

DENNYS CORP  
Form 10-Q  
November 04, 2011

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 September 28, 2011

Commission File Number 0-18051  
DENNY'S CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

13-3487402  
(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Accelerated filer  Non-accelerated filer

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Large accelerated  
filer

Smaller reporting  
company

(Do not check if a  
smaller  
reporting company)

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

Yes " No p

As of October 31, 2011, 96,362,731 shares of the registrant's common stock, par value \$.01 per share, were outstanding.

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TABLE OF CONTENTS

|   | Page |
|---|------|
| <u>Part I - FINANCIAL INFORMATION</u>   |      |
| <u>Item 1. Financial Statements</u>   |      |
| <u>Condensed Consolidated Statements of Operations</u><br><u>Quarter and Three Quarters Ended September 28, 2011 and September 29, 2010</u><br><u>(unaudited)</u> | 3    |
| <u>Condensed Consolidated Balance Sheets (unaudited)</u>  | 4    |
| <u>Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive</u><br><u>Loss (unaudited)</u>   | 5    |
| <u>Condensed Consolidated Statements of Cash Flows (unaudited)</u>  | 6    |
| <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>   | 7    |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and</u><br><u>Results of Operations</u>  | 15   |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | 23   |
| <u>Item 4. Controls and Procedures</u>  | 23   |
| <u>PART II - OTHER INFORMATION</u>  |      |
| <u>Item 1. Legal Proceedings</u>  | 23   |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 24   |
| <u>Item 6. Exhibits</u>   | 24   |
| <u>Signatures</u>   | 25   |

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

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

|  | Quarter Ended                            |                       | Three Quarters Ended  |                       |
|--|--|-----------------------|-----------------------|-----------------------|
|  | September 28,<br>2011                    | September 29,<br>2010 | September 28,<br>2011 | September 29,<br>2010 |
|  | (In thousands, except per share amounts) |                       |                       |                       |
| Revenue:   |  |                       |                       |                       |
| Company restaurant sales                         | \$ 104,659                               | \$ 107,171            | \$ 313,235            | \$ 320,255            |
| Franchise and license revenue                    | 32,023                                   | 32,761                | 95,105                | 92,326                |
| Total operating revenue                          | 136,682                                  | 139,932               | 408,340               | 412,581               |
| Costs of company restaurant sales:               |  |                       |                       |                       |
| Product costs                                    | 25,847                                   | 25,405                | 77,095                | 75,597                |
| Payroll and benefits                             | 41,261                                   | 41,533                | 127,876               | 129,072               |
| Occupancy  | 6,928                                    | 7,097                 | 20,581                | 21,406                |
| Other operating expenses                         | 15,851                                   | 17,158                | 46,437                | 49,016                |
| Total costs of company restaurant sales          | 89,887                                   | 91,193                | 271,989               | 275,091               |
| Costs of franchise and license revenue           | 10,747                                   | 12,009                | 33,397                | 35,498                |
| General and administrative expenses              | 13,335                                   | 14,375                | 41,566                | 40,560                |
| Depreciation and amortization                    | 6,955                                    | 7,320                 | 21,377                | 21,984                |
| Operating (gains), losses and other charges, net | 1,791                                    | (1,900)               | 843                   | (1,594)               |
| Total operating costs and expenses               | 122,715                                  | 122,997               | 369,172               | 371,539               |
| Operating income                                 | 13,967                                   | 16,935                | 39,168                | 41,042                |
| Other expenses:                                  |  |                       |                       |                       |
| Interest expense, net                            | 4,796                                    | 6,394                 | 15,390                | 19,306                |
| Other nonoperating expense, net                  | 780                                      | 188                   | 2,526                 | 746                   |
| Total other expenses, net                        | 5,576                                    | 6,582                 | 17,916                | 20,052                |
| Net income before income taxes                   | 8,391                                    | 10,353                | 21,252                | 20,990                |
| Provision for income taxes                       | 406                                      | 419                   | 1,013                 | 1,010                 |
| Net income                                       | \$ 7,985                                 | \$ 9,934              | \$ 20,239             | \$ 19,980             |
| Net income per share:                            |  |                       |                       |                       |
| Basic  | \$ 0.08                                  | \$ 0.10               | \$ 0.21               | \$ 0.20               |
| Diluted  | \$ 0.08                                  | \$ 0.10               | \$ 0.20               | \$ 0.20               |

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Weighted average shares  
outstanding:

|         |        |         |         |         |
|---------|--------|---------|---------|---------|
| Basic   | 96,997 | 99,579  | 98,132  | 98,646  |
| Diluted | 98,746 | 101,305 | 100,203 | 101,264 |

See accompanying notes

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

|   | September 28,<br>2011 | December 29,<br>2010 |
|---|-----------------------|----------------------|
| (In thousands)  |                       |                      |
| <b>Assets</b>   |                       |                      |
| <b>Current assets:</b>  |                       |                      |
| Cash and cash equivalents   | \$ 14,947             | \$ 29,074            |
| Receivables, less allowance for doubtful accounts of \$5 and \$207, respectively              | 13,523                | 17,280               |
| Inventories   | 3,520                 | 4,037                |
| Assets held for sale  | 2,380                 | 1,933                |
| Prepaid and other current assets  | 9,979                 | 10,162               |
| <b>Total current assets</b>   | <b>44,349</b>         | <b>62,486</b>        |
| Property, net of accumulated depreciation of \$239,809 and \$247,492, respectively            | 120,652               | 129,518              |
| <b>Other assets:</b>  |                       |                      |
| Goodwill  | 31,023                | 31,308               |
| Intangible assets, net  | 50,092                | 52,054               |
| Deferred financing costs, net   | 6,457                 | 5,286                |
| Other noncurrent assets   | 28,063                | 30,554               |
| <b>Total assets</b>   | <b>\$ 280,636</b>     | <b>\$ 311,206</b>    |
| <b>Liabilities</b>  |                       |                      |
| <b>Current liabilities:</b>   |                       |                      |
| Current maturities of long-term debt  | \$ 2,589              | \$ 2,583             |
| Current maturities of capital lease obligations   | 4,548                 | 4,109                |
| Accounts payable  | 20,280                | 25,957               |
| Other current liabilities   | 57,040                | 57,685               |
| <b>Total current liabilities</b>  | <b>84,457</b>         | <b>90,334</b>        |
| <b>Long-term liabilities:</b>   |                       |                      |
| Long-term debt, less current maturities, net of discount of \$2,509 and \$3,455, respectively | 205,023               | 234,143              |
| Capital lease obligations, less current maturities  | 19,269                | 18,988               |
| Liability for insurance claims, less current portion  | 18,190                | 18,810               |
| Deferred income taxes   | 13,396                | 13,339               |
| Other noncurrent liabilities and deferred credits   | 35,780                | 39,304               |
| <b>Total long-term liabilities</b>  | <b>291,658</b>        | <b>324,584</b>       |
| <b>Total liabilities</b>  | <b>376,115</b>        | <b>414,918</b>       |
| <b>Commitments and contingencies</b>  |                       |                      |
| <b>Shareholders' deficit</b>  |                       |                      |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Common stock \$0.01 par value; authorized - 135,000; September 28, 2011: 102,546 shares issued and 96,484 shares outstanding; December 29, 2010: 100,073 shares issued and 99,036 shares outstanding |    | 1,026     |    | 1,001     |
| Paid-in capital  |    | 555,852   |    | 548,490   |
| Deficit  |    | (609,875) |    | (630,114) |
| Accumulated other comprehensive loss, net of tax   |    | (19,199)  |    | (19,199)  |
| Shareholders' deficit before treasury stock  |    | (72,196)  |    | (99,822)  |
| Treasury stock, at cost, 6,062 and 1,037 shares, respectively  |    | (23,283)  |    | (3,890)   |
| Total Shareholders' Deficit  |    | (95,479)  |    | (103,712) |
| Total Liabilities and Shareholders' Deficit  | \$ | 280,636   | \$ | 311,206   |

See accompanying notes

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

|   | Common Stock |          | Treasury Stock |             | Paid-in<br>Capital | (Deficit)    | Accumulated<br>Other<br>Comprehensive<br>Loss, Net | Total<br>Shareholders'<br>Deficit |
|---|--------------|----------|----------------|-------------|--------------------|--------------|--|-----------------------------------|
|   | Shares       | Amount   | Shares         | Amount      |                    |              |  |                                   |
| (In thousands)  |              |          |                |             |                    |              |  |                                   |
| Balance, December 29, 2010                            | 100,073      | \$ 1,001 | (1,037)        | \$ (3,890)  | \$ 548,490         | \$ (630,114) | \$ (19,199)  | \$ (103,712)                      |
| Comprehensive income:                                 |              |          |                |             |                    |              |  |                                   |
| Net income  | —            | —        | —              | —           | —                  | 20,239       | —  | 20,239                            |
| Comprehensive income                                  | —            | —        | —              | —           | —                  | 20,239       | —  | 20,239                            |
| Share-based compensation on equity classified awards  | —            | —        | —              | —           | 2,594              | —            | —  | 2,594                             |
| Purchase of treasury stock                            | —            | —        | (5,025)        | (19,393)    | —                  | —            | —  | (19,393)                          |
| Issuance of common stock for share-based compensation | 391          | 4        | —              | —           | (4)                | —            | —  | —                                 |
| Exercise of common stock options                      | 2,082        | 21       | —              | —           | 4,772              | —            | —  | 4,793                             |
| Balance, September 28, 2011                           | 102,546      | \$ 1,026 | (6,062)        | \$ (23,283) | \$ 555,852         | \$ (609,875) | \$ (19,199)  | \$ (95,479)                       |

See accompanying notes



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

|   | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|
|   | September 28,<br>2011 | September 29,<br>2010 |
|   | (In thousands)        |                       |
| Cash flows from operating activities:   |                       |                       |
| Net income  | \$ 20,239             | \$ 19,980             |
| Adjustments to reconcile net income to cash flows provided by operating activities: |                       |                       |
| Depreciation and amortization   | 21,377                | 21,984                |
| Operating (gains), losses and other charges, net                                    | 843                   | (1,594)               |
| Amortization of deferred financing costs  | 1,023                 | 771                   |
| Amortization of debt discount   | 418                   | —                     |
| Loss on early extinguishment of debt  | 2,287                 | 221                   |
| Loss on interest rate swap  | —                     | 167                   |
| Deferred income tax expense   | 57                    | 105                   |
| Share-based compensation  | 3,180                 | 2,010                 |
| Changes in assets and liabilities, net of effects of acquisitions and dispositions: |                       |                       |
| Decrease (increase) in assets:  |                       |                       |
| Receivables   | 4,167                 | 1,704                 |
| Inventories   | 517                   | 422                   |
| Other current assets  | 182                   | (1,716)               |
| Other assets  | 965                   | (2,117)               |
| Increase (decrease) in liabilities:   |                       |                       |
| Accounts payable  | (2,145)               | (977)                 |
| Accrued salaries and vacations  | 2,003                 | (5,600)               |
| Accrued taxes   | 1,520                 | 1,932                 |
| Other accrued liabilities   | (4,722)               | (1,496)               |
| Other noncurrent liabilities and deferred credits                                   | (5,304)               | (4,203)               |
| Net cash flows provided by operating activities                                     | 46,607                | 31,593                |
| Cash flows from investing activities:   |                       |                       |
| Purchase of property  | (12,927)              | (13,202)              |
| Proceeds from disposition of property   | 4,986                 | 9,917                 |
| Collections on notes receivable   | 756                   | 3,151                 |
| Net cash flows used in investing activities   | (7,185)               | (134)                 |
| Cash flows from financing activities:   |                       |                       |
| Long-term debt payments   | (33,212)              | (17,747)              |
| Proceeds from exercise of stock options   | 4,793                 | 3,339                 |
| Tax withholding on share-based payments   | (377)                 | (154)                 |
| Deferred financing costs  | (3,414)               | (58)                  |
| Debt transaction costs  | (814)                 | (10)                  |
| Purchase of treasury stock  | (19,170)              | —                     |

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|  |           |           |
|--|-----------|-----------|
| Net bank overdrafts                              | (1,355)   | (2,716)   |
| Net cash flows used in financing activities      | (53,549)  | (17,346)  |
| (Decrease) increase in cash and cash equivalents | (14,127)  | 14,113    |
| Cash and cash equivalents at:                    |           |           |
| Beginning of period                              | 29,074    | 26,525    |
| End of period                                    | \$ 14,947 | \$ 40,638 |

See accompanying notes

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

Note 1. Introduction and Basis of Presentation

Denny's Corporation, or Denny's, is one of America's largest family-style restaurant chains. At September 28, 2011, the Denny's brand consisted of 1,677 restaurants, 1,454 (87%) of which were franchised/licensed restaurants and 223 (13%) of which were company-owned and operated.

The following table shows the unit activity for the quarter and three quarters ended September 28, 2011 and September 29, 2010:

|   | Quarter Ended         |                       | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 28,<br>2011 | September 29,<br>2010 | September 28,<br>2011 | September 29,<br>2010 |
| Company-owned<br>restaurants,<br>beginning of period              | 225                   | 228                   | 232                   | 233                   |
| Units opened  | 2                     | 6                     | 8                     | 10                    |
| Units sold to<br>franchisees                                      | (3)                   | (2)                   | (13)                  | (11)                  |
| Units closed  | (1)                   | —                     | (4)                   | —                     |
| End of period   | 223                   | 232                   | 223                   | 232                   |
| Franchised and<br>licensed<br>restaurants,<br>beginning of period | 1,452                 | 1,328                 | 1,426                 | 1,318                 |
| Units opened  | 9                     | 55                    | 39                    | 68                    |
| Units relocated   | —                     | 2                     | 1                     | 3                     |
| Units purchased<br>from Company                                   | 3                     | 2                     | 13                    | 11                    |
| Units closed<br>(including units<br>relocated)                    | (10)                  | (7)                   | (25)                  | (20)                  |
| End of period   | 1,454                 | 1,380                 | 1,454                 | 1,380                 |
| Total restaurants,<br>end of<br>period                            | 1,677                 | 1,612                 | 1,677                 | 1,612                 |

Of the 48 units opened and relocated during the three quarters ended September 28, 2011, eight company-owned and 15 franchise units represent conversions and openings of restaurants at Pilot Flying J Travel Centers. Of the 81 units opened and relocated during the three quarters ended September 29, 2010, ten company-owned and 43 franchise unit represent conversions and openings of restaurants at Pilot Flying J Travel Centers.

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 notes normally included in financial

statements prepared in accordance with U.S. generally accepted accounting principles 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 condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 29, 2010 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 29, 2010. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire fiscal year ending December 28, 2011.

## Note 2. Summary of Significant Accounting Policies

### Newly Adopted Accounting Standards

#### Fair Value

ASU No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements"

Effective December 30, 2010, the first day of fiscal 2011, we adopted the disclosure requirements of ASU No. 2010-06 about purchases, sales, issuances and settlements relating to Level 3 measurements. The adoption did not have any impact on the disclosures included in our Condensed Consolidated Financial Statements.

#### Receivables

ASU No. 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses"

Effective December 30, 2010, we adopted the disclosure provisions of ASU No. 2010-20 requiring a rollforward of the allowance for credit losses and new disclosures about modifications. The adoption resulted in increased notes receivable disclosure, but did not have any impact on our Condensed Consolidated Financial Statements.

#### Goodwill

ASU No. 2010-28, "Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)"

Effective December 30, 2010, we adopted ASU No. 2010-28, which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. The guidance requires an entity to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The adoption did not have a material impact on our Condensed Consolidated Financial Statements.



## Accounting Standards to be Adopted

## Fair Value

ASU No. 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs"

In May 2011, the FASB issued ASU 2011-04 to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. The amended guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. We are required to adopt the provisions of this ASU in the first quarter of 2012. We do not believe the adoption will have a material impact on our Condensed Consolidated Financial Statements.

## Comprehensive Income

ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income"

In May 2011, the FASB issued ASU 2011-05, which amends existing guidance to allow only two options for presenting the components of net income and other comprehensive income: (1) in a single continuous statement of comprehensive income or (2) in two separate but consecutive financial statements consisting of an income statement followed by a statement of other comprehensive income. ASU No. 2011-05 requires retrospective application. We are required to adopt the provisions of this ASU in the first quarter of 2012. We do not believe the adoption will have a material impact on our Condensed Consolidated Financial Statements.

## Goodwill

ASU No. 2011-08, "Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment"

In September 2011, the FASB issued ASU 2011-08, which modifies the impairment test for goodwill. Under the new guidance, an entity is permitted to make a qualitative assessment of whether it is more likely than not that the reporting unit's fair value is less than the carrying value before applying the two-step goodwill impairment model that is currently in place. If it is determined through the qualitative assessment that a reporting unit's fair value is more likely than not greater than its carrying value, the remaining impairment steps would be unnecessary. The qualitative assessment is optional, allowing companies to go directly to the quantitative assessment. We are required to adopt the provision of this ASU in the first quarter of 2012. We do not believe the adoption will have a material impact on our Condensed Consolidated Financial Statements.

## Note 3. Receivables

Receivables were comprised of the following:

|   | September 28,<br>2011 | December 29,<br>2010 |
|---|-----------------------|----------------------|
|   | (In thousands)        |                      |
| Current assets:                                     |                       |                      |
| Receivables:  |                       |                      |
| Trade accounts receivable from franchisees          | \$ 9,377              | \$ 11,538            |
| Notes receivable from franchisees and third parties | 1,479                 | 1,020                |

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|  |           |           |
|--|-----------|-----------|
| Vendor receivables   | 999       | 2,571     |
| Credit card receivables  | 840       | 1,206     |
| Other  | 833       | 1,152     |
| Allowance for doubtful accounts  | (5)       | (207)     |
| Total receivables  | \$ 13,523 | \$ 17,280 |
| Direct financing lease receivables (included as a component of prepaid and other current assets) | \$ 74     | \$ 74     |
| Noncurrent assets (included as a component of other noncurrent assets):                          |           |           |
| Notes receivable from franchisees and third parties  | \$ 663    | \$ 1,329  |
| Direct financing lease receivables   | 5,522     | 5,119     |
| Total noncurrent receivables   | \$ 6,185  | \$ 6,448  |

During the quarters ended September 28, 2011 and September 29, 2010, we reversed provisions for credit losses of \$0.1 million and recorded provisions for credit losses of less than \$0.1 million, respectively. During both the three quarters ended September 28, 2011 and September 29, 2010, we recorded provisions for credit losses of less than \$0.1 million.

#### Note 4. Assets Held for Sale

Assets held for sale of \$2.4 million and \$1.9 million as of September 28, 2011 and December 29, 2010, respectively, include restaurants to be sold to franchisees. We expect to sell each of these assets within 12 months. Our credit facility (as described in Note 8) requires us to make mandatory prepayments to reduce outstanding indebtedness with the net cash proceeds from the sale of restaurant assets and restaurant operations to franchisees, net of a voluntary \$25.0 million annual exclusion. As of September 28, 2011 and December 29, 2010, no reclassification of long-term debt to current liabilities was necessary pursuant to this requirement. As a result of classifying certain assets as held for sale, we recognized impairment charges of \$0.8 million for the quarter and three quarters ended September 28, 2011 and \$0.1 million for the quarter and three quarters ended September 29, 2010. This expense is included as a component of operating (gains), losses and other charges, net in our Condensed Consolidated Statements of Operations.

## Note 5. Goodwill and Other Intangible Assets

The following table reflects the changes in carrying amounts of goodwill:

|   | September 28, 2011<br>(In thousands) |        |
|---|--------------------------------------|--------|
| Balance, beginning of year                      | \$                                   | 31,308 |
| Adjustments associated with sale of restaurants |                                      | (46)   |
| Reclassification to assets held for sale        |                                      | (239)  |
| Balance, end of period                          | \$                                   | 31,023 |

Goodwill and intangible assets were comprised of the following:

|  | September 28, 2011          |                             | December 29, 2010           |                             |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|  | (In thousands)              |                             |                             |                             |
| Goodwill                                 | \$ 31,023                   | \$                          | —\$ 31,308                  | \$ —                        |
| Intangible assets with indefinite lives: |                             |                             |                             |                             |
| Trade names                              | \$ 42,500                   | \$                          | —\$ 42,493                  | \$ —                        |
| Liquor licenses                          | 164                         |                             | —                           | 164                         |
| Intangible assets with definite lives:   |                             |                             |                             |                             |
| Franchise and license agreements         | 43,155                      | 35,796                      | 46,088                      | 36,769                      |
| Foreign license agreements               | 241                         | 172                         | 241                         | 163                         |
| Intangible assets                        | \$ 86,060                   | \$ 35,968                   | \$ 88,986                   | \$ 36,932                   |
| Other assets with definite lives:        |                             |                             |                             |                             |
| Software development costs               | \$ 33,817                   | \$ 31,732                   | \$ 33,673                   | \$ 30,426                   |

## Note 6. Operating (Gains), Losses and Other Charges, Net

Operating (gains), losses and other charges, net are comprised of the following:

|   | Quarter Ended         |                       | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September<br>28, 2011 | September 29,<br>2010 | September 28,<br>2011 | September 29,<br>2010 |
|   | (In thousands)        |                       |                       |                       |
| Gains on sales of assets and other, net | \$ (867)              | \$ (3,757)            | \$ (2,742)            | \$ (5,233)            |
| Restructuring charges and exit costs    | 490                   | 1,778                 | 1,359                 | 3,560                 |
| Impairment charges                      | 2,168                 | 79                    | 2,226                 | 79                    |
| Operating (gains), losses               | \$ 1,791              | \$ (1,900)            | \$ 843                | \$ (1,594)            |



and  
other charges,  
net

#### Gains on Sales of Assets

During the quarter ended September 28, 2011, we recognized \$0.6 million of gains on the sale of three restaurant operations to two franchisees for net proceeds of \$0.9 million. During the quarter ended September 29, 2010, we recognized \$0.1 million of gains on the sale of two restaurant operations to two franchisees for net proceeds of \$0.8 million. In addition, during the quarter ended September 29, 2010, we recognized \$3.7 million of gains on real estate sold to franchisees.

During the three quarters ended September 28, 2011, we recognized \$1.4 million of gains on the sale of 13 restaurant operations to five franchisees for net proceeds of \$4.1 million (which included a note receivable of \$0.5 million). In addition, during the three quarters ended September 28, 2011, we recognized \$0.9 million of gains on the sale of real estate and \$0.4 million of deferred gains, primarily related to a restaurant sold to a franchisee during a prior period. During the three quarters ended September 29, 2010, we recognized \$1.4 million of gains on the sale of 11 restaurant operations to six franchisees for net proceeds of \$3.8 million (which included a note receivable of \$0.2 million). In addition, during the three quarters ended September 29, 2010, we recognized \$3.6 million of gains on real estate sold to franchisees.

#### Restructuring Charges and Exit Costs

Restructuring charges and exit costs were comprised of the following:

|  | Quarter Ended         |                       | Three Quarters Ended  |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September<br>28, 2011 | September 29,<br>2010 | September 28,<br>2011 | September 29,<br>2010 |
|  | (In thousands)        |                       |                       |                       |
| Exit costs   | \$ 465                | \$ (45)               | \$ 1,078              | \$ 818                |
| Severance and<br>other<br>restructuring<br>charges | 25                    | 1,823                 | 281                   | 2,742                 |
| Total<br>restructuring and<br>exit<br>costs        | \$ 490                | \$ 1,778              | \$ 1,359              | \$ 3,560              |

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

|  | (In thousands) |         |
|--|----------------|---------|
| Balance at December 29, 2010                               | \$             | 4,948   |
| Provisions for units closed during the year (1)            |                | 420     |
| Changes in estimates of accrued exit costs, net (1)        |                | 658     |
| Payments, net of sublease receipts                         |                | (1,712) |
| Reclassification of certain lease liabilities              |                | (166)   |
| Interest accretion   |                | 333     |
| Balance at September 28, 2011                              |                | 4,481   |
| Less current portion included in other current liabilities |                | 1,377   |
| Long-term portion included in other noncurrent liabilities | \$             | 3,104   |

(1) Included as a component of operating (gains), losses and other charges, net.

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

|  | (In thousands) |       |
|--|----------------|-------|
| Remainder of 2011                      | \$             | 531   |
| 2012                                   |                | 1,294 |
| 2013                                   |                | 873   |
| 2014                                   |                | 718   |
| 2015                                   |                | 457   |
| Thereafter                             |                | 1,125 |
| Total                                  |                | 4,998 |
| Less imputed interest                  |                | 517   |
| Present value of exit cost liabilities | \$             | 4,481 |

As of both September 28, 2011 and December 29, 2010, we had accrued severance and other restructuring charges of \$0.1 million or less. The balance as of September 28, 2011 is expected to be paid during the next 12 months.

#### Note 7. Fair Value of Financial Instruments

##### Fair Value of Assets and Liabilities Measured on a Recurring and Nonrecurring Basis

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

|   | Fair Value Measurements as of September 28, 2011 |   |      |   |  | Valuation<br>Technique |
|---|--|---|------|---|--|------------------------|
|   | Total  | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets/Liabilities<br>(Level 1) |      | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                        |
|   |  | (In thousands)  |      |   |  |                        |
| Deferred compensation<br>plan investments | \$ 4,602   | \$ 4,602  | \$ — | \$ —  | \$ —   | market approach        |
| Total                                     | \$ 4,602   | \$ 4,602  | \$ — | \$ —  | \$ —   | —                      |

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| Fair Value Measurements as of December 29, 2010 |          |   |           |   |           |  |
|---|----------|---|-----------|---|-----------|--|
|   | Total    | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets/Liabilities<br>(Level 1) |           | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |           | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|   |          | (Level 1)   | (Level 2) | (Level 2)   | (Level 3) | Valuation<br>Technique                             |
| (In thousands)                                  |          |   |           |   |           |  |
| Deferred compensation                           |          |   |           |   |           |  |
| plan investments                                | \$ 5,926 | \$ 5,926  | \$ —      | \$ —  | \$ —      | market approach                                    |
| Total   | \$ 5,926 | \$ 5,926  | \$ —      | \$ —  | \$ —      | —  |

Those assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

| Fair Value Measurements as of September 28, 2011 |          |  |           |   |           |  |
|--|----------|--|-----------|---|-----------|--|
|  | Total    | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets/Liabilities<br>(Level 1) |           | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |           | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|  |          | (Level 1)  | (Level 2) | (Level 2)   | (Level 3) | Valuation<br>Technique                             |
| (In thousands)                                   |          |  |           |   |           |  |
| Assets held for sale (1)                         | \$ 2,380 | \$ —   | \$ 2,380  | \$ —  | \$ —      | market approach                                    |
| Total  | \$ 2,380 | \$ —   | \$ 2,380  | \$ —  | \$ —      | —  |

- (1) During the third quarter of 2011, assets held for sale with a carrying amount of \$3.2 million were written down to their fair value of \$2.4 million. Impairment charges of \$0.8 million were recognized as a component of operating (gains), losses and other charges, net in our Condensed Consolidated Statements of Operations.

In addition to the assets measured at fair value on a nonrecurring basis shown above, as of September 28, 2011 and December 29, 2010, impaired assets related to underperforming units were written down to a fair value of \$0 based on the income approach.

## Fair Value of Long-Term Debt

The book value and estimated fair value of our long-term debt, excluding capital lease obligations, was as follows:

|  | September 28,<br>2011 | December 29,<br>2010 |
|--|-----------------------|----------------------|
|  | (In thousands)        |                      |
| Book value:  |                       |                      |
| Fixed rate long-term debt                          | \$ 121                | \$ 181               |
| Variable rate long-term debt                       | 210,000               | 240,000              |
| Long-term debt excluding capital lease obligations | \$ 210,121            | \$ 240,181           |
| Estimate fair value:                               |                       |                      |
| Fixed rate long-term debt                          | \$ 120                | \$ 181               |
| Variable rate long-term debt                       | 209,475               | 243,000              |
| Long-term debt excluding capital lease obligations | \$ 209,595            | \$ 243,181           |

The difference between the estimated fair value of long-term debt compared with its historical cost reported in our Condensed Consolidated Balance Sheets at September 28, 2011 and December 29, 2010 relates to market quotations for our senior secured term loan.

## Note 8. Long-Term Debt

Our subsidiaries, Denny's, Inc. and Denny's Realty, LLC, have a credit facility consisting of a \$60 million senior secured revolver (with a \$30 million letter of credit sublimit) and a senior secured term loan in an original principal amount of \$240 million. As of September 28, 2011, we had an outstanding term loan of \$207.5 million (\$210.0 million less unamortized OID of \$2.5 million) and outstanding letters of credit of \$27.0 million under our revolving letter of credit facility. There were no revolving loans outstanding at September 28, 2011. These balances resulted in availability of \$33.0 million under the revolving facility. The weighted-average interest rate under the term loan was 5.25% and 6.50%, as of September 28, 2011 and December 29, 2010, respectively.

During the first quarter of 2011, we amended our credit facility principally to take advantage of lower interest rates available in the senior secured debt market. Additionally, during the first quarter of 2011, we used the credit facility's accordion feature, which allows us to increase the size of the facility by up to \$25 million subject to lender approval, to increase the amount available under the revolver from \$50 million to \$60 million.

A commitment fee of 0.625% is paid on the unused portion of the revolving credit facility. Interest on the credit facility is payable at per annum rates equal to LIBOR plus 375 basis points with a LIBOR floor of 1.50% for the term loan and no LIBOR floor for the revolver. The term loan was originally issued at 98.5% reflecting an original issue discount ("OID") of \$3.8 million. The OID is being amortized into interest expense over the life of the term loan using the effective interest rate method. The maturity date for the revolver is September 30, 2015 and the maturity date for the term loan is September 30, 2016. The term loan amortizes in equal quarterly installments of \$625,000 with all remaining amounts due on the maturity date. Mandatory prepayments will be required under certain circumstances and we have the option to make certain prepayments under the credit facility.

The credit facility is guaranteed by the Company and its material subsidiaries and is secured by substantially all of the assets of the Company and its subsidiaries, including the stock of the Company's subsidiaries. The credit facility

includes certain financial covenants with respect to a maximum leverage ratio, a maximum lease-adjusted leverage ratio, a minimum fixed charged coverage ratio and limitations on capital expenditures.

As a result of the debt amendment, during the first quarter of 2011, we recorded \$1.4 million of losses on early extinguishment of debt, consisting primarily of \$0.8 million of transaction costs, \$0.4 million from the write-off of deferred financing costs and \$0.2 million from the write-off of OID. These losses are included as a component of other nonoperating expense in the condensed Consolidated Statements of Operations.

During the quarter and three quarters ended September 28, 2011, we paid \$10.0 million (which included \$9.4 million of prepayments and \$0.6 million of scheduled payments) and \$30.0 million (which included \$28.1 million of prepayments and \$1.9 million of scheduled payments), respectively on the term loan under the credit facility through a combination of cash generated from operations and proceeds on sales of restaurant operations to franchisees, real estate and other assets. As a result of these prepayments, during the quarter ended September 28, 2011, we recorded \$0.3 million of losses on early extinguishment of debt resulting from the write-off of \$0.2 million in deferred financing costs and \$0.1 million in OID. As a result of these prepayments, during the three quarters ended September 28, 2011, we recorded \$1.0 million of losses on early extinguishment of debt resulting from the write-off of \$0.6 million in deferred financing costs and \$0.4 million in OID. These losses are included as a component of other nonoperating expense in our condensed Consolidated Statements of Operations.

We believe that our estimated cash flows from operations for 2011, combined with our capacity for additional borrowings under our credit facility, will enable us to meet our anticipated cash requirements and fund capital expenditures over the next twelve months.

## Note 9. Defined Benefit Plans

The components of net periodic benefit cost were as follows:

|                                   | Pension Plan<br>Quarter Ended |                       | Other Defined Benefit Plans<br>Quarter Ended |                       |
|-----------------------------------|-------------------------------|-----------------------|--|-----------------------|
|                                   | September 28,<br>2011         | September 29,<br>2010 | September<br>28, 2011                        | September<br>29, 2010 |
|                                   | (In thousands)                |                       |  |                       |
| Service cost                      | \$ 84                         | \$ 94                 | \$ —   | \$ —                  |
| Interest cost                     | 841                           | 858                   | 32   | 35                    |
| Expected return<br>on plan assets | (1,046)                       | (982)                 | —  | —                     |
| Amortization of<br>net loss       | 251                           | 229                   | 8  | 5                     |
| Net periodic<br>benefit cost      | \$ 130                        | \$ 199                | \$ 40  | \$ 40                 |

|                                   | Pension Plan<br>Three Quarters Ended |                       | Other Defined Benefit Plans<br>Three Quarters Ended |                       |
|-----------------------------------|--------------------------------------|-----------------------|---|-----------------------|
|                                   | September 28,<br>2011                | September 29,<br>2010 | September<br>28, 2011                               | September<br>29, 2010 |
|                                   | (In thousands)                       |                       |   |                       |
| Service cost                      | \$ 251                               | \$ 282                | \$ —  | \$ —                  |
| Interest cost                     | 2,523                                | 2,574                 | 95  | 104                   |
| Expected return<br>on plan assets | (3,137)                              | (2,946)               | —   | —                     |
| Amortization of<br>net loss       | 753                                  | 686                   | 24  | 16                    |
| Net periodic<br>benefit cost      | \$ 390                               | \$ 596                | \$ 119  | \$ 120                |

We made contributions of \$1.5 million to our qualified pension plan during the three quarters ended September 28, 2011. We did not make any contributions to our qualified pension plan during the three quarters ended September 29, 2010. We made contributions of \$0.1 million to our other defined benefit plans during both the three quarters ended September 28, 2011 and September 29, 2010. We expect to contribute an additional \$0.3 million to our qualified pension plan and an additional \$0.1 million to our other defined benefit plans over the remainder of fiscal 2011.

Additional minimum pension liability of \$19.2 million is reported as a component of accumulated other comprehensive loss in the Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive Loss as of September 28, 2011 and December 29, 2010.

## Note 10. Share-Based Compensation

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

|  | Quarter Ended         |                       | Three Quarters Ended  |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 28,<br>2011 | September<br>29, 2010 | September 28,<br>2011 | September 29,<br>2010 |
|  |                       |                       |                       |                       |

(In thousands)

|   |    |       |    |     |    |       |    |       |
|---|----|-------|----|-----|----|-------|----|-------|
| Share-based compensation related to liability classified restricted stock units | \$ | 326   | \$ | 211 | \$ | 586   | \$ | 422   |
| Share based compensation related to equity classified awards:                   |    |       |    |     |    |       |    |       |
| Stock options   | \$ | 266   | \$ | 347 | \$ | 788   | \$ | 882   |
| Restricted stock units  |    | 186   |    | 93  |    | 1,262 |    | 501   |
| Board deferred stock units  |    | 253   |    | 110 |    | 544   |    | 205   |
| Total share-based compensation related to equity classified awards              |    | 705   |    | 550 |    | 2,594 |    | 1,588 |
| Total share-based compensation  | \$ | 1,031 | \$ | 761 | \$ | 3,180 | \$ | 2,010 |

### Stock Options

During the three quarters ended September 28, 2011, we granted approximately 0.9 million stock options to certain employees. These stock options vest evenly over 3 years and have a 10-year contractual life.

The weighted average fair value per option for options granted during the three quarters ended September 28, 2011 was \$1.98. The fair value of these stock options 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 (i.e., 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 Condensed Consolidated Statements of Operations.

We used the following weighted average assumptions for the stock option grants for the three quarters ended September 28, 2011:

|                                |           |
|--------------------------------|-----------|
| Dividend yield                 | 0.0%      |
| Expected volatility            | 60.3%     |
| Risk-free interest rate        | 2.02%     |
| Weighted average expected term | 4.7 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 September 28, 2011, we had approximately \$1.8 million of unrecognized compensation cost related to unvested stock option awards outstanding, which is expected to be recognized over a weighted average of 1.9 years.

#### Restricted Stock Units

In February 2011, we granted approximately 0.2 million performance shares and related performance-based target cash awards of \$0.7 million to certain employees. Since these awards contain a market condition, a Monte Carlo valuation was used to determine the performance shares' grant date fair value of \$4.63 per share and the payout probability of the target cash awards. The awards granted to our named executive officers also contain a performance condition based on certain operating measures for the fiscal year ended December 28, 2011. The performance period is the three year fiscal period beginning December 30, 2010 and ending December 25, 2013. The performance shares and cash awards will vest and be earned (from 0% to 150% of the target award for each such increment) at the end of the performance period based on the Total Shareholder Return of our stock compared to the Total Shareholder Returns of a group of peer companies.

Also in February 2011, we granted approximately 0.2 million performance-based restricted stock units as an employment incentive related to the hiring of our new Chief Executive Officer. Since these awards contain a market condition, a Monte Carlo valuation was used to determine the grant date fair value. The weighted average fair value per share was \$3.29. The units will vest and be earned if the closing price of Denny's common stock meets or exceeds set price hurdles for 20 consecutive days. The performance period is the five year period beginning February 1, 2011 and ending February 1, 2016.

During the three quarters ended September 28, 2011, we made payments of \$0.6 million (before taxes) in cash and issued 0.3 million shares of common stock, net of 0.1 million shares that were used to pay for taxes, related to restricted stock unit awards.

Accrued compensation expense included as a component of the Condensed Consolidated Balance Sheet was as follows:

|  | September 28,<br>2011 | December 29,<br>2010 |
|--|-----------------------|----------------------|
|  | (In thousands)        |                      |
| Liability classified restricted stock units: |                       |                      |
| Other current liabilities                    | \$ 487                | \$ 414               |
| Other noncurrent liabilities                 | \$ 284                | \$ 365               |
| Equity classified restricted stock units:    |                       |                      |
| Additional paid-in capital                   | \$ 4,418              | \$ 4,259             |

As of September 28, 2011, we had approximately \$1.9 million of unrecognized compensation cost (approximately \$0.5 million for liability classified units and approximately \$1.4 million for equity classified units) related to all unvested restricted stock unit awards outstanding, which is expected to be recognized over a weighted average of 0.8 years.



## Board Deferred Stock Units

During the three quarters ended September 28, 2011, we granted 0.2 million deferred stock units (which are equity classified) with a weighted average grant date fair value of \$4.00 per unit to non-employee members of our Board of Directors. A director may elect to convert these awards into shares of common stock either on a specific date in the future (while still serving as a member of the Board of Directors) or upon termination as a member of the Board of Directors. During the three quarters ended September 28, 2011, 0.1 million deferred stock units were converted into shares of common stock.

## Note 11. Comprehensive Income and Accumulated Other Comprehensive Loss

Total comprehensive income was \$20.2 million and \$20.1 million for the three quarters ended September 28, 2011 and September 29, 2010, respectively.

Accumulated Other Comprehensive Loss, Net in the Condensed Consolidated Statement of Shareholder's Deficit and Comprehensive Loss was comprised of additional minimum pension liability of \$19.2 million as of both September 28, 2011 and December 29, 2010.

## Note 12. Income Taxes

The provision for income taxes was \$0.4 and \$1.0 million for the quarter and three quarters ended September 28, 2011, respectively, and \$0.4 million and \$1.0 million for the quarter and three quarters ended September 29, 2010, respectively. The provision for income taxes for the first three quarters of 2011 and 2010 was determined using our effective rate estimated for the entire fiscal year. We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our net operating losses ("NOL") generated in previous periods.

In conjunction with our ongoing review of our actual results and anticipated future earnings, we have reassessed the possibility of releasing all or a portion of the valuation allowance currently in place for our deferred tax assets. Based upon this assessment, a release of the valuation allowance is not appropriate as of September 28, 2011, but may occur during 2011 or 2012. The required accounting for a release of the valuation allowance may result in a significant tax benefit and impact earnings in the quarter in which it is deemed appropriate to release all or a portion of the reserve.

## Note 13. Net Income Per Share

|  | Quarter Ended                                |                       | Three Quarters Ended  |                       |
|--|--|-----------------------|-----------------------|-----------------------|
|  | September<br>28, 2011                        | September 29,<br>2010 | September 28,<br>2011 | September 29,<br>2010 |
|  | (In thousands, except for per share amounts) |                       |                       |                       |
| Numerator:   |  |                       |                       |                       |
| Numerator for basic and diluted net income per share   |  |                       |                       |                       |
| – net income   | \$ 7,985                                     | \$ 9,934              | \$ 20,239             | \$ 19,980             |
| Denominator:   |  |                       |                       |                       |
| Denominator for basic net income per share   |  |                       |                       |                       |
| – weighted average shares  | 96,997                                       | 99,579                | 98,132                | 98,646                |
| Effect of dilutive securities:   |  |                       |                       |                       |
| Options  | 803  | 627                   | 1,022                 | 1,248                 |
| Restricted stock units and awards  | 946  | 1,099                 | 1,049                 | 1,370                 |
| Denominator for diluted net income per share – adjusted weighted average shares and assumed conversions of dilutive securities |  |                       |                       |                       |
|  | 98,746                                       | 101,305               | 100,203               | 101,264               |
| Basic net income per share   |  |                       |                       |                       |
|  | \$ 0.08                                      | \$ 0.10               | \$ 0.21               | \$ 0.20               |
| Diluted net income per share   |  |                       |                       |                       |
|  | \$ 0.08                                      | \$ 0.10               | \$ 0.20               | \$ 0.20               |
| Stock options excluded (1)   |  |                       |                       |                       |
|  | 2,070  | 3,206                 | 2,177                 | 2,232                 |
| Restricted stock units and awards excluded (1)   |  |                       |                       |                       |
|  | 538  | —                     | 747                   | —                     |

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Excluded from diluted weighted-average shares outstanding as the impact would have been antidilutive.

Note 14. Supplemental Cash Flow Information

|  | Three Quarters Ended  |                       |
|--|-----------------------|-----------------------|
|  | September 28,<br>2011 | September 29,<br>2010 |
|  | (In thousands)        |                       |
| Income taxes paid, net   | \$ 988                | \$ 389                |
| Interest paid  | \$ 17,057             | \$ 14,426             |
| Noncash investing activities:  |                       |                       |
| Notes received in connection with disposition of property            | \$ 500                | \$ 200                |
| Execution of direct financing leases                                 | \$ 458                | \$ —                  |
| Noncash financing activities:  |                       |                       |
| Issuance of common stock, pursuant to share-based compensation plans | \$ 1,482              | \$ 1,120              |
| Execution of capital leases  | \$ 4,094              | \$ 2,173              |
| Treasury stock payable   | \$ 223                | \$ —                  |
| Accrued deferred financing costs                                     | \$ —                  | \$ 841                |

Note 15. Share Repurchase

Our credit facility permits the payment of cash dividends and the purchase of Denny's stock subject to certain limitations. In November 2010, the Board of Directors approved a share repurchase program authorizing us to repurchase up to 3.0 million shares of our Common Stock. Under the program, we could, from time to time, purchase shares through December 31, 2011 in the open market (including pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934) or in privately negotiated transactions, subject to market and business conditions. During the first quarter of 2011, we repurchased 2.0 million shares for approximately \$7.6 million. As of March 30, 2011, we had repurchased 3.0 million shares of Common Stock for approximately \$11.5 million under this share repurchase program, thus completing the program.

On April 4, 2011, we announced that our Board of Directors approved a share repurchase program authorizing us to repurchase up to an additional 6.0 million shares of our Common Stock. Under the program, we could, from time to time, purchase shares in the open market (including pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934) or in privately negotiated transactions, subject to market and business conditions. As of September 28, 2011, we had repurchased 3.1 million shares of Common Stock for approximately \$11.8 million under this share repurchase program.

Repurchased shares are included as treasury stock in the condensed Consolidated Balance Sheets and the condensed Consolidated Statements of Shareholders' Deficit and Comprehensive Loss.

Note 16. Related Party Transactions

During the three quarters ended September 28, 2011, we sold a company-owned restaurant to a franchisee that is a former employee. We received cash proceeds of \$0.3 million and recognized a gain of \$0.2 million from this related party sale. In relation to this sale, we entered into a sublease with the franchisee at normal market rates.



Note 17. Commitments and Contingencies

There are various claims and pending legal actions against or indirectly involving us, including actions involving employees and guests, other employment related matters, taxes, sales of franchise rights and businesses and other matters. Based on our examination of these matters and our experience to date, we have recorded reserves reflecting our best estimate of liability, if any, with respect to these matters. However, the ultimate disposition of these matters cannot be determined with certainty. We record legal expenses and other litigation costs as those costs are incurred.

Note 18. Subsequent Events

We performed an evaluation of subsequent events and determined that no events required disclosure.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The following discussion is intended to highlight significant changes in our financial position as of September 28, 2011 and results of operations for the quarter and three quarters ended September 28, 2011 compared to the quarter and three quarters ended September 29, 2010. The forward-looking statements included in Management's Discussion and Analysis of Financial Condition and Results of Operations, which reflect our best judgment based on factors currently known, are intended to speak only as of the date such statements are made and involve risks, uncertainties, and other factors which may cause our actual performance to be materially different from the performance indicated or implied by such statements. Such factors include, among others: competitive pressures from within the restaurant industry; the level of success of our operating initiatives and advertising and promotional efforts; adverse publicity; changes in business strategy or development plans; terms and availability of capital; regional weather conditions; overall changes in the general economy (including with regard to energy costs), particularly at the retail level; political environment (including acts of war and terrorism); and other factors included in the discussion below, or in Part II. Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Part I. Item 1A. Risk Factors, contained in our Annual Report on Form 10-K for the year ended December 29, 2010.

## Statements of Operations

The following table contains information derived from our Condensed Consolidated Statements of Operations expressed as a percentage of total operating revenues, except as noted below. Percentages may not add due to rounding.

|  | Quarter Ended          |         |                    |         | Three Quarters Ended |         |                    |         |
|--|------------------------|---------|--------------------|---------|----------------------|---------|--------------------|---------|
|  | September 28, 2011     |         | September 29, 2010 |         | September 28, 2011   |         | September 29, 2010 |         |
|  | (Dollars in thousands) |         |                    |         |                      |         |                    |         |
| <b>Revenue:</b>                                    |                        |         |                    |         |                      |         |                    |         |
| Company restaurant sales                           | \$104,659              | 76.6 %  | \$107,171          | 76.6 %  | \$313,235            | 76.7 %  | \$320,255          | 77.6 %  |
| Franchise and license revenue                      | 32,023                 | 23.4 %  | 32,761             | 23.4 %  | 95,105               | 23.3 %  | 92,326             | 22.4 %  |
| Total operating revenue                            | 136,682                | 100.0 % | 139,932            | 100.0 % | 408,340              | 100.0 % | 412,581            | 100.0 % |
| <b>Costs of company restaurant sales (a):</b>      |                        |         |                    |         |                      |         |                    |         |
| Product costs                                      | 25,847                 | 24.7 %  | 25,405             | 23.7 %  | 77,095               | 24.6 %  | 75,597             | 23.6 %  |
| Payroll and benefits                               | 41,261                 | 39.4 %  | 41,533             | 38.8 %  | 127,876              | 40.8 %  | 129,072            | 40.3 %  |
| Occupancy  | 6,928                  | 6.6 %   | 7,097              | 6.6 %   | 20,581               | 6.6 %   | 21,406             | 6.7 %   |
| Other operating expenses                           | 15,851                 | 15.1 %  | 17,158             | 16.0 %  | 46,437               | 14.8 %  | 49,016             | 15.3 %  |
| Total costs of company restaurant sales            | 89,887                 | 85.9 %  | 91,193             | 85.1 %  | 271,989              | 86.8 %  | 275,091            | 85.9 %  |
| <b>Costs of franchise and license revenue (a)</b>  |                        |         |                    |         |                      |         |                    |         |
|  | 10,747                 | 33.6 %  | 12,009             | 36.7 %  | 33,397               | 35.1 %  | 35,498             | 38.4 %  |
| <b>General and administrative expenses</b>         |                        |         |                    |         |                      |         |                    |         |
|  | 13,335                 | 9.8 %   | 14,375             | 10.3 %  | 41,566               | 10.2 %  | 40,560             | 9.8 %   |
| <b>Depreciation and amortization</b>               |                        |         |                    |         |                      |         |                    |         |
|  | 6,955                  | 5.1 %   | 7,320              | 5.2 %   | 21,377               | 5.2 %   | 21,984             | 5.3 %   |
| <b>Operating (gains), losses and other charges</b> |                        |         |                    |         |                      |         |                    |         |
|  | 1,791                  | 1.3 %   | (1,900 )           | (1.4 %) | 843                  | 0.2 %   | (1,594 )           | (0.4 %) |
| <b>Total operating costs and expenses</b>          |                        |         |                    |         |                      |         |                    |         |
|  | 122,715                | 89.8 %  | 122,997            | 87.9 %  | 369,172              | 90.4 %  | 371,539            | 90.1 %  |
| <b>Operating income</b>                            |                        |         |                    |         |                      |         |                    |         |
|  | 13,967                 | 10.2 %  | 16,935             | 12.1 %  | 39,168               | 9.6 %   | 41,042             | 9.9 %   |
| <b>Other expenses:</b>                             |                        |         |                    |         |                      |         |                    |         |
| Interest expense, net                              | 4,796                  | 3.5 %   | 6,394              | 4.6 %   | 15,390               | 3.8 %   | 19,306             | 4.7 %   |
| Other nonoperating expense, net                    | 780                    | 0.6 %   | 188                | 0.1 %   | 2,526                | 0.6 %   | 746                | 0.2 %   |
| Total other expenses, net                          | 5,576                  | 4.1 %   | 6,582              | 4.7 %   | 17,916               | 4.4 %   | 20,052             | 4.9 %   |
| <b>Net income before income taxes</b>              |                        |         |                    |         |                      |         |                    |         |
|  | 8,391                  | 6.1 %   | 10,353             | 7.4 %   | 21,252               | 5.2 %   | 20,990             | 5.1 %   |
| <b>Provision for income taxes</b>                  |                        |         |                    |         |                      |         |                    |         |
|  | 406                    | 0.3 %   | 419                | 0.3 %   | 1,013                | 0.2 %   | 1,010              | 0.2 %   |
| <b>Net income</b>                                  |                        |         |                    |         |                      |         |                    |         |
|  | \$7,985                | 5.8 %   | \$9,934            | 7.1 %   | \$20,239             | 5.0 %   | \$19,980           | 4.8 %   |
| <b>Other Data:</b>                                 |                        |         |                    |         |                      |         |                    |         |
| Company-owned average unit sales                   | \$468                  |         | \$462              |         | \$1,383              |         | \$1,368            |         |

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|   |       |   |       |   |         |   |         |   |
|---|-------|---|-------|---|---------|---|---------|---|
| Franchise average unit sales  | \$355 |   | \$348 |   | \$1,043 |   | \$1,029 |   |
| Company-owned equivalent units (b)  | 224   |   | 232   |   | 226     |   | 234     |   |
| Franchise equivalent units (b)  | 1,451 |   | 1,348 |   | 1,441   |   | 1,330   |   |
| Same-store sales increase (decrease) (company-owned) (c)(d)                 | 1.1   | % | (0.7) | % | 0.7     | % | (4.2)   | % |
| Guest check average increase (decrease) (d)                                 | 1.3   | % | (2.9) | % | 0.8     | % | (1.8)   | % |
| Guest count increase (decrease) (d)   | (0.2) | % | 2.3   | % | 0.0     | % | (2.4)   | % |
| Same-store sales increase (decrease) (franchised and licensed units) (c)(d) | 0.8   | % | (1.2) | % | 0.3     | % | (4.5)   | % |

- (a) Costs of company restaurant sales percentages are as a percentage of company restaurant sales. Costs of franchise and license revenue percentages are as a percentage of franchise and license revenue. All other percentages are as a percentage of total operating revenue.
- (b) Equivalent units are calculated as the weighted average number of units outstanding during a defined time period.
- (c) Same-store sales include sales from restaurants that were open the same period in the prior year.
- (d) Prior year amounts have not been restated for 2011 comparable units.

Quarter Ended September 28, 2011 Compared with Quarter Ended September 29, 2010

### Unit Activity

|  | Quarter Ended         |                       |
|--|-----------------------|-----------------------|
|  | September 28,<br>2011 | September 29,<br>2010 |
| Company-owned restaurants, beginning of period           | 225                   | 228                   |
| Units opened   | 2                     | 6                     |
| Units sold to franchisees                                | (3)                   | (2)                   |
| Units closed   | (1)                   | —                     |
| End of period  | 223                   | 232                   |
| Franchised and licensed restaurants, beginning of period | 1,452                 | 1,328                 |
| Units opened   | 9                     | 55                    |
| Units relocated  | —                     | 2                     |
| Units purchased from Company                             | 3                     | 2                     |
| Units closed (including units relocated)                 | (10)                  | (7)                   |
| End of period  | 1,454                 | 1,380                 |
| Total restaurants, end of period                         | 1,677                 | 1,612                 |

Of the 11 units opened and relocated during the quarter ended September 28, 2011, two company-owned units and one franchise unit represent conversions and openings of restaurants at Pilot Flying J Travel Centers. Of the 63 units opened and relocated during the quarter ended September 29, 2010, six company-owned and 42 franchise units represents the conversion of a restaurant at a Pilot Flying J Travel Center.

### Company Restaurant Operations

During the quarter ended September 28, 2011, we realized a 1.1% increase in same-store sales, comprised of a 1.3% increase in guest check average, partially offset by a 0.2% decrease in guest counts. Company restaurant sales decreased \$2.5 million, or 2.3%, primarily resulting from an eight equivalent unit decrease in company-owned restaurants, partially offset by the increase in same-store sales for the quarter. The decrease in equivalent units primarily resulted from the sale of company-owned restaurants to franchisees.

Total costs of company restaurant sales as a percentage of company restaurant sales increased to 85.9% from 85.1%. Product costs increased to 24.7% from 23.7% primarily due to the impact of increased commodity costs. Payroll and benefits increased to 39.4% from 38.8% primarily due to \$2.1 million, or 2.0%, of favorable workers' compensation claims development in the prior year period, partially offset by improved scheduling of restaurant staff. Occupancy costs remained constant at 6.6%. Other operating expenses were comprised of the following amounts and percentages of company restaurant sales:

|                         | Quarter Ended          |      |                    |      |
|-------------------------|------------------------|------|--------------------|------|
|                         | September 28, 2011     |      | September 29, 2010 |      |
|                         | (Dollars in thousands) |      |                    |      |
| Utilities               | \$ 4,762               | 4.6% | \$ 4,926           | 4.6% |
| Repairs and maintenance | 1,754                  | 1.7% | 1,767              | 1.6% |
| Marketing               | 3,926                  | 3.8% | 4,645              | 4.3% |



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|                          |           |       |           |       |
|--------------------------|-----------|-------|-----------|-------|
| Legal settlement costs   | 607       | 0.6%  | 602       | 0.6%  |
| Other direct costs       | 4,802     | 4.6%  | 5,218     | 4.9%  |
| Other operating expenses | \$ 15,851 | 15.1% | \$ 17,158 | 16.0% |

Marketing decreased 0.5 percentage points primarily as a result of additional corporate investment in media in the prior year period.

Franchise Operations

Franchise and license revenue and related costs were comprised of the following amounts and percentages of franchise and license revenue for the periods indicated:

|  | Quarter Ended          |        |                    |        |
|--|------------------------|--------|--------------------|--------|
|  | September 28, 2011     |        | September 29, 2010 |        |
|  | (Dollars in thousands) |        |                    |        |
| Royalties                              | \$ 20,449              | 63.9%  | \$ 18,670          | 57.0%  |
| Initial and other fees                 | 437                    | 1.3%   | 2,760              | 8.4%   |
| Occupancy revenue                      | 11,137                 | 34.8%  | 11,331             | 34.6%  |
| Franchise and license revenue          | \$ 32,023              | 100.0% | \$ 32,761          | 100.0% |
| Occupancy costs                        | 8,349                  | 26.1%  | 8,743              | 26.7%  |
| Other direct costs                     | 2,398                  | 7.5%   | 3,266              | 10.0%  |
| Costs of franchise and license revenue | \$ 10,747              | 33.6%  | \$ 12,009          | 36.7%  |

Royalties increased by \$1.8 million, or 9.5%, primarily resulting from a 103 equivalent unit increase in franchised and licensed units, as compared to the prior year, and a 0.8% increase in same-store sales. The increase in equivalent units primarily resulted from the conversion of restaurants at Pilot Flying J Travel Centers during 2010 and 2011. Initial fees decreased by \$2.3 million, or 84.2%. The decrease in initial fees resulted from the higher number of restaurants opened by franchisees during the prior year period. Occupancy revenue remained relatively constant, as the increase due to the sale of restaurants to franchisees over the last 12 months was offset by the impact of lease expirations and terminations.

Costs of franchise and license revenue decreased by \$1.3 million, or 10.5%. The decrease in occupancy costs of \$0.4 million, or 4.5%, is primarily the result of lease expirations and terminations. Other direct costs decreased by \$0.9 million, or 26.6%, primarily resulting from lower opening and training costs related to the higher number of openings by franchisees during the prior year period. As a result, costs of franchise and license revenue as a percentage of franchise and license revenue decreased to 33.6% for the quarter ended September 28, 2011 from 36.7% for the quarter ended September 29, 2010.

#### Other Operating Costs and Expenses

Other operating costs and expenses such as general and administrative expenses and depreciation and amortization expense relate to both company and franchise operations.

General and administrative expenses were comprised of the following:

|   | Quarter Ended      |                    |
|---|--------------------|--------------------|
|   | September 28, 2011 | September 29, 2010 |
|   | (In thousands)     |                    |
| Share-based compensation                  | \$ 1,031           | \$ 761             |
| Other general and administrative expenses | 12,304             | 13,614             |
| Total general and administrative expenses | \$ 13,335          | \$ 14,375          |

The \$0.3 million increase in share-based compensation expense is primarily due to the issuance of employment inducement awards to certain employees. Other general and administrative expenses decreased \$1.3 million. This decrease is primarily the result of a decrease in performance-based and deferred compensation.

Depreciation and amortization was comprised of the following:

|   | Quarter Ended      |                    |
|---|--------------------|--------------------|
|   | September 28, 2011 | September 29, 2010 |
|   | (In thousands)     |                    |
| Depreciation of property and equipment      | \$ 5,228           | \$ 5,384           |
| Amortization of capital lease assets        | 833                | 710                |
| Amortization of intangible assets           | 894                | 1,226              |
| Total depreciation and amortization expense | \$ 6,955           | \$ 7,320           |

Operating (gains), losses and other charges, net were comprised of the following:

|  | Quarter Ended      |                    |
|--|--------------------|--------------------|
|  | September 28, 2011 | September 29, 2010 |
|  | (In thousands)     |                    |
| Gains on sales of assets and other, net          | \$ (867)           | \$ (3,757)         |
| Restructuring charges and exit costs             | 490                | 1,778              |
| Impairment charges                               | 2,168              | 79                 |
| Operating (gains), losses and other charges, net | \$ 1,791           | \$ (1,900)         |

During the quarter ended September 28, 2011, we recognized gains of \$0.9 million, primarily resulting from the sale of three restaurant operations to two franchisees. During the quarter ended September 29, 2010, we recognized gains of \$3.8 million, primarily resulting from the sale of real estate to franchisees.

Restructuring charges and exit costs were comprised of the following:

|   | Quarter Ended      |                    |
|---|--------------------|--------------------|
|   | September 28, 2011 | September 29, 2010 |
|   | (In thousands)     |                    |
| Exit costs                                | \$ 465             | \$ (45)            |
| Severance and other restructuring charges | 25                 | 1,823              |
| Total restructuring and exit costs        | \$ 490             | \$ 1,778           |

Severance and other restructuring charges for the quarter ended September 29, 2010 includes \$1.5 million related to the departure of the Company's former Chief Executive Officer.

Impairment charges of \$2.2 million for the quarter ended September 28, 2011 resulted from the impairment of assets of one underperforming unit and two units identified as assets held for sale during the quarter.

Operating income was \$14.0 million for the quarter ended September 28, 2011 compared with \$16.9 million for the quarter ended September 29, 2010.

Interest expense, net was comprised of the following:

|  | Quarter Ended         |                       |
|--|-----------------------|-----------------------|
|  | September 28,<br>2011 | September 29,<br>2010 |
|  | (In thousands)        |                       |
| Interest on credit facilities            | \$ 2,917              | \$ 4,363              |
| Interest on senior notes                 | —                     | 402                   |
| Interest on capital lease liabilities    | 977                   | 964                   |
| Letters of credit and other fees         | 457                   | 397                   |
| Interest income                          | (324)                 | (345)                 |
| Total cash interest                      | 4,027                 | 5,781                 |
| Amortization of deferred financing costs | 361                   | 254                   |
| Amortization of debt discount            | 134                   | —                     |
| Interest accretion on other liabilities  | 274                   | 359                   |
| Total interest expense, net              | \$ 4,796              | \$ 6,394              |

The decrease in interest expense resulted from a decrease in interest rates related to the 2010 refinancing and 2011 re-pricing of our credit facility, as well as debt reductions during both years.

Other nonoperating expense, net was \$0.8 million for the quarter ended September 28, 2011 compared with \$0.2 million for the quarter ended September 29, 2010.

The provision for income taxes was \$0.4 million for both the quarters ended September 28, 2011 and September 29, 2010. The provision for income taxes for the third quarters of 2011 and 2010 was determined using our effective rate estimated for the entire fiscal year. We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our net operating losses (NOL) generated in previous periods. In conjunction with our ongoing review of our actual results and anticipated future earnings, we have reassessed the possibility of releasing all or a portion of the valuation allowance currently in place for our deferred tax assets. Based upon this assessment, a release of the valuation allowance is not appropriate as of September 28, 2011, but may occur during 2011 or 2012. The required accounting for a release of the valuation allowance may result in a significant tax benefit and impact earnings in the quarter in which it is deemed appropriate to release all or a portion of the reserve.

Net income was \$8.0 million for the quarter ended September 28, 2011 compared with \$9.9 million for the quarter ended September 29, 2010 due to the factors noted above.

#### Three Quarters Ended September 28, 2011 Compared with Three Quarters Ended September 29, 2010

##### Unit Activity

|  | Three Quarters Ended  |                       |
|--|-----------------------|-----------------------|
|  | September 28,<br>2011 | September 29,<br>2010 |
| Company-owned restaurants, beginning of period | 232                   | 233                   |
| Units opened                                   | 8                     | 10                    |
| Units sold to franchisees                      | (13)                  | (11)                  |
| Units closed                                   | (4)                   | —                     |
| End of period                                  | 223                   | 232                   |

|  |       |       |
|--|-------|-------|
| Franchised and licensed restaurants, beginning of period | 1,426 | 1,318 |
| Units opened   | 39    | 68    |
| Units relocated  | 1     | 3     |
| Units purchased from Company                             | 13    | 11    |
| Units closed (including units relocated)                 | (25)  | (20)  |
| End of period  | 1,454 | 1,380 |
| Total restaurants, end of period                         | 1,677 | 1,612 |

Of the 48 units opened and relocated during the three quarters ended September 28, 2011, eight company-owned and 15 franchise units represent conversions and openings of restaurants at Pilot Flying J Travel Centers. Of the 81 units opened and relocated during the three quarters ended September 29, 2010, ten company-owned and 43 franchise units represent conversions and openings of restaurants at Pilot Flying J Travel Centers.

#### Company Restaurant Operations

During the three quarters ended September 28, 2011, we realized a 0.7% increase in same-store sales, comprised of a 0.8% increase in guest check average and essentially flat guest counts. Company restaurant sales decreased \$7.0 million, or 2.2%, primarily resulting from an eight equivalent unit decrease in company-owned restaurants. The decrease in equivalent units primarily resulted from the sale of company-owned restaurants to franchisees.

Total costs of company restaurant sales as a percentage of company restaurant sales increased to 86.8% from 85.9%. Product costs increased to 24.6% from 23.6% primarily due to the impact of increased commodity costs. Payroll and benefits increased to 40.8% from 40.3% primarily due to \$2.8 million, or 0.9%, of favorable workers' compensation claims development in the prior year period and higher incentive compensation, partially offset by improved scheduling of restaurant staff. Occupancy costs decreased to 6.6% from 6.7%. Other operating expenses were comprised of the following amounts and percentages of company restaurant sales:

|                          | Three Quarters Ended   |       |                    |       |
|--------------------------|------------------------|-------|--------------------|-------|
|                          | September 28, 2011     |       | September 29, 2010 |       |
|                          | (Dollars in thousands) |       |                    |       |
| Utilities                | \$ 13,741              | 4.4%  | \$ 13,968          | 4.4%  |
| Repairs and maintenance  | 5,485                  | 1.8%  | 5,711              | 1.8%  |
| Marketing                | 11,738                 | 3.7%  | 13,469             | 4.2%  |
| Legal settlement costs   | 671                    | 0.2%  | 802                | 0.3%  |
| Other direct costs       | 14,802                 | 4.7%  | 15,066             | 4.7%  |
| Other operating expenses | \$ 46,437              | 14.8% | \$ 49,016          | 15.3% |

Marketing decreased 0.5 percentage points primarily as a result of additional corporate investment in media in the prior year period.

#### Franchise Operations

Franchise and license revenue and costs of franchise and license revenue were comprised of the following amounts and percentages of franchise and license revenue for the periods indicated:

|  | Three Quarters Ended   |        |                    |        |
|--|------------------------|--------|--------------------|--------|
|  | September 28, 2011     |        | September 29, 2010 |        |
|  | (Dollars in thousands) |        |                    |        |
| Royalties                              | \$ 59,669              | 62.7%  | \$ 54,488          | 59.0%  |
| Initial fees                           | 2,050                  | 2.2%   | 3,872              | 4.2%   |
| Occupancy revenue                      | 33,386                 | 35.1%  | 33,966             | 36.8%  |
| Franchise and license revenue          | \$ 95,105              | 100.0% | \$ 92,326          | 100.0% |
| Occupancy costs                        | 25,567                 | 26.9%  | 26,062             | 28.2%  |
| Other direct costs                     | 7,830                  | 8.2%   | 9,436              | 10.2%  |
| Costs of franchise and license revenue | \$ 33,397              | 35.1%  | \$ 35,498          | 38.4%  |

Royalties increased by \$5.2 million, or 9.5%, primarily resulting from the effects of a 111 equivalent unit increase in franchised and licensed units, as compared to the prior year, and a 0.3% increase in same-store sales. The increase in equivalent units primarily resulted from the conversion of restaurants at Pilot Flying J Travel Centers during 2010 and 2011. Initial fees decreased by \$1.8 million, or 47.1%. The decrease in initial fees resulted from the higher number of restaurants opened by franchisees during the prior year period. The decrease in occupancy revenue of \$0.6 million, or 1.7%, is primarily the result of lease expirations and terminations where the franchisee has obtained their own lease with the landlord and we are no longer party to the lease.

Costs of franchise and license revenue decreased by \$2.1 million, or 5.9%. The decrease in occupancy costs of \$0.5 million, or 1.9%, is primarily the result of lease expirations and terminations as described above. Other direct costs decreased by \$1.6 million, or 17.0%, primarily resulting from lower opening and training costs related to the higher number of openings by franchisees in the prior year period and the franchise-related costs associated with our Super Bowl promotion in the prior year, partially offset by a \$0.5 million franchisee settlement. As a result, costs of franchise and license revenue as a percentage of franchise and license revenue decreased to 35.1% for the three quarters ended September 28, 2011 from 38.4% for the three quarters ended September 29, 2010.

#### Other Operating Costs and Expenses

Other operating costs and expenses such as general and administrative expenses and depreciation and amortization expense relate to both company and franchise operations.

General and administrative expenses are comprised of the following:

|   | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|
|   | September 28,<br>2011 | September 29,<br>2010 |
|   | (In thousands)        |                       |
| Share-based compensation                  | \$ 3,180              | \$ 2,010              |
| General and administrative expenses       | 38,386                | 38,550                |
| Total general and administrative expenses | \$ 41,566             | \$ 40,560             |

The \$1.2 million increase in share-based compensation expense is primarily due to the issuance of employment inducement awards to certain employees and reductions in the prior year related to forfeitures. Other general and administrative expenses decreased \$0.2 million. This decrease is primarily the result of \$2.0 million in proxy contest costs incurred during the 2010 period and a decrease in deferred compensation. These decreases were partially offset by an increase in performance-based compensation and an increase in headcount, including executive positions that were vacant in the prior year period.

Depreciation and amortization is comprised of the following:

|   | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|
|   | September 28,<br>2011 | September 29,<br>2010 |
|   | (In thousands)        |                       |
| Depreciation of property and equipment      | \$ 15,772             | \$ 16,180             |
| Amortization of capital lease assets        | 2,330                 | 2,055                 |
| Amortization of intangible assets           | 3,275                 | 3,749                 |
| Total depreciation and amortization expense | \$ 21,377             | \$ 21,984             |

Operating gains, losses and other charges, net are comprised of the following:

|   | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|
|   | September 28,<br>2011 | September 29,<br>2010 |
|   | (In thousands)        |                       |
| Gains on sales of assets and other, net             | \$ (2,742)            | \$ (5,233)            |
| Restructuring charges and exit costs                | 1,359                 | 3,560                 |
| Impairment charges                                  | 2,226                 | 79                    |
| Operating (gains), losses and other charges,<br>net | \$ 843                | \$ (1,594)            |

During the three quarters ended September 28, 2011, we recognized gains of \$2.7 million, primarily resulting from the sale of 13 restaurant operations to five franchisees, the sale of real estate and the recognition of deferred gains related to a restaurant sold to a franchisee during a prior period. During the three quarters ended September 29, 2010, we recognized gains of \$5.2 million, primarily resulting from the sale of real estate to franchisees and the sale of 11 restaurant operations to six franchisees.

Restructuring charges and exit costs were comprised of the following:

|   | Three Quarters Ended  |                       |
|---|-----------------------|-----------------------|
|   | September 28,<br>2011 | September 29,<br>2010 |
|   | (In thousands)        |                       |
| Exit costs                                | \$ 1,078              | \$ 818                |
| Severance and other restructuring charges | 281                   | 2,742                 |
| Total restructuring and exit costs        | \$ 1,359              | \$ 3,560              |

Severance and other restructuring charges for the three quarters ended September 29, 2010 includes \$2.3 million related to the departure of the Company's former Chief Executive Officer.

Impairment charges of \$2.2 million for the three quarters ended September 28, 2011 resulted primarily from the impairment of assets of one underperforming unit and two units identified as assets held for sale during the third quarter.

Operating income was \$39.2 million for the three quarters ended September 28, 2011 and \$41.0 million for the three quarters ended September 29, 2010.

Interest expense, net is comprised of the following:

|                                       | Three Quarters Ended  |                       |
|---------------------------------------|-----------------------|-----------------------|
|                                       | September 28,<br>2011 | September 29,<br>2010 |
|                                       | (In thousands)        |                       |
| Interest on credit facilities         | \$ 9,666              | \$ 1,329              |
| Interest on senior notes              | —                     | 13,089                |
| Interest on capital lease liabilities | 2,929                 | 2,943                 |
| Letters of credit and other fees      | 1,471                 | 1,173                 |
| Interest income                       | (954)                 | (1,183)               |



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|  |           |           |
|--|-----------|-----------|
| Total cash interest                      | 13,112    | 17,351    |
| Amortization of deferred financing costs | 1,023     | 771       |
| Amortization of debt discount            | 418       | —         |
| Interest accretion on other liabilities  | 837       | 1,184     |
| Total interest expense, net              | \$ 15,390 | \$ 19,306 |

The decrease in interest expense resulted from a decrease in interest rates related to the 2010 refinancing and 2011 re-pricing of our credit facility, as well as debt reductions during both years.

Other nonoperating expense, net was \$2.5 million for the three quarters ended September 28, 2011 compared with \$0.7 million for the three quarters ended September 29, 2010. The increase in other nonoperating expense resulted primarily from the \$1.4 million of losses on early extinguishment of debt related to the debt amendment in the first quarter of 2011 and the \$1.0 million of losses on early extinguishment of debt related to prepayments made during 2011. These increases were partially offset by a \$0.7 million decrease in valuation adjustments related to changes in the discount rate applied to workers' compensation and general liability insurance liabilities.

The provision for income taxes was \$1.0 million for both the three quarters ended September 28, 2011 and the three quarters ended September 29, 2010. The provision for income taxes for the first three quarters of 2011 and 2010 was determined using our effective rate estimated for the entire fiscal year. We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our NOL generated in previous periods. In conjunction with our ongoing review of our actual results and anticipated future earnings, we have reassessed the possibility of releasing all or a portion of the valuation allowance currently in place for our deferred tax assets. Based upon this assessment, a release of the valuation allowance is not appropriate as of September 28, 2011, but may occur during 2011 or 2012. The required accounting for a release of the valuation allowance may result in a significant tax benefit and impact earnings in the quarter in which it is deemed appropriate to release all or a portion of the reserve.

Net income was \$20.2 million for the three quarters ended September 28, 2011 compared with \$20.0 million for the three quarters ended September 29, 2010 due to the factors noted above.

### Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash generated from operations, borrowings under our credit facility (as described below) and, in recent years, cash proceeds from sales of restaurant operations to franchisees and sales of surplus properties, to the extent allowed by our credit facility. Principal uses of cash are operating expenses, capital expenditures, debt repayments and, recently, the repurchasing of shares of our Common Stock.

The following table presents a summary of our sources and uses of cash and cash equivalents for the periods indicated:

|  | Three Quarters Ended  |                       |
|--|-----------------------|-----------------------|
|  | September 28,<br>2011 | September 29,<br>2010 |
|  | (In thousands)        |                       |
| Net cash provided by operating activities            | \$ 46,607             | \$ 31,593             |
| Net cash used in investing activities                | (7,185)               | (134)                 |
| Net cash used in financing activities                | (53,549)              | (17,346)              |
| Net (decrease) increase in cash and cash equivalents | \$ (14,127)           | \$ 14,113             |

We believe that our estimated cash flows from operations for 2011, combined with our capacity for additional borrowings under our credit facility, will enable us to meet our anticipated cash requirements and fund capital expenditures over the next twelve months.

Net cash flows used in investing activities were \$7.2 million for the three quarters ended September 28, 2011. These cash flows include capital expenditures of \$12.9 million, partially offset by \$5.0 million in proceeds from asset sales and \$0.8 million of notes receivable collections. Our principal capital requirements have been largely associated with the following:

|                  | Three Quarters Ended  |                       |
|------------------|-----------------------|-----------------------|
|                  | September 28,<br>2011 | September 29,<br>2010 |
|                  | (In thousands)        |                       |
| Facilities       | \$ 4,175              | \$ 3,932              |
| New construction | 7,031                 | 6,806                 |

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|                        |           |           |
|------------------------|-----------|-----------|
| Remodeling             | 698       | 1,187     |
| Information technology | 452       | 622       |
| Strategic initiatives  | 226       | 6         |
| Other                  | 345       | 649       |
| Capital expenditures   | \$ 12,927 | \$ 13,202 |

The increase in new construction is primarily the result of the conversion of restaurants at Pilot Flying J Travel Centers. We generally expect our capital requirements to trend downward as we reduce our company-owned restaurant portfolio and remain selective in our new restaurant investments. Capital expenditures for fiscal 2011 are expected to be approximately \$17 million, comprised primarily of costs related to the conversion of Pilot Flying J Travel Centers, facilities and new construction.

Cash flows used in financing activities were \$53.5 million for the three quarters ended September 28, 2011, which included long-term debt payments of \$33.2 million, stock repurchases of \$19.2 million and deferred financing costs of \$3.4 million.

Our working capital deficit was \$40.1 million at September 28, 2011 compared with \$27.8 million at December 29, 2010. The increase in working capital deficit primarily related to a decrease in cash resulting from \$28.1 million in term loan prepayments and \$19.2 million in stock repurchases, made during 2011. We are able to operate with a substantial working capital deficit because (1) restaurant operations and most food service operations are conducted primarily on a cash (and cash equivalent) basis with a low level of accounts receivable, (2) rapid turnover allows a limited investment in inventories, and (3) accounts payable for food, beverages and supplies usually become due after the receipt of cash from the related sales.

#### Credit Facility

During the first quarter of 2011, we amended our credit facility principally to take advantage of lower interest rates available in the senior secured debt market. Additionally, during the first quarter of 2011, we used the credit facility's accordion feature, which allows us to increase the size of the facility by up to \$25 million subject to lender approval, to increase the amount available under the revolver from \$50 million to \$60 million.

A commitment fee of 0.625% is paid on the unused portion of the revolving credit facility. Interest on the credit facility is payable at per annum rates equal to LIBOR plus 375 basis points with a LIBOR floor of 1.50% for the term loan and no LIBOR floor for the revolver. The term loan was originally issued at 98.5% reflecting an original issue discount ("OID") of \$3.8 million. The OID is being amortized into interest expense over the life of the term loan using the effective interest rate method. The maturity date for the revolver is September 30, 2015 and the maturity date for the term loan is September 30, 2016. The term loan amortizes in equal quarterly installments of \$625,000 with all remaining amounts due on the maturity date. Mandatory prepayments will be required under certain circumstances and we have the option to make certain prepayments under the credit facility.

The credit facility is guaranteed by the Company and its material subsidiaries and is secured by substantially all of the assets of the Company and its subsidiaries, including the stock of the Company's subsidiaries. The credit facility includes certain financial covenants with respect to a maximum leverage ratio, a maximum lease-adjusted leverage ratio, a minimum fixed charged coverage ratio and limitations on capital expenditures. We were in compliance with the terms of the credit facility as of September 28, 2011.

As of September 28, 2011, we had an outstanding term loan of \$207.5 million (\$210.0 million less unamortized OID of \$2.5 million) and outstanding letters of credit of \$27.0 million under our revolving letter of credit facility. There were no revolving loans outstanding at September 28, 2011. These balances resulted in availability of \$33.0 million under the revolving facility. As of September 28, 2011, the weighted-average interest rate under the term loan was 5.25%.

#### Implementation of New Accounting Standards

See Note 2 to our Condensed Consolidated Financial Statements.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

#### Interest Rate Risk

We have exposure to interest rate risk related to certain instruments entered into for other than trading purposes. Specifically, as of September 28, 2011, borrowings under the term loan and revolver bear interest at variable rates based on LIBOR plus a spread of 375 basis points per annum with a LIBOR floor of 1.50% for the term loan and no LIBOR floor for the revolver.

Based on the levels of borrowings under the credit facility at September 28, 2011, if interest rates changed by 100 basis points, there would be no impact to our annual cash flow or our income before income taxes. This computation is determined by considering the impact of hypothetical interest rates on the credit facility at September 28, 2011, taking into consideration the 1.50% LIBOR floor for the term loan. However, the nature and amount of our borrowings under the credit facility may vary as a result of future business requirements, market conditions and other factors. The estimated fair value of our borrowings under the credit facility was approximately \$209.5 million compared with a book value of \$210.0 million at September 28, 2011. This computation is based on market quotations for the same or similar debt issues or the estimated borrowing rates available to us. Our other outstanding long-term debt bears fixed rates of interest.

We also have exposure to interest rate risk related to our pension plan, other defined benefit plans and self-insurance liabilities. A 25 basis point increase or decrease in discount rate would decrease or increase our projected benefit obligation related to our pension plan by approximately \$1.9 million and would impact the pension plan's net periodic benefit cost by \$0.1 million. The impact of a 25 basis point increase or decrease in discount rate would decrease or increase our projected benefit obligation related to our other defined benefit plans by less than \$0.1 million while the plans' net periodic benefit cost would remain flat. A 25 basis point increase or decrease in discount rate related to our self-insurance liabilities would result in a decrease or increase of \$0.2 million, respectively.

#### Commodity Price Risk

We purchase certain food products, such as beef, poultry, pork, eggs and coffee, and utilities such as gas and electricity, which are affected by commodity pricing and are, therefore, subject to price volatility caused by weather, production problems, delivery difficulties and other factors that are outside our control and which are generally unpredictable. Changes in commodity prices affect us and our competitors generally and often simultaneously. In

general, we purchase food products and utilities based upon market prices established with vendors. Although many of the items purchased are subject to changes in commodity prices, the majority of our purchasing arrangements are structured to contain features that minimize price volatility by establishing fixed pricing and/or price ceilings and floors. We use these types of purchase arrangements to control costs as an alternative to using financial instruments to hedge commodity prices. In many cases, we believe we will be able to address commodity cost increases which are significant and appear to be long-term in nature by adjusting our menu pricing or changing our product delivery strategy. However, competitive circumstances could limit such actions and, in those circumstances, increases in commodity prices could lower our margins. Because of the often short-term nature of commodity pricing aberrations and our ability to change menu pricing or product delivery strategies in response to commodity price increases, we believe that the impact of commodity price risk is not significant.

We have established a policy to identify, control and manage market risks which may arise from changes in interest rates, commodity prices and other relevant rates and prices. We do not use derivative instruments for trading purposes.

#### Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our management conducted an evaluation (under the supervision and with the participation of our President and Chief Executive Officer, John C. Miller, and our Executive Vice President, Chief Administrative Officer and Chief Financial Officer, F. Mark Wolfinger) as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based on that evaluation, Messrs. Miller and Wolfinger each concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) is accumulated and communicated to our management, including Messrs. Miller and Wolfinger, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

#### Item 1. Legal Proceedings

There are various claims and pending legal actions against or indirectly involving us, including actions involving employees and guests, other employment related matters, taxes, sales of franchise rights and businesses and other matters. Based on our examination of these matters and our experience to date, we have recorded reserves reflecting our best estimate of liability, if any, with respect to these matters. However, the ultimate disposition of these matters cannot be determined with certainty.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Purchases of Equity Securities by the Issuer

The table below provides information concerning repurchases of shares of our Common Stock during the quarter ended September 28, 2011.

| Period                               | Total<br>Number<br>of<br>Shares<br>Purchased | Average<br>Price<br>Paid Per<br>Share (1) | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Programs<br>(2)(3) | Maximum<br>Number of<br>Shares that<br>May Yet<br>be<br>Purchased<br>Under the<br>Program<br>(3) |
|--------------------------------------|--|---|--|--|
|                                      | (In thousands, except per share amounts)     |   |  |  |
| June 30, 2011 – July 27, 2011        | 274  | \$ 3.90                                   | 274  | 3,958  |
| July 28, 2011 – August 24, 2011      | 699  | 3.71                                      | 699  | 3,259  |
| August 25, 2011 – September 28, 2011 | 321  | 3.48                                      | 321  | 2,939  |
| Total                                | 1,294  | \$ 3.69                                   | 1,294  |  |

- (1) Average price paid per share excludes commissions.
- (2) On April 4, 2011, we announced that our Board of Directors had approved the repurchase of up to 6 million shares of Common Stock (in addition to a previous 3 million share authorization completed in the first quarter), which may take place from time to time on the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934) or through negotiated transactions, subject to market and business conditions.
- (3) During the quarter ended September 28, 2011, we purchased 1,293,900 shares of Common Stock for an aggregate consideration of approximately \$4.8 million, pursuant to the share repurchase program.

## Item 6. Exhibits

The following are included as exhibits to this report:

| Exhibit No. | Description  |
|-------------|--|
| 31.1        | Certification of John C. Miller, President and Chief Executive Officer of Denny's Corporation, pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2        | Certification of F. Mark Wolfinger, Executive Vice President, Chief Administrative Officer and Chief Financial Officer of Denny's Corporation, pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

32.1 Certification of John C. Miller, President and Chief Executive Officer of Denny's Corporation and F. Mark Wolfinger, Executive Vice President, Chief Administrative Officer and Chief Financial Officer of Denny's Corporation, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS\* XBRL Instance Document

101.SCH\* XBRL Taxonomy Extension Schema Document

101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB\* XBRL Taxonomy Extension Label Linkbase Document

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document

\* In accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed "furnished" and not "filed."

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DENNY'S CORPORATION

Date: November 4, 2011

By: /s/ F. Mark Wolfinger  
F. Mark Wolfinger  
Executive Vice President,  
Chief Administrative Officer  
and  
Chief Financial Officer

Date: November 4, 2011

By: /s/ Jay C. Gilmore  
Jay C. Gilmore  
Vice President,  
Chief Accounting Officer and  
Corporate Controller