DENNYS CORP
Form 10-Q
August 03, 2010

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 June 30, 2010

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 þ 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.

Large accelerated filer	o	Accelerated filer	þ	Non-accelerated filer	o	Smaller reporting company	o

(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 þ

As of July 30, 2010, 99,623,334 shares of the registrant’s common stock, par value $.01 per share, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands, except per share amounts)			
Revenue:				
Company restaurant sales	$ 105,301	$ 125,500	$ 213,084	$ 261,076
Franchise and license revenue	29,776	30,313	59,565	60,497
Total operating revenue	135,077	155,813	272,649	321,573
Costs of company restaurant sales:				
Product costs	24,500	29,306	50,192	61,589
Payroll and benefits	43,363	52,151	87,539	109,911
Occupancy	6,908	8,056	14,309	17,100
Other operating expenses	15,994	17,994	31,858	38,592
Total costs of company restaurant sales	90,765	107,507	183,898	227,192
Costs of franchise and license revenue	11,123	10,689	23,489	21,987
General and administrative expenses	13,111	15,907	26,185	29,754
Depreciation and amortization	7,291	8,015	14,664	16,727
Operating (gains), losses and other charges, net	(117)	(3,751)	306	(3,453)
Total operating costs and expenses	122,173	138,367	248,542	292,207
Operating income	12,904	17,446	24,107	29,366
Other expenses:				
Interest expense, net	6,514	8,239	12,912	16,730
Other nonoperating expense (income), net	570	(745)	558	(1,231)
Total other expenses, net	7,084	7,494	13,470	15,499
Net income before income taxes	5,820	9,952	10,637	13,867
Provision for income taxes	362	616	591	224
Net income	$ 5,458	$ 9,336	$ 10,046	$ 13,643
Net income per share:				
Basic	$ 0.05	$ 0.10	$ 0.10	$ 0.14
Diluted	$ 0.05	$ 0.09	$ 0.10	$ 0.14
Weighted average shares outstanding:				
Basic	99,263	96,113	98,179	96,079
Diluted	101,983	98,457	101,068	97,893

See accompanying notes

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

	June 30, 2010	December 30, 2009
	(In thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 21,677	$ 26,525
Receivables, less allowance for doubtful accounts of $147 and $171, respectively	13,352	18,106
Inventories	3,741	4,165
Assets held for sale	2,941	—
Prepaid and other current assets	12,583	9,549
Total current assets	54,294	58,345
Property, net of accumulated depreciation of $254,158 and $258,695, respectively	122,987	131,484
Other assets:		
Goodwill	32,283	32,440
Intangible assets, net	53,587	55,110
Deferred financing costs, net	2,128	2,676
Other noncurrent assets	31,386	32,572
Total assets	$ 296,665	$ 312,627
Liabilities and shareholders' deficit		
Current liabilities:		
Current maturities of notes and debentures	$ 753	$ 900
Current maturities of capital lease obligations	3,785	3,725
Accounts payable	17,676	22,842
Other current liabilities	55,251	64,641
Total current liabilities	77,465	92,108
Long-term liabilities:		
Notes and debentures, less current maturities	239,467	254,357
Capital lease obligations, less current maturities	19,934	19,684
Liability for insurance claims, less current portion	20,973	21,687
Deferred income taxes	13,109	13,016
Other noncurrent liabilities and deferred credits	38,628	39,273
Total long-term liabilities	332,111	348,017
Total liabilities	409,576	440,125
Commitments and contingencies		
Shareholders' deficit:		
Common stock $0.01 par value; authorized - 135,000; issued – 99,362 and 96,613, respectively	994	966

Paid-in capital		546,922		542,576
Deficit		(642,781)		(652,827)
Accumulated other comprehensive loss, net of tax		(18,046)		(18,213)
Total shareholders' deficit		(112,911)		(127,498)
Total liabilities and shareholders' deficit	$	296,665	$	312,627

See accompanying notes

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

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Deficit	Accumulated Other Comprehensive Loss, Net	Total Shareholders' Deficit
			(In thousands)			
Balance, December 30, 2009	96,613	$ 966	$ 542,576	$ (652,827)	$ (18,213)	$ (127,498)
Comprehensive income:						
Net income	—	—	—	10,046	—	10,046
Amortization of unrealized loss on hedged transactions, net of tax	—	—	—	—	167	167
Comprehensive income	—	—	—	10,046	167	10,213
Share-based compensation on equity classified awards	—	—	1,038	—	—	1,038
Issuance of common stock for share-based compensation	198	2	(2)	—	—	—
Exercise of common stock options	2,551	26	3,310	—	—	3,336
Balance, June 30, 2010	99,362	$ 994	$ 546,922	$ (642,781)	$ (18,046)	$ (112,911)

See accompanying notes

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

	Two Quarters Ended June 30, 2010	Two Quarters Ended July 1, 2009
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 10,046	$ 13,643
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation and amortization	14,664	16,727
Operating (gains), losses and other charges, net	306	(3,453)
Amortization of deferred financing costs	516	542
(Gain) loss on early extinguishment of debt	7	12
(Gain) loss on interest rate swap	167	(875)
Deferred income tax expense	93	278
Share-based compensation	1,249	2,702
Changes in assets and liabilities, net of effects of acquisitions and dispositions:		
Decrease (increase) in assets:		
Receivables	2,344	1,242
Inventories	424	1,072
Other current assets	(3,040)	(5,051)
Other assets	(1,268)	(1,100)
Increase (decrease) in liabilities:		
Accounts payable	(2,472)	(3,112)
Accrued salaries and vacations	(7,899)	(3,067)
Accrued taxes	(105)	(342)
Other accrued liabilities	(2,470)	(9,230)
Other noncurrent liabilities and deferred credits	(1,870)	(2,561)
Net cash flows provided by operating activities	10,692	7,427
Cash flows from investing activities:		
Purchase of property	(6,310)	(7,936)
Proceeds from disposition of property	3,322	13,030
Collections on notes receivable	2,691	—
Net cash flows (used in) provided by investing activities	(297)	5,094
Cash flows from financing activities:		
Long-term debt payments	(16,793)	(12,025)
Proceeds from exercise of stock options	3,336	24
Net bank overdrafts	(1,786)	(1,697)
Net cash flows used in financing activities	(15,243)	(13,698)
Decrease in cash and cash equivalents	(4,848)	(1,177)
Cash and cash equivalents at:		
Beginning of period	26,525	21,042
End of period	$ 21,677	$ 19,865

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 June 30, 2010, the Denny's brand consisted of 1,556 restaurants, 1,328 (85%) of which were franchised/licensed restaurants and 228 (15%) of which were company-owned and operated.

The following table shows the unit activity for the quarter and two quarters ended June 30, 2010 and July 1, 2009:

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
Company-owned restaurants, beginning of period	237	286	233	315
Units opened	—	—	4	1
Units sold to franchisees	(9)	(22)	(9)	(52)
Units closed	—	(1)	—	(1)
End of period	228	263	228	263
Franchised and licensed restaurants, beginning of period	1,322	1,260	1,318	1,226
Units opened	7	10	13	20
Units purchased from Company	9	22	9	52
Units closed	(10)	(11)	(12)	(17)
End of period	1,328	1,281	1,328	1,281
Total restaurants, end of period	1,556	1,544	1,556	1,544

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 30, 2009 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 30, 2009. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire fiscal year ending December 29, 2010.

Note 2. Summary of Significant Accounting Policies

Newly Adopted Accounting Standards

Fair Value

Accounting Standards Update (“ASU”) No. 2010-06, “Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements”

Effective March 31, 2010, we adopted ASU No. 2010-06, which improves disclosure requirements related to fair value measurements under the Codification. The new disclosure requirements relate to transfers in and out of Levels 1 and 2. ASU No. 2010-06 also includes separate disclosure requirements about purchases, sales, issuances and settlements relating to Level 3 measurements, which we are required to adopt in the first quarter of 2011. The adoption did not have a material impact on the disclosures included in our Condensed Consolidated Financial Statements.

Subsequent Events

ASU No. 2010-09, “Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements"

Effective December 31, 2009, the first day of fiscal 2010, we adopted ASC No. 2010-09, which removes the requirement to disclose the date through which subsequent events have been evaluated. The adoption did not have a material impact on the disclosures included in our Condensed Consolidated Financial Statements. See Note 18.

Variable Interest Entities

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810 "Consolidation"

Effective December 31, 2009, the first day of fiscal 2010, we adopted FASB ASC 810, which amends the guidance on the consolidation of variable interest entities for determining whether an entity is a variable interest entity and modifies the methods allowed for determining the primary beneficiary of a variable interest entity. In addition, it requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and enhanced disclosures related to an enterprise's involvement in a variable interest entity. The adoption did not have a material impact on our Condensed Consolidated Financial Statements.

There have been no other material changes to our significant accounting policies and estimates from the information provided in Note 2 of our Consolidated Financial Statements included in our Form 10-K for the fiscal year ended December 30, 2009.

Accounting Standards to be Adopted

Fair Value

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

As mentioned under the "Fair Value" section above, we are required to adopt the disclosure requirements of ASU 2010-06 about purchases, sales, issuances and settlements relating to Level 3 measurements in the first quarter of 2011. We do not anticipate the adoption to have a material impact on the disclosures included in our Condensed Consolidated Financial Statements.

Accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on our Condensed Consolidated Financial Statements upon adoption.

Note 3. Notes Receivables

Notes receivable were comprised of the following:

	June 30, 2010	December 30, 2009
	(In thousands)	
Current assets (included as a component of receivables):		
Receivables related to sale of restaurants to franchisees	$ 1,093	$ 3,504
Receivables related to sale of real estate to a third party	62	61
Total current notes receivable	$ 1,155	$ 3,565
Noncurrent (included as a component of other noncurrent assets):		
Receivables related to sale of restaurants to franchisees	$ 1,844	$ 1,894
Receivables related to sale of real estate to a third party	80	111
Total noncurrent notes receivable	$ 1,924	$ 2,005

Note 4. Assets Held for Sale

Assets held for sale of $2.9 million as of June 30, 2010, include restaurants and real estate to be sold to franchisees. There were no assets held for sale as of December 30, 2009. We expect to sell each of these assets within 12 months. Our Credit Facility (defined in Note 8) requires us to make mandatory prepayments to reduce outstanding indebtedness with the net cash proceeds from the sale of specified real estate properties, restaurant assets and restaurant operations to franchisees, net of a voluntary $10.0 million annual exclusion related to proceeds from the sale of restaurant operations to franchisees and a voluntary $10.0 million annual exclusion related to proceeds from the sale of restaurant assets. As of June 30, 2010 and December 30, 2009, no reclassification of long-term debt to current liabilities was required. There were no impairment charges recognized related to assets held for sale for the quarter and two quarters ended June 30, 2010. As a result of classifying certain assets as held for sale, we recognized impairment charges of $0.1 million and $0.4 million for the quarter and two quarters ended July 1, 2009. 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 changes in carrying amounts of goodwill for the quarter ended June 30, 2010 are as follows:

	(In thousands)
Balance at December 30, 2009	$ 32,440
Write-offs associated with sale of restaurants	(157)
Balance at June 30, 2010	$ 32,283

Goodwill and intangible assets were comprised of the following:

	June 30, 2010		December 30, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Goodwill	$ 32,283	$ —	$ 32,440	$ —
Intangible assets with indefinite lives:				
Trade names	$ 42,463	$ —	$ 42,454	$ —
Liquor licenses	176	—	176	—
Intangible assets with definite lives:				
Franchise and license agreements	46,513	35,649	50,787	38,397
Foreign license agreements	241	157	241	151
Intangible assets	$ 89,393	$ 35,806	$ 93,658	$ 38,548
Other assets with definite lives:				
Software development costs	$ 33,438	$ 29,392	$ 32,806	$ 28,401

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

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

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands)			
Gains on sales of assets and other, net	$ (1,266)	$ (3,508)	$ (1,476)	$ (4,032)
Restructuring charges and exit costs	1,149	(673)	1,782	(244)
Impairment charges	—	430	—	823
Operating gains, losses and other charges, net	$ (117)	$ (3,751)	$ 306	$ (3,453)

Gains on Sales of Assets

Proceeds and gains on sales of assets were comprised of the following:

Quarter Ended	Quarter Ended
June 30, 2010	July 1, 2009

	Net Proceeds	Gains	Net Proceeds	Gains
		(In thousands)		
Sales of restaurant operations and related real estate to franchisees	$ 3,003	$ 1,196	$ 6,960	$ 2,343
Sales of other real estate assets	515	39	2,754	1,134
Recognition of deferred gains	—	31	—	31
Total	$ 3,518	$ 1,266	$ 9,714	$ 3,508

During the quarter ended June 30, 2010, we recognized $1.2 million of gains on the sale of nine restaurant operations to four franchisees for net proceeds of $3.0 million (which included a note receivable of $0.2 million). During the quarter ended July 1, 2009, we recognized $2.3 million of gains on the sale of 22 restaurant operations to eight franchisees for net proceeds of $7.0 million (which included a note receivable of $0.1 million).

	Two Quarters Ended June 30, 2010		Two Quarters Ended July 1, 2009	
	Net Proceeds	Gains	Net Proceeds	Gains
	(In thousands)			
Sales of restaurant operations and related real estate to franchisees	$ 2,998	$ 1,366	$ 11,751	$ 2,803
Sales of other real estate assets	524	48	2,754	1,134
Recognition of deferred gains	—	62	—	95
Total	$ 3,522	$ 1,476	$ 14,505	$ 4,032

During the two quarters ended June 30, 2010, we recognized $1.2 million of gains on the sale of nine restaurant operations to four franchisees for net proceeds of $3.0 million (which included a note receivable of $0.2 million) and additional gains on prior year restaurant sale transactions. During the two quarters ended July 1, 2009, we recognized $2.8 million of gains on the sale of 52 restaurant operations to ten franchisees for net proceeds of $11.8 million (which included notes receivable of $1.5 million).

Restructuring Charges and Exit Costs

Restructuring charges and exit costs were comprised of the following:

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands)			
Exit costs	$ 235	$ (795)	$ 863	$ (745)
Severance and other restructuring charges	914	122	919	501
Total restructuring and exit costs	$ 1,149	$ (673)	$ 1,782	$ (244)

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

	(In thousands)
Balance at December 30, 2009	$ 6,555
Provisions for units closed during the year (1)	500
Changes in estimates of accrued exit costs, net (1)	363
Payments, net of sublease receipts	(1,628)
Interest accretion	295
Balance at June 30, 2010	6,085
Less current portion included in other current liabilities	1,838
Long-term portion included in other noncurrent liabilities	$ 4,247

(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 2010	$	1,449
2011		1,583
2012		1,086
2013		800
2014		677
Thereafter		1,422
Total		7,017
Less imputed interest		932
Present value of exit cost liabilities	$	6,085

As of June 30, 2010 and December 30, 2009, we had accrued severance and other restructuring charges of $1.1 million and $0.9 million, respectively. The balance as of June 30, 2010 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 June 30, 2010				
	Total	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
	(In thousands)				
Deferred compensation plan investments	$ 6,192	$ 6,192	$ —	$ —	market approach
Total	$ 6,192	$ 6,192	$ —	$ —	

	Fair Value Measurements as of December 30, 2009				
	Total	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique
	(In thousands)				
Deferred compensation plan investments	$ 5,721	$ 5,721	$ —	$ —	market approach
Total	$ 5,721	$ 5,721	$ —	$ —	

In addition to the financial assets and liabilities that are measured at fair value on a recurring basis, we measure certain assets and liabilities at fair value on a nonrecurring basis. As of June 30, 2010, there were no such nonrecurring measurements. As of December 30, 2009, impaired assets related to an underperforming unit 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:

	June 30, 2010	December 30, 2009
	(In thousands)	
Book value:		
Fixed rate long-term debt	$ 175,220	$ 175,257

Variable rate long-term debt		65,000		80,000
Long term debt excluding capital lease obligations	$	240,220	$	255,257
Estimate fair value:				
Fixed rate long-term debt	$	175,220	$	179,194
Variable rate long-term debt		65,000		80,000
Long term debt excluding capital lease obligations	$	240,220	$	259,194

The market quotation for our Denny's Holdings, Inc. 10% Senior Notes due 2012 ("the 10% Notes") was equal to their par value as of June 30, 2010. Therefore, there was no difference between the estimated fair value of long-term debt and its historical cost reported in our Condensed Consolidated Balance Sheets at June 30, 2010. The difference between the estimated fair value and historical cost at December 30, 2009 directly relates to the market quotations for the 10% Notes.

Note 8. Long-Term Debt

Credit Facility

Our subsidiaries, Denny's, Inc. and Denny's Realty, LLC (the "Borrowers"), have a senior secured credit agreement consisting of a $50 million revolving credit facility (including up to $10 million for a revolving letter of credit facility for short term needs), a $65 million term loan and an additional $30 million letter of credit facility for longer term needs (together, the "Credit Facility"). At June 30, 2010, we had outstanding letters of credit of $24.5 million (comprised of $24.4 million under our letter of credit facility and less than $0.1 million under our revolving letter of credit facility). There were no revolving loans outstanding at June 30, 2010. These balances result in availability of $5.6 million under our letter of credit facility and $49.9 million under the revolving facility.

The revolving facility matures on December 15, 2011. The term loan and the $30 million letter of credit facility mature on March 31, 2012. The term loan amortizes in equal quarterly installments at a rate equal to approximately 1% per annum with all remaining amounts due on the maturity date. The Credit Facility is available for working capital, capital expenditures and other general corporate purposes. We will be required to make mandatory prepayments under certain circumstances (such as required payments related to asset sales) typical for this type of credit facility and may make certain optional prepayments under the Credit Facility. We believe that our estimated cash flows from operations for 2010, 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.

The Credit Facility is guaranteed by Denny's and its other subsidiaries and is secured by substantially all of the assets of Denny's and its subsidiaries. In addition, the Credit Facility is secured by first-priority mortgages on approximately 100 company-owned real estate assets. The Credit Facility contains certain financial covenants (i.e., maximum total debt to EBITDA (as defined under the Credit Facility) ratio requirements, maximum senior secured debt to EBITDA ratio requirements, minimum fixed charge coverage ratio requirements and limitations on capital expenditures), negative covenants, conditions precedent, material adverse change provisions, events of default and other terms, conditions and provisions customarily found in credit agreements for facilities and transactions of this type.

A commitment fee of 0.5% is paid on the unused portion of the revolving credit facility. Interest on loans under the revolving facility is payable at per annum rates equal to LIBOR plus 250 basis points and will adjust over time based on our leverage ratio. Interest on the term loan and letter of credit facility is payable at per annum rates equal to LIBOR plus 200 basis points. The weighted-average interest rate under the term loan was 2.5% and 3.6% as of June 30, 2010 and July 1, 2009, respectively. Taking into consideration our interest rate swap, described below, the weighted-average interest rate under the term loan was 6.4% as of July 1, 2009.

Note 9. Derivative Financial Instruments

We may choose to utilize derivative financial instruments to manage our exposure to interest rate risk and commodity risk in relation to natural gas costs. We do not enter into derivative instruments for trading or speculative purposes.

As of June 30, 2010 and December 30, 2009, there were no derivative instruments included in the Condensed Consolidated Balance Sheet.

The gains (losses) recognized in our Condensed Consolidated Statements of Operations as a result of interest rate swaps and natural gas hedge contracts are as follows:

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands)			
Realized gains (losses):				
Interest rate swap - included as a component of interest expense	$ —	$ (927)	$ —	$ (1,794)
Natural gas contracts - included as a component of utility expense, which is included in other operating expenses	$ —	$ (438)	$ —	$ (1,020)
Unrealized gains (losses) included as a component of nonoperating expense:				
Interest rate swap	$ —	$ 312	$ (167)	$ 875

Natural gas contracts	$	—	$ 400	$	—	$ 406

The unrealized gains (losses) related to the interest rate swap include both the changes in the fair value of the swap and the amortization of losses previously recorded in accumulated other comprehensive income.

Interest Rate Swap

In 2007, we entered into an interest rate swap with a notional amount of $150 million that was designated as a cash flow hedge of our interest rate exposure. Under the terms of the swap, we paid a fixed rate of 4.8925% on the notional amount and received payments from the counterparties based on the 3-month LIBOR rate for a term ending on March 30, 2010, effectively resulting in a fixed rate of 6.8925% on the notional amount. Interest rate differentials paid or received under the swap agreement were recognized as adjustments to interest expense. At the end of 2007, we determined that a portion of the underlying cash flows related to the swap were no longer probable of occurring over the term of the swap as a result of the probability of paying the debt down below the notional amount. As a result, we discontinued hedge accounting treatment. The losses included in accumulated other comprehensive income as of December 26, 2007 were amortized to other nonoperating expense over the remaining term of the swap. In 2008, we terminated $50 million of the notional amount of the swap. In the fourth quarter of 2009 we terminated the remaining $100 million of the notional amount of the swap. The 2009 termination resulted in a $1.3 million cash payment, which was made in the fourth quarter of 2009. There were no interest rate swaps outstanding as of December 30, 2009 or June 30, 2010.

Natural Gas Hedge Contracts

Realized gains (losses) on the contracts are recorded as utility cost which is a component of other operating expenses. The contracts are not accounted for under hedge accounting; therefore, changes in the contracts' fair value are recorded in other nonoperating expense.

Note 10. Defined Benefit Plans

The components of net periodic benefit cost were as follows:

	Pension Plan Quarter Ended		Other Defined Benefit Plans Quarter Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands)			
Service cost	$ 94	$ 107	$ —	$ —
Interest cost	858	862	34	38
Expected return on plan assets	(979)	(864)	—	—
Amortization of net loss	240	313	6	3
Net periodic benefit cost	$ 213	$ 418	$ 40	$ 41

	Pension Plan Two Quarters Ended		Other Defined Benefit Plans Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands)			
Service cost	$ 188	$ 195	$ —	$ —
Interest cost	1,716	1,726	69	76
Expected return on plan assets	(1,964)	(1,732)	—	—
Amortization of net loss	457	653	11	7
Net periodic benefit cost	$ 397	$ 842	$ 80	$ 83

We did not make any contributions to our qualified pension plan during the two quarters ended June 30, 2010. We made contributions of $0.6 million to our qualified pension plan during the two quarters ended July 1, 2009. We made contributions of $0.1 million and $0.1 million to our other defined benefit plans during the two quarters ended June 30, 2010 and July 1, 2009, respectively. We do not expect to contribute to our qualified pension plan during 2010. We expect to contribute an additional $0.1 million to our other defined benefit plans over the remainder of fiscal 2010.

Additional minimum pension liability of $18.0 million is reported as a component of accumulated other comprehensive loss in the Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive Income as of June 30, 2010 and December 30, 2009.

Note 11. Share-Based Compensation

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

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands)			
Share-based compensation related to liability classified restricted stock units	$ (513)	$ 523	$ 211	$ 596

Share based compensation related to equity classified awards:								
Stock options	$	225	$	364	$	535	$	506
Restricted stock units		105		781		408		1,443
Board deferred stock units		74		149		95		157
Total share-based compensation related to equity classified awards		404		1,294		1,038		2,106
Total share-based compensation	$	(109)	$	1,817	$	1,249	$	2,702

Stock Options

During the two quarters ended June 30, 2010, we granted approximately 0.6 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 two quarters ended June 30, 2010 was $1.21. 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 ("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 two quarters ended June 30, 2010:

Dividend yield	0.0%
Expected volatility	60.2%
Risk-free interest rate	2.48%
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 June 30, 2010, we had approximately $1.3 million of unrecognized compensation cost related to unvested stock option awards outstanding, which is expected to be recognized over a weighted average of 1.8 years.

Restricted Stock Units

In June 2010, we granted two awards of less than 0.1 million restricted stock units to certain non-employee board members. One award had a grant date fair value of $2.72 and the other had a grant date fair value of $2.82. The units vest 12 months from the grant date and, based on the participant's election, are converted to shares of Denny's stock either upon vesting or upon the board member's separation from the Board of Directors.

In January 2010, we granted approximately 0.1 million performance shares and 0.1 million performance units to certain employees. As these awards contain a market condition, a Monte Carlo valuation was used to determine the performance shares grant date fair value of $2.69 per share. The awards granted to our named executive officers also contain a performance condition based on certain operating measures for the fiscal year ended December 29, 2010. The performance units were valued at $2.00 per unit. The performance period is the three year fiscal period beginning December 31, 2009 and ending December 26, 2012. The performance shares and units 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.

During the two quarters ended June 30, 2010, we made payments of $0.9 million (before taxes) in cash and issued 0.2 million shares of common stock related to the restricted stock unit awards that vested as of December 30, 2009.

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

	June 30, 2010	December 30, 2009
	(In thousands)	
Liability classified restricted stock units:		
Other current liabilities	$ 440	$ 1,303
Other noncurrent liabilities	$ 596	$ 506
Equity classified restricted stock units:		
Additional paid-in capital	$ 5,207	$ 5,237

As of June 30, 2010, we had approximately $1.6 million of unrecognized compensation cost (approximately $0.6 million for liability classified units and approximately $1.0 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 1.4 years.

Board Deferred Stock Units

During the two quarters ended June 30, 2010, we granted 0.1 million deferred stock units (which are equity classified) with a weighted average grant date fair value of $2.92 per unit to non-employee members of our Board of Directors. The directors 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.

Note 12. Comprehensive Income and Accumulated Other Comprehensive Loss

Total comprehensive income was $10.2 million and $14.2 million for the two quarters ended June 30, 2010 and July 1, 2009, respectively.

The components of Accumulated Other Comprehensive Loss, Net in the Condensed Consolidated Statement of Shareholder's Deficit and Comprehensive Loss are as follows:

	June 30, 2010	December 30, 2009
	(In thousands)	
Additional minimum pension liability	$ (18,046)	$ (18,046)
Unrealized loss on interest rate swap	—	(167)
Accumulated other comprehensive loss	$ (18,046)	$ (18,213)

Note 13. Income Taxes

The provision for income taxes was $0.4 and $0.6 million for the quarter and two quarters ended June 30, 2010 compared to $0.6 million and $0.2 million for the quarter and two quarters ended July 1, 2009. The provision for income taxes for the first two quarters of 2010 and 2009 was determined using our effective rate estimated for the entire fiscal year. The increase in our effective tax rate for the two quarters ended June 30, 2010 results primarily from the recognition of $0.7 million of current tax benefits during the first quarter of 2009 related to the enactment of certain federal laws during the first quarter of 2009. 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.

Note 14. Net Income Per Share

	Quarter Ended		Two Quarters Ended	
	June 30, 2010	July 1, 2009	June 30, 2010	July 1, 2009
	(In thousands, except for per share amounts)			
Numerator:				
Numerator for basic and diluted net income per share - net income	$ 5,458	$ 9,336	$ 10,046	$ 13,643
Denominator:				
Denominator for basic net income per share – weighted average shares	99,263	96,113	98,179	96,079
Effect of dilutive securities:				
Options	1,235	1,311	1,585	1,132
Restricted stock units and awards	1,485	1,033	1,304	682
Denominator for diluted net income per share – adjusted weighted average shares and assumed conversions of dilutive securities	101,983	98,457	101,068	97,893
Basic net income per share	$ 0.05	$ 0.10	$ 0.10	$ 0.14
Diluted net income per share	$ 0.05	$ 0.09	$ 0.10	$ 0.14
Stock options excluded (1)	2,313	6,147	2,231	5,583
Restricted stock units and awards excluded (1)	—	420	—	420

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

Note 15. Supplemental Cash Flow Information

	Two Quarters Ended	
	June 30, 2010	July 1, 2009
	(In thousands)	
Income taxes paid, net	$ 882	$ 791
Interest paid	$ 12,612	$ 15,750

Noncash investing activities:				
Notes received in connection with disposition of property	$	200	$	1,475
Execution of direct financing leases	$	—	$	2,275
Noncash financing activities:				
Issuance of common stock, pursuant to share-based compensation plans	$	438	$	1,021
Execution of capital leases	$	2,084	$	35

Note 16. Related Party Transactions:

During the quarter and two quarters ended July 1, 2009, we sold company-owned restaurants to franchisees that are former employees, including a former executive. We received cash proceeds of $1.1 million and recognized losses of $0.1 million from these related party sales during the quarter and two quarters ended July 1, 2009. In relation to these sales, we may enter into leases or subleases with the franchisees. These leases and subleases are entered into at fair market value.

Note 17. Commitments and Contingencies

On July 23, 2010, the Company received notice that our former Chief Executive Officer ("CEO") has elected to arbitrate issues with respect to the settlement of any outstanding obligations related to his departure. Under the terms of the employment agreement with our former CEO, such arbitration proceeding is to be held before a single arbitrator in Charlotte, North Carolina in accordance with the rules of the American Arbitration Association and is to be completed within 60 days of the delivery of such notice. We estimate that the arbitration could result in payments to our former CEO ranging from approximately $0.8 million to $3.2 million. At June 30, 2010, we have recorded $0.8 million of severance and other restructuring charges related to the resolution of this matter.

In addition, there are various other 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 June 30, 2010 and results of operations for the quarter and two quarters ended June 30, 2010 compared to the quarter and two quarters ended July 1, 2009. 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, 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 30, 2009.

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				Two Quarters Ended			
	June 30, 2010		July 1, 2009		June 30, 2010		July 1, 2009	
	(Dollars in thousands)							
Revenue:								
Company restaurant sales	$ 105,301	78.0%	$ 125,500	80.5%	$ 213,084	78.2%	$ 261,076	81.2%
Franchise and license revenue	29,776	22.0%	30,313	19.5%	59,565	21.8%	60,497	18.8%
Total operating revenue	135,077	100.0%	155,813	100.0%	272,649	100.0%	321,573	100.0%
Costs of company restaurant sales (a):								
Product costs	24,500	23.3%	29,306	23.4%	50,192	23.6%	61,589	23.6%
Payroll and benefits	43,363	41.2%	52,151	41.6%	87,539	41.1%	109,911	42.1%
Occupancy	6,908	6.6%	8,056	6.4%	14,309	6.7%	17,100	6.5%
Other operating expenses	15,994	15.2%	17,994	14.3%	31,858	15.0%	38,592	14.8%
Total costs of company restaurant sales	90,765	86.2%	107,507	85.7%	183,898	86.3%	227,192	87.0%
Costs of franchise and license revenue (a)	11,123	37.4%	10,689	35.3%	23,489	39.4%	21,987	36.3%
General and administrative expenses	13,111	9.7%	15,907	10.2%	26,185	9.6%	29,754	9.3%
Depreciation and amortization	7,291	5.4%	8,015	5.1%	14,664	5.4%	16,727	5.2%
Operating (gains), losses and other charges	(117)	(0.1%)	(3,751)	(2.4%)	306	0.1%	(3,453)	(1.1%)
Total operating costs and expenses	122,173	90.4%	138,367	88.8%	248,542	91.2%	292,207	90.9%
Operating income	12,904	9.6%	17,446	11.2%	24,107	8.8%	29,366	9.1%
Other expenses:								
Interest expense, net	6,514	4.8%	8,239	5.3%	12,912	4.7%	16,730	5.2%
Other nonoperating expense (income), net	570	0.4%	(745)	(0.5%)	558	0.2%	(1,231)	(0.4%)
Total other expenses, net	7,084	5.2%	7,494	4.8%	13,470	4.9%	15,499	4.8%
Net income before income taxes	5,820	4.3%	9,952	6.4%	10,637	3.9%	13,867	4.3%
Provision for income taxes	362	0.3%	616	0.4%	591	0.2%	224	0.1%
Net income	$ 5,458	4.0%	$ 9,336	6.0%	$ 10,046	3.7%	$ 13,643	4.2%
Other Data:								
Company-owned average unit sales	$ 448		$ 460		$ 906		$ 915	

Franchise average unit sales	$ 339	$ 357	$ 681	$ 719
Company-owned equivalent units (b)	235	272	235	285
Franchise equivalent units (b)	1,322	1,273	1,321	1,257
Same-store sales decrease (company-owned) (c)(d)	(6.2%)	(2.7%)	(5.8%)	(1.1%)
Guest check average (decrease) increase (d)	(2.7%)	2.3%	(1.3%)	1.3%
Guest count decrease (d)	(3.7%)	(4.9%)	(4.6%)	(2.5%)
Same-store sales decrease (franchised and licensed units) (c) (d)	(5.9%)	(4.7%)	(6.1%)	(3.1%)

(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 2010 comparable units.

Quarter Ended June 30, 2010 Compared with Quarter Ended July 1, 2009

Unit Activity

	Quarter Ended	
	June 30, 2010	July 1, 2009
Company-owned restaurants, beginning of period	237	286
Units opened	—	—
Units sold to franchisees	(9)	(22)
Units closed	—	(1)
End of period	228	263
Franchised and licensed restaurants, beginning of period	1,322	1,260
Units opened	7	10
Units purchased from Company	9	22
Units closed	(10)	(11)
End of period	1,328	1,281
Total restaurants, end of period	1,556	1,544

Company Restaurant Operations

During the quarter ended June 30, 2010, we incurred a 6.2% decrease in same-store sales, comprised of a 2.7% decrease in guest check average and a 3.7% decrease in guest counts. Company restaurant sales decreased $20.2 million, or 16.1%, primarily resulting from a 37 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 86.2% from 85.7%. Product costs decreased to 23.3% from 23.4%. Payroll and benefits decreased to 41.2% from 41.6% primarily as a result of a decrease in incentive compensation, partially offset by the deleveraging effect of lower sales and unfavorable workers' compensation claims development. Occupancy costs increased to 6.6% from 6.4% primarily due to the effect of lower sales. Other operating expenses were comprised of the following amounts and percentages of company restaurant sales:

	Quarter Ended			
	June 30, 2010		July 1, 2009	
	(Dollars in thousands)			
Utilities	$ 4,391	4.2%	$ 5,584	4.4%
Repairs and maintenance	1,999	1.9%	2,533	2.0%
Marketing	4,522	4.3%	4,812	3.8%
Legal settlement costs	77	0.1%	—	0.0%
Other direct costs	5,005	4.8%	5,065	4.0%
Other operating expenses	$ 15,994	15.2%	$ 17,994	14.3%

Utilities decreased 0.2 percentage points primarily due to the recognition of $0.4 million in losses on natural gas contracts during the prior year quarter. Marketing increased 0.5 percentage