DineEquity, Inc
Form 10-Q
August 01, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2008

OR

o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 001-15283

DineEquity, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**95-3038279**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
450 North Brand Boulevard, Glendale, California	**91203-1903**
(Address of principal executive offices)	(Zip Code)

(818) 240-6055
(Registrant s telephone number, including area code)

IHOP Corp.

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class		Outstanding as of July 25, 2008
Common Stock, $.01 par value		17,503,766

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DINEEQUITY, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

DINEEQUITY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 38,033	$ 26,838
Restricted cash	142,003	128,138
Short-term investments, at market value	278	300
Receivables, net	87,260	115,335
Inventories	13,323	13,280
Prepaid income taxes		30,695
Prepaid expenses	12,288	30,831
Deferred income taxes	40,649	21,862
Assets held for sale	40,168	60,347
Current assets related to discontinued operations	5,775	6,052
Total current assets	379,777	433,678
Non-current restricted cash	57,763	57,962
Restricted assets related to captive insurance subsidiary	6,401	10,518
Long-term receivables	281,886	288,452
Property and equipment, net	933,371	1,139,616
Goodwill	820,686	730,728
Other intangible assets, net	1,008,423	1,011,457
Other assets, net	155,272	156,193
Non-current assets related to discontinued operations	2,558	2,558
Total assets	$ 3,646,137	$ 3,831,162
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	$ 44,960	$ 99,019
Accrued employee compensation and benefits	46,209	56,795
Deferred revenue	43,170	76,802
Accrued financing costs	41,361	63,045
Other accrued expenses	73,414	49,203
Deferred compensation	71	21,236
Accrued interest payable	5,502	15,240

Total current liabilities		254,687		381,340
Long-term debt		1,955,238		2,263,887
Financing obligations, less current maturities		332,031		
Capital lease obligations, less current maturities		165,331		168,242
Deferred income taxes		426,207		504,865
Other liabilities		124,406		113,103
Non-current liabilities related to discontinued operations		2,594		3,302
Commitments and contingencies				
Preferred stock, Series A, $1 par value, 220,000 shares authorized; 190,000 shares issued and outstanding as of June 30, 2008 and December 31, 2007		187,050		187,050
Stockholders equity				
Convertible Preferred stock, Series B, at accreted value, 10,000,000 shares authorized; 35,000 shares issued and outstanding at June 30, 2008 and December 31, 2007		36,237		35,181
Common stock, $.01 par value, 40,000,000 shares authorized; June 30, 2008: 23,695,962 shares issued and 17,465,367 shares outstanding; December 31, 2007: 23,359,664 shares issued and 17,105,469 shares outstanding		230		230
Additional paid-in-capital		157,918		149,564
Retained earnings		314,080		338,790
Accumulated other comprehensive loss		(33,353)		(36,738)
Treasury stock, at cost (6,230,595 shares and 6,254,195 shares at June 30, 2008 and December 31, 2007, respectively)		(276,519)		(277,654)
Total stockholders equity		198,593		209,373
Total liabilities and stockholders equity	$	3,646,137	$	3,831,162

See the accompanying Notes to Consolidated Financial Statements.

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DINEEQUITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Revenues				
Franchise revenues	$ 87,421	$ 46,934	$ 177,355	$ 93,984
Company restaurant sales	296,496	4,625	608,418	8,609
Rental income	32,568	33,058	65,533	66,068
Financing revenues	7,648	4,870	15,616	10,950
Total revenues	424,133	89,487	866,922	179,611
Costs and Expenses				
Franchise expenses	22,384	21,369	45,761	42,590
Company restaurant expenses	259,723	5,371	536,269	9,985
Rental expenses	24,561	24,594	49,270	49,175
Financing expenses	2,548	57	5,887	529
General and administrative expenses	49,230	14,103	96,804	30,224
Interest expense	51,561	3,277	102,208	5,492
Impairment and closure charges	41,080	48	41,155	55
Amortization of intangible assets	3,080		5,979	
Other (income) expense, net	(3)	509	(1,860)	1,250
Early debt extinguishment costs				2,223
Total costs and expenses	454,164	69,328	881,473	141,523
(Loss) income from continuing operations before income taxes	(30,031)	20,159	(14,551)	38,088
Benefit (provision) for income taxes	10,760	(6,029)	9,222	(12,645)
(Loss) income from continuing operations	(19,271)	14,130	(5,329)	25,443
Loss from discontinued operations, net of tax	(114)		(202)	
Net (loss) income	$ (19,385)	$ 14,130	$ (5,531)	$ 25,443
Net (loss) income	$ (19,385)	$ 14,130	$ (5,531)	$ 25,443
Less: Series A preferred stock dividends	(4,750)		(9,500)	
Less: Accretion of Series B preferred stock	(535)		(1,056)	
Less: Unvested participating restricted stock	930		539	
Net (loss) income available to common stockholders	$ (23,740)	$ 14,130	$ (15,548)	$ 25,443
Net (loss) income available to common stockholders per share				
Basic	$ (1.42)	$ 0.82	$ (0.93)	$ 1.45
Diluted	$ (1.42)	$ 0.82	$ (0.93)	$ 1.44
Weighted average shares outstanding				
Basic	16,768	17,156	16,735	17,500
Diluted	16,768	17,328	16,735	17,688
Dividends declared per common share	$ 0.25	$ 0.25	$ 0.50	$ 0.50
Dividends paid per common share	$ 0.25	$ 0.25	$ 0.50	$ 0.50

See the accompanying Notes to Consolidated Financial Statements.

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DINEEQUITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash flows from operating activities		
Net (loss) income	$ (5,531)	$ 25,443
Adjustments to reconcile net (loss) income to cash flows provided by operating activities		
Depreciation and amortization	55,369	10,830
Impairment and closure charges	41,155	55
Debt extinguishment and other costs		2,223
Deferred income taxes	(38,420)	(2,753)
Stock-based compensation expense	7,057	2,245
Tax benefit from stock-based compensation	945	2,343
Excess tax benefit from stock options exercised	(315)	(2,343)
Gain on disposition of assets	(166)	(98)
Changes in operating assets and liabilities		
Receivables	28,336	2,595
Inventories	(43)	94
Prepaid expenses	26,090	(2,603)
Accounts payable	(27,007)	(6,986)
Accrued employee compensation and benefits	(10,586)	(3,915)
Deferred revenues	(33,632)	
Other accrued expenses	12,439	(2,243)
Other	1,125	(1,308)
Cash flows provided by operating activities	56,816	23,579
Cash flows from investing activities		
Additions to property and equipment	(23,216)	(1,449)
Additions to long-term receivables	(1,573)	(893)
Payment of accrued acquisition costs	(10,063)	
Collateral released by captive insurance subsidiary	3,823	
Proceeds from sale of property and equipment		795
Principal receipts from notes and equipment contracts receivable	7,871	8,283
Reductions (additions) to assets held for sale	11,930	(429)
Property insurance proceeds	478	(173)
Cash flows (used in) provided by investing activities	(10,750)	6,134
Cash flows from financing activities		
Proceeds from issuance of long-term debt		208,000
Proceeds from financing obligations	333,617	
Repayment of long-term debt	(312,800)	(129,206)
Principal payments on capital lease and financing obligations	(3,167)	(2,809)
Dividends paid	(15,115)	(8,820)
Payment of preferred stock issuance costs	(1,500)	
Purchase of treasury stock, net		(77,020)
Reissuance of treasury stock	755	

Proceeds from stock options exercised		989		6,370
Excess tax benefit from stock options exercised		315		2,343
Payment of accrued debt issuance costs		(24,299)		(14,307)
Prepayment penalties on early debt extinguishment				(1,219)
Restricted cash related to securitization		(13,666)		
Cash flows used in financing activities		(34,871)		(16,668)
Net change in cash and cash equivalents		11,195		13,045
Cash and cash equivalents at beginning of year		26,838		19,516
Cash and cash equivalents at end of year	$	38,033	$	32,561
Supplemental disclosures				
Interest paid	$	90,487	$	15,694
Income taxes paid	$	12,514	$	17,513

See the accompanying Notes to Consolidated Financial Statements.

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DINEEQUITY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Effective June 2, 2008, IHOP Corp. s corporate name changed to DineEquity, Inc. (the Company). The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The consolidated balance sheet at December 31, 2007 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

2. Basis of Presentation

The Company s fiscal quarter ends on the Sunday closest to the last day of each quarter. For convenience, we report all fiscal quarters as ending on March 31, June 30, September 30 and December 31. The second fiscal quarters presented herein ended June 29, 2008 and July 1, 2007, respectively.

On November 29, 2007, the Company completed the acquisition of Applebee s International, Inc. (Applebee s) pursuant to an agreement and plan of merger entered into by and among the Company, CHLH Corp. and Applebee s. Upon consummation of the acquisition, Applebee s became a wholly owned subsidiary of the Company. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated on consolidation.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the Company s management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to provisions for doubtful accounts, legal contingencies, income taxes, long-lived assets and goodwill. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Certain reclassifications have been made to prior year information to conform to the current year presentation.

3. New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*, which delayed for one year the applicability of SFAS 157 s fair-value measurements to certain nonfinancial assets and liabilities. The Company adopted SFAS 157 as of January 1, 2008, except as it applies to those nonfinancial assets and liabilities affected by the one-year delay. The adoption did not have a material impact on the Company s consolidated financial position or results of operations. The Company is currently evaluating the potential impact of adopting the remaining provisions of SFAS 157 on its consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)). SFAS 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company will adopt SFAS 141(R) in the first quarter of fiscal

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3. New Accounting Pronouncements, continued

2009 and apply the provisions of this statement for any acquisition after the adoption date. As the statement may only be applied prospectively, the adoption of SFAS 141(R) would impact our consolidated financial statements only if we enter into a business combination after the effective date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). This statement requires companies to provide enhanced disclosures about (a) how and why they use derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (c) how derivative instruments and related hedged items affect a company s financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company will adopt the new disclosure requirements on or before the required effective date. As SFAS 161 does not change current accounting practice, there will be no impact on the Company s Consolidated Balance Sheets, Statements of Operations or Statements of Cash Flows.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other applicable accounting literature. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. The Company is currently evaluating the potential impact, if any, of FSP FAS 142-3 on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). This statement is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements of nongovernmental entities that are presented in conformity with GAAP. This statement will be effective 60 days following the U.S. Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 162 on its consolidated financial statements.

4. Business Acquisition

The total transaction value (including direct transaction costs and expenses) of the Applebee s acquisition was approximately $2.0 billion. The Company has accounted for the Applebee s acquisition using the purchase method and, accordingly, the results of operations related to this acquisition have been included in the consolidated results of the Company since the acquisition date. The purchase price for this acquisition was allocated to tangible and intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date of November 29, 2007. The Company believes the fair values assigned to the assets acquired and liabilities assumed were based on reasonable assumptions. The purchase price allocation for the Applebee s acquisition is preliminary. The Company s fair value estimates for the purchase price allocation may change during the allowable allocation period, which is up to one year from the acquisition date, if additional information becomes available.

A significant portion of the fair value assigned to property and equipment in the preliminary purchase price allocation was related to 511 Applebee s-owned restaurants. In the preliminary purchase price allocation, the Company used global assumptions as to rental data and capitalization rates that were applied to the entire portfolio of properties. Subsequently, the Company analyzed this information on a store-by-store basis and determined certain fair values from the preliminary purchase price valuation should be revised downwards. Additionally, the data used to estimate the capitalization rate in the preliminary allocation was based in part on industry data, the reporting of which lagged the actual timing by several months. Once data on capitalization rates being utilized in late November 2007 became available, the Company updated the capitalization rate assumptions accordingly. As a result of the review described above, the estimated fair value allocated to property and equipment was revised downward by approximately $146 million.

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4. Business Acquisition, continued

The table below summarizes the three balance sheet items most impacted by the revision to the preliminary purchase price allocation as of November 29, 2007. The impact on all other balance sheet items was not significant.

	Preliminary Purchase Price Allocation	Adjustment (in thousands)	Revised Purchase Price Allocation
Property and equipment *	$ 890,623	$ (146,017)	$ 744,606
Goodwill	719,961	89,828	809,789
Deferred income tax liability (non-current)	(479,453)	56,735	(422,718)

* Including assets reclassified to held for sale subsequent to November 29, 2007

The unaudited pro forma data of the Company for the three-month and six-month periods ended June 30, 2007 set forth below gives effect to the Applebee s acquisition as if it had occurred at the beginning of 2007 and includes (1) the amortization of other comprehensive loss resulted from a swap the Company entered into in July 2007 to hedge the interest payments on the securitization transactions which were entered into on November 29, 2007 to finance the acquisition; (2) interest expense (including amortization) related to the securitization transactions that took place during 2007; (3) additional depreciation and amortization expense related to the pro forma stepped-up basis of assets acquired in the acquisition and (4) the tax effect resulting from the pro forma adjustments based on an assumed effective annual tax rate of 39.5%. This pro forma data is presented for informational purposes only and does not purport to be indicative of the results of future operations of the Company or of the results that would have actually been attained had the acquisition taken place at the beginning of 2007.

	Three Months Ended June 30,	
	2008 actual	2007 pro forma
	(In thousands, except per share amounts)	
Total revenues	$ 424,133	$ 421,643
Total net (loss) income	$ (19,385)	$ 16,811
Total net (loss) income available to common shareholders	$ (23,740)	$ 11,536
Pro forma net (loss) income per share		
Basic	$ (1.42)	$ 0.67
Diluted	$ (1.42)	$ 0.67

	Six Months Ended June 30,	
	2008 actual	2007 pro forma
	(In thousands, except per share amounts)	
Total revenues	$ 866,922	$ 847,906
Total net (loss) income	$ (5,531)	$ 16,114
Total net (loss) income available to common shareholders	$ (15,548)	$ 5,564
Pro forma net (loss) income per share		
Basic	$ (0.93)	$ 0.32

Diluted	$	(0.93)	$	0.31

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5. Impairment of Long-Lived Assets

The Company assesses long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. As discussed in Note 9, Financing Obligations, the Company entered into sale-leaseback transactions related to 182 parcels of real estate (land, buildings and improvements). The net book value of the real estate assets exceeded the proceeds received by the Company from the transactions by approximately $41 million. Accordingly, the Company has recognized an impairment loss of that amount in the Consolidated Statement of Operations for the three-month and six-month periods ended June 30, 2008.

6. Segments

The Company s revenues and expenses are recorded in four segments: franchise operations, company restaurant operations, rental operations, and financing operations. Within each segment, the Company operates two distinct restaurant concepts: Applebee s and IHOP.

Applebee s

The franchise operations segment consists of restaurants operated by Applebee s franchisees in the United States, 17 countries outside the United States and one U.S. territory. Franchise operations revenue consists primarily of franchise royalty revenues. Franchise operations expenses include costs related to intellectual property provided to certain franchisees.

The company restaurant operations segment consists of Company-operated restaurants in the United States and China. Company restaurant sales are retail sales at Company-operated restaurants. Company restaurant expenses are operating expenses at Company-operated restaurants and include food, labor, benefits, utilities, rent and other restaurant operating costs. The operating results of this segment on a consolidated basis are substantially generated by Applebee s restaurants.

Rental operations and financing operations activities are not currently part of Applebee s business.

IHOP

The franchise operations segment consists of restaurants operated by IHOP franchisees and area licensees in the United States, one U.S. territory and two countries outside the United States. Franchise operations revenue consists primarily of franchise royalty revenues, sales of proprietary products, franchise advertising fees and the portion of the franchise fees allocated to IHOP intellectual property. Franchise operations expenses include advertising expense, the cost of proprietary products and pre-opening training expenses and other franchise-related costs.

The company restaurant operations segment consists of Company-operated restaurants in the United States. In addition, from time to time, restaurants that are reacquired from franchisees are operated by IHOP on a temporary basis. Company restaurant sales are retail sales at Company-operated restaurants. Company restaurant expenses are operating expenses at Company-operated restaurants and include food, labor, benefits, utilities, rent and other restaurant operating costs.

Rental operations revenue includes revenue from operating leases and interest income from direct financing leases. Rental operations expenses are costs of operating leases and interest expense on capital leases on franchisee-operated restaurants.

Financing operations revenue consists of the portion of franchise fees not allocated to IHOP intellectual property, sales of equipment, as well as interest income from the financing of franchise fees and equipment leases. Financing expenses are primarily the cost of restaurant equipment.

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6. Segments, continued

Information on segments is as follows:

	For the Three Months Ended June 30, 2008			
	Applebee s	IHOP	Total	2007
	(In thousands)			
Revenues from External Customers				
Franchise operations	$ 37,713	$ 49,708	$ 87,421	$ 46,934
Company restaurants	292,866	3,630	296,496	4,625
Rental operations		32,568	32,568	33,058
Financing operations		7,648	7,648	4,870
Total	$ 330,579	$ 93,554	$ 424,133	$ 89,487
Interest Expense				
Company restaurants	$ 167	$ 97	$ 264	$
Rental operations		5,067	5,067	5,212
Financing operations		2	2	11
Corporate	42,883	8,678	51,561	3,277
Total	$ 43,050	$ 13,844	$ 56,894	$ 8,500
Depreciation and amortization				
Franchise operations	$ 2,509	$	$ 2,509	$
Company restaurants	8,338	181	8,519	238
Rental operations		2,995	2,995	3,094
Corporate	1,285	1,522	2,807	2,318
Total	$ 12,132	$ 4,698	$ 16,830	$ 5,650
(Loss) income from continuing operations before income taxes				
Franchise operations	$ 37,147	$ 27,890	$ 65,037	$ 25,565
Company restaurants	37,248	(475)	36,773	(692)
Rental operations		8,007	8,007	8,464
Financing operations		5,100	5,100	2,301
Corporate	(111,493)	(33,455)	(144,948)	(15,479)
Total	$ (37,098)	$ 7,067	$ (30,031)	$ 20,159

	For the Six Months Ended June 30, 2008			
	Applebee s	IHOP	Total	2007
	(In thousands)			
Revenues from External Customers				
Franchise operations	$ 75,650	$ 101,705	$ 177,355	$ 93,984
Company restaurants	600,893	7,525	608,418	8,609
Rental operations		65,533	65,533	66,068
Financing operations		15,616	15,616	10,950
Total	$ 676,543			