DENNYS CORP
Form 10-Q
May 02, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 28, 2007

Commission File Number 0-18051

DENNY'S CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**13-3487402**
(State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)

203 East Main Street
Spartanburg, South Carolina 29319-0001
(Address of principal executive offices)
(Zip Code)

(864) 597-8000
(Registrant's telephone number, including area code)

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 [ ]

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

As of April 27, 2007, 93,675,086 shares of the registrant’s common stock, par value $.01 per share, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Denny's Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Quarter Ended	
	March 28, 2007	March 29, 2006
	(In thousands, except per share amounts)	
Revenue:		
Company restaurant sales	$ 215,801	$ 225,022
Franchise and license revenue	20,950	22,963
Total operating revenue	236,751	247,985
Costs of company restaurant sales:		
Product costs	55,126	55,729
Payroll and benefits	92,868	94,008
Occupancy	13,128	13,137
Other operating expenses	30,313	32,444
Total costs of company restaurant sales	191,435	195,318
Costs of franchise and license revenue	6,475	7,213
General and administrative expenses	15,926	17,229
Depreciation and amortization	12,878	14,065
Operating gains, losses and other charges, net	(2,633)	(850)
Total operating costs and expenses	224,081	232,975
Operating income	12,670	15,010
Other expenses:		
Interest expense, net	11,341	14,643
Other nonoperating income, net	(197)	(162)
Total other expenses, net	11,144	14,481
Net income before income taxes and cumulative effect of change in accounting principle	1,526	529
Provision for income taxes	363	49
Net income before cumulative effect of change in accounting principle	$ 1,163	$ 480
Cumulative effect of change in accounting principle, net of tax	—	232
Net income	$ 1,163	$ 712
Basic and diluted net income per share:		
Basic and diluted net income before cumulative effect of change in accounting principle, net of tax	$ 0.01	$ 0.01
Cumulative effect of change in accounting principle, net of tax	—	0.00
Basic and diluted net income per share	$ 0.01	$ 0.01
Weighted average shares outstanding:		
Basic	93,416	91,785
Diluted	98,976	96,907

See accompanying notes

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Denny's Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	March 28, 2007	December 27, 2006
	(In thousands)	
Assets		
Current Assets:		
Cash and cash equivalents	$ 35,165	$ 26,226
Receivables, net	13,521	14,564
Inventories	8,345	8,199
Assets held for sale	5,255	4,735
Prepaid and other current assets	9,289	9,072
Total Current Assets	71,575	62,796
Property, net	227,453	236,264
Other Assets:		
Goodwill	50,548	50,064
Intangible assets, net	66,005	66,882
Deferred financing costs, net	6,314	6,311
Other assets	21,788	21,595
Total Assets	$ 443,683	$ 443,912
Liabilities and Shareholders' Deficit		
Current Liabilities:		
Current maturities of notes and debentures	$ 4,024	$ 5,532
Current maturities of capital lease obligations	6,962	6,979
Accounts payable	40,405	42,148
Other	87,277	81,143
Total Current Liabilities	138,668	135,802
Long-Term Liabilities:		
Notes and debentures, less current maturities	412,799	415,801
Capital lease obligations, less current maturities	23,493	24,948
Liability for insurance claims, less current portion	28,739	28,784
Deferred income taxes	12,285	12,126
Other noncurrent liabilities and deferred credits	48,942	50,469
Total Long-Term Liabilities	526,258	532,128
Total Liabilities	664,926	667,930
Total Shareholders' Deficit	(221,243)	(224,018)
Total Liabilities and Shareholders' Deficit	$ 443,683	$ 443,912

See accompanying notes

Denny's Corporation and Subsidiaries
Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive Loss
(Unaudited)

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Deficit	Accumulated Other Comprehensive Loss, Net	Total Shareholders' Deficit
				(In thousands)		
Balance, December 27, 2006	93,186	$ 932	$ 527,911	$ (735,438)	$ (17,423)	$ (224,018)
Comprehensive income:						
Net income	—	—	—	1,163	—	1,163
Comprehensive income	—	—	—	1,163	—	1,163
Share-based compensation on equity classified awards	—	—	711	—	—	711
Issuance of common stock for share-based compensation	44	—	222	—	—	222
Exercise of common stock options	415	4	675	—	—	679
Balance, March 28, 2007	93,645	$ 936	$ 529,519	$ (734,275)	$ (17,423)	$ (221,243)

See accompanying notes

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Denny's Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Quarter Ended	
	March 28,2007	March 29,2006
	(In thousands)	
Cash Flows from Operating Activities:		
Net income	$ 1,163	$ 712
Adjustments to reconcile net income to cash flows provided by operating activities:		
Cumulative effect of change in accounting principle, net of tax	—	(232)
Depreciation and amortization	12,878	14,065
Operating gains, losses and other charges, net	(2,633)	(850)
Amortization of deferred financing costs	288	873
Loss on early extinguishment of debt	16	—
Deferred income tax expense	264	—
Share-based compensation	1,184	2,432
Changes in assets and liabilities, net of effects of acquisitions and dispositions:		
Decrease (increase) in assets:		
Receivables	1,044	1,469
Inventories	(147)	5
Other current assets	(216)	134
Other assets	(914)	(1,978)
Increase (decrease) in liabilities:		
Accounts payable	(2,052)	(5,372)
Accrued salaries and vacations	(4,724)	(3,226)
Accrued taxes	(1,429)	(481)
Other accrued liabilities	11,520	173
Other noncurrent liabilities and deferred credits	(1,729)	(564)
Net cash flows provided by operating activities	14,513	7,160
Cash Flows from Investing Activities:		
Purchase of property	(4,621)	(7,014)
Proceeds from sales of property	5,736	3,073
Acquisition of restaurant units	(2,208)	(825)
Collection of note receivable payments from former subsidiary	—	381
Net cash flows used in investing activities	(1,093)	(4,385)
Cash Flows from Financing Activities:		
Long-term debt payments	$ (6,324)	$ (2,153)
Deferred financing costs paid	(306)	—
Proceeds from exercise of stock options	679	82
Net bank overdrafts	1,470	969
Net cash flows used in financing activities	(4,481)	(1,102)
Increase in cash and cash equivalents	8,939	1,673
Cash and Cash Equivalents at:		
Beginning of period	26,226	28,236

End of period	$	35,165	$	29,909

See accompanying notes

Denny’s Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Introduction and Basis of Reporting

Denny’s Corporation, through its wholly owned subsidiaries, Denny’s Holdings, Inc. and Denny’s, Inc., owns and operates the Denny’s restaurant brand, or Denny’s.

Our unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Therefore, certain information and footnotes normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. In our opinion, all adjustments considered necessary for a fair presentation of the interim periods presented have been included. Such adjustments are of a normal and recurring nature. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates, including those for the above-described items, are reasonable. These interim consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 27, 2006 and the related Management’s Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the fiscal year ended December 27, 2006. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire fiscal year ending December 26, 2007.

Note 2. Summary of Significant Accounting Policies

Effective December 28, 2006, the first day of fiscal 2007, we adopted the Financial Accounting Standards Board's Interpretation No. 48 “Accounting for Uncertainty in Income Taxes,” or FIN 48. See Note 8 to the Condensed Consolidated Financial Statements, “Income Taxes.”

There have been no other material changes to our significant accounting policies and estimates from the information provided in Note 2 of our Consolidated Financial Statements included in our Form 10-K for the fiscal year ended December 27, 2006.

Note 3. Assets Held for Sale

Assets held for sale of $5.3 million, as of March 28, 2007, include certain company-operated restaurants pending sale to franchisees and the real estate related to closed restaurants and restaurants operated by franchisees. We expect to sell each of these assets within 12 months. Assets held for sale of $4.7 million, as of December 27, 2006, included the real estate related to closed restaurants and restaurants operated by franchisees. Our Credit Facility (defined in Note 5) requires us to make mandatory prepayments to reduce outstanding indebtedness with the net cash proceeds from the sale of the real estate related to the restaurants operated by franchisees. As a result, we have classified a corresponding $2.0 million and $3.5 million of our long-term debt as a current liability in the Condensed Consolidated Balance Sheet as of March 28, 2007 and December 27, 2006, respectively. These amounts represent the net book value of the specified properties as of the balance sheet dates.

Note 4. Operating Gains, Losses and Other Charges, Net

Operating gains, losses and other charges, net represent gains or losses on the sale of assets, restructuring charges, exit costs and impairment charges and were comprised of the following:

	Quarter Ended	
	March 28, 2007	March 29, 2006
	(In thousands)	
Gains on sales of assets and other, net	$ (3,271)	$ (1,571)
Restructuring charges and exit costs	638	721
Impairment charges	—	—
Operating gains, losses and other charges, net	$ (2,633)	$ (850)

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Restructuring Charges and Exit Costs

Restructuring charges and exit costs were comprised of the following:

	Quarter Ended March 28, 2007	Quarter Ended March 29, 2006
	(In thousands)	
Exit costs	$ 147	$ 211
Severance and other restructuring charges	491	510
Total restructuring and exit costs	$ 638	$ 721

The components of the change in accrued exit cost liabilities are as follows:

	(In thousands)
Balance, beginning of year	$ 11,934
Provisions for units closed during the period	—
Changes in estimate of accrued exit costs, net	147
Payments, net	(1,717)
Interest accretion (included in interest expense)	225
Balance, end of quarter	10,589
Less current portion included in other current liabilities	1,791
Long-term portion included in other noncurrent liabilities	$ 8,798

Estimated net cash payments related to exit cost liabilities in the next five fiscal years are as follows:

	(In thousands)
Remainder of 2007	$ 2,100
2008	2,434
2009	1,956
2010	1,627
2011	1,436
Thereafter	3,552
Total	13,105
Less imputed interest	2,516
Present value of exit cost liabilities	$ 10,589

At the beginning of fiscal 2007, the liability for severance and other restructuring charges was $0.5 million. During the quarter ended March 28, 2007, an additional $0.5 million of expense was recorded and $0.3 million was paid related to these charges. The remaining balance of $0.7 million is expected to be paid during the next 12 months.

Gains on Sales of Assets

During the quarter ended March 28, 2007, we received net proceeds of $5.7 million and recognized gains of $3.3 million primarily related to sales of restaurant operations to franchisees and real estate related to closed restaurants and restaurants operated by franchisees.

Note 5. Long-Term Debt

Credit Facility

Our subsidiaries, Denny's, Inc. and Denny's Realty, LLC (the "Borrowers"), have a senior secured credit agreement consisting of a $50 million revolving credit facility (including up to $10 million for a revolving letter of credit facility), a $241.1 million term loan and an additional $40 million letter of credit facility (together, the "Credit Facility"). At March 28, 2007, we had outstanding letters of credit of $37.7 million (comprised of $35.2 million under our letter of credit facility and $2.5 million under our revolving facility). There were no revolving loans outstanding at March 28, 2007. These balances result in availability of $4.8 million under our letter of credit facility and $47.5 million under the revolving facility.

The revolving facility matures on December 15, 2011. The term loan and the $40 million letter of credit facility mature on March 31, 2012. The term loan amortizes in equal quarterly installments at a rate equal to approximately 1% per annum with all remaining amounts due on the maturity date. The Credit Facility is available for working capital, capital expenditures and other general corporate purposes. We will be required to make mandatory prepayments under certain circumstances (such as the sale of specified properties) typical for this type of credit facility and may make certain optional prepayments under the Credit Facility.

The Credit Facility is guaranteed by Denny's and its other subsidiaries and is secured by substantially all of the assets of Denny's and its subsidiaries. In addition, the Credit Facility is secured by first-priority mortgages on 140 company-owned real estate assets. The Credit Facility contains certain financial covenants (i.e., maximum total debt to EBITDA (as defined under the Credit Facility) ratio requirements, maximum senior secured debt to EBITDA ratio requirements, minimum fixed charge coverage ratio requirements and limitations on capital expenditures), negative covenants, conditions precedent, material adverse change provisions, events of default and other terms, conditions and provisions customarily found in credit agreements for facilities and transactions of this type. We were in compliance with the terms of the Credit Facility as of March 28, 2007.

Interest on loans under the new revolving facility will be payable at per annum rates equal to LIBOR plus 250 basis points and will adjust over time based on our leverage ratio. Interest on the new term loan and letter of credit facility was initially payable at per annum rates equal to LIBOR plus 225 basis points. Effective March 8, 2007, we amended the Credit Facility to reduce the per annum interest rate on the term loan and letter of credit facility to LIBOR plus 200 basis points. The weighted-average interest rate under the term loan was 7.4% as of March 28, 2007. The weighted average interest rate under the term loan facility was 8.6% as of March 29, 2006.

The amendment states that upon the event of a refinancing transaction, under certain circumstances within one year of the amendment, we would be required to pay the term loan and letter of credit facility lenders a 1.0% prepayment premium.

Interest Rate Swap

Subsequent to the end of the first quarter of fiscal 2007, we entered into an interest rate swap with a notional amount of $150 million to hedge a portion of the cash flows of our variable rate debt. We have designated the interest rate swap as a cash flow hedge of our exposure to variability in future cash flows attributable to interest payments on $150 million of floating rate debt. Under the terms of the swap, we will pay a fixed rate of 4.8925% on the $150 million notional amount and receive payments from a counterparty based on the 3-month LIBOR rate for a term ending on March 30, 2010, resulting in a fixed rate of 6.8925% on the $150 million notional amount. Interest rate differentials paid or received under the swap agreement will be recognized as adjustments to interest expense. To the extent the swap is effective in offsetting the variability of the hedged cash flows, changes in the fair value of the swap will not be included in current earnings, but will be reported as other comprehensive income (loss).

Note 6. Defined Benefit Plans

Employee Benefit Plans

The components of net pension cost of the pension plan and other defined benefit plans as determined under Statement of Financial Accounting Standards No. 87, “Employers’ Accounting for Pensions,” are as follows:

	Pension Plan Quarter Ended		Other Defined Benefit Plans Quarter Ended	
	March 28, 2007	March 29, 2006	March 28, 2007	March 29, 2006
	(In thousands)			
Service cost	$ 87	$ 91	$ —	$ —
Interest cost	783	771	47	48
Expected return on plan assets	(885)	(814)	—	—
Amortization of net loss	217	251	6	6
Net periodic benefit cost	$ 202	$ 299	$ 53	$ 54

We made contributions of $0.8 million and $0.7 million to our qualified pension plan in the quarters ended March 28, 2007 and March 29, 2006, respectively. We made contributions of $0.1 million and $0.1 million to our other defined benefit plans during the quarters ended March 28, 2007 and March 29, 2006, respectively. We expect to contribute $3.3 million to our qualified pension plan and an additional $0.2 million to our other defined benefit plans during the remainder of fiscal 2007.

Additional minimum pension liability of $17.4 million is reported as a component of accumulated other comprehensive loss in the Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive Loss as of March 28, 2007 and December 27, 2006.

Note 7. Share-Based Compensation

Total share-based compensation included as a component of net income was as follows:

	Quarter Ended March 28, 2007	Quarter Ended March 29, 2006
	(In thousands)	
Share-based compensation related to liability classified restricted stock units	$ 473	$ 1,066
Share-based compensation related to equity classified awards:		
Stock options	$ 198	$ 792
Restricted stock units	432	487
Board deferred stock units	81	87
Total share-based compensation related to equity classified awards	711	1,366
Total share-based compensation	$ 1,184	$ 2,432

During the quarter ended March 28, 2007, we issued approximately 44,000 shares of common stock in lieu of cash to pay approximately $0.2 million of incentive compensation.

Stock Options

During the quarter ended March 28, 2007, we granted approximately 0.7 million stock options to certain employees. The options granted vest evenly over 3 years and have a 10-year contractual life. The weighted average fair value per option of options granted during the quarter ended March 28, 2007 was $3.08.

The fair value of the stock options granted in the period ended March 28, 2007 was estimated at the date of grant using the Black-Scholes option pricing model. Use of this option pricing model requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them ("expected term"), the estimated volatility of our common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements ("forfeitures"). Changes in the subjective assumptions can materially affect the estimate of the fair value of share-based compensation and consequently, the related amount recognized in the Consolidated Statements of Operations.

We used the following weighted average assumptions for the grants for the quarter ended March 28, 2007:

Dividend yield	0.0%
Expected volatility	68%
Risk-free interest rate	4.5%
Weighted-average expected term	6.0 years

The dividend yield assumption was based on our dividend payment history and expectations of future dividend payments. The expected volatility was based on the historical volatility of our stock for a period approximating the expected life. The risk-free interest rate was based on published U.S. Treasury spot rates in effect at the time of grant with terms approximating the expected life of the option. The weighted average expected term of the options represents the period of time the options are expected to be outstanding based on historical trends.

As of March 28, 2007, there was approximately $3.4 million of unrecognized compensation cost related to unvested stock option awards granted, which is expected to be recognized over a weighted average of 2.2 years.

Restricted Stock Units

In March 2007, we granted approximately 0.5 million restricted stock units (which are equity classified) with a grant date fair value of $4.61 per share to certain employees. These restricted units will be earned (from 0% to 200% of the target award) based on certain operating performance measures for fiscal 2007. Once earned, the restricted stock units will vest 15% as of December 26, 2007, 35% as of December 31, 2008 and 50% as of December 30, 2009. Subsequent to the vesting periods, the earned restricted stock units will be paid to the holder in shares of common stock, provided the holder is then still employed with Denny's or an affiliate. Compensation expense related to the restricted stock units is based on the number of units expected to vest, the period over which the units are expected to vest and the fair market value of the common stock on the date of grant.

At March 28, 2007, approximately $1.3 million and $2.7 million of accrued compensation was included as a component of other current liabilities and other noncurrent liabilities, respectively, in the Condensed Consolidated Balance Sheet related to all liability classified restricted stock units and $3.6 million was included as a component of additional paid-in capital in the Condensed Consolidated Balance Sheet related to all equity classified restricted stock units. At December 27, 2006, approximately $0.8 million and $2.7 million of accrued compensation was included as a component of other current liabilities and other noncurrent liabilities, respectively, in the Condensed Consolidated Balance Sheet related to all liability classified restricted stock units and $3.2 million was included as a component of additional paid-in capital in the Condensed Consolidated Balance Sheet related to all equity classified restricted stock units.

As of March 28, 2007, there was approximately $7.6 million of unrecognized compensation cost (approximately $2.4 million for liability classified units and approximately $5.2 million for equity classified units) related to all unvested restricted stock unit awards granted, which is expected to be recognized over a weighted average of 2.5 years.

Board Deferred Stock Units

During the quarter ended March 28, 2007, we granted approximately 0.1 million deferred stock units (which are equity classified) with a weighted-average grant date fair value of $5.38 to non-employee members of the Board of Directors in return for attendance at non-regularly scheduled meetings. These awards are restricted in that they may not be exercised until the recipient has ceased serving as a member of the Board of Directors for Denny's.

Note 8. Income Taxes

Adoption of FIN 48

Effective December 28, 2006, the first day of fiscal 2007, we adopted FIN 48. This interpretation clarifies the accounting for uncertainty in income tax recognized in an entity’s financial statements in accordance with Statement of Financial Accounting Standards No. 109 “Accounting for Income Taxes.” FIN 48 requires companies to determine whether it is more-likely-than-not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. This interpretation also provides guidance on derecognition, classification, accounting in interim periods, and expanded disclosure requirements. FIN 48 does not require or permit retrospective application, thus the cumulative effect of the change in accounting principle, if any, is recorded as an adjustment to opening retained earnings.

The Company files income tax returns in the U.S. federal jurisdictions and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. Federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003.

As a result of the implementation of FIN 48, the Company did not recognize any change to its liability for unrecognized tax benefits. The total amount of unrecognized tax benefits as of the date of adoption was approximately $0.7 million. These benefits, if recognized, would also affect the Company’s effective tax rate.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. The total amount of accrued interest and penalties at date of adoption was less than $0.1 million.

The Company expects that, during the next twelve months, the liability for unrecognized tax benefits will be settled in full.

The Company remains subject to examination for U.S. Federal taxes for 2003-2006. The Company remains subject to examination in the following major state jurisdictions: California (2002-2006); Florida (2003-2006) and Texas (2002-2006).

Note 9. Net Income (Loss) Per Share

	Quarter Ended	
	March 28, 2007	March 29, 2006
	(In thousands, except per share amounts)	
Numerator:		