Denny’s Corporation Reports Results for the First Quarter 2008

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Denny’s Corporation (NASDAQ:DENN) reported results for its first quarter ended March 26, 2008.

First Quarter Summary

Same-store sales increased 0.7% at company units and decreased 0.9% at franchised units

Net income increased $3.8 million to $5.0 million

Adjusted income before taxes increased $2.1 million to $2.0 million

Sold 21 company restaurants to four franchisees under Franchise Growth Initiative (FGI)

Opened nine new franchised restaurants and one new company restaurant

Nelson Marchioli, President and Chief Executive Officer, stated, ’We are pleased with the progress we are making to optimize our business model and strengthen our balance sheet, despite the difficult operating and economic environment impacting our industry. We are confronting the challenges of reduced consumer spending and rising commodity costs with promotional items that have strong customer appeal and offer a compelling value but are also designed to benefit our food cost margins. In addition, our current marketing campaign ’Real Breakfast 24/7’ powerfully emphasizes the quality and value of Denny’s real breakfast experience.’

Mr. Marchioli concluded, ’While we do not foresee near-term improvement in the macroeconomic pressures on our business, we believe our strategic actions will strengthen our long-term financial performance and enhance shareholder value.’

First Quarter Results

For the first quarter of 2008, Denny’s reported total operating revenue, including company restaurant sales and franchise revenue, of $196.0 million compared with $236.8 million in the prior year quarter. Company restaurant sales decreased $46.2 million due to the sale of company restaurants to franchisees under the Franchise Growth Initiative. A 0.7% increase in same-store sales at company restaurants partially offset the impact of 128 fewer equivalent company restaurants compared with the prior year quarter. During the first quarter, Denny’s opened one new company restaurant, closed one and sold 21 to franchisee operators.

Company restaurant operating margin (as a percentage of company restaurant sales) for the first quarter was 10.7%, a decrease of 0.6 percentage points compared with the same period last year. Product costs for the first quarter decreased 0.8 percentage points to 24.7% of sales due primarily to favorable menu mix. Payroll and benefit costs increased 0.5 percentage points to 43.5% of sales as a result of investment in restaurant management staffing. Other operating expenses increased 0.6 percentage points to 4.3% of sales due primarily to an insurance benefit of $0.6 million in the prior year period.

Franchise revenue in the first quarter increased $5.5 million, or 26%, to $26.4 million due primarily to an increase of 136 equivalent franchise restaurants compared with the prior year period. The growth in franchise revenue included a $2.7 million increase in rental income, a $2.0 million increase in royalties and a $0.7 million increase in franchise fees. Franchise operating margin increased by $3.8 million, or 26%, in the first quarter as higher franchise revenue offset a $1.7 million increase in franchise costs attributable to higher rental expense. During the first quarter, Denny’s franchisees opened nine new restaurants, closed five and purchased 21 company restaurants.

General and administrative expenses for the first quarter declined $0.3 million from the same period last year resulting primarily from a $0.6 million decrease in share-based compensation expenses.

Depreciation and amortization expense for the first quarter declined by $2.6 million compared with the prior year period primarily as a result of 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 $7.0 million in the quarter due primarily to a $7.4 million increase in gains on the sale of restaurants.

Operating income for the first quarter increased $7.5 million to $20.2 million due primarily to the increase in gains on the sale of restaurants. Excluding gains, losses, and other charges in both periods, operating income increased $0.5 million despite a $40.8 million decrease in total operating revenue.

Interest expense for the first quarter decreased $2.1 million, or approximately 19%, to $9.2 million as a result of a $94.4 million reduction in debt from the prior year period.

Other nonoperating expense increased $5.6 million in the first quarter due primarily to the discontinuance of hedge accounting related to a $150 million interest rate swap on Denny’s credit facility term loans. Under the current accounting treatment, changes in the fair value of the swap are reflected as nonoperating expense or income.

Net income for the first quarter was $5.0 million, or $0.05 per diluted common share, an increase of $3.8 million compared with prior year net income of $1.2 million, or $0.01 per diluted common share. Adjusted income before taxes for the first quarter was $2.0 million, an increase of $2.1 million compared with the prior year loss of $0.1 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.

Accounting Methodology Review

We are currently in the process of reviewing, in consultation with our external auditors, our current and historical methodology for writing off a portion of goodwill as restaurants are sold to franchisees. The unaudited financial statements presented herein have not been adjusted for any change to our methodology that may result from our review. We currently expect that a change to our methodology could cause goodwill, operating gains, losses and other charges, net, and net income before taxes to decrease as follows:

Quarter ended March 28, 2007 approximately $0.0 to $0.5 million

Year ended December 26, 2007 approximately $3.0 to $4.5 million

Quarter ended March 26, 2008 approximately $0.5 to $1.5 million

These potential adjustments would be noncash in nature and would have no impact on cash flows, adjusted income (loss) before taxes, as defined herein, or adjusted EBITDA, as defined herein. Our estimates are preliminary and could change based on our final conclusions. We expect to complete this review by the time we file our Form 10-Q on May 5, 2008 for the quarter ended March 26, 2008.

Franchise Growth Initiative (FGI)

Denny’s continues its strategic initiative to increase franchise restaurant development through the sale of certain company restaurants. During the first quarter, the company sold 21 restaurants to four franchisee operators. This brings the total number of company restaurants sold to-date under FGI to 151. The first quarter transactions generated net cash proceeds of $14.4 million, however, approximately $12.7 million of the proceeds are included in receivables on the quarter-end balance sheet as the funds were received after the first quarter closed.

During the first quarter, franchisees signed FGI-related development agreements committing to build 9 franchise restaurants. Also during the quarter, franchisees signed traditional development agreements (MGIP) committing to build an additional 6 restaurants. Over the last 15 months, Denny’s has signed development agreements for 135 new restaurants, 12 of which have opened, yielding a current development pipeline of 123 restaurant commitments.