DineEquity, Inc
Form 10-Q
May 04, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from to

Commission File Number 001-15283

DineEquity, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was Required to submit and post such files). Yes o No o

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

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

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

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

Class	**Outstanding as of April 29, 2011**

Common Stock, $.01 par value	18,524,781

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DINEEQUITY, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

DINEEQUITY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	March 31, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 50,360	$ 102,309
Restricted cash	3,975	854
Receivables, net	73,929	98,776
Inventories	9,895	10,757
Prepaid income taxes	1,924	34,094
Prepaid gift cards	22,360	27,465
Prepaid expenses	13,958	14,602
Deferred income taxes	27,128	24,301
Assets held for sale	7,025	37,944
Total current assets	210,554	351,102
Non-current restricted cash	49	778
Restricted assets related to captive insurance subsidiary	3,970	3,562
Long-term receivables	238,002	239,945
Property and equipment, net	568,913	612,175
Goodwill	697,470	697,470
Other intangible assets, net	832,476	835,879
Other assets, net	114,665	115,730
Total assets	$ 2,666,099	$ 2,856,641
Liabilities and Stockholders Equity		
Current liabilities:		
Current maturities of long-term debt	$ 7,420	$ 9,000
Accounts payable	35,894	32,724
Accrued employee compensation and benefits	20,598	32,846
Gift card liability	77,974	124,972
Accrued interest payable	34,711	17,482
Current maturities of capital lease and financing obligations	15,794	16,556
Other accrued expenses	30,070	31,502
Total current liabilities	222,461	265,082
Long-term debt, less current maturities	1,485,929	1,631,469
Financing obligations, less current maturities	204,561	237,826
Capital lease obligations, less current maturities	141,703	144,016
Deferred income taxes	374,621	375,697
Other liabilities	114,435	118,972
Total liabilities	2,543,710	2,773,062
Commitments and contingencies		
Stockholders equity:		
Convertible preferred stock, Series B, at accreted value, 10,000,000 shares authorized; 35,000 shares issued; March 31, 2011: 34,900 shares outstanding; December 31, 2010:	42,564	42,055

35,000 shares outstanding				
Common stock, $.01 par value, 40,000,000 shares authorized; March 31, 2011: 24,736,019 shares issued and 18,536,111 shares outstanding; December 31, 2010: 24,382,991 shares issued and 18,183,083 shares outstanding		247		243
Additional paid-in-capital		201,420		192,214
Retained earnings		153,320		124,250
Accumulated other comprehensive loss		(261)		(282)
Treasury stock, at cost (March 31, 2011 and December 31, 2010: 6,199,908 shares)		(274,901)		(274,901)
Total stockholders equity		122,389		83,579
Total liabilities and stockholders equity	$	2,666,099	$	2,856,641

See the accompanying Notes to Consolidated Financial Statements.

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DINEEQUITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31, 2011	2010
Segment Revenues:		
Franchise revenues	$ 104,552	$ 95,367
Company restaurant sales	154,703	224,615
Rental revenues	32,216	33,932
Financing revenues	8,729	4,150
Total segment revenues	300,200	358,064
Segment Expenses:		
Franchise expenses	27,443	24,838
Company restaurant expenses	131,766	192,557
Rental expenses	24,647	25,064
Financing expenses	5,575	469
Total segment expenses	189,431	242,928
Gross segment profit	110,769	115,136
General and administrative expenses	37,969	40,366
Interest expense	36,306	45,048
Impairment and closure costs	4,938	711
Debt modification costs	4,114	
Amortization of intangible assets	3,075	3,077
Loss (gain) on extinguishment of debt	6,946	(3,585)
Gain on disposition of assets	(23,754)	(253)
Income before income taxes	41,175	29,772
Provision for income taxes	(11,476)	(10,101)
Net income	$ 29,699	$ 19,671
Net income available to common stockholders		
Net income	$ 29,699	$ 19,671
Less: Series A preferred stock dividends		(5,760)
Less: Accretion of Series B preferred stock	(629)	(595)
Less: Net income allocated to unvested participating restricted stock	(1,014)	(509)
Net income available to common stockholders	$ 28,056	$ 12,807
Net income available to common stockholders per share		
Basic	$ 1.59	$ 0.75
Diluted	$ 1.53	$ 0.75
Weighted average shares outstanding		
Basic	17,697	17,011
Diluted	18,763	17,972

See the accompanying Notes to Consolidated Financial Statements.

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DINEEQUITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2011	2010
Cash flows from operating activities		
Net income	$ 29,699	$ 19,671
Adjustments to reconcile net income to cash flows provided by operating activities		
Depreciation and amortization	13,290	16,156
Non-cash interest expense	1,417	10,371
Loss (gain) on extinguishment of debt	6,946	(3,585)
Impairment and closure charges	4,717	509
Debt modification costs	4,114	
Deferred income taxes	(3,903)	(7,009)
Non-cash stock-based compensation expense	1,863	3,956
Tax benefit from stock-based compensation	5,121	1,035
Excess tax benefit from stock options exercised	(4,866)	(1,792)
Gain on disposition of assets	(23,754)	(253)
Other	(3,753)	(287)
Changes in operating assets and liabilities		
Receivables	24,636	26,008
Inventories	(378)	3
Prepaid expenses	5,567	1,500
Current income tax receivables and payables	32,194	14,525
Accounts payable	1,358	(1,147)
Accrued employee compensation and benefits	(12,249)	(9,031)
Gift card liability	(46,998)	(40,171)
Other accrued expenses	15,455	(189)
Cash flows provided by operating activities	50,476	30,270
Cash flows from investing activities		
Additions to property and equipment	(3,835)	(2,649)
Proceeds from sale of property and equipment and assets held for sale	54,597	2,784
Principal receipts from notes, equipment contracts and other long-term receivables	3,395	6,753
Other	(128)	655
Cash flows provided by investing activities	54,029	7,543
Cash flows from financing activities		
Repayment of long-term debt	(145,273)	(50,100)
Principal payments on capital lease and financing obligations	(3,553)	(3,791)
Dividends paid		(5,700)
Payment of debt modification and issuance costs	(12,208)	
Repurchase of restricted stock	(3,272)	(577)
Proceeds from stock options exercised	5,378	1,275
Excess tax benefit from stock options exercised	4,866	1,792
Change in restricted cash	(2,392)	5,479
Other		(46)
Cash flows used in financing activities	(156,454)	(51,668)
Net change in cash and cash equivalents	(51,949)	(13,855)
Cash and cash equivalents at beginning of period	102,309	82,314

Cash and cash equivalents at end of period	$	50,360	$	68,459
Supplemental disclosures				
Interest paid	$	22,292	$	38,942
Income taxes paid	$	1,276	$	2,726

See the accompanying Notes to Consolidated Financial Statements.

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DINEEQUITY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

The accompanying unaudited consolidated financial statements of DineEquity, Inc. (the Company) have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The consolidated balance sheet at December 31, 2010 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

2. Basis of Presentation

The Company s fiscal quarters end on the Sunday closest to the last day of each quarter. For convenience, the fiscal quarters are reported as ending on March 31, June 30, September 30 and December 31. The first fiscal quarter of 2011 ended April 3, 2011 and the first fiscal quarter of 2010 ended April 4, 2010.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries that are consolidated in accordance with U.S. GAAP. All intercompany balances and transactions have been eliminated in consolidation.

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

Subsequent events

The Company has evaluated the period after the balance sheet date through the date the consolidated financial statements were issued and determined there were no subsequent events or transactions that required recognition or disclosure in the consolidated financial statements other than the items described in Note 16, Subsequent Events.

Reclassifications

Certain reclassifications have been made to prior year information to conform to the current year presentation. These reclassifications had no effect on the net income or financial position previously reported.

The following items previously reported as other expense (income), net for the three months ended March 31, 2010 have been reclassified as follows:

		(In thousands)
Total other expense, as reported	$	1,498
Reclassified to:		
Rental expenses	$	664
Impairment and closure costs		711
General and administrative expenses		181
Interest expense		170
Franchise revenue		(91)
Gain on disposition of assets		(67)
Other line items		(70)
Total reclassified	$	1,498

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3. Accounting Policies

Recently Adopted Accounting Standards

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures About Fair Value Measurement* (ASU 2010-06). On January 1, 2011, the Company adopted the provisions of ASU 2010-06 that required disclosures about purchases, sales, issuances, and settlements to be presented on a gross basis in the reconciliation of Level 3 fair value measurements. As these provisions amended only the disclosure requirements for fair value measurements, the adoption did not have any impact on the Company s balance sheets, statements of operations or statements of cash flows.

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20). On January 1, 2011, the Company adopted the provisions of ASU 2010-20 that amend disclosure requirements about activity that occurs during a reporting period with respect to the credit quality of financing receivables and the related allowance for credit losses. As these provisions only amended disclosure requirements, not current accounting practice, adoption of this ASU did not have any impact on the Company s balance sheets, statements of operations or statements of cash flows.

The Company reviewed all other significant newly issued accounting pronouncements and concluded that they either are not applicable to the Company s operations or that no material effect is expected on the financial statements as a result of future adoption.

4. Assets Held for Sale

The Company classifies assets as held for sale and ceases the depreciation and amortization of the assets when there is a plan for disposal of the assets and those assets meet the held for sale criteria, as defined in applicable U.S. GAAP. The balance of assets held for sale at December 31, 2010 of $37.9 million was comprised of assets of 36 Applebee s company-operated restaurants in the St. Louis market area of Missouri, 30 Applebee s company-operated restaurants in the Washington, D.C. area, three parcels of land on which Applebee s franchised restaurants are situated, three parcels of land previously intended for future restaurant development and one IHOP restaurant held for refranchising.

During the three months ended March 31, 2011, 36 Applebee s company-operated restaurants in the St. Louis market area of Missouri, 29 Applebee s company-operated restaurants in the Washington, D.C. area and one parcel of land on which an Applebee s franchised restaurant is situated were sold and the IHOP restaurant was refranchised. The balance of assets held for sale at March 31, 2011 of $7.0 million was comprised of two parcels of land on which Applebee s franchised restaurants are situated, three parcels of land previously acquired and held for future development and assets of one Applebee s company-operated restaurant in the Washington, D.C. area.

The following table summarizes the changes in the balance of assets held for sale during 2011:

		(In millions)
Balance December 31, 2010	$	37.9
Assets sold		(30.6)
Assets refranchised		(0.3)
Balance March 31, 2011	$	7.0

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5. Long-Term Debt

Long-term debt consists of the following components:

	March 31, 2011	December 31, 2010
	(In millions)	
Senior Secured Credit Facility, due October 2017, at a variable interest rate of 4.25% and 6.0% as of March 31, 2011 and December 31, 2010, respectively	$ 734.0	$ 844.0
Senior Notes due October 2018, at a fixed rate of 9.5%	792.7	825.0
Discount	(33.4)	(28.5)
Total debt	1,493.3	1,640.5
Less current maturities	(7.4)	(9.0)
Long-term debt	$ 1,485.9	$ 1,631.5

For a description of the respective instruments, refer to Note 8 of the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

Amendment of Credit Agreement

On February 25, 2011, the Company entered into Amendment No. 1 (the Amendment) to the Credit Agreement dated as of October 8, 2010 (the Credit Agreement) under which a senior secured credit facility (Credit Facility) was established among the Company, lenders and the agents named therein. Pursuant to the Amendment, the interest rate margin applicable to LIBOR-based term loans made under the Credit Facility (Term Loans) was reduced from 4.50% to 3.00%, and the interest rate floors used to determine the LIBOR and Base Rate reference rates for Term Loans was reduced from 1.50% to 1.25% for LIBOR-based Term Loans and from 2.50% to 2.25% for Base Rate-denominated Term Loans. In addition, the Amendment increased the lender commitments under the Company s revolving credit facility (the Revolving Credit Facility) available under the Credit Facility from $50 million to $75 million. The Amendment also modified certain restrictive covenants of the Credit Agreement, including those relating to repurchases of other debt securities, permitted acquisitions and payments on equity.

The Company paid $12.3 million in fees and costs related to the Amendment, of which $7.4 million in fees paid to lenders was recorded as additional discount on debt and $0.8 million of costs related to the increase in the Revolving Credit Facility was recorded as deferred financing costs. Fees paid to third parties of $4.1 million were recorded as Debt modification costs in the Consolidated Statements of Income for the three months ended March 31, 2011.

Loss (Gain) on Extinguishment of Debt

During the quarter ended March 31, 2011, the Company repurchased $32.3 million of its 9.5% Senior Notes due October 2018 (the Senior Notes) for a cash payment of $35.3 million, inclusive of a premium of $3.0 million. The Company also repaid $110.0 million of Term Loans at face value. Including write-off of the discount and deferred financing costs related to the debt extinguished, the Company recognized a loss on the extinguishment of debt of $6.9 million.

During the quarter ended March 31, 2010, the Company retired $48.7 million of its Class A-2-II-X Fixed Rate Senior Term Notes then outstanding for a cash payment of $43.8 million. The Company recognized a gain on the early retirement of debt of $3.6 million, including write-off of the discount and deferred financing costs related to the retired debt.

Quarter Ended	Instrument	Face Amount Retired/Repaid	Cash Paid (In millions)	Loss (Gain)(1)
March 2011	Term Loans	$ 110.0	$ 110.0	$ 2.7
March 2011	Senior Notes	32.3	35.3	4.2
Total		$ 142.3	$ 145.3	$ 6.9
March 2010	Class A-2-II-X Notes	$ 48.7	$ 43.8	$ (3.6)

(1) Including write-off of the discount and deferred financing costs related to the debt retired.

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Compliance with Covenants and Restrictions

The Company was in compliance with all the covenants and restrictions related to its Credit Facility and Senior Notes as of March 31, 2011.

6. Financing Obligations

As of March 31, 2011, future minimum lease payments under financing obligations during the initial terms of the leases related to sale-leaseback transactions are as follows:

Fiscal Years	(In millions)	
Remainder of 2011	$	16.6
2012(1)		20.7
2013		22.9
2014		23.1
2015		23.1
Thereafter		273.9
Total minimum lease payments		380.3
Less interest		(168.8)
Total financing obligations		211.5
Less current portion(2)		(6.9)
Long-term financing obligations	$	204.6

(1) Due to the varying closing dates of the Company s fiscal year, 11 monthly payments will be made in fiscal 2012.

(2) Included in current maturities of capital lease and financing obligations on the consolidated balance sheet.

During the quarter ended March 31, 2011, the Company s continuing involvement with 20 properties subject to financing obligations was ended by assignment of the lease obligations to a qualified franchisee. As a result, the Company s financing obligations were reduced by $32.7 million.

7. Impairment and Closure Charges

The Company assesses tangible long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The following table summarizes the components of impairment and closure charges for the three-month periods ended March 31, 2011 and 2010:

	Three Months Ended March 31, 2011	2010
	(In millions)	
Impairment and closure charges:		
Impairment	$ 4.5	$ 0.3
Closure	0.4	0.4
Total impairment and closure charges	$ 4.9	$ 0.7

Impairment charges for the three months ended March 31, 2011, related to furniture, fixtures and leasehold improvements at the Applebee s Restaurant Support Center in Lenexa, Kansas, whose book value is not realizable as the result of the termination of the Company s sublease of the premises (See Note 17, Subsequent Events).

Impairment and closure charges for the three months ended March 31, 2010 primarily related to closure of the Applebee s company-operated restaurant in China and the write-off of costs related to a prior remodeling program, partially offset by the downward revision of estimates of closure costs previously recorded.

8. Income Taxes

The effective tax rate was 27.9% for the three-month period ended March 31, 2011. The effective tax rate is lower than the federal statutory rate of 35% due to tax credits and the release of liabilities for unrecognized tax benefits, which were partially offset by state income taxes. The tax credits are primarily FICA tip and other compensation-related tax credits associated with Applebee s company-owned restaurant operations.

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8. Income Taxes, continued

At March 31, 2011, the Company had a liability for unrecognized tax benefits, including potential interest and penalties net of related tax benefit, totaling $10.8 million, of which approximately $1.7 million is expected to be paid within one year. For the remaining liability, due to the uncertainties related to these tax matters, the Company is unable to make a reasonably reliable estimate when cash settlements with taxing authorities will occur.

As of March 31, 2011, accrued interest and penalties were $4.1 million and $0.5 million, respectively, excluding any related income tax benefits. As of December 31, 2010, accrued interest and penalties were $8.9 million and $0.5 million, respectively, excluding any related income tax benefits. The decrease of $4.8 million of accrued interest is primarily related to the release of liabilities for unrecognized tax benefits surrounding gift card income deferral as a result of the issuance of new guidance by the U.S. Internal Revenue Service, partially offset by the accrual of interest on the remaining liability for unrecognized tax benefits during the three months ended March 31, 2011. The Company recognizes interest accrued related to unrecognized tax benefits and penalties as a component of income tax expense which is recognized in the Consolidated Statements of Income.

The Company or one of its subsidiaries files federal income tax returns and income tax returns in various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to federal, state or non-U.S. tax examinations by tax authorities for years before 2006 for federal returns and other jurisdictions. Applebee s is currently under audit by the U.S. Internal Revenue Service for the period ended November 29, 2007. The Company is currently under audit by the U.S. Internal Revenue Service for the period ended December 31, 2007.

9. Stock-Based Compensation

From time to time, the Company grants stock options and restricted stock to officers and employees of the Company under the IHOP Corp. 2001 Stock Incentive Plan, as amended and restated (the 2001 Plan) and restricted stock or restricted stock units to non-employee directors of the Company under the DineEquity, Inc. Amended and Restated 2005 Stock Incentive Plan for Non-Employee Directors (the 2005 Plan). The stock options generally vest over a three-year period and have a term of ten years from the issuance date. Option exercise prices equal the closing price of the Company s common stock on the New York Stock Exchange on the date of grant. Restricted stock and restricted stock units are issued at no cost to the holder and vest over terms determined by the Compensation Committee of the Company s Board of Directors, generally three years. Restricted stock granted to officers and employees generally vests only if the officer or employee is actively employed by the Company on the vesting date, and unvested restricted stock is forfeited upon either termination, retirement before age 65, death or disability, unless the Compensation Committee of the Company s Board of Directors determines otherwise. When vested options are exercised and restricted stock is issued, the Company generally issues shares of common stock from its authorized but unissued share pool or utilizes treasury stock. The Company currently intends to utilize treasury stock for future issuances of shares pursuant to equity compensation plans.

The following table summarizes the components of the Company s stock-based compensation expense included in general and administrative expenses in the consolidated financial statements:

Three Months Ended
March 31,

	2011		2010	
	(In millions)			
Pre-tax compensation expense	$	3.1	$	4.9
Tax provision		(1.2)		(2.0)
Total stock-based compensation expense, net of tax	$	1.9	$	2.9

As of March 31, 2011, $8.6 million and $10.3 million (including estimated forfeitures) of total unrecognized compensation cost related to restricted stock and stock options, respectively, is expected to be recognized over a weighted average period of 1.65 years for restricted stock and 1.78 years for stock options.

The estimated fair values of the options granted during 2011 were calculated using a Black-Scholes option pricing model. The following summarizes the assumptions used in the Black-Scholes model:

Risk-free interest rate	2.12%
Weighted average historical volatility	82.5%
Dividend yield	
Expected years until exercise	4.85
Forfeitures	11.0%
Weighted average fair value of options granted	