Hotel News Resource

AFC Reports Financial Results for Second Quarter 2008

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AFC Enterprises, Inc. (NASDAQ:AFCE) , the franchisor and operator of Popeyes(R) restaurants, today reported results for its fiscal second quarter which ended July 13, 2008.

Second Quarter 2008 Highlights compared to Second Quarter 2007:

Net income was $6.6 million, or $0.26 per diluted share, compared to $6.6 million, or $0.22 per diluted share, last year. Excluding the pre-tax impact of $3.8 million from other non-operating income, net income would have been $4.3 million, or $0.17 per diluted share.

Total system-wide sales increased by 1.5 percent compared to 2.9 percent last year.

Total domestic same-store sales decreased 1.7 percent compared to a decrease of 2.1 percent last year. International same-store sales increased 1.7 percent compared to an increase of 1.7 percent last year. Total global same-store sales decreased 1.4 percent compared to a decrease of 1.7 percent last year.

The Popeyes system opened 32 and closed 31 restaurants, bringing total net unit count to 1,901 compared to 1,878 last year.

The Company received $12.3 million for a net favorable settlement related to a director and officers insurance claim previously described in the Company’s public filings.

The Company’s board of directors authorized the negotiation of definitive agreements to refranchise and sell company-operated restaurant assets in Atlanta, Georgia and Nashville, Tennessee. As a result, the Company recorded an $8.1 million impairment charge associated with the restaurant assets.

Year-to-date, the Company repurchased 2.1 million shares of common stock for $18.9 million. During the quarter, the Company recorded an additional $2.3 million payment for the final installment of the previously announced accelerated stock repurchase program.

Effective June 30, 2008, the Company’s interest rate on $100 million of its term loan was reduced to 4.87 percent from 6.40 percent.

Cheryl Bachelder, AFC Chief Executive Officer, stated, "We were pleased with our earnings performance for the second quarter. Our same-store sales continue to be impacted by the current economic environment, however, we believe our marketing and messaging helped us during the quarter as our comparable sales performance continued to outpace the chicken QSR segment. As we move into the second half of this year, we are excited to be rolling-out three new menu platforms designed to generate incremental sales with a focus on portability, value, and lunch occasions."

Strategic Plan Update

Build the Popeyes Brand

During the second quarter, the Company promoted menu offerings with competitive price points in the $3-$5 range. In May and June, Popeyes restaurants featured 8-piece Buffalo Nuggets for $2.99 and in July, the restaurants promoted a Popeyes Firecracker Butterfly Shrimp combo for $4.99.

In August, Popeyes will be rolling-out the first of three new menu platforms. The Big Deals platform will feature three new value products priced at $1.49 - The Loaded Chicken Wrap, Delta Mini (featuring Popeyes new Delta sauce), and a Chicken Biscuit. This value offering is focused on driving new traffic from younger consumers while capturing snack and late night dayparts. Each product delivers high quality food at a compelling value.

The Company announced GSD&M Idea City as Popeyes new national creative advertising agency. GSD&M clients include Southwest Airlines, BMW, and Kohler. Their initial work for Popeyes will be launched in August with the new Big Deals value sandwiches.

Run Great Restaurants

The Company continues to focus on utilizing industry-proven tools to improve operations consistency and performance throughout the Popeyes system. The guest experience monitor (GEM) survey is now in place at more than 75 percent of Popeyes domestic restaurants. The Company has completed in-restaurant quarterly assessments in approximately two-thirds of Popeyes domestic restaurants. By year-end 2008, all Popeyes restaurants will have received two assessments, moving toward the goal of quarterly assessments in 2009.

Strengthen Unit Economics

The Company is continuing to work to identify restaurant level margin improvement by implementing tools for ideal food cost, labor scheduling and a new cooking oil management process to increase efficiency in the restaurants. The Company will roll-out these initiatives to the Popeyes system in the fourth quarter of 2008.

Align People and Resources to Deliver Results

Refranchising of company-operated restaurants

Consistent with the Company’s announced strategic initiative to refranchise company-operated restaurants, the Company has considered refranchising proposals from qualified operators. Such refranchising is in the ordinary course of business and includes the buyers’ obligation to develop new restaurants in under-penetrated markets.

During the second quarter, the Company’s board of directors authorized the negotiation of definitive agreements to refranchise the company-operated restaurants in Atlanta, Georgia. As a result, the Atlanta restaurants are classified as "Assets held for sale" in the balance sheet. Subsequent to the end of the quarter, the board of directors further authorized the negotiation of a definitive agreement to refranchise the company-operated restaurants in Nashville, Tennessee. The Nashville restaurants will be classified as "Assets held for sale" in the third quarter.

The Company expects to receive cash of approximately $9 million from refranchising the Atlanta and Nashville restaurants, which is consistent with the Company’s original estimates of proceeds for these markets made at the time the Company’s refranchising strategy was announced. Based on the proposed terms of the refranchising transactions for the Atlanta and Nashville markets, the Company recognized an impairment charge of $8.1 million in the second quarter, which includes a portion of the long-lived assets to be sold plus additional allocated goodwill.

The Company remains committed to the strategy of refranchising its restaurants with the best franchise operators for Popeyes long- term growth. Due to the uncertainty in the credit markets, the Company is currently unable to estimate the timing of future refranchising transactions or the aggregate earnings effect. The Company continues to expect cash proceeds of no less than the original estimate of $38-42 million upon the refranchising of all company-operated markets. Future refranchising of the company-operated restaurants in the Memphis and New Orleans markets would, in aggregate, result in substantial net gains.

Second Quarter Performance Review compared to Second Quarter Last Year

Total system-wide sales increased by 1.5 percent. This increase in system-wide sales was comprised of a 1.4 percent increase in franchisee restaurant sales to $387.4 million, and a 3.9 percent increase in company-operated restaurant sales to $18.8 million.

Total domestic same-store sales decreased 1.7 percent compared to a decrease of 2.1 percent last year, and total global same-store sales decreased 1.4 percent compared to a decrease of 1.7 percent last year. Same-store sales for company-operated restaurants decreased 4.3 percent compared to a 7.3 percent decrease last year. Same-store sales performance continues to be impacted by lower transactions as traffic continues to slow due to challenges in the economy and to industry-wide pricing increases to offset rising commodity costs.

Total revenues were $39.3 million, compared to $38.3 million last year. This increase was comprised of approximately $0.8 million from new openings of company-operated restaurants in the Atlanta and Tennessee markets, $0.6 million from the timing of temporary restaurant closures primarily in New Orleans, and $0.7 million primarily from royalties and fees from new franchised restaurants, partially offset by a $0.9 million decrease in same-store sales.

Company-operated restaurant expenses for food, beverages and packaging as a percentage of sales were 35 percent compared to 34 percent last year, increasing primarily due to commodity costs for chicken, wheat and shortening. Restaurant employee, occupancy and other expenses as a percentage of sales were 53 percent compared to 51 percent last year, increasing primarily due to utilities and insurance related reserves.

General and administrative expenses were $12.0 million, or 3.0 percent of system-wide sales, compared to $9.5 million, or 2.4 percent of system-wide sales last year. This increase was due primarily to costs of new management talent and non-recurring marketing and menu professional fees.

Other income was $3.8 million, or $0.09 per diluted share, which includes a net favorable settlement of a $12.3 million director and officers insurance claim and an $8.1 million impairment charge recognized for company-operated restaurant assets, as discussed above.

Second quarter year-to-date EBITDA was $29.9 million, including $5.1 million for other non-operating income, at a margin of 32.3 percent of total revenues, compared to last year’s EBITDA of $29.4 million, at a margin of 32.9 percent. AFC’s EBITDA computation and reconciliation to GAAP measures are described in detail under the heading "Use of Non-GAAP Financial Measures."

Operating profit was $12.9 million, compared to $12.7 million last year.

Income tax expense was $4.4 million, an effective tax rate of 40.0 percent, compared to an effective tax rate of 38.3 percent last year.

Net income was $6.6 million, or $0.26 per diluted share, compared to $6.6 million, or $0.22 per diluted share, last year. Net income in the second quarter benefited by approximately $0.09 per diluted share from other non-operating income discussed above.

The Company's second quarter year-to-date free cash flow remains strong at $16.8 million, including $5.1 million for other non-operating income, compared to $15.4 million last year. AFC's free cash flow computation and reconciliation to GAAP measures are described in detail under the heading "Use of Non-GAAP Financial Measures."

The Company recorded an additional $2.3 million payment for the final installment related to the Company's previously announced accelerated stock repurchase program which was completed on July 7, 2008. Second quarter year- to-date, the Company repurchased 2.1 million shares of common stock for $18.9 million. Under the terms of its current credit facility, the Company has the ability to repurchase an additional $19.3 million of shares during fiscal year 2008. As of August 8, 2008, there were approximately 25.2 million shares of the Company's common stock outstanding.

Effective June 30, 2008 through June 30, 2010, the Company entered into an interest rate swap agreement on an amount of $100.0 million. The effect of the agreement is to limit interest rate exposure on this portion of the 2005 Credit Facility to a fixed rate of 4.87 percent, compared to 6.40 percent on the previous interest rate swap agreement.

The Popeyes system opened 32 new restaurants, including 17 units domestically and 15 units internationally, compared to 24 new restaurants last year, and reported 31 permanent restaurant closures.

On a system-wide basis, Popeyes had 1,901 units operating at the end of the second quarter, compared to 1,878 units last year. Total unit count was comprised of 1,576 domestic units and 325 international units in 25 foreign countries and two territories. Of this total, 1,834 were franchised and 67 were company-operated restaurants.

Fiscal 2008 Guidance

The Company expects total domestic same-store sales for fiscal 2008 to be consistent with previous guidance of negative 1.0 to 2.0 percent. The Company also expects global new restaurant openings for 2008 to remain in the range of 115-130 and expects its closure rate to be similar to the past few years. Net openings are expected to be consistent with previous guidance of 5-15 units.

The Company now expects its full year earnings to be $0.75-$0.80 per diluted share, compared to previous guidance of $0.66-$0.71 per diluted share. The revised earnings guidance includes an increase of $0.09 per diluted share of other non-operating income realized in the second quarter, as discussed above.

General and administrative expenses as a percentage of system-wide sales are expected to remain at previous guidance of 3.0 to 3.1 percent, among the lowest percentage in the industry.

Ms. Bachelder concluded, "At the conclusion of our second quarter, I am satisfied that we are managing our resources well in a difficult market environment. We remain confident in our full year earnings guidance. Our highly franchised business model continues to generate strong EBITDA margins and solid free cash flows, giving us the ability to invest in the initiatives that will return maximum value to our shareholders."