defined, and also limit additional indebtedness in excess of specified amounts. The debt agreements also restrict the amount of retained earnings available for the payment of cash dividends. At December 28, 1997, retained earnings were not restricted for the payment of cash dividends. The Company is currently in compliance with the covenants of all of its debt agreements.

As of December 28, 1997, the Company held liquid assets totaling $19,814,000, consisting of cash and cash equivalents ($8,908,000) and short-term investments ($10,906,000). No amounts were outstanding under the revolving credit facility; however, standby letters of credit issued under the facility totaling $1,887,000 were outstanding as of December 28, 1997.

On January 22, 1998, the Company entered into a loan commitment with Merrill Lynch Capital Corporation to provide $225,000,000 in senior secured credit facilities, consisting of an eight-year senior secured term loan of $125,000,000 and a five-year secured revolving credit facility of $100,000,000.

The Company anticipates that it will use the proceeds of the facilities approximately as follows:

- $105,000,000 to fund the Virginia Acquisition (including related transaction fees and expenses);
- $20,000,000 to refinance certain existing indebtedness currently bearing interest at 7.70%; and
- $100,000,000 for ongoing working capital needs and general corporate purposes (including stock repurchases as described below).

Up to $50,000,000 of the facilities will be available to fund repurchases of the Company's common stock. Since December 28, 1997 and through March 9, 1998, the Company has repurchased 1,270,000 shares of its common stock at an aggregate value of $25,000,000, pursuant to plans approved by the Company's Board of Directors. The Company contemplates further purchases of up to $25,000,000, subject to the completion of the financing discussed above.

The senior term loan is expected to bear interest at LIBOR plus 2.25% and require semi-annual principal payments aggregating $1,250,000 per year for each of the first seven years, with the remaining $116,250,000 due during the eighth year. The revolving credit facility is expected to bear interest at LIBOR plus 1.375%.

Both the senior term loan and the revolving credit facility will be subject to standard other terms, conditions, covenants, and fees and will be secured by the stock of each of the Company's present and future subsidiaries and all intercompany debt of the Company and such subsidiaries. The loan commitment is anticipated to close concurrently with the Virginia Acquisition.

The Company believes that its liquid assets and cash generated from operations, combined with borrowings available under its new $225,000,000 senior secured credit facilities, will provide sufficient funds for its capital requirements for the foreseeable future.

Inflation

Substantial increases in costs and expenses, particularly food, supplies, labor and operating expenses, could have a significant impact on the Company's operating results to the extent that such increases cannot be passed along to customers. The Company does not believe that inflation has materially affected its operating results during the past three years.

A majority of the Company's employees are paid hourly rates related to federal and state minimum wage laws and various laws that allow for credits to that wage. An increase in the Federal minimum wage went into effect on October 1, 1996 and a second increase became effective on September 1, 1997. In addition, increases in the minimum wage are also being discussed by various state governments. Although the Company has been able to and will continue to attempt to pass along increases in costs through food and beverage price increases, there can be no assurance that all such increases can be reflected in its prices or that increased prices will be absorbed by customers without diminishing, to some degree, customer spending at its restaurants.

New Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. This statement is effective for fiscal years beginning after December 15, 1997.

The Company does not believe the reporting and display of comprehensive income will materially impact the financial statements.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for the way public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. This statement is effective for financial statements for periods beginning after December 15, 1997. In the initial year of application, comparative information for earlier years is to be presented. This statement need not be applied to interim financial statements in the initial year of its application, but comparative information for interim periods in the initial year of application is to be reported in financial statements for interim periods in the second year of application.

Forward-Looking Statements

The statements contained herein regarding future sales, operating costs, restaurant development and capital expenditures are forward-looking and based on current expectations. There are several risks and uncertainties that could cause actual results to differ materially from those described. For a discussion of the principal factors that could cause actual results to be materially different, refer to the Company's current report on Form 8-K filed with the Securities and Exchange Commission on February 9, 1998.

Impact of the Year 2000

The Year 2000 will have a broad impact on the business environment in which the Company operates due to the possibility that many computer systems across all industries will be unable to process information containing dates beginning in the Year 2000. The Company has conducted a preliminary assessment of the impact of the Year 2000 on its accounting, finance, and other systems, as well as the impact on its external business partners, in order to identify and address potential business issues relating to the Year 2000. Based on this preliminary assessment, the Company believes that its significant systems are Year 2000 compliant, and the costs associated with such compliance have not had, and will not have, a material impact on the Company's results of operations.

Consolidated Balance Sheets

(dollars in thousands, except per share amounts)	Dec. 28, 1997	Dec. 29, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,908	$ 17,346
Short-term investments, at market value	10,906	40,064
Receivables, net of allowance	16,390	19,245
Inventories	4,788	4,557
Prepaid and other current assets	2,962	2,780
Total current assets	43,954	83,992
Property and equipment, net	276,082	196,950
Goodwill, net	48,065	22,607
Franchise interest and rights, net	4,667	5,236
Deferred income taxes	—	1,366
Other assets	4,706	3,960
	$377,474	$314,111
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 6,306	$ 968
Current portion of obligations under noncompetition and consulting agreement	220	220
Accounts payable	19,731	11,949
Accrued expenses and other current liabilities	28,547	25,597
Accrued dividends	2,518	2,191
Accrued income taxes	5,166	918
Total current liabilities	62,488	41,843
Non-current liabilities:		
Long-term debt – less current portion	22,579	24,435
Franchise deposits	1,532	1,793
Obligations under noncompetition and consulting agreement – less current portion	—	220
Deferred income taxes	432	—
Total non-current liabilities	24,543	26,448
Total liabilities	87,031	68,291
Minority interest in joint venture	—	1,056
Commitments and contingencies (Notes 7, 8 and 12)		
Stockholders' equity:		
Preferred stock – par value $0.01 per share: authorized – 1,000,000 shares; no shares issued	—	—
Common stock – par value $0.01 per share: authorized – 125,000,000 shares; issued – 31,744,009 shares in 1997 and 31,580,955 shares in 1996	317	316
Additional paid-in capital	156,165	153,028
Retained earnings	134,654	92,081
Unrealized gain on short-term investments, net of income taxes	95	188
	291,231	245,613
Treasury stock – 261,629 shares in 1997 and 281,772 shares in 1996, at cost	(788)	(849)
Total stockholders' equity	290,443	244,764
	$377,474	$314,111

See notes to consolidated financial statements

Consolidated Statements of Earnings

(in thousands, except per share amounts)	Fiscal Year Ended Dec. 28, 1997	Dec. 29, 1996	Dec. 31, 1995
Revenues:			
Company restaurant sales	$452,173	$358,990	$299,824
Franchise income	63,647	54,141	43,739
Total operating revenues	515,820	413,131	343,563
Cost of Company restaurant sales:			
Food and beverage	124,469	100,534	84,776
Labor	145,165	112,969	94,935
Direct and occupancy	114,196	87,740	72,228
Pre-opening expense	3,661	3,557	2,234
Total cost of Company restaurant sales	387,491	304,800	254,173
General and administrative expenses	52,579	43,887	38,753
Merger costs	—	—	1,770
Amortization of intangible assets	3,258	2,293	2,305
Loss on disposition of restaurants and equipment	1,209	3,318	850
Operating earnings	71,283	58,833	45,712
Other income (expense):			
Investment income	1,834	2,863	1,764
Interest expense	(1,705)	(1,571)	(2,507)
Other income	389	600	357
Total other income (expense)	518	1,892	(386)
Earnings before income taxes	71,801	60,725	45,326
Income taxes	26,710	22,711	17,906
Net earnings	$ 45,091	$ 38,014	$ 27,420
Basic net earnings per common share	$ 1.44	$ 1.22	$ 0.94
Diluted net earnings per common share	$ 1.43	$ 1.21	$ 0.92
Basic weighted average shares outstanding	31,401	31,188	29,319
Diluted weighted average shares outstanding	31,640	31,533	29,860

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(dollars in thousands, except per share amounts)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unrealized Gain (Loss) on Short-Term Investments	Treasury Stock	Total Stockholders' Equity
Balance, December 25, 1994	28,295,479	$283	$ 78,675	$ 30,775	$(96)	$(849)	$108,788
Issuance of common stock from public offering	2,415,000	24	60,410	—	—	—	60,434
Dividends on common stock, $0.06 per share	—	—	—	(1,861)	—	—	(1,861)
Stock options exercised:							
Company	588,038	6	4,649	—	—	—	4,655
IRC	—	—	1,333	—	—	—	1,333
Income tax benefit upon exercise of stock options	—	—	2,615	—	—	—	2,615
Change in unrealized gain on short-term investments, net of income taxes	—	—	—	—	286	—	286
Adjustment related to tax basis of pooled entities	—	—	250	—	—	—	250
Pro forma provision for income taxes of pooled company	—	—	—	73	—	—	73
Reclassification of net income of IRC partnerships	—	—	149	(149)	—	—	—
Net earnings	—	—	—	27,420	—	—	27,420
Balance, December 31, 1995	31,298,517	313	148,081	56,258	190	(849)	203,993
Dividends on common stock, $0.07 per share	—	—	—	(2,191)	—	—	(2,191)
Stock options exercised	282,438	3	3,798	—	—	—	3,801
Income tax benefit upon exercise of stock options	—	—	1,149	—	—	—	1,149
Change in unrealized gain on short-term investments, net of income taxes	—	—	—	—	(2)	—	(2)
Net earnings	—	—	—	38,014	—	—	38,014
Balance, December 29, 1996	31,580,955	316	153,028	92,081	188	(849)	244,764
Dividends on common stock, $0.08 per share	—	—	—	(2,518)	—	—	(2,518)
Stock options exercised	163,054	1	2,193	—	—	—	2,194
Shares sold under employee stock purchase plan	—	—	396	—	—	61	457
Income tax benefit upon exercise of stock options	—	—	548	—	—	—	548
Change in unrealized gain on short-term investments, net of income taxes	—	—	—	—	(93)	—	(93)
Net earnings	—	—	—	45,091	—	—	45,091
Balance, December 28, 1997	31,744,009	$317	$156,165	$134,654	$ 95	$(788)	$290,443

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(dollars in thousands)	Fiscal Year Ended Dec. 28, 1997	Dec. 29, 1996	Dec. 31, 1995
Cash flows from operating activities:			
Net earnings	$45,091	$38,014	$27,420
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	20,877	15,652	11,964
Amortization of intangible assets	3,258	2,293	2,305
Loss (gain) on sale of investments	20	27	(67)
Deferred income tax provision (benefit)	1,001	128	(179)
Loss on disposition of restaurants and equipment	1,209	3,318	850
Pro forma provision for income taxes of pooled company	—	—	73
Changes in assets and liabilities (exclusive of effects of acquisitions other than pooled company):			
Receivables	2,451	(2,702)	(2,447)
Inventories	(66)	5,479	(4,877)
Prepaid and other current assets	671	(898)	155
Accounts payable	7,782	766	433
Accrued expenses and other current liabilities	2,400	2,806	5,307
Accrued income taxes	4,248	(723)	(328)
Franchise deposits	(261)	625	(187)
Other	(1,302)	(139)	356
Net cash provided by operating activities	87,379	64,646	40,778
Cash flows from investing activities:			
Purchases of short-term investments	(19,150)	(49,487)	(16,809)
Maturities and sales of short-term investments	48,117	31,149	4,392
Purchases of property and equipment	(90,480)	(65,672)	(51,899)
Acquisitions of restaurants	(33,650)	—	(9,682)
Acquisition of minority interest in joint venture	(1,525)	—	—
Proceeds from sale of restaurants and equipment	988	4,314	104
Net cash used by investing activities	(95,700)	(79,696)	(73,894)
Cash flows from financing activities:			
Proceeds from issuance of common stock	—	—	60,434
Dividends paid	(2,191)	(1,861)	(1,269)
Issuance of common stock upon exercise of stock options	2,194	3,801	5,988
Income tax benefit upon exercise of stock options	548	1,149	2,615
Shares sold under employee stock purchase plan	457	—	—
Proceeds from issuance of long-term debt	—	—	8,087
Payments on long-term debt	(974)	(945)	(22,179)
Payments under noncompetition and consulting agreement	(220)	(220)	(220)
Minority interest in net earnings of joint venture	69	284	214
Net cash provided (used) by financing activities	(117)	2,208	53,670
Net increase (decrease) in cash and cash equivalents	(8,438)	(12,842)	20,554
Cash and cash equivalents, beginning of period	17,346	30,188	9,634
Cash and cash equivalents, end of period	$ 8,908	$17,346	$30,188
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Income taxes	$20,613	$22,437	$15,537
Interest	$ 2,573	$ 1,061	$ 3,060

Supplemental Disclosures of Noncash Investing and Financing Activities:

Capitalized leases of $2,610,000 were recorded in April 1995 when the Company acquired the operations and assets of five franchise restaurants (see Note 4). A capitalized lease of $424,000 was recorded in July 1995 when the Company entered into a lease for a new restaurant. This lease was transferred to a franchisee in connection with the sale of six restaurants in October 1996.

The Company received a $5,000,000 promissory note in connection with the sale of six restaurants in October 1996 (see Note 10), which was paid in full in January 1997.

Capitalized leases of $4,055,000 were recorded in April 1997 when the Company acquired the operations and assets of 11 franchise restaurants. In connection with this acquisition, the Company issued $2,500,000 of promissory notes (see Note 4).

Disclosure of Accounting Policy:

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Organization

Applebee's International, Inc. and its subsidiaries (the "Company") develops, franchises and operates casual dining restaurants principally under the names "Applebee's Neighborhood Grill & Bar" and "Rio Bravo Cantina." As of December 28, 1997, there were 960 Applebee's restaurants, of which 770 were operated by franchisees and 190 were operated by the Company, and 55 Rio Bravo Cantina restaurants, of which 24 were operated by franchisees and 31 were operated by the Company. The Company also operated four other specialty restaurants. Such restaurants were located in 48 states, Canada, Europe and the Caribbean.

2. Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany profits, transactions and balances have been eliminated.

Fiscal Year: The Company's fiscal year ends on the last Sunday of the calendar year. The fiscal years ended December 28, 1997 and December 29, 1996 contained 52 weeks, and the fiscal year ended December 31, 1995 contained 53 weeks, and are referred to hereafter as 1997, 1996 and 1995, respectively.

Short-Term Investments: Short-term investments are comprised of U.S. government and agency securities, certificates of deposit, state and municipal bonds, and preferred stocks. Gains and losses from sales are determined using the specific identification method. As of December 28, 1997, all short-term investments have been classified as available-for-sale.

Inventories: Inventories are stated at the lower of cost (first-in, first-out method) or market.

Pre-Opening Expense: The Company expenses direct training and other costs related to opening new or relocated restaurants in the month of opening.

Property and Equipment: Property and equipment are stated at cost. Depreciation is provided primarily on a straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the lease term, including renewal options, or the estimated useful life of the related asset. The general ranges of original depreciable lives are as follows:

	Years
Buildings	20
Leasehold improvements	15-20
Furniture and equipment	3-7

Interest has been capitalized in connection with the development of new restaurants and is amortized over the estimated useful life of the related asset. Interest costs of $755,000, $618,000 and $624,000 were capitalized during 1997, 1996 and 1995, respectively.

Goodwill: Goodwill represents the excess of cost over fair market value of net assets acquired by the Company. Goodwill is being amortized over periods ranging from 15 to 20 years on a straight-line basis. Accumulated amortization at December 28, 1997 and December 29, 1996 was $7,595,000 and $5,155,000, respectively.

Impairment of Long-Lived Assets: Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Franchise Interest and Rights: Franchise interest and rights represent allocations of purchase price to either the purchased restaurants or franchise operations acquired. The allocated costs are amortized over the estimated life of the restaurants or the franchise agreements on a straight-line basis ranging from 7 to 20 years. Accumulated amortization at December 28, 1997 and December 29, 1996 was $6,263,000 and $5,695,000, respectively.

Franchise Revenues: Franchise revenues are deferred until substantial performance of franchisor obligations is complete. Initial franchise fees, included in franchise income in the consolidated statements of earnings, totaled $4,263,000, $4,615,000 and $4,162,000 for 1997, 1996 and 1995, respectively.

Advertising Costs: The Company expenses advertising costs for Company owned restaurants as incurred except for production costs of advertising which are expensed the first time the advertising takes place. Advertising expense related to Company restaurants was $20,752,000, $16,470,000 and $12,749,000 for 1997, 1996 and 1995, respectively.

Stock-Based Compensation: The Company has adopted the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." The Statement encourages rather than requires companies to adopt a method that accounts for stock compensation awards based on their estimated fair value at the date they are granted. Companies are permitted, however, to account for stock compensation awards under Accounting Principles Board ("APB") Opinion No. 25 which requires compensation cost to be recognized based on the excess, if any, between the quoted market price of the stock at the date of grant and the amount an employee must pay to acquire the stock. The Company has elected to continue to apply APB Opinion No. 25 and has disclosed the pro forma net earnings and earnings per share, determined as if the fair value method had been applied, in Note 14.

Earnings Per Share: The Company adopted SFAS No. 128, "Earnings Per Share," during 1997. SFAS No. 128 requires presentation of basic and diluted earnings per share. Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. All prior period weighted average and per share information has been restated in accordance with SFAS No. 128. Outstanding stock options issued by the Company represent the only dilutive effect on weighted average shares. A reconciliation between basic and diluted weighted average shares outstanding and the related earnings per share calculation is presented below:

(in thousands, except per share amounts)	1997	1996	1995
Net earnings	$45,091	$38,014	$27,420
Basic weighted average shares outstanding	31,401	31,188	29,319
Dilutive effect of stock options	239	345	541
Diluted weighted average shares outstanding	31,640	31,533	29,860
Basic net earnings per common share	$ 1.44	$ 1.22	$ 0.94
Diluted net earnings per common share	$ 1.43	$ 1.21	$ 0.92

Stock options with exercise prices greater than the average market price of the Company's common stock for the applicable periods are excluded from the computation of diluted weighted average shares outstanding. Such options totaled approximately 1,625,000, 1,368,000 and 374,000 for 1997, 1996 and 1995, respectively.

Pervasiveness of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements: In June 1997, the Financial Accounting Standards Board issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. This statement is effective for fiscal years beginning after December 15, 1997. The Company does not believe the reporting and display of comprehensive income will materially impact the financial statements.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for the way public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. This statement is effective for financial statements for periods beginning after December 15, 1997. In the initial year of application, comparative information for earlier years is to be presented. This statement need not be applied to interim financial statements in the initial year of its application, but comparative information for interim periods in the initial year of application is to be reported in financial statements for interim periods in the second year of application.

3. Disclosures about Fair Value of Financial Instruments

The following methods were used in estimating fair value disclosures for significant financial instruments of the Company. The carrying amount of cash and cash equivalents approximates fair value because of the short maturity of those instruments. The carrying amount of short-term investments is based on quoted market prices. The fair value of the Company's long-term debt, excluding capitalized lease obligations, is estimated based on quotations made on similar issues.

The estimated fair values of the Company's financial instruments are as follows:

	Dec. 28, 1997		Dec. 29, 1996	
(in thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Short-term investments	$10,906	$10,906	$40,064	$40,064
Long-term debt, excluding capitalized lease obligations	$24,306	$24,941	$22,780	$23,099

4. Acquisitions

IRC Merger: On March 23, 1995, a wholly-owned subsidiary of the Company merged with and into Innovative Restaurant Concepts, Inc. ("IRC"), referred to herein as the "IRC Merger." Immediately prior to the IRC Merger, IRC's affiliated limited partnerships, Cobb/Gwinnett Rio, Ltd., Rio Real Estate, L.P. and CG Restaurant Partners, Ltd., were liquidated, and contemporaneously with the IRC Merger, the Company acquired the interests of the limited partners in the distributed assets of these partnerships. As a result of the IRC Merger, IRC became a wholly-owned subsidiary of the Company. A total of approximately 2,630,000 shares of the Company's newly-issued common stock was issued to the shareholders and limited partners of IRC, including IRC shares issued in 1995 upon the exercise of IRC stock options prior to the IRC Merger. IRC employees also exchanged pre-existing stock options for options to purchase approximately 147,000 shares of the Company's common stock. In addition, the Company assumed approximately $13,700,000 of IRC indebtedness, of which $1,270,000 was repaid at closing and the remainder was repaid during 1995. At the time of the IRC Merger, IRC operated 17 restaurants, 13 of which were Rio Bravo Cantinas, a Mexican restaurant concept, and four were other specialty restaurants. The IRC Merger was accounted for as a pooling of interests. Merger costs of $1,770,000 relating to the IRC Merger were expensed in 1995. Merger costs include investment banking fees, legal and accounting fees, and other merger related expenses. The impact of these costs on net earnings per common share was approximately $0.06 in 1995.

Other Restaurant Acquisitions: On April 3, 1995, the Company acquired the operations of five franchise restaurants and the related furniture and fixtures, certain land and leasehold improvements, and rights to future development of restaurants for a total purchase price of $9,682,000. The acquisition was accounted for as a purchase, and accordingly, the purchase price has been allocated to the fair value of net assets acquired and resulted in an allocation to goodwill of $6,432,000. In connection with this acquisition, the Company also recorded capitalized leases of $2,610,000. The 1995 financial statements reflect the results of operations of such restaurants subsequent to the date of acquisition. Results of operations of such restaurants prior to acquisition were not material in relation to the Company's operating results for the periods shown.

In 1997, the Company exercised its option to purchase the remaining 50% interest in a joint venture arrangement with its franchisee in Nevada for $1,525,000.

On April 14, 1997, the Company acquired the operations of 11 franchise Applebee's restaurants located in the St. Louis metropolitan area and the related furniture and fixtures, certain land and leasehold improvements, and rights to future development of restaurants for a total purchase price of $36,150,000. The purchase price was paid in a combination of $33,650,000 in cash and $2,500,000 of promissory notes, of which $1,500,000 was payable in January 1998 and $1,000,000 is payable in December 1998. One of the principals of the franchisee was related to a person who was a director of the Company until May 1997. The acquisition was accounted for as a purchase, and accordingly, the purchase price has been allocated to the fair value of net assets acquired and resulted in an allocation to goodwill of approximately $27,000,000 which is being amortized on a straight-line basis over 20 years. In connection with this acquisition, the Company also recorded capitalized leases of $4,055,000. The results of operations of such restaurants have been reflected in the consolidated financial statements subsequent to the date of acquisition. Results of operations of such restaurants prior to acquisition were not material in relation to the Company's operating results for the periods shown.

On December 23, 1997, the Company entered into an agreement with Apple South, Inc. ("Apple South"), its largest franchisee, to acquire 31 Applebee's restaurants plus one restaurant under construction in the Virginia markets of Norfolk, Richmond, Roanoke and Charlottesville for approximately $93,400,000, subject to certain closing adjustments, referred to herein as the "Virginia Acquisition." The Virginia Acquisition is anticipated to close in late March 1998, subject to obtaining financing, operating licenses and third-party consents, and will be accounted for as a purchase. See Note 12 for additional commitments and contingencies relating to the agreement with Apple South.

5. Short-Term Investments

The amortized cost, estimated market value and unrealized gains or losses on short-term investments are as follows:

	Dec. 28, 1997			Dec. 29, 1996		
(in thousands)	Amortized Cost	Unrealized Gain	Market Value	Amortized Cost	Unrealized Gain	Market Value
Certificates of deposit	$ 19	$ —	$ 19	$ 19	$ —	$ 19
Preferred stocks	402	56	458	1,374	52	1,426
U.S. government and agency securities	4,496	—	4,496	19,829	150	19,979
State and local municipal securities	5,837	96	5,933	18,541	99	18,640
	$10,754	$152	$10,906	$39,763	$301	$40,064

The amortized cost and estimated market value of debt securities as of December 28, 1997, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(in thousands)	Amortized Cost	Market Value
Due within one year or less	$ 2,911	$ 2,911
Due after one year through five years	7,422	7,518
	$10,333	$10,429

6. Receivables

Receivables are comprised of the following:

(in thousands)	Dec. 28, 1997	Dec. 29, 1996
Franchise royalty, advertising and trade receivables	$12,406	$ 9,801
Notes receivable	1,150	6,305
Credit card receivables	2,272	1,636
Interest and dividends receivable	288	833
Franchise fee receivables	743	425
Other	368	515
	17,227	19,515
Less allowance for bad debts	837	270
	$16,390	$19,245

Included in notes receivable as of December 29, 1996 was a $5,000,000 promissory note which was received from a franchisee in connection with the sale of six restaurants in October 1996 (see Note 10), which was paid in full in January 1997.

The provision for bad debts totaled $635,000 for 1997 and $250,000 for 1995. No provision for bad debts was recorded during 1996. Write-offs against the allowance for bad debts totaled $68,000, $453,000 and $267,000 during 1997, 1996 and 1995, respectively.

7. Property and Equipment

Property and equipment, net is comprised of the following:

(in thousands)	Dec. 28, 1997	Dec. 29, 1996
Land	$ 52,638	$ 38,340
Buildings and leasehold improvements	176,517	125,486
Furniture and equipment	106,125	77,034
Construction in progress	10,238	7,882
	345,518	248,742
Less accumulated depreciation and capitalized lease amortization	69,436	51,792
	$276,082	$196,950

Property under capitalized leases in the amount of $4,540,000 and $2,610,000 at December 28, 1997 and December 29, 1996, respectively, is included in buildings and leasehold improvements. Accumulated amortization of such property amounted to $235,000 and $225,000 at December 28, 1997 and December 29, 1996, respectively. Capitalized leases relate to the buildings on certain restaurant properties. The land portions of the restaurant property leases are accounted for as operating leases.

Depreciation and capitalized lease amortization expense relating to property and equipment totaled $20,877,000, $15,652,000 and $11,964,000 for 1997, 1996 and 1995, respectively. Of these amounts, $210,000, $145,000 and $105,000 related to capitalized lease amortization during 1997, 1996 and 1995, respectively.

The Company leases certain of its restaurants. The leases generally provide for payment of minimum annual rent, real estate taxes, insurance and maintenance and, in some cases, contingent rent (calculated as a percentage of sales) in excess of minimum rent. Total rental expense for all operating leases is comprised of the following:

(in thousands)	1997	1996	1995
Minimum rent	$10,452	$8,138	$7,300
Contingent rent	1,298	1,451	1,520
	$11,750	$9,589	$8,820

The present value of capitalized lease payments and the future minimum lease payments under noncancelable operating leases (including leases executed for sites to be developed in 1998) as of December 28, 1997 are as follows:

(in thousands)	Capitalized Leases	Operating Leases
1998	$ 642	$ 12,483
1999	664	12,754
2000	691	12,159
2001	717	11,900
2002	741	11,764
Thereafter	11,308	103,691
Total minimum lease payments	14,763	$164,751
Less amounts representing interest	10,184	
Present value of minimum lease payments	$ 4,579	

8. Long-Term Debt

Long-term debt, including capitalized lease obligations, is comprised of the following:

(in thousands)	Dec. 28, 1997	Dec. 29, 1996
Unsecured notes payable; 7.70% interest per annum, with principal payments beginning in 1998; due May 2004	$20,000	$20,000
Secured bank note; 6.69% interest per annum; due in quarterly installments of principal and interest through October 1998	600	1,200
Unsecured promissory notes issued in connection with the acquisition of restaurants; 8.00% interest per annum; due in annual installments of principal and interest through February 2000	1,187	1,544
Unsecured promissory notes issued in connection with the acquisition of restaurants; 8.00% interest per annum; due in two installments of principal and interest in January and December 1998	2,500	—
Capitalized lease obligations	4,579	2,623
Other	19	36
Total long-term debt	28,885	25,403
Less current portion of long-term debt	6,306	968
Long-term debt – less current portion	$22,579	$24,435

During 1995, the Company obtained a $20,000,000 unsecured bank revolving credit facility that was to expire on December 31, 1997. In September 1997, the terms of the facility were amended to extend the expiration date to December 31, 1998. Of this amount, $5,000,000 can be utilized for standby letters of credit. The revolving credit facility bears interest at LIBOR plus 0.60% or the prime rate, at the Company's option, and requires the Company to pay a commitment fee of 0.15% on any unused portion of the facility. As of December 28, 1997, no amounts were outstanding under the facility. Standby letters of credit issued under the facility totaling $1,887,000 and $1,324,000 were outstanding as of December 28, 1997 and December 29, 1996, respectively.

The debt agreements contain various covenants and restrictions which, among other things, require the maintenance of a stipulated fixed charge coverage ratio and minimum consolidated net worth, as defined, and limit additional indebtedness in excess of specified amounts. The debt agreements also restrict the amount available for the payment of cash dividends. At December 28, 1997, retained earnings were not restricted for the payment of cash dividends. The Company is currently in compliance with the covenants of all of its debt agreements.

Maturities of long-term debt, including capitalized lease obligations, for each of the five fiscal years subsequent to December 28, 1997, ending during the years indicated, are as follows:

(in thousands)	
1998	$6,306
1999	3,199
2000	3,249
2001	2,853
2002	2,874

The Company entered into a financing commitment in January 1998 (see Note 16). As a result of this commitment, the Company expects to refinance the $20,000,000 unsecured notes payable due in 2004, and to cancel the $20,000,000 unsecured bank revolving credit facility.

9. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities are comprised of the following:

(in thousands)	Dec. 28, 1997	Dec. 29, 1996
Compensation and related taxes	$ 9,060	$ 9,828
Gift certificates	4,129	3,826
Sales and use taxes	2,790	2,006
Insurance	4,473	1,596
Rent	2,782	2,477
Other	5,313	5,864
	$28,547	$25,597

10. Loss on Disposition of Restaurants and Equipment

In October 1996, the Company completed the sale of six of its eight Company owned Applebee's restaurants located in the San Bernardino and Riverside counties of southern California. The operations of the six restaurants and future restaurant development in the market area were assumed by an existing Applebee's franchisee. The sales price was $8,500,000 and a loss on the disposition of the properties of $75,000 was recorded in the third quarter of 1996. During the fourth quarter of 1996, the Company recognized a loss of $2,500,000 primarily relating to the intended disposition of the two remaining restaurants in the territory.

11. Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. The combined earnings of IRC, a pooled company, included earnings of limited partnerships which were not taxable entities for federal and state income tax purposes. The accompanying consolidated statements of earnings reflect provisions for income taxes on a pro forma basis as if the Company were liable for federal and state income taxes on the earnings of IRC's limited partnerships for periods prior to the IRC Merger at a statutory rate of 39%.

The income tax provision consists of the following:

(in thousands)	1997	1996	1995
Current provision:			
Federal	$22,016	$18,783	$15,163
State	3,693	3,800	2,849
Deferred provision (benefit)	1,001	128	(179)
Pro forma provision for income taxes of pooled company	—	—	73
Income taxes	$26,710	$22,711	$17,906

The deferred income tax provision is comprised of the following:

(in thousands)	1997	1996	1995
Depreciation	$2,270	$617	$ 13
Franchise deposits	(534)	77	85
Allowance for bad debts	(111)	345	(72)
Accrued expenses	(758)	203	(125)
Property and equipment writedown	671	(935)	—
Other	(537)	(179)	(80)
Deferred income tax provision (benefit)	1,001	128	(179)
Adjustment to tax basis of pooled company	—	—	(1,350)
Deferred income taxes related to change in unrealized gain (loss) on investments	57	(3)	173
Net change in deferred income taxes	$1,058	$125	$(1,356)

A reconciliation between the income tax provision and the expected tax determined by applying the statutory federal income tax rates to earnings before income taxes follows:

(in thousands)	1997	1996	1995
Federal income tax at statutory rates	$25,130	$21,254	$15,864
Increase (decrease) to income tax expense:			
Amortization of goodwill	280	276	281
State income taxes, net of federal benefit	2,625	2,470	1,852
Merger costs	—	—	625
Tax exempt investment income	(310)	(338)	(169)
Meals and entertainment disallowance	278	317	258
FICA tip tax credit	(1,598)	(1,136)	(985)
Other	305	(132)	180
Income taxes	$26,710	$22,711	$17,906

The net current deferred income tax asset amounts are included in "prepaid and other current assets" in the accompanying consolidated balance sheets. The significant components of deferred income tax assets and liabilities and the related balance sheet classifications are as follows:

(in thousands)	Dec. 28, 1997	Dec. 29, 1996
Classified as current:		
Allowance for bad debts	$ 126	$ 15
Accrued expenses	1,003	245
Other, net	(624)	(495)
Net deferred income tax asset (liability)	$ 505	$ (235)
Classified as non-current:		
Depreciation	$(1,786)	$ 484
Franchise deposits	900	366
Other, net	454	516
Net deferred income tax asset (liability)	$ (432)	$1,366

12. Commitments and Contingencies

Litigation, Claims and Disputes: As of December 28, 1997, the Company was using assets owned by a former franchisee in the operation of one restaurant under a purchase rights agreement which required the Company to make certain payments to the franchisee's lender. In 1991, a dispute arose between the lender and the Company over the amount of the payments due the lender. Based upon a then current independent appraisal, the Company offered to settle the dispute and purchase the assets for $1,000,000 in 1991. In November 1992, the lender was declared insolvent by the FDIC and has since been liquidated. The Company closed one of the three restaurants in 1994 and one of the two remaining restaurants in February 1996. In the fourth quarter of 1996, the Company received information indicating that the franchisee's indebtedness to the FDIC had been acquired by a third party. In June 1997, the third party filed a lawsuit against the Company seeking approximately $3,800,000. The lawsuit remains in the discovery phase. The Company believes it has meritorious defenses and will vigorously defend this lawsuit. In the event that the Company were to pay an amount determined to be in excess of the fair market value of the assets, the Company will recognize a loss at the time of such payment.

In addition, the Company is involved in various legal actions arising in the normal course of business. While the resolution of any of such actions or the matter described above may have an impact on the financial results for the period in which it is resolved, the Company believes that the ultimate disposition of these matters will not, in the aggregate, have a material adverse effect upon its business or consolidated financial position.

Franchise Financing: The Company entered into an agreement in 1992 with a financing source to provide up to $75,000,000 of financing to Company franchisees to fund development of new franchise restaurants. The Company provided a limited guaranty of loans made under the agreement. The Company's maximum recourse obligation of 10% of the amount funded is reduced beginning in the second year of each long-term loan and thereafter decreases ratably to zero after the seventh year of each loan. At December 28, 1997, approximately $48,000,000 had been funded through this financing source, of which approximately $19,000,000 was outstanding. This agreement expired on December 31, 1994 and was not renewed, although some loan commitments as of the termination date were thereafter funded through December 31, 1995.

Severance Agreements: The Company has severance and employment agreements with certain officers providing for severance payments to be made in the event the employee resigns or is terminated related to a change in control (as defined in the agreements). If the severance payments had been due as of December 28, 1997, the Company would have been required to make payments aggregating approximately $4,900,000. In addition, the Company has severance and employment agreements with certain officers which contain severance provisions not related to a change in control, and such provisions would have required aggregate payments of approximately $3,900,000 if such officers had been terminated as of December 28, 1997.

Apple South Divestiture Plan: As part of the agreement with Apple South relating to the Virginia Acquisition (see Note 4), Apple South has also agreed to use its best efforts to sell its other Applebee's restaurants as soon as practical, resulting in its exit as an Applebee's franchisee. To the extent any restaurants are not divested by Apple South by December 31, 1999, the Company has an option to purchase the remaining restaurants at a predetermined formula. The Company and Apple South have committed to work together to identify and approve qualified franchise groups to acquire the remaining Apple South restaurants and to effect an efficient transition of ownership. To assist in this transition, the Company has agreed to provide the availability of guarantees up to 10% of the borrowings of qualified franchise groups, up to a maximum of $10,000,000 in the aggregate.

13. Stockholders' Equity

On July 28, 1995, the Company completed a public offering of its common stock consisting of 2,100,000 shares sold by the Company and 300,000 shares sold by certain stockholders of the Company. In addition, the Company and the selling stockholders granted the underwriters an option to purchase 315,000 and 45,000 shares, respectively, to cover over-allotments, which was exercised on August 9, 1995. Net proceeds of $60,434,000, after expenses, were received from the offering. A portion of the net proceeds of the offering was used to retire approximately $12,500,000 of secured debt assumed in certain acquisitions and to repay the outstanding balance of the Company's revolving credit facility of $5,000,000.

On September 7, 1994, the Company's Board of Directors adopted a Shareholder Rights Plan (the "Rights Plan") and declared a dividend, issued on September 19, 1994, of one Right for each outstanding share of Common Stock of the Company (the "Common Shares"). The Rights become exercisable if a person or group acquires more than 15% of the outstanding Common Shares, other than pursuant to a Qualifying Offer (as defined) or makes a tender offer for more than 15% of the outstanding Common Shares, other than pursuant to a Qualifying Offer. Upon the occurrence of such an event, each Right entitles the holder (other than the acquiror) to purchase for $75 the economic equivalent of Common Shares, or in certain circumstances, stock of the acquiring entity, worth twice as much. The Rights will expire on September 7, 2004 unless earlier redeemed by the Company, and are redeemable prior to becoming exercisable at $0.01 per Right.

14. Employee Benefit Plans

Employee Stock Option Plan: During 1989, the Company's Board of Directors approved the 1989 Employee Stock Option Plan (the "1989 Plan") which provided for the grant of both qualified and nonqualified options as determined by a committee appointed by the Board of Directors. At the 1995 Annual Meeting of Stockholders, the 1989 Employee Stock Option Plan was terminated, and the 1995 Equity Incentive Plan (the "1995 Plan") was approved. Stock options outstanding under the existing 1989 Stock Option Plan were not affected by the termination of that plan.

Options under the 1989 Plan were granted for a term of three to ten years and were generally exercisable one year from date of grant. The 1995 Plan allows the granting of stock options, stock appreciation rights, restricted stock awards, performance unit awards and performance share awards (collectively, "Awards") to eligible participants. The number of shares authorized to be issued pursuant to the 1995 Plan is 2,300,000. Options granted under the 1995 Plan during 1995 have a term of five to ten years and are generally exercisable three years from date of grant. Options granted under the 1995 Plan during 1996 and 1997 have a term of ten years and are generally 50% exercisable three years from date of grant, 25% exercisable four years from date of grant, and 25% exercisable five years from date of grant. Subject to the terms of the 1995 Plan, the Committee has the sole discretion to determine the employees who shall be granted Awards, the size and types of such Awards, and the terms and conditions of such Awards. Under both plans, the option price for both qualified and nonqualified options as of the date granted cannot be less than the fair market value of the Company's common stock.

The Company accounts for both plans in accordance with APB Opinion No. 25 which requires compensation cost to be recognized based on the excess, if any, between the quoted market price of the stock at the date of grant and the amount an employee must pay to acquire the stock. Under this method, no compensation cost has been recognized for stock option awards.

Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value as prescribed by SFAS No. 123 (see Note 2), the Company's net earnings and net earnings per common share would have been reduced to the pro forma amounts indicated below:

(in thousands, except per share amounts)	1997	1996	1995
Net earnings, as reported	$45,091	$38,014	$27,420
Net earnings, pro forma	$41,119	$32,863	$25,613
Basic net earnings per common share, as reported	$ 1.44	$ 1.22	$ 0.94
Basic net earnings per common share, pro forma	$ 1.31	$ 1.05	$ 0.87
Diluted net earnings per common share, as reported	$ 1.43	$ 1.21	$ 0.92
Diluted net earnings per common share, pro forma	$ 1.30	$ 1.04	$ 0.86

The weighted average fair value at date of grant for options granted during 1997, 1996 and 1995 was $12.76, $15.14 and $14.77 per share, respectively, which, for the purposes of this disclosure, is assumed to be amortized over the respective vesting period of the grants. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 1997, 1996 and 1995: dividend yield of 0.3% for all years; expected volatility of 56.0%, 58.1% and 63.4%, respectively; risk-free interest rate of 5.7%, 6.2% and 6.4%, respectively; and expected lives of 4.6, 4.9 and 4.0 years, respectively.

Transactions relative to both plans are as follows:

	1995 Plan		1989 Plan	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options outstanding at December 25, 1994	—	—	1,594,679	$11.29
Granted	891,300	$28.01	163,000	$18.80
Exercised	—	—	(588,038)	$ 7.92
Canceled	(15,000)	$28.50	(71,100)	$15.59
Options outstanding at December 31, 1995	876,300	$28.00	1,098,541	$13.92
Granted	1,073,701	$27.99	—	—
Exercised	—	—	(282,438)	$27.46
Canceled	(120,658)	$28.39	(4,400)	$13.73
Options outstanding at December 29, 1996	1,829,343	$27.97	811,703	$14.09
Granted	142,825	$24.98	—	—
Exercised	(2,167)	$25.88	(160,887)	$13.29
Canceled	(228,902)	$28.03	(10,804)	$20.52
Options outstanding at December 28, 1997	1,741,099	$27.72	640,012	$14.17
Options exercisable at December 28, 1997	214,000	$26.23	640,012	$14.17
Options available for grant at December 28, 1997	556,734		—	

The following table summarizes information relating to fixed-priced stock options outstanding for both plans at December 28, 1997:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
1989 Plan:					
$ 3.02 to $ 7.63	28,562	3.9 years	$ 4.62	28,562	$ 4.62
$11.83 to $14.69	521,950	3.7 years	$13.74	521,950	$13.74
$19.25 to $21.88	89,500	2.6 years	$19.78	89,500	$19.78
$ 3.02 to $21.88	640,012	3.5 years	$14.17	640,012	$14.17
1995 Plan:					
$22.75 to $25.75	258,358	6.0 years	$24.98	130,000	$24.97
$28.00 to $29.25	1,482,741	8.1 years	$28.19	84,000	$28.18
$22.75 to $29.25	1,741,099	7.8 years	$27.72	214,000	$26.23

Employee Retirement Plans: During 1992, the Company established a profit sharing plan and trust in accordance with Section 401(k) of the Internal Revenue Code. Prior to 1997, the Company matched 25% of employee contributions, not to exceed 2% of the employee's total annual compensation, with the Company contributions vesting at the rate of 20% each year beginning after the employee's second year of service. The Company adopted amendments to the 401(k) plan which were effective beginning in 1997. The Company's matching contributions were increased to 35% and 50% of employee contributions in 1997 and 1998, respectively, not to exceed 2.8% and 4.0%, respectively, of the employee's total annual compensation, and will be made in shares of the Company's common stock. The Company's contributions vest at the rate of 60% after the employee's third year of service, 80% after four years of service and 100% after five years of service. The number of common shares authorized pursuant to the 401(k) plan is 50,000. During 1994, the Company established a non-qualified defined contribution retirement plan for key employees. The Company's contributions under both plans in 1997, 1996 and 1995 were $702,000, $570,000 and $312,000, respectively.

Employee Stock Purchase Plan: During 1996, the Company established an employee stock purchase plan in accordance with Section 423 of the Internal Revenue Code, and the plan was approved at the 1997 Annual Meeting of Stockholders. The plan allows employees to purchase shares of the Company's common stock at a 10% discount through payroll deductions. The number of common shares authorized pursuant to the plan is 200,000. During 1997, employees purchased 20,143 shares under this plan.

Employee Stock Ownership Plan: The Company's Board of Directors approved an employee stock ownership plan in January 1997. The Company's contributions to this plan are completely discretionary and will be made in shares of the Company's common stock. The Company's contribution to the plan was $500,000 for 1997.

15. Related Party Transactions

The Company and certain franchisees have obtained restaurant equipment from a company owned by an individual who is related to a person who was a director of the Company until May 1997. During 1997, 1996 and 1995, the Company paid $264,000, $426,000 and $3,128,000, respectively, for equipment and services purchased from this company.

The Company leases a restaurant site from a corporation whose ownership is composed of certain current and former stockholders, directors and officers of the Company. The lease has a term of 20 years with two renewal options. The lease provides for rentals in an amount equal to approximately 7% of gross sales of the restaurants. During 1995, the Company entered into an agreement with this party to lease additional parking space at the same site. Rents incurred under both leases totaled $166,000, $185,000 and $186,000 for 1997, 1996 and 1995, respectively, and are included in direct and occupancy costs in the consolidated statements of earnings.

The Company leases a restaurant site from a partnership in which a former director, who is related to a person who was a director of the Company until May 1997, holds a 50% interest. The lease has a term of 20 years with two options to renew. The lease provides for rentals in an amount equal to approximately 7% of gross sales of the restaurant. Rents incurred under the lease were $128,000 for 1997 and $113,000 for both 1996 and 1995, and are included in direct and occupancy costs in the consolidated statements of earnings.

The Company leases certain office space under an operating lease from a partnership in which a person, who was a director of the Company until August 1997 and who remains a significant stockholder of the Company, holds a 37.5% interest. The lease expires in December 1998 and is renewable for one-year terms at the Company's option. Rents incurred under the lease were $120,000, $104,000 and $84,000 for 1997, 1996 and 1995, respectively, and are included in general and administrative expenses in the consolidated statements of earnings.

16. Subsequent Events

On January 22, 1998, the Company entered into a loan commitment with Merrill Lynch Capital Corporation to provide $225,000,000 in senior secured credit facilities, consisting of an eight-year senior secured term loan of $125,000,000 and a five-year secured revolving credit facility of $100,000,000.

The Company anticipates that it will use the proceeds of the facilities approximately as follows:

- $105,000,000 to fund the Virginia Acquisition (including related transaction fees and expenses);
- $20,000,000 to refinance certain existing indebtedness currently bearing interest at 7.70% (see Note 8); and
- $100,000,000 for ongoing working capital needs and general corporate purposes (including stock repurchases as described below).

Up to $50,000,000 of the facilities will be available to fund repurchases of the Company's common stock. Since December 28, 1997 and through March 9, 1998, the Company has repurchased 1,270,000 shares of its common stock at an aggregate value of $25,000,000, pursuant to plans approved by the Company's Board of Directors. The Company contemplates additional purchases of up to $25,000,000 subject to the completion of the financing discussed above.

The senior term loan is expected to bear interest at LIBOR plus 2.25% and require semi-annual principal payments aggregating $1,250,000 per year for each of the first seven years, with the remaining $116,250,000 due during the eighth year. The revolving credit facility is expected to bear interest at LIBOR plus 1.375%.

Both the senior term loan and the revolving credit facility will be subject to standard other terms, conditions, covenants, and fees and will be secured by the common stock of each of the Company's present and future subsidiaries and all intercompany debt of the Company and such subsidiaries. The loan commitment is anticipated to close concurrently with the Virginia Acquisition (see Note 4).

In February 1998, the Company entered into an agreement to sell its six restaurants located in the Long Island, New York area for approximately $10,000,000 in cash. The operations of the restaurants and future restaurant development in the market area will be assumed by an existing Applebee's franchisee. The Company expects the sale to close in the second quarter of 1998 with minimal effect, if any, on its consolidated net earnings or financial position.

17. Quarterly Results of Operations (Unaudited)

The following presents the unaudited consolidated quarterly results of operations for 1997 and 1996.

	1997				1996			
	Fiscal Quarter Ended				Fiscal Quarter Ended			
(in thousands, except per share amounts)	March 30, 1997	June 29, 1997	Sept. 28, 1997	Dec. 28, 1997	March 31, 1996	June 30, 1996	Sept. 29, 1996	Dec. 29, 1996
Revenues:								
Company restaurant sales	$100,843	$114,775	$117,607	$118,948	$82,640	$ 91,116	$ 92,969	$ 92,265
Franchise income	15,409	15,917	16,260	16,061	12,401	13,469	14,105	14,166
Total operating revenues	116,252	130,692	133,867	135,009	95,041	104,585	$107,074	$106,431
Cost of Company restaurant sales:								
Food and beverage	27,721	31,661	32,228	32,859	23,351	25,549	26,172	25,462
Labor	32,101	36,025	37,914	39,125	26,859	28,292	29,027	28,791
Direct and occupancy	26,022	28,419	28,884	30,871	20,463	22,865	22,049	22,363
Pre-opening expense	510	902	864	1,385	249	925	865	1,518
Total cost of Company restaurant sales	86,354	97,007	99,890	104,240	70,922	77,631	78,113	78,134
General and administrative expenses	12,446	13,109	13,060	13,964	10,385	11,109	11,152	11,241
Amortization of intangible assets	568	857	913	920	588	570	570	565
Loss on disposition of restaurants and equipment	233	251	262	463	115	424	183	2,596
Operating earnings	16,651	19,468	19,742	15,422	13,031	14,851	17,056	13,895
Other income (expense):								
Investment income	933	446	180	275	801	597	694	771
Interest expense	(359)	(473)	(407)	(466)	(446)	(434)	(363)	(328)
Other income	148	90	58	93	105	200	205	90
Total other income (expense)	722	63	(169)	(98)	460	363	536	533
Earnings before income taxes	17,373	19,531	19,573	15,324	13,491	15,214	17,592	14,428
Income taxes	6,497	7,305	7,320	5,588	5,126	5,639	6,598	5,348
Net earnings	$ 10,876	$ 12,226	$ 12,253	$ 9,736	$ 8,365	$ 9,575	$ 10,994	$ 9,080
Basic net earnings per common share	$ 0.35	$ 0.39	$ 0.39	$ 0.31	$ 0.27	$ 0.31	$ 0.35	$ 0.29
Diluted net earnings per common share	$ 0.34	$ 0.39	$ 0.39	$ 0.31	$ 0.27	$ 0.30	$ 0.35	$ 0.29
Basic weighted average shares outstanding	31,310	31,370	31,444	31,478	31,033	31,148	31,277	31,295
Diluted weighted average shares outstanding	31,606	31,611	31,692	31,654	31,338	31,553	31,680	31,600

Independent Auditors' Report

Applebee's International, Inc.:

We have audited the accompanying consolidated balance sheets of Applebee's International, Inc. and subsidiaries (the "Company") as of December 28, 1997 and December 29, 1996, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three fiscal years in the period ended December 28, 1997. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Applebee's International, Inc. and subsidiaries at December 28, 1997 and December 29, 1996, and the consolidated results of their operations and cash flows for each of the three fiscal years in the period ended December 28, 1997 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Kansas City, Missouri
February 13, 1998
(March 9, 1998 as to the
third paragraph of Note 16)

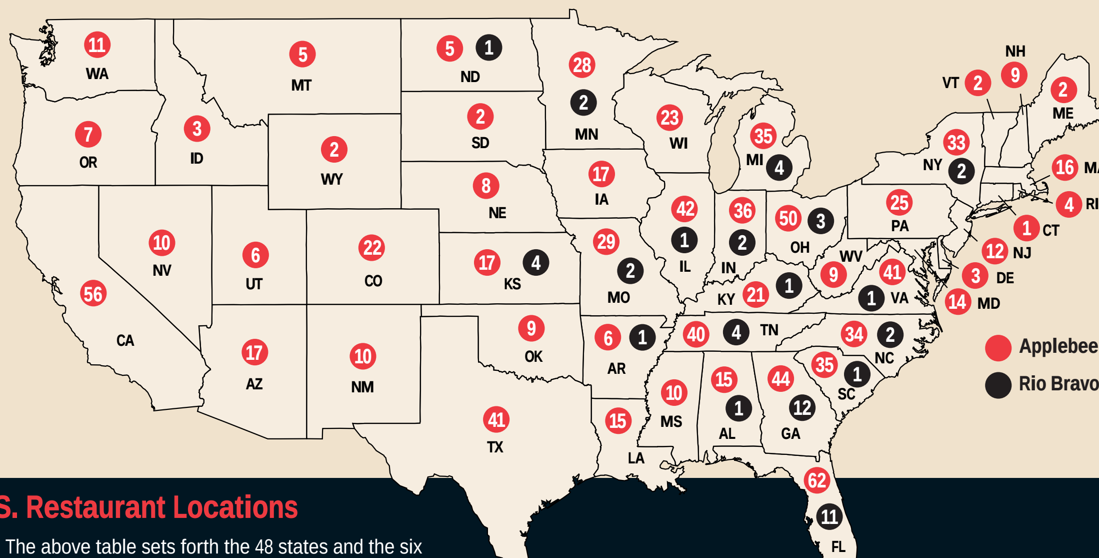
Common Stock Information

The Company's common stock trades on the Nasdaq National Market tier of The Nasdaq Stock Market under the symbol APPB. The table below sets forth for the fiscal quarters indicated the reported high and low sale prices of the Company's common stock, as reported on The Nasdaq Stock Market. At December 28, 1997, there were 1,282 stockholders of record.

	1997		1996	
	High	Low	High	Low
First Quarter	$31.13	$23.88	$25.75	$17.75
Second Quarter	$27.50	$20.13	$32.50	$25.00
Third Quarter	$30.38	$24.00	$34.25	$25.00
Fourth Quarter	$25.44	$18.00	$30.00	$23.12

An annual dividend of $0.07 per common share was declared on November 25, 1996 for stockholders of record on December 6, 1996, and the dividend was payable on January 13, 1997. An annual dividend of $0.08 per common share was declared on December 10, 1997 for stockholders of record on December 22, 1997, and the dividend was payable on January 26, 1998.

State or Country	NUMBER OF RESTAURANTS					
	Franchise		Company		Total System	
	Applebee's	Rio Bravo	Applebee's	Rio Bravo	Applebee's	Rio Bravo
DOMESTIC:						
Alabama	15	1	—	—	15	1
Arizona	17	—	—	—	17	—
Arkansas	6	1	—	—	6	1
California	48	—	8	—	56	—
Colorado	22	—	—	—	22	—
Connecticut	1	—	—	—	1	—
Delaware	3	—	—	—	3	—
Florida	62	1	—	10	62	11
Georgia	37	4	7	8	44	12
Idaho	3	—	—	—	3	—
Illinois	39	1	3	—	42	1
Indiana	36	2	—	—	36	2
Iowa	17	—	—	—	17	—
Kansas	8	2	9	2	17	4
Kentucky	21	1	—	—	21	1
Louisiana	15	—	—	—	15	—
Maine	—	—	2	—	2	—
Maryland	14	—	—	—	14	—
Massachusetts	—	—	16	—	16	—
Michigan	6	—	29	4	35	4
Minnesota	—	—	28	2	28	2
Mississippi	10	—	—	—	10	—
Missouri	7	1	22	1	29	2
Montana	5	—	—	—	5	—
Nebraska	8	—	—	—	8	—
Nevada	—	—	10	—	10	—
New Hampshire	—	—	9	—	9	—
New Jersey	12	—	—	—	12	—
New Mexico	4	—	6	—	10	—
DOMESTIC: *(continued)*						
New York	27	2	6	—	33	2
North Carolina	34	2	—	—	34	2
North Dakota	5	1	—	—	5	1
Ohio	50	3	—	—	50	3
Oklahoma	9	—	—	—	9	—
Oregon	7	—	—	—	7	—
Pennsylvania	17	—	8	—	25	—
Rhode Island	—	—	4	—	4	—
South Carolina	35	1	—	—	35	1
South Dakota	2	—	—	—	2	—
Tennessee	40	—	—	4	40	4
Texas	20	—	21	—	41	—
Utah	6	—	—	—	6	—
Vermont	—	—	2	—	2	—
Virginia	41	1	—	—	41	1
Washington	11	—	—	—	11	—
West Virginia	9	—	—	—	9	—
Wisconsin	23	—	—	—	23	—
Wyoming	2	—	—	—	2	—
INTERNATIONAL:						
Canada	6	—	—	—	6	—
Curacao	1	—	—	—	1	—
Germany	3	—	—	—	3	—
Greece	1	—	—	—	1	—
The Netherlands	4	—	—	—	4	—
Sweden	1	—	—	—	1	—
Total	770	24	190	31	960	55



U.S. Restaurant Locations

The above table sets forth the 48 states and the six international countries in which Applebee's and Rio Bravo Cantina restaurants are located and the number of restaurants operating in each state or country as of December 28, 1997.

Board of Directors

Date in parentheses indicates year elected to board.

Abe J. Gustin, Jr. (1983)
Chairman of the Board
Applebee's International, Inc.

D. Patrick Curran 1, 2, 3 (1992)
Chairman and Chief
Executive Officer
The Curran Companies

Eric L. Hansen 1, 2, 3 (1991)
Shareholder in Holman,
McCollum, and Hansen, P.C.
Attorneys

Jack P. Helms 1, 2, 3 (1994)
Principal and Shareholder in
Goldsmith, Agio, Helms and
Company

Kenneth D. Hill (1992)
Formerly consultant for
Governmental Affairs
and Industry Relations
Applebee's International, Inc.

Lloyd L. Hill 3 (1989)
Chief Executive Officer,
President and Chief
Operating Officer
Applebee's International, Inc.

Robert A. Martin (1989)
Executive Vice President
of Marketing
Applebee's International, Inc.

Burton M. Sack (1994)
Retired former executive
Applebee's International, Inc.

Committee Memberships

1 Audit
2 Executive Compensation
3 Nominating

Officers

Abe J. Gustin, Jr.
Chairman of the Board

Lloyd L. Hill
Chief Executive Officer,
President and Chief
Operating Officer

Robert A. Martin
Executive Vice President
of Marketing

George D. Shadid
Executive Vice President, Chief
Financial Officer and Treasurer

Louis A. Kaucic
Senior Vice President
of Human Resources

Steven K. Lumpkin
Senior Vice President
of Strategic Development

Stuart F. Waggoner
President and Chief
Executive Officer
Rio Bravo International, Inc.

Larry A. Cates
President of International
Division

W. Matthew Carpenter
Vice President of Training

Robert A. Hoffmeister
Vice President of Operations

Richard K. Horn
Vice President of
Concept Development

William L. McClave
Vice President of Marketing

Mark A. Peterson
Vice President and Controller

Robert T. Steinkamp
Vice President, Secretary
and General Counsel

Harry B. Stroup
Vice President of Development

John A. Weber
Vice President of Purchasing

Corporate Information

Corporate Headquarters
4551 West 107th Street
Overland Park, Kansas 66207
(913) 967-4000
Fax: (913) 341-1694

Independent Accountants
Deloitte & Touche LLP
1010 Grand Avenue, Suite 400
Kansas City, Missouri 64106

SEC Form 10-K
Shareholders may receive a copy of the Company's 1997 Annual Report to the Securities and Exchange Commission on Form 10-K free of charge by writing or calling the Investor Relations Department at Applebee's corporate headquarters, as listed above.

Financial Community Information
Inquiries from institutional investors, financial analysts, registered representatives, portfolio managers and individual shareholders should be directed to: Bill Lackey, Director of Investor Relations, at Applebee's corporate headquarters, as listed above. Telephone: (913) 967-8196, Fax: (913) 341-4970.

Registrar and Transfer Agent
American Stock Transfer & Trust Co.
40 Wall Street
New York, New York 10005
(212) 936-5100

Annual Meeting
Shareholders are cordially invited to attend the 1998 Annual Meeting of Stockholders which will be held at 10:00 a.m., CDT, on May 6, 1998 at the Overland Park Marriott, 10800 Metcalf, Overland Park, Kansas 66210.

Management urges all shareholders to vote their proxies and thus participate in the decisions that will be made at this meeting.

Dividends
The 1997 annual dividend was 8 cents per share, paid in January 1998.

Shareholders
There were approximately 30,000 beneficial shareholders including 1,282 shareholders of record as of December 28, 1997.

Stock Listing
The Company's common stock trades on the Nasdaq National Market tier of The Nasdaq Stock Market under the symbol APPB.

Trademarks
The following are registered trademarks of Applebee's International, Inc. and Subsidiaries: Applebee's Neighborhood Grill & Bar®, Applebee's Neighborhood Grill & Bar and Design®, Applebee's and Design®, America's Favorite Neighbor®, Rio Bravo Cantina®, Rio Bravo Cantina and Design®, You Belong at Applebee's®, Skillet Sensations™.

Design: The Falk Design Group, St. Louis

Applebee's International, Inc.

Our Values … Desired Standards

Teamwork: We cooperate and collaborate for the good of the team, its members and the Company. We treat each other with dignity, fairness and respect. We foster open communications in all directions and encourage candor and effective feedback.

Results: We continuously establish and achieve measurable, challenging goals that remain true to our values and guiding principles.

Integrity: We establish trust and trustworthiness through our words and actions, first in ourselves and then in our teams and our Company.

Passion for Service: We always put the customer first, both internal and external. We strive to delight our guests.

Our Guiding Principles … Fundamental Truths

Have Fun!: We keep smiling … and look for reasons to laugh.

Create Balance: We strive for balance … in our work life and in our personal life. We seek to balance the long-term and short-term, effort and results.

Innovate: We seek to continuously improve. We take measured risks … making and allowing mistakes, and learning from them. We think cutting edge and focus on adding value.

Operations Driven/User Friendly: We keep the restaurant guest in mind in everything we do. We design products, systems and forms with the end-user customer in mind.

A special thanks to all the Applebee's and Rio Bravo employees and customers who appeared in this report.

Applebee's International, Inc.
4551 West 107th Street
Overland Park, Kansas 66207

"I love my neighborhood Applebee's!"

Applebee's
Neighborhood Grill & Bar

RIO BRAVO CANTINA