Denny’s Corporation Reports Results for the Fourth Quarter and Year End 2007

2008-02-14

Same-store sales decreased 1.2% at company units and increased 0.3% at franchised units

Fourth Quarter Summary

Same-store sales decreased 1.2% at company units and increased 0.3% at franchised units

Net income increased $14.4 million to $16.7 million

Adjusted income before taxes decreased $3.9 million to $3.4 million

Sold 74 company restaurants to 19 franchisees under Franchise Growth Initiative (FGI)

Signed franchise restaurant development commitments for 49 new units

Generated $44.7 million in net asset sale proceeds

Reduced outstanding debt by $55.1 million, or 14%

Full Year Summary

Same-store sales increased 0.3% at company units and 1.7% at franchised units

Net income increased $4.4 million to $34.7 million

Adjusted income before taxes of $10.5 million exceeded guidance

Sold 130 company restaurants to 30 franchisees under FGI

Net positive unit growth for Denny’s system

Shifted system mix to 75% franchised units and 25% company units

Signed franchise restaurant development commitments for 120 new units

Generated $80.7 million in net asset sales proceeds

Reduced outstanding debt by $100.3 million, or 22%

Nelson Marchioli, President and Chief Executive Officer, stated, ’Despite a challenging operating environment which got progressively more difficult throughout the year, we were able to deliver positive same store sales growth in 2007 and generate earnings above our expectations. As importantly, we made significant progress on our Franchise Growth Initiative (FGI). The early success of FGI is moving us more quickly towards our optimal business model with franchise restaurants now comprising 75% of the Denny’s system and contributing to a 34% increase in franchise income in the fourth quarter. We achieved positive net unit growth for the first time in seven years and began to build a robust franchise development pipeline. Our growth in cash flow from operations combined with the proceeds from our asset sales enabled Denny’s to pay down over $100 million in debt for the second consecutive year.’

Mr. Marchioli concluded, ’Given the current economic conditions and weak consumer spending environment, it is difficult to make projections for 2008, but we will continue to execute on our strategic initiatives which we believe will improve our long-term financial performance and enhance shareholder value. We are excited about the launch of our new ’Real Breakfast 24/7’ campaign and the opportunity to reinforce Denny’s real breakfast dominance. We expect to expand our development pipeline to facilitate consistent growth in our franchise system. We will also continue to focus on increasing operating cash flow, rationalizing our operating assets and strengthening our balance sheet.’

Fourth Quarter Results

For the fourth quarter of 2007, Denny’s reported total operating revenue, including company restaurant sales and franchise revenue, of $220.3 million compared with $244.4 million in the prior year quarter. The company restaurant sales component of total revenue decreased $29.9 million due primarily to the sale of company restaurants to franchisees under the Franchise Growth Initiative. During the fourth quarter, Denny’s opened two new company restaurants, closed two and sold 74 to franchisee operators. A 1.2% decrease in same-store sales at company restaurants added to the impact of 74 fewer equivalent company restaurants in the fourth quarter.

Franchise revenue in the fourth quarter increased $5.8 million, or 28%, to $26.6 million primarily as a result of the Franchise Growth Initiative. During the quarter, Denny’s franchisees opened eleven new restaurants, closed four and purchased 74 company restaurants for a net 63-unit increase in equivalent franchise restaurants. The fourth quarter franchise revenue increase included a $3.1 million increase in franchise fees, a $1.6 million increase in franchise rental income, and a $1.1 million increase in royalties. A $1.0 million increase in franchise costs, primarily franchise rental expense, partially offset the

$5.8 million increase in franchise revenue resulting in a $4.8 million, or 34%, increase in franchise operating margin in the fourth quarter.

Company restaurant operating margin (as a percentage of company restaurant sales) for the fourth quarter was 12.0%, a decrease of 3.5 percentage points compared with the same period last year. The margin decrease is partially attributable to the impact on fixed costs from lower same-store sales as well as continued cost pressures. Product costs for the fourth quarter increased 0.2 percentage points to 25.3% of sales due primarily to increasing commodity costs. Payroll and benefit costs increased 2.0 percentage points to 42.6% of sales due primarily to investment in customer experience through improved staffing levels for both restaurant crew and management. Legal settlement expense of $0.5 million in the fourth quarter was $1.2 million, or 0.6 percentage points, higher due to an atypical benefit of $0.7 million in the prior year.

General and administrative expenses for the fourth quarter increased $1.1 million from the same period last year due primarily to a $1.5 million increase in core G&A expenses attributable to higher incentive compensation along with investments in staffing for growth initiatives, partially offset by a $0.4 million reduction in share-based compensation.

Depreciation and amortization expense for the fourth quarter decreased by $1.4 million compared with the prior year period due primarily to the sale of restaurant and real estate assets over the past year. Operating gains, losses and other charges, net, which reflect restructuring charges, exit costs, impairment charges and gains or losses on the sale of assets, increased $14.0 million in the quarter due primarily to an $11.3 million increase in gains on the sale of restaurants and real estate from the prior year quarter.

Operating income for the fourth quarter increased $7.5 million to $30.2 million due primarily to the increase in operating gains. Excluding operating gains in both periods, operating income for the fourth quarter decreased $6.6 million on $24.1 million less total operating revenue.

Interest expense for the fourth quarter decreased $3.1 million, or approximately 23%, to $10.2 million due primarily to reduced debt balances and improved borrowing costs.

Net income for the fourth quarter was $16.7 million, or $0.17 per diluted common share, an increase of $14.4 million compared with prior year net income of $2.3 million, or $0.02 per diluted common share. Adjusted income before taxes for the fourth quarter was $3.4 million, a decrease of $3.9 million compared with prior year adjusted income of $7.3 million. This measure, which is used as an internal profitability metric, excludes restructuring charges, exit costs, impairment charges, asset sale gains, share-based compensation, other nonoperating expenses and income taxes.

Franchise Growth Initiative (FGI)

During the fourth quarter, Denny’s made considerable progress on its strategic initiative to increase franchise restaurant development through the sale of certain company restaurants. The company sold 74 restaurant operations and certain related real estate to 19 franchisees for net asset sale proceeds of $42.6 million. This brings the total number of company restaurants sold in 2007 to 130 and the total net asset sale proceeds to $73.2 million.

Fulfilling the unit growth expectations of this program, the franchisees that purchased company restaurants during the quarter signed development agreements to build an additional 32 new franchise restaurants. This brings the total number of franchise restaurant development agreements signed in 2007 under FGI to 67.

In addition to franchise development agreements signed under FGI, Denny’s has been negotiating development agreements outside of the FGI program under its Market Growth Incentive Plan (MGIP). During the fourth quarter, franchisees signed MGIP agreements to build an additional 17 franchise restaurants. This brings the total for MGIP development agreements signed in 2007 to 53 restaurants.

The Company also divested three other real estate assets during the fourth quarter for net proceeds of $2.1 million, bringing the full year total for other real estate proceeds to $7.5 million.

During the fourth quarter, net cash proceeds from asset sales along with cash flow from operations were used to reduce outstanding debt by $55.1 million. For 2007, total outstanding debt was reduced by $100.3 million, or approximately 22%.

Business Outlook

Certain key considerations for understanding the Company’s outlook for fiscal 2008 compared with its 2007 results include:

2008 will include 53 operating weeks (14 in the fourth quarter) compared with 52 operating weeks in 2007

The expectation of approximately 150 fewer equivalent company restaurants in 2008 compared with 2007 due to the impact of FGI across both years

The expectation that guest traffic may remain negative for much of 2008

Improved product cost margins due to proactive menu mix efforts which are expected to help offset higher commodity costs

Higher payroll costs as a result of higher minimum wage rates and improved staffing levels

Flat general and administrative expenses excluding incentive and share-based compensation

Lower interest expense due to significantly lower average debt balances in 2008 compared with 2007

The following financial guidance for 2008 is based on 2007 results and management’s expectations at this time.

Company same-store sales of (2.0%) to 0.0% compared with 0.3% in 2007

Franchise same-store sales of (1.0%) to 1.0% compared with 1.7% in 2007

4 to 6 company unit openings compared with 6 in 2007

30 to 34 franchise unit openings compared with 18 in 2007

75 to 100 units sold under FGI compared with 130 in 2007

A total revenue decline of $155 to $177 million from 2007

Company restaurant sales of $650 to $670 million, compared with $845 million in 2007

Franchise and license revenue of $112 to $114 million, compared with $95 million in 2007

Adjusted EBITDA* of $83 to $89 million compared with $93 million in 2007

Adjusted income before taxes* of $8 to $14 million compared with $11 million in 2007

Cash interest expense of $32 million compared with $39 million in 2007

Cash capital expenditures of $35 million compared with $33 million in 2007