

DENNYS CORP
Form 10-Q
July 31, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 27, 2018

OR

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 0-18051

DENNY'S CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 13-3487402

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization 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 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated Accelerated Non-accelerated filer Smaller reporting Emerging growth
filer filer company company

Edgar Filing: DENNYS CORP - Form 10-Q

(Do not check if a
smaller
reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

As of July 25, 2018, 63,386,252 shares of the registrant's common stock, par value \$0.01 per share, were outstanding.

TABLE OF CONTENTS

| | Page |
|--|-----------|
| <u>PART I - FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements</u> | |
| <u>Condensed Consolidated Balance Sheets (Unaudited)</u> | <u>3</u> |
| <u>Condensed Consolidated Statements of Income (Unaudited)</u> | <u>4</u> |
| <u>Condensed Consolidated Statements of Comprehensive Income (Unaudited)</u> | <u>5</u> |
| <u>Condensed Consolidated Statement of Shareholders' Deficit (Unaudited)</u> | <u>6</u> |
| <u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u> | <u>7</u> |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> | <u>8</u> |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>21</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>29</u> |
| <u>Item 4. Controls and Procedures</u> | <u>29</u> |
| <u>PART II - OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | <u>30</u> |
| <u>Item 1A. Risk Factors</u> | <u>30</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>30</u> |
| <u>Item 6. Exhibits</u> | <u>31</u> |
| <u>Signatures</u> | <u>32</u> |

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | June 27, 2018 | December 27, 2017 |
|--|------------------|----------------------|
| | (In thousands) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$3,750 | \$ 4,983 |
| Receivables, net | 18,975 | 21,384 |
| Inventories | 3,096 | 3,134 |
| Prepaid and other current assets | 12,040 | 11,788 |
| Total current assets | 37,861 | 41,289 |
| Property, net of accumulated depreciation of \$245,733 and \$243,325, respectively | 142,645 | 139,856 |
| Goodwill | 39,843 | 38,269 |
| Intangible assets, net | 60,851 | 57,109 |
| Deferred financing costs, net | 2,638 | 2,942 |
| Deferred income taxes | 19,333 | 16,945 |
| Other noncurrent assets | 31,388 | 27,372 |
| Total assets | \$334,559 | \$ 323,782 |
| Liabilities | | |
| Current liabilities: | | |
| Current maturities of capital lease obligations | \$3,092 | \$ 3,168 |
| Accounts payable | 26,095 | 32,487 |
| Other current liabilities | 53,218 | 59,246 |
| Total current liabilities | 82,405 | 94,901 |
| Long-term liabilities: | | |
| Long-term debt, less current maturities | 282,000 | 259,000 |
| Capital lease obligations, less current maturities | 27,945 | 27,054 |
| Liability for insurance claims, less current portion | 12,255 | 12,236 |
| Other noncurrent liabilities | 47,831 | 27,951 |
| Total long-term liabilities | 370,031 | 326,241 |
| Total liabilities | 452,436 | 421,142 |
| Commitments and contingencies | | |
| Shareholders' equity (deficit) | | |
| Common stock \$0.01 par value; shares authorized - 135,000; June 27, 2018: 108,470 shares issued and 63,456 shares outstanding; December 27, 2017: 107,740 shares issued and 64,589 shares outstanding | \$1,084 | \$ 1,077 |
| Paid-in capital | 596,248 | 594,166 |
| Deficit | (328,722) | (334,661) |
| Accumulated other comprehensive loss, net of tax | (2,017) | (2,316) |
| Shareholders' equity before treasury stock | 266,593 | 258,266 |

Edgar Filing: DENNYS CORP - Form 10-Q

| | | |
|---|------------|------------|
| Treasury stock, at cost, 45,014 and 43,151 shares, respectively | (384,470) | (355,626) |
| Total shareholders' deficit | (117,877) | (97,360) |
| Total liabilities and shareholders' deficit | \$ 334,559 | \$ 323,782 |

See accompanying notes

3

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

| | Quarter Ended | | Two Quarters Ended | |
|--|--|------------------|--------------------|------------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands, except per share amounts) | | | |
| Revenue: | | | | |
| Company restaurant sales | \$102,741 | \$98,355 | \$203,934 | \$192,134 |
| Franchise and license revenue | 54,593 | 35,021 | 108,673 | 69,152 |
| Total operating revenue | 157,334 | 133,376 | 312,607 | 261,286 |
| Costs of company restaurant sales: | | | | |
| Product costs | 25,054 | 24,769 | 49,989 | 47,902 |
| Payroll and benefits | 41,065 | 38,492 | 82,291 | 75,889 |
| Occupancy | 5,435 | 5,503 | 11,082 | 10,237 |
| Other operating expenses | 15,021 | 12,933 | 30,071 | 25,504 |
| Total costs of company restaurant sales | 86,575 | 81,697 | 173,433 | 159,532 |
| Costs of franchise and license revenue | 29,049 | 10,244 | 57,605 | 19,990 |
| General and administrative expenses | 15,597 | 16,581 | 32,157 | 34,090 |
| Depreciation and amortization | 6,691 | 5,799 | 13,205 | 11,535 |
| Operating (gains), losses and other charges, net | 462 | 2,046 | 822 | 2,829 |
| Total operating costs and expenses, net | 138,374 | 116,367 | 277,222 | 227,976 |
| Operating income | 18,960 | 17,009 | 35,385 | 33,310 |
| Interest expense, net | 5,385 | 3,740 | 10,010 | 7,281 |
| Other nonoperating income, net | (629) | (410) | (417) | (767) |
| Net income before income taxes | 14,204 | 13,679 | 25,792 | 26,796 |
| Provision for income taxes | 2,578 | 4,930 | 4,407 | 9,674 |
| Net income | \$11,626 | \$8,749 | \$21,385 | \$17,122 |
| Basic net income per share | \$0.18 | \$0.13 | \$0.33 | \$0.24 |
| Diluted net income per share | \$0.18 | \$0.12 | \$0.32 | \$0.24 |
| Basic weighted average shares outstanding | 63,644 | 69,407 | 64,038 | 70,205 |
| Diluted weighted average shares outstanding | 66,128 | 71,661 | 66,552 | 72,459 |

See accompanying notes

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

| | Quarter Ended | | Two Quarters Ended | |
|--|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Net income | \$11,626 | \$8,749 | \$21,385 | \$17,122 |
| Other comprehensive income, net of tax: | | | | |
| Minimum pension liability adjustment, net of tax of \$7, \$9, \$13 and \$18, respectively | 21 | 14 | 43 | 28 |
| Recognition of unrealized loss on hedge transactions, net of tax of \$1,175, \$(985), \$90 and \$(1,382), respectively | 3,369 | (1,544) | 256 | (2,167) |
| Other comprehensive income (loss) | 3,390 | (1,530) | 299 | (2,139) |
| Total comprehensive income | \$15,016 | \$7,219 | \$21,684 | \$14,983 |

See accompanying notes

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

| | Common Stock | | Treasury Stock | | Paid-in Capital | Deficit | Accumulated Other Comprehensive Loss, Net | Total Shareholders' Deficit |
|---|----------------|----------|----------------|-------------|--------------------|-------------|--|-----------------------------------|
| | Shares | Amount | Shares | Amount | | | | |
| | (In thousands) | | | | | | | |
| Balance, December 27, 2017 | 107,740 | \$ 1,077 | (43,151) | \$(355,626) | \$594,166 | \$(334,661) | \$ (2,316) | \$(97,360) |
| Cumulative effect adjustment | — | — | — | — | — | (15,446) | — | (15,446) |
| Net income | — | — | — | — | — | 21,385 | — | 21,385 |
| Other comprehensive loss | — | — | — | — | — | — | 299 | 299 |
| Share-based compensation on equity classified awards | — | — | — | — | 1,076 | — | — | 1,076 |
| Purchase of treasury stock | — | — | (1,863) | (28,844) | — | — | — | (28,844) |
| Issuance of common stock for share-based compensation | 444 | 4 | — | — | (4) | — | — | — |
| Exercise of common stock options | 286 | 3 | — | — | 1,010 | — | — | 1,013 |
| Balance, June 27, 2018 | 108,470 | \$ 1,084 | (45,014) | \$(384,470) | \$596,248 | \$(328,722) | \$ (2,017) | \$(117,877) |

See accompanying notes

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

| | Two Quarters Ended June 27, 2018 (In thousands) | June 28, 2017 |
|---|---|---------------|
| Cash flows from operating activities: | | |
| Net income | \$ 21,385 | \$ 17,122 |
| Adjustments to reconcile net income to cash flows provided by operating activities: | | |
| Depreciation and amortization | 13,205 | 11,535 |
| Operating (gains), losses and other charges, net | 822 | 2,829 |
| Amortization of deferred financing costs | 303 | 297 |
| (Gain) loss on early extinguishments of debt and leases | (161) | 68 |
| Deferred income tax expense | 2,896 | 6,291 |
| Share-based compensation | 2,561 | 4,053 |
| Changes in assets and liabilities: | | |
| Decrease (increase) in assets: | | |
| Receivables | 2,323 | 3,741 |
| Inventories | 38 | (1) |
| Other current assets | (253) | 3,587 |
| Other assets | (445) | (3,869) |
| Increase (decrease) in liabilities: | | |
| Accounts payable | (7,280) | (1,986) |
| Accrued salaries and vacations | (2,029) | (9,692) |
| Accrued taxes | 428 | 276 |
| Other accrued liabilities | (6,352) | (365) |
| Other noncurrent liabilities | (1,345) | (1,068) |
| Net cash flows provided by operating activities | 26,096 | 32,818 |
| Cash flows from investing activities: | | |
| Capital expenditures | (9,512) | (8,208) |
| | (10,416) | (6,871) |

| | | | | |
|--|----------|---|----------|---|
| Acquisition of restaurants and real estate | | | | |
| Proceeds from disposition of property | 4 | | 1,032 | |
| Collections on notes receivable | 1,921 | | 3,186 | |
| Issuance of notes receivable | (2,455) |) | (1,825) |) |
| Net cash flows used in investing activities | (20,458) |) | (12,686) |) |
| Cash flows from financing activities: | | | | |
| Revolver borrowings | 66,500 | | 58,500 | |
| Revolver payments | (43,500) |) | (42,000) |) |
| Long-term debt payments | (1,643) |) | (1,633) |) |
| Proceeds from exercise of stock options | 1,013 | | 135 | |
| Tax withholding on share-based payments | (1,696) |) | — |) |
| Purchase of treasury stock | (28,964) |) | (35,629) |) |
| Net bank overdrafts | 1,419 | | (429) |) |
| Net cash flows used in financing activities | (6,871) |) | (21,056) |) |
| Decrease in cash and cash equivalents | (1,233) |) | (924) |) |
| Cash and cash equivalents at beginning of period | 4,983 | | 2,592 | |
| Cash and cash equivalents at end of period | \$ 3,750 | | \$ 1,668 | |

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 or the Company, is one of America's largest full-service restaurant chains based on number of restaurants. At June 27, 2018, the Denny's brand consisted of 1,720 restaurants, 1,540 of which were franchised/licensed restaurants and 180 of which were company operated.

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 ("GAAP") 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 27, 2017 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 27, 2017. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire fiscal year ending December 26, 2018.

Note 2. Summary of Significant Accounting Policies

Newly Adopted Accounting Standards

Effective December 28, 2017, the first day of fiscal 2018, we adopted Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)" and all subsequent ASUs that modified Topic 606. The new guidance clarifies the principles used to recognize revenue for all entities and requires companies to recognize revenue when it transfers goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled. We elected to apply the modified retrospective method of adoption to those contracts which were not completed as of December 28, 2017. In doing so, we applied the practical expedient to aggregate all contract modifications that occurred before December 28, 2017 in determining the satisfied and unsatisfied performance obligations, the transaction price and the allocation of the transaction price to the satisfied and unsatisfied performance obligations. Results for reporting periods beginning after December 28, 2017 are presented under Topic 606. Prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605 "Revenue Recognition." Our transition to Topic 606 represents a change in accounting principle. See Note 3 for further information about our transition to Topic 606 and the newly required disclosures.

Effective December 28, 2017, we adopted ASU 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities". The new guidance requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires separate presentation of financial assets and financial liabilities by measurement category and form of

financial asset, and eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we adopted ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)”. The new guidance addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we adopted ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business”. The new guidance clarifies the definition of a business. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we adopted ASU 2017-07, “Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost”. The new guidance requires an entity to report the service cost component in the same line on the income statement as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside the subtotal of income from operations, if one is presented. If a separate line item is not used, the line item used in the income statement must be disclosed. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we adopted ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting”. The new update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we early adopted ASU 2018-02, “Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income”. The new guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) and requires certain disclosures about stranded tax effects. Due to the immateriality of the stranded tax effects resulting from the implementation Tax Act, we have elected not to reclassify these amounts from accumulated other comprehensive income to retained earnings. Therefore the adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we early adopted ASU 2018-03, “Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities”. The new update clarifies certain aspects of the guidance issued in ASU 2016-01. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Effective December 28, 2017, we early adopted ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities”. The new update better aligns an entity’s risk management activities and financial reporting for hedging relationships, simplifies the hedge accounting requirements, and improves the disclosures of hedging arrangements. The amended presentation and disclosure guidance has been applied on a prospective basis. The adoption of this guidance did not have any impact on our Consolidated Financial Statements.

Accounting Standards to be Adopted

In February 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-02, “Leases (Topic 842)”, which provides guidance for accounting for leases. The new guidance requires companies to recognize a right-of-use asset and a lease liability for all operating and capital (financing) leases with lease terms greater than 12 months. The FASB has subsequently amended this guidance by issuing ASU 2018-10 in July 2018 to provide clarification and further guidance around areas identified as potential implementation issues. Both standards are effective for annual and interim periods beginning after December 15, 2018 (our fiscal 2019) with early adoption permitted. The guidance will be adopted using a modified retrospective approach.

The adoption of ASU 2016-02 will have a material impact on our Consolidated Balance Sheets resulting from the recognition of operating lease right-of-use assets and liabilities. Although the new guidance is also expected to impact the measurement and presentation of certain expenses and cash flows related to leasing arrangements, we do not believe there will be a material impact to our Consolidated Statements of Income or Consolidated Statements of Cash Flows. We do not expect the recognition of the additional operating lease liabilities will impact any credit facility debt covenants as these liabilities are not considered to be debt.

We have decided to elect the package of practical expedients that do not require us to reassess whether existing contracts are or contain leases, lease classification or initial direct costs. In addition, we have decided not to elect the hindsight practical expedient which would allow us to reassess lease terms and impairment of the right-to-use assets. We have completed the implementation of a new lease management system in preparation for adoption and continue to assess the impact that the new guidance will have on our financial statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”. The new guidance replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform financial statement users of credit loss estimates. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019 (our fiscal 2020) with early adoption permitted for annual and interim periods beginning after December 15, 2018 (our fiscal 2019). We do not expect the adoption of this guidance to have a material impact on our Consolidated Financial Statements.

We reviewed all other newly issued accounting pronouncements and concluded that they are either not applicable to our business or are not expected to have a material effect on our Consolidated Financial Statements as a result of future adoption.

Note 3. Revenues

Our revenues are derived primarily from two sales channels, which we operate as one segment: company restaurants and franchised and licensed restaurants. The following table disaggregates our revenue by sales channels and types of goods or services.

| | Quarter Ended | | Two Quarters Ended | |
|--------------------------------|------------------------|------------------------------|--------------------|------------------------------|
| | June 27, 2018 | June 28, 2017 ⁽¹⁾ | June 27, 2018 | June 28, 2017 ⁽¹⁾ |
| | (Dollars in thousands) | | | |
| Company restaurant sales | \$102,741 | \$98,355 | \$203,934 | \$192,134 |
| Franchise and license revenue: | | | | |
| Royalties | 25,192 | 25,338 | 50,357 | 49,882 |
| Advertising revenue | 19,530 | — | 38,840 | — |
| Initial and other fees | 1,810 | 588 | 3,227 | 1,072 |
| Occupancy revenue | 8,061 | 9,095 | 16,249 | 18,198 |
| Franchise and license revenue | 54,593 | 35,021 | 108,673 | 69,152 |
| Total operating revenue | \$157,334 | \$133,376 | \$312,607 | \$261,286 |

⁽¹⁾ As disclosed in Note 2, prior period amounts have not been adjusted under the modified retrospective method of adoption of Topic 606.

Company Restaurant Revenue

Company restaurant revenue is recognized at the point in time when food and beverage products are sold at company restaurants. We present company restaurant sales net of sales-related taxes collected from customers and remitted to governmental taxing authorities. The adoption of Topic 606 did not impact the recognition of company restaurant sales.

Franchise Revenue

Franchise and license revenues consist primarily of royalties, advertising revenue, initial and other fees and occupancy revenue. Our performance obligations under franchise agreements consist of a license of our brand’s symbolic intellectual property, administration of advertising programs (including local co-operatives), and other ongoing support services. These performance obligations are highly interrelated so we do not consider them to be individually

distinct, and therefore account for them under Topic 606 as a single performance obligation. Revenue from franchise agreements is recognized evenly over the term of the agreement with the exception of sales-based royalties and revenue allocated to goods and services distinct from the franchise right.

Royalty and advertising revenues represent sales-based royalties that are recognized in the period in which the sales occur. Sales-based royalties are variable consideration related to our performance obligations to our franchisees to maintain the intellectual property being licensed. Under our franchise agreements, franchisee advertising contributions must be spent on marketing and related activities. The adoption of Topic 606 did not impact the recognition of royalties. Upon adoption of Topic 606, advertising revenues and expenditures are recorded on a gross basis within the Consolidated Statements of Income. Under the previous guidance of Topic 605, we recorded franchise advertising expense net of contributions from franchisees to our advertising programs, including local co-operatives. While this change materially impacts the gross amount of reported franchise and license revenue and costs of franchise and license revenue, the impact is generally an offsetting increase to both revenue and expense with little, if any, impact on operating income and net income.

Initial and other fees consist of initial, successor and assignment franchise fees (“initial franchise fees”), training fees and other franchise services fees. Initial franchise fees are billed and received upon the signing of the franchise agreement. Under Topic 606, recognition of these fees is deferred until the commencement date of the agreement and occurs over time based on the term of the underlying franchise agreement. In the event a franchise agreement is terminated, any remaining deferred fees are recognized in the period of termination. Under the previous guidance, initial franchise fees were recognized upon the opening of a franchise restaurant. Training and other franchise services fees are billed and recognized at a point in time as services are rendered. Similar to advertising revenue, upon adoption of Topic 606, other franchise services fees are recorded on a gross basis within the Consolidated Statements of Income, whereas, under previous guidance, they were netted against the related expenses.

Occupancy revenue results from leasing or subleasing restaurants to franchisees and is recognized over the term of the lease agreement.

With the exception of initial and other franchise fees, revenues are typically billed and collected on a weekly basis.

Gift Card Breakage

Under previous guidance, we recorded gift card breakage when the likelihood of redemption was remote. Breakage was recorded as a benefit to our advertising fund or reduction to other operating expenses, depending on where the gift cards were sold. Upon adoption of Topic 606, gift card breakage is recognized proportionally as redemptions occur. Our gift card breakage primarily relates to cards sold by third parties. Breakage revenue related to third party sales is recorded as advertising revenue (included as a component of franchise and license revenue) with an offsetting amount recorded as advertising expense (included as a component of costs of franchise and license revenue).

Financial Statement Impact of Adoption

The following tables summarize the impact of adopting Topic 606 on our financial statement line items as of June 27, 2018 and for the quarter and two quarters ended June 27, 2018.

| Consolidated Balance Sheet | Quarter ended June 27, 2018 | | |
|----------------------------------|-----------------------------|-------------|---------------------------------------|
| | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands) | | |
| Prepaid and other current assets | \$12,040 | \$ 509 | \$12,549 |
| Deferred income taxes | 19,333 | (5,141) | 14,192 |
| Other current liabilities | 53,218 | (1,230) | 51,988 |
| Other noncurrent liabilities | 47,831 | (18,138) | 29,693 |
| Deficit | (328,722) | 14,736 | (313,986) |

Edgar Filing: DENNYS CORP - Form 10-Q

| Consolidated Statement of Income | Quarter ended June 27, 2018 | | | Two quarters ended June 27, 2018 | | |
|--|--|--------------|---------------------------------------|----------------------------------|--------------|---------------------------------------|
| | As Reported | Adjustments | Amounts without adoption of Topic 606 | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands, except per share amounts) | | | | | |
| Franchise and license revenue | \$54,593 | \$ (20,949) | \$ 33,644 | \$108,673 | \$ (41,256) | \$ 67,417 |
| Costs of franchise and license revenue | 29,049 | (20,535) | 8,514 | 57,605 | (40,299) | 17,306 |
| Provision for income taxes | 2,578 | (107) | 2,471 | 4,407 | (247) | 4,160 |
| Net income | 11,626 | (307) | 11,319 | 21,385 | (710) | 20,675 |
| Basic net income per share | \$0.18 | \$ 0.00 | \$ 0.18 | \$0.33 | \$ (0.01) | \$ 0.32 |
| Diluted net income per share | \$0.18 | \$ (0.01) | \$ 0.17 | \$0.32 | \$ (0.01) | \$ 0.31 |

| Consolidated Statement of Comprehensive Income | Quarter ended June 27, 2018 | | | Two quarters ended June 27, 2018 | | |
|--|-----------------------------|-------------|---------------------------------------|----------------------------------|-------------|---------------------------------------|
| | As Reported | Adjustments | Amounts without adoption of Topic 606 | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands) | | | | | |
| Net income | \$11,626 | \$ (307) | \$ 11,319 | \$21,385 | \$ (710) | \$ 20,675 |
| Total comprehensive income | 15,016 | (307) | 14,709 | 21,684 | (710) | 20,974 |

| Consolidated Statement of Cash Flow | Two quarters ended June 27, 2018 | | |
|---|----------------------------------|-------------|---------------------------------------|
| | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands) | | |
| Net income | \$21,385 | \$ (710) | \$20,675 |
| Deferred income tax expense | 2,896 | (247) | 2,649 |
| Changes in assets and liabilities: | | | |
| Other current assets | (253) | (509) | (762) |
| Other accrued liabilities | (6,352) | 851 | (5,501) |
| Other noncurrent liabilities | (1,345) | 615 | (730) |
| Net cash flows provided by operating activities | 26,096 | — | 26,096 |

The following significant changes impacted our financial statement line items as of June 27, 2018 and for the quarter and two quarters ended June 27, 2018:

Upon adoption of Topic 606, we recorded a cumulative effect adjustment related to previously recognized initial franchise fees resulting in a \$21.0 million increase to deferred franchise revenue, a \$15.6 million increase to opening deficit and a \$5.4 million increase to deferred tax assets. The deferred franchise revenue resulting from the cumulative effect adjustment will be amortized over the remaining lives of the individual franchise agreements. Also upon adoption, we recorded a cumulative effect adjustment to recognize breakage in proportion to redemptions that

occurred prior to December 28, 2017 resulting in a decrease of \$0.6 million to gift card liability (a component of other current liabilities), a \$0.5 million increase to accrued advertising (a component of other current liabilities) and a \$0.1 million decrease to opening deficit.

We recognized franchise and license revenue and costs of franchise and license revenue of \$19.5 million for the quarter and \$38.8 million year-to-date resulting from the recording of advertising revenues and expenditures on a gross basis under Topic 606 versus recording these amounts on a net basis under Topic 605.

We recognized additional franchise and license revenue of \$0.4 million for the quarter and \$1.0 million year-to-date under Topic 606 than we would have recognized under Topic 605, resulting from the timing of recognition of initial franchise fees.

We recognized franchise and license revenue and costs of franchise and license revenue of \$1.0 million for the quarter and \$1.5 million year-to-date resulting from the recording of other franchise services fees on a gross basis under Topic 606 versus recording these amount on a net basis under Topic 605.

Contract Balances

Contract balances related to contracts with customers consists of receivables, deferred franchise revenue and deferred gift card revenue. See Note 4 for details on our receivables.

Deferred franchise revenue consists primarily of the unamortized portion of initial franchise fees that are currently being amortized into revenue and amounts related to development agreements and unopened restaurants that will begin amortizing into revenue when the related restaurants are opened. Deferred franchise revenue represents our remaining performance obligations to our franchisees, excluding amounts of variable consideration related to sale-based royalties and advertising. The components of the change in deferred franchise revenue are as follows:

| | |
|---|-------------------|
| | (In thousands) |
| Balance, December 27, 2017 | \$ 1,643 |
| Cumulative effect adjustment recognized upon adoption of Topic 606 | 20,976 |
| Fees received from franchisees | 521 |
| Revenue recognized ⁽¹⁾ | (1,710) |
| Balance, June 27, 2018 | 21,430 |
| Less current portion included in other current liabilities | 3,292 |
| Deferred franchise revenue included in other noncurrent liabilities | \$ 18,138 |

(1) Of this amount \$1.7 million was included in either the deferred franchise revenue balance as of December 27, 2017 or the cumulative effect adjustment.

As of June 27, 2018, the deferred franchise revenue expected to be recognized in the future is as follows:

| | |
|---|-------------------|
| | (In thousands) |
| Remainder of 2018 | \$ 1,093 |
| 2019 | 2,107 |
| 2020 | 1,983 |
| 2021 | 1,773 |
| 2022 | 1,665 |
| Thereafter | 11,360 |
| Development agreements and unopened restaurants | 1,449 |
| Deferred franchise revenue | \$ 21,430 |

Deferred gift card liabilities consist of the unredeemed portion of gift cards sold in company restaurants and at third party locations. We recognize gift card revenue when a gift card is redeemed in one of our company restaurants. Gift card breakage is recognized proportionally as redemptions occur. The balance of deferred gift card liabilities represents our remaining performance obligations to our customers. The balance of deferred gift card liabilities as of June 27, 2018 and December 27, 2017 was \$4.5 million and \$6.5 million, respectively. During the two quarters ended June 27, 2018, we recognized revenue of \$1.1 million from gift card redemptions at company restaurants.

Note 4. Receivables

Receivables were comprised of the following:

| | June 27, 2018 | December 27, 2017 |
|--|------------------|----------------------|
| | (In thousands) | |
| Receivables, net: | | |
| Trade accounts receivable from franchisees | \$10,060 | \$ 10,688 |
| Financing receivables from franchisees | 4,046 | 5,084 |
| Vendor receivables | 2,003 | 3,256 |
| Credit card receivables | 1,458 | 1,870 |
| Other | 1,835 | 762 |
| Allowance for doubtful accounts | (427) | (276) |
| Total receivables, net | \$18,975 | \$ 21,384 |
| Other noncurrent assets: | | |
| Financing receivables from franchisees | \$1,329 | \$ 427 |

During the two quarters ended June 27, 2018, we recorded an allowance for doubtful accounts of \$0.2 million of financing receivables from a franchisee.

Note 5. Goodwill and Other Intangible Assets

The following table reflects the changes in carrying amounts of goodwill.

| | (In thousands) |
|----------------------------------|-------------------|
| Balance, December 27, 2017 | \$ 38,269 |
| Additions related to acquisition | 1,574 |
| Balance, June 27, 2018 | \$ 39,843 |

Other intangible assets were comprised of the following:

| | June 27, 2018 | | December 27, 2017 | |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| | (In thousands) | | | |
| Intangible assets with indefinite lives: | | | | |
| Trade names | \$44,082 | \$ — | \$44,080 | \$ — |
| Liquor licenses | 166 | — | 166 | — |
| Intangible assets with definite lives: | | | | |
| Reacquired franchise rights | 20,672 | 4,069 | 15,252 | 2,389 |
| Intangible assets | \$64,920 | \$ 4,069 | \$59,498 | \$ 2,389 |

During the two quarters ended June 27, 2018, we acquired six franchised restaurants for \$8.1 million, of which \$5.4 million was allocated to reacquired franchise rights, \$1.1 million to property and \$1.6 million to goodwill. In addition, we recorded \$2.4 million of capital leases in connection with the acquired franchised restaurants. We account for the

acquisition of franchised restaurants using the acquisition method of accounting for business combinations. The purchase price allocations were based on Level 3 fair value estimates.

Note 6. Other Current Liabilities

Other current liabilities consisted of the following:

| | June 27, December 27, 2018 2017 | |
|--|------------------------------------|-----------|
| | (In thousands) | |
| Accrued payroll | \$ 19,022 | \$ 20,998 |
| Accrued insurance, primarily current portion of liability for insurance claims | 7,194 | 6,922 |
| Accrued taxes | 7,812 | 7,384 |
| Accrued advertising | 4,614 | 8,417 |
| Gift cards | 4,463 | 6,480 |
| Other | 10,113 | 9,045 |
| Other current liabilities | \$ 53,218 | \$ 59,246 |

Note 7. 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 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Software implementation costs | — | 1,544 | \$— | \$ 3,668 |
| (Gains) losses on sales of assets and other, net | (27) | 205 | (64) | (1,235) |
| Restructuring charges and exit costs | 408 | 297 | 768 | 396 |
| Impairment charges | 81 | — | 118 | — |
| Operating (gains), losses and other charges, net | \$ 462 | \$ 2,046 | \$ 822 | \$ 2,829 |

Software implementation costs of \$3.7 million for the two quarters ended June 28, 2017 were the result of our investment in a new cloud-based Enterprise Resource Planning system. Gains on sales of assets and other, net of \$1.2 million for the two quarters ended June 28, 2017 primarily related to real estate sold to a franchisee.

Restructuring charges and exit costs were comprised of the following:

| | Quarter Ended | | Two Quarters Ended | |
|--|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Exit costs | \$ 275 | \$ 295 | \$ 299 | \$ 326 |
| Severance and other restructuring charges | 133 | 2 | 469 | 70 |
| Total restructuring charges and exit costs | \$ 408 | \$ 297 | \$ 768 | \$ 396 |

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

| | (In thousands) |
|--|-------------------|
| Balance, December 27, 2017 | \$ 1,180 |
| Exit costs ⁽¹⁾ | 299 |
| Payments, net of sublease receipts | (316) |
| Interest accretion | 40 |
| Balance, June 27, 2018 | 1,203 |
| Less current portion included in other current liabilities | 519 |
| Long-term portion included in other noncurrent liabilities | \$ 684 |

(1) Included as a component of operating (gains), losses and other charges, net.

As of June 27, 2018 and December 27, 2017, we had accrued severance and other restructuring charges of \$0.2 million and less than \$0.1 million, respectively. The balance as of June 27, 2018 is expected to be paid during the next 12 months.

Note 8. Fair Value of Financial Instruments

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

| | 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) | | | | |
| Fair value measurements as of June 27, 2018: | | | | | |
| Deferred compensation plan investments ⁽¹⁾ | \$ 12,679 | \$ 12,679 | \$ — | \$ — | —market approach |
| Interest rate swaps, net ⁽²⁾ | (1,841) | — | (1,841) | — | income approach |
| Total | \$ 10,838 | \$ 12,679 | \$ (1,841) | \$ — | |
| Fair value measurements as of December 27, 2017: | | | | | |
| Deferred compensation plan investments ⁽¹⁾ | \$ 12,663 | \$ 12,663 | \$ — | \$ — | —market approach |
| Interest rate swaps, net ⁽²⁾ | (2,187) | — | (2,187) | — | income approach |
| Total | \$ 10,476 | \$ 12,663 | \$ (2,187) | \$ — | |

(1) The fair values of our deferred compensation plan investments are based on the closing market prices of the elected investments.

(2) The fair values of our interest rate swaps are based upon Level 2 inputs, which include valuation models as reported by our counterparties. The key inputs for the valuation models are quoted market prices, interest rates and forward yield curves. See Note 9 for details on the interest rate swaps.

Note 9. Long-Term Debt

Denny's and certain of its subsidiaries have a credit facility consisting of a five-year \$400 million senior secured revolver (with a \$30 million letter of credit sublimit). The credit facility includes an accordion feature that would allow us to increase the size of the revolver to \$450 million. As of June 27, 2018, we had outstanding revolver loans of \$282.0 million and outstanding letters of credit under the senior secured revolver of \$20.8 million. These balances resulted in availability of \$97.2 million under the credit facility. Prior to considering the impact of our interest rate swaps, described below, the weighted-average interest rate on outstanding revolver loans was 4.30% and 3.42% as of June 27, 2018 and December 27, 2017, respectively. Taking into consideration our interest rate swaps, the weighted-average interest rate of outstanding revolver loans was 4.57% and 3.32% as of June 27, 2018 and December 27, 2017, respectively.

A commitment fee, which is based on our consolidated leverage ratio, is paid on the unused portion of the credit facility and was 0.35% as of June 27, 2018. Borrowings under the credit facility bear a tiered interest rate, also based on our leverage ratio, and was set at LIBOR plus 225 basis points as of June 27, 2018. The maturity date for the credit facility is October 26, 2022.

The credit facility is available for working capital, capital expenditures and other general corporate purposes. The credit facility is guaranteed by Denny's and its material subsidiaries and is secured by assets of Denny's and its subsidiaries, including the stock of its subsidiaries. It includes negative covenants that are usual for facilities and transactions of this type. The credit facility also includes certain financial covenants with respect to a maximum consolidated leverage ratio and a minimum consolidated fixed charge coverage ratio. We were in compliance with all financial covenants as of June 27, 2018.

Interest Rate Hedges

We have interest rate swaps to hedge a portion of the forecasted cash flows of our floating rate debt. We designated the interest rate swaps as cash flow hedges of our exposure to variability in future cash flows attributable to payments of LIBOR due on forecasted notional amounts.

Under the interest rate swaps, we pay a fixed rate on the notional amount in addition to the current interest rate as determined by our consolidated leverage ratio in effect at the time. A summary of our interest rate swaps as of June 27, 2018 is as follows:

| Trade Date | Effective Date | Maturity Date | Notional Amount (In thousands) | Fixed Rate |
|-------------------|----------------|-------------------|-----------------------------------|------------|
| March 20, 2015 | March 29, 2018 | March 31, 2025 | \$ 120,000 | 2.44 % |
| October 1, 2015 | March 29, 2018 | March 31, 2026 | 50,000 | 2.46 % |
| February 15, 2018 | March 31, 2020 | December 31, 2033 | 80,000 | (1) 3.19 % |

(1) The notional amount of the swaps entered into on February 15, 2018 increases annually beginning September 30, 2020 until they reach the maximum notional amount of \$425.0 million on September 28, 2029.

As of June 27, 2018, the fair value of the interest rate swaps was a net liability of \$1.8 million, which is comprised of assets of \$3.3 million recorded as a component of other noncurrent assets and liabilities of \$5.2 million recorded as a component of other noncurrent liabilities in our Condensed Consolidated Balance Sheets. See Note 14 for the amounts recorded in accumulated other comprehensive loss related to the interest rate swaps.

Note 10. Share-Based Compensation

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

| | Quarter Ended | | Two Quarters Ended | |
|--|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Performance share awards | \$942 | \$ 1,904 | \$2,020 | \$ 3,844 |
| Restricted stock units for board members | 269 | 176 | 541 | 209 |
| Total share-based compensation | \$1,211 | \$ 2,080 | \$2,561 | \$ 4,053 |

Performance Share Units

During the two quarters ended June 27, 2018, we granted certain employees approximately 0.2 million performance share units that vest based on the total shareholder return (“TSR”) of our common stock compared to the TSRs of a group of peer companies and 0.3 million performance share units that vest based on our Adjusted EPS growth rate versus plan, as defined under the terms of the award. As the TSR based performance share units contain a market condition, a Monte Carlo valuation was used to determine the grant date fair value of \$18.17 per share. The performance share units based on the Adjusted EPS growth rate have a grant date fair value of \$15.93 per share, the market value of our common stock on the date of grant. The awards granted to our named executive officers also contain a performance condition based on the attainment of an operating measure for the fiscal year ended December 26, 2018. The performance period for these performance share units is the three year fiscal period beginning December 28, 2017 and ending December 30, 2020. They will vest and be earned (from 0% to 150% of the target award for each such increment) at the end of the performance period.

During the two quarters ended June 27, 2018, we issued 0.2 million shares of common stock related to vested performance share units. In addition 0.3 million shares of common stock were deferred and 0.1 million shares of common stock were withheld in lieu of taxes related to vested performance share units.

As of June 27, 2018, we had approximately \$11.7 million of unrecognized compensation cost related to all unvested performance share awards outstanding, which is expected to be recognized over a weighted average of 2.0 years.

Restricted Stock Units for Board Members

During the two quarters ended June 27, 2018, we granted less than 0.1 million deferred stock units (which are equity classified) with a weighted average grant date fair value of \$15.49 per unit to non-employee members of our Board of Directors. The deferred stock units vest after a one year service period. A director 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 our Board of Directors) or upon termination as a member of our Board of Directors. During the two quarters ended June 27, 2018, 0.2 million deferred stock units were converted into shares of common stock. As of June 27, 2018, we had approximately \$0.8 million of unrecognized compensation cost related to all unvested restricted stock unit awards outstanding, which is expected to be recognized over a weighted average of 0.8 years.

Note 11. Income Taxes

The effective income tax rate was 18.1% for the quarter ended June 27, 2018 and 17.1% for the two quarters ended June 27, 2018 compared to 36.0% and 36.1%, respectively, for the prior year periods. The 2018 periods were impacted by the Tax Act. In addition, the 2018 quarterly and year-to-date rates benefited from a discrete item relating to share-based compensation of 5.2% and 4.6%, respectively. The Tax Act reduces the U.S. statutory tax rate from 35% to 21% for years after 2017. We revalued our deferred taxes during fiscal 2017 to reflect the reduced rate that will apply in future periods when these deferred taxes are realized. The implementation of the Tax Act resulted in certain stranded tax effects in accumulated other comprehensive income. Due to the immateriality of the stranded tax effects, we have elected not to reclassify these amounts from accumulated other comprehensive income to retained earnings.

Note 12. Net Income Per Share

The amounts used for the basic and diluted net income per share calculations are summarized below:

| | Quarter Ended | | Two Quarters Ended | |
|--|--|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands, except for per share amounts) | | | |
| Net income | \$11,626 | \$ 8,749 | \$21,385 | \$17,122 |
| Weighted average shares outstanding - basic | 63,644 | 69,407 | 64,038 | 70,205 |
| Effect of dilutive share-based compensation awards | 2,484 | 2,254 | 2,514 | 2,254 |
| Weighted average shares outstanding - diluted | 66,128 | 71,661 | 66,552 | 72,459 |
| Basic net income per share | \$0.18 | \$0.13 | \$0.33 | \$0.24 |
| Diluted net income per share | \$0.18 | \$0.12 | \$0.32 | \$0.24 |
| Anti-dilutive share-based compensation awards | 1 | 606 | 1 | 606 |

Note 13. Supplemental Cash Flow Information

| | Two Quarters Ended | |
|--|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 |
| | (In thousands) | |
| Income taxes paid, net | \$1,495 | \$2,668 |
| Interest paid | \$9,224 | \$6,718 |
| Noncash investing and financing activities: | | |
| Insurance proceeds receivable | \$282 | \$— |
| Issuance of common stock, pursuant to share-based compensation plans | \$4,619 | \$4,961 |
| Execution of capital leases | \$2,484 | \$4,225 |
| Treasury stock payable | \$— | \$1,394 |
| Notes received in connection with disposition of property | \$— | \$1,750 |

Note 14. Shareholders' Equity

Share Repurchase

Our credit facility permits the purchase of Denny's stock and the payment of cash dividends subject to certain limitations. In October 2017, our Board of Directors approved a share repurchase program authorizing us to repurchase up to \$200 million of our common stock (in addition to prior authorizations). Under this program, we may, from time to time, purchase shares in the open market (including pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934, as amended) or in privately negotiated transactions, subject to market and business conditions.

During the two quarters ended June 27, 2018, we repurchased 1.9 million shares of our common stock for approximately \$28.8 million. This brings the total amount repurchased under the current repurchase program to 2.1 million shares of our common stock for approximately \$32.5 million, leaving approximately \$167.5 million that can be used to repurchase our common stock under this program as of June 27, 2018. Repurchased shares are included as treasury stock in our Condensed Consolidated Balance Sheets and our Condensed Consolidated Statement of Shareholders' Equity.

Accumulated Other Comprehensive Loss

The components of the change in accumulated other comprehensive loss were as follows:

| | Pension | Derivatives | Accumulated Other Comprehensive Loss |
|---|----------------|-------------|---|
| | (In thousands) | | |
| Balance as of December 27, 2017 | \$(982) | \$ (1,334) | \$ (2,316) |
| Amortization of net loss ⁽¹⁾ | 56 | — | 56 |
| Net change in fair value of derivatives | — | 260 | 260 |
| Reclassification of derivatives to interest expense, net ⁽²⁾ | — | 86 | 86 |
| Income tax (expense) benefit related to items of other comprehensive loss | (13) | (90) | (103) |
| Balance as of June 27, 2018 | \$(939) | \$ (1,078) | \$ (2,017) |

(1) Before-tax amount related to our defined benefit plans that was reclassified from accumulated other comprehensive loss and included as a component of pension expense within general and administrative expenses in our Condensed Consolidated Statements of Income during the two quarters ended June 27, 2018.

(2) Amounts reclassified from accumulated other comprehensive loss into income represent payments either received from or made to the counterparty for the effective portions of the interest rate swaps. These amounts are included as a component of interest expense, net in our Condensed Consolidated Statements of Income. We expect to make payments to the counterparty and reclassify approximately \$0.8 million from accumulated other comprehensive loss related to our interest rate swaps during the next twelve months. See Note 9 for additional details.

Note 15. Commitments and Contingencies

We have guarantees related to certain franchisee loans. Payments under these guarantees would result from the inability of a franchisee to fund required payments when due. Through June 27, 2018, no events had occurred that caused us to make payments under these guarantees. There were \$4.2 million and \$5.1 million of loans outstanding under these programs as of June 27, 2018 and December 27, 2017, respectively. As of June 27, 2018, the maximum amount payable under the loan guarantees was \$1.1 million. As a result of these guarantees, we have recorded liabilities of less than \$0.1 million as of both June 27, 2018 and December 27, 2017, which are included as a component of other noncurrent liabilities in our Condensed Consolidated Balance Sheets and other nonoperating expense in our Condensed Consolidated Statements of Income.

There are various claims and pending legal actions against or indirectly involving us, incidental to and arising out of the ordinary course of the business. In the opinion of management, based upon information currently available, the ultimate liability with respect to these proceedings and claims will not materially affect the Company's consolidated results of operations or financial position.

Note 16. 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

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements reflect our best judgment based on factors currently known and are intended to speak only as of the date such statements are made. Forward-looking statements 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. You should consider our forward-looking statements in light of the risks discussed under Part I, Item 1A, "Risk Factors" in our most recent Annual Report on Form 10-K, as well as our consolidated financial statements, related notes, and the other financial information appearing elsewhere in this report and our other filings with the United States Securities and Exchange Commission. While we may elect to update forward-looking statements at some point in the future, we expressly disclaim any obligation to update any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law.

Factors Impacting Comparability

Impact of New Revenue Recognition Standard

Effective December 28, 2017, the first day of fiscal 2018, the Company adopted Accounting Standards Update 2014-09, "Revenue from Contracts with Customers (Topic 606)" and all subsequent ASUs that modified Topic 606 on a modified retrospective basis. Results for reporting periods beginning after December 28, 2017 are presented under Topic 606. Prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605 "Revenue Recognition."

The most significant effects of the new guidance on the comparability of our results of operations between 2018 and 2017 include the following:

Under Topic 606, advertising revenues and expenditures are recorded on a gross basis within the Consolidated Statements of Income. Under the previous guidance of Topic 605, we recorded franchise advertising expense net of contributions from franchisees to our advertising programs, including local co-operatives. While this change materially impacts the gross amount of reported franchise and license revenue and costs of franchise and license revenue, the impact is generally an offsetting increase to both revenue and expense with little, if any, impact on operating income and net income. Similarly, upon adoption, other franchise services fees are recorded on a gross basis within the Consolidated Statements of Income, whereas, under previous guidance, they were netted against the related expenses.

Under Topic 606, recognition of initial franchise fees is deferred until the commencement date of the agreement and occurs over time based on the term of the underlying franchise agreement. In the event a franchise agreement is terminated, any remaining deferred fees are recognized in the period of termination. Under the previous guidance, initial franchise fees were recognized upon the opening of a franchise restaurant. The effect of the required deferral of initial franchise fees received in a given year is mitigated by the recognition of revenue from fees received in prior periods.

Under previous guidance, we recorded gift card breakage when the likelihood of redemption was remote. Breakage was recorded as a benefit to our advertising fund or reduction to other operating expenses, depending on where the gift cards were sold. Under Topic 606, gift card breakage is recognized proportionally as redemptions occur. Our gift card breakage primarily relates to cards sold by third parties. Breakage revenue related to third party sales is recorded as advertising revenue (included as a component of franchise and license revenue) with an offsetting amount recorded

as advertising expense (included as a component of costs of franchise and license revenue).

See Note 2 and Note 3 for information on the implementation of Topic 606 and its impact on our Consolidated Financial Statements.

Edgar Filing: DENNYS CORP - Form 10-Q

Statements of Income

The following table contains information derived from our Condensed Consolidated Statements of Income 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 27, 2018 | | June 28, 2017 | | June 27, 2018 | | June 28, 2017 | |
| | (Dollars in thousands) | | | | | | | |
| Revenue: | | | | | | | | |
| Company restaurant sales | \$102,741 | 65.3 % | \$98,355 | 73.7 % | \$203,934 | 65.2 % | \$192,134 | 73.5 % |
| Franchise and license revenue | 54,593 | 34.7 % | 35,021 | 26.3 % | 108,673 | 34.8 % | 69,152 | 26.5 % |
| Total operating revenue | 157,334 | 100.0 % | 133,376 | 100.0 % | 312,607 | 100.0 % | 261,286 | 100.0 % |
| Costs of company restaurant sales (a): | | | | | | | | |
| Product costs | 25,054 | 24.4 % | 24,769 | 25.2 % | 49,989 | 24.5 % | 47,902 | 24.9 % |
| Payroll and benefits | 41,065 | 40.0 % | 38,492 | 39.1 % | 82,291 | 40.4 % | 75,889 | 39.5 % |
| Occupancy | 5,435 | 5.3 % | 5,503 | 5.6 % | 11,082 | 5.4 % | 10,237 | 5.3 % |
| Other operating expenses | 15,021 | 14.6 % | 12,933 | 13.1 % | 30,071 | 14.7 % | 25,504 | 13.3 % |
| Total costs of company restaurant sales | 86,575 | 84.3 % | 81,697 | 83.1 % | 173,433 | 85.0 % | 159,532 | 83.0 % |
| Costs of franchise and license revenue (a) | 29,049 | 53.2 % | 10,244 | 29.3 % | 57,605 | 53.0 % | 19,990 | 28.9 % |
| General and administrative expenses | 15,597 | 9.9 % | 16,581 | 12.4 % | 32,157 | 10.3 % | 34,090 | 13.0 % |
| Depreciation and amortization | 6,691 | 4.3 % | 5,799 | 4.3 % | 13,205 | 4.2 % | 11,535 | 4.4 % |
| Operating (gains), losses and other charges, net | 462 | 0.3 % | 2,046 | 1.5 % | 822 | 0.3 % | 2,829 | 1.1 % |
| Total operating costs and expenses, net | 138,374 | 87.9 % | 116,367 | 87.2 % | 277,222 | 88.7 % | 227,976 | 87.3 % |
| Operating income | 18,960 | 12.1 % | 17,009 | 12.8 % | 35,385 | 11.3 % | 33,310 | 12.7 % |
| Interest expense, net | 5,385 | 3.4 % | 3,740 | 2.8 % | 10,010 | 3.2 % | 7,281 | 2.8 % |
| Other nonoperating income, net | (629) | (0.4)% | (410) | (0.3)% | (417) | (0.1)% | (767) | (0.3)% |
| Net income before income taxes | 14,204 | 9.0 % | 13,679 | 10.3 % | 25,792 | 8.3 % | 26,796 | 10.3 % |
| Provision for income taxes | 2,578 | 1.6 % | 4,930 | 3.7 % | 4,407 | 1.4 % | 9,674 | 3.7 % |
| Net income | \$11,626 | 7.4 % | \$8,749 | 6.6 % | \$21,385 | 6.8 % | \$17,122 | 6.6 % |
| Other Data: | | | | | | | | |
| Company average unit sales | \$570 | | \$576 | | \$1,135 | | \$1,129 | |
| Franchise average unit sales | \$402 | | \$400 | | \$798 | | \$785 | |
| Company equivalent units (b) | 180 | | 171 | | 179 | | 170 | |
| Franchise equivalent units (b) | 1,543 | | 1,559 | | 1,543 | | 1,560 | |
| Company same-store sales increase (decrease) (c)(d) | (0.1)% | | 2.7 % | | 1.5 % | | 0.6 % | |

Domestic franchise
 same-store sales increase (0.8)% 2.6 % 0.2 % 0.8 %
 (decrease) (c)(d)

- Costs of company restaurant sales percentages are as a percentage of company restaurant sales. Costs of franchise (a) 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 company restaurants or non-consolidated franchised and licensed restaurants that were open the same period in the prior year.
- (d) Prior year amounts have not been restated for 2018 comparable units.

Unit Activity

| | Quarter Ended | | Two Quarters Ended | |
|--|---------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| Company restaurants, beginning of period | 182 | 172 | 178 | 169 |
| Units opened | — | 1 | — | 1 |
| Units acquired from franchisees | 1 | 3 | 6 | 6 |
| Units sold to franchisees | — | (4) | — | (4) |
| Units closed | (3) | — | (4) | — |
| End of period | 180 | 172 | 180 | 172 |
| Franchised and licensed restaurants, beginning of period | 1,542 | 1,559 | 1,557 | 1,564 |
| Units opened | 8 | 7 | 18 | 15 |
| Units purchased from Company | — | 4 | — | 4 |
| Units acquired by Company | (1) | (3) | (6) | (6) |
| Units closed | (9) | (15) | (29) | (25) |
| End of period | 1,540 | 1,552 | 1,540 | 1,552 |
| Total restaurants, end of period | 1,720 | 1,724 | 1,720 | 1,724 |

Company Restaurant Operations

During the quarter ended June 27, 2018, company restaurant sales increased \$4.4 million, or 4.5%, primarily resulting from a nine equivalent unit increase in company restaurants as compared to the prior year period. During the two quarters ended June 27, 2018, company restaurant sales increased \$11.8 million, or 6.1%, primarily resulting from a nine equivalent unit increase in company restaurants as compared to the prior year period and a 1.5% increase in company same-store sales.

Total costs of company restaurant sales as a percentage of company restaurant sales increased to 84.3% for the quarter and 85.0% year-to-date from 83.1% and 83.0%, respectively, in the prior year periods.

Product costs were 24.4% for the quarter and 24.5% year-to-date compared to 25.2% and 24.9%, respectively, for the prior year periods. The decreases were primarily due to leverage gained from increased pricing, partially offset by higher commodity costs.

Payroll and benefits were 40.0% for the quarter and 40.4% year-to-date compared to 39.1% and 39.5%, respectively, in the prior year periods. The increases for both the quarter and year-to-date periods were primarily due to minimum wage increases.

Occupancy costs were 5.3% for the quarter and 5.4% year-to-date compared to 5.6% and 5.3%, respectively, for the prior year period. The decrease for the quarter was primarily due to decreases in rent and property taxes as a percent of sales and decreases in general liability insurance costs. The year-to-date increase was primarily related to increases in general liability insurance costs, as the prior year included \$0.4 million in favorable claims development.

Edgar Filing: DENNYS CORP - Form 10-Q

Other operating expenses were comprised of the following amounts and percentages of company restaurant sales:

| | Quarter Ended | | | Two Quarters Ended | | |
|--------------------------|------------------------|---------------|----------|--------------------|---------------|-------|
| | June 27, 2018 | June 28, 2017 | | June 27, 2018 | June 28, 2017 | |
| | (Dollars in thousands) | | | | | |
| Utilities | \$3,359 | 3.3 % | \$3,053 | 3.1 % | \$6,764 | 3.3 % |
| Repairs and maintenance | 1,887 | 1.8 % | 1,667 | 1.7 % | 3,777 | 1.9 % |
| Marketing | 3,711 | 3.6 % | 3,621 | 3.7 % | 7,476 | 3.7 % |
| Other direct costs | 6,064 | 5.9 % | 4,592 | 4.7 % | 12,054 | 5.9 % |
| Other operating expenses | \$15,021 | 14.6% | \$12,933 | 13.1% | \$30,071 | 14.7% |

The increase in other direct costs was primarily related to increased third party delivery fees related to Denny's On Demand of \$0.7 million for the quarter and \$1.4 million year-to-date.

Franchise Operations

Franchise and license revenue and costs of franchise and license revenue were comprised of the following amounts and percentages of franchise and license revenue for the periods indicated:

| | Quarter Ended | | | Two Quarters Ended | | |
|--|------------------------|---------------|----------|--------------------|---------------|--------|
| | June 27, 2018 | June 28, 2017 | | June 27, 2018 | June 28, 2017 | |
| | (Dollars in thousands) | | | | | |
| Royalties | \$25,192 | 46.1 % | \$25,338 | 72.4 % | \$50,357 | 46.3 % |
| Advertising revenue | 19,530 | 35.8 % | — | — % | 38,840 | 35.7 % |
| Initial and other fees | 1,810 | 3.3 % | 588 | 1.7 % | 3,227 | 3.0 % |
| Occupancy revenue | 8,061 | 14.8 % | 9,095 | 26.0 % | 16,249 | 15.0 % |
| Franchise and license revenue | \$54,593 | 100.0% | \$35,021 | 100.0% | \$108,673 | 100.0% |
| Advertising costs | \$19,530 | 35.8 % | \$588 | 1.7 % | \$38,840 | 35.7 % |
| Occupancy costs | \$5,645 | 10.3 % | \$6,571 | 18.8 % | \$11,474 | 10.6 % |
| Other direct costs | 3,874 | 7.1 % | 3,085 | 8.8 % | 7,291 | 6.7 % |
| Costs of franchise and license revenue | \$29,049 | 53.2 % | \$10,244 | 29.3 % | \$57,605 | 53.0 % |

During the quarter ended June 27, 2018, royalties decreased \$0.1 million, or 0.6%, primarily resulting from a 0.8% decrease in domestic same-store sales and a 16 equivalent unit decrease in franchised and licensed restaurants. During the two quarters ended June 27, 2018, royalties increased \$0.5 million, or 1.0%, primarily resulting from a higher average royalty rate as compared to the prior year period, partially offset by a 17 equivalent unit decrease in franchised and licensed restaurants.

The increases in initial and other fees and advertising revenue primarily resulted from the implementation of Topic 606 related to revenue recognition. We recognized additional franchise and license revenue of \$0.4 million for the quarter and \$1.0 million year-to-date, resulting from the timing of recognition of initial franchise fees under the new guidance. In addition, we recognized other franchise fees of \$1.0 million for the quarter and \$1.5 million year-to-date resulting from the recording of other franchise services fees on a gross basis under the new guidance versus recording these amounts on a net basis as previously presented. Advertising revenue and costs are also now required to be presented on a gross basis, instead of a net basis as previously presented. The decrease in occupancy revenue of \$1.0 million, or 11.4%, for the quarter and \$1.9 million, or 10.7%, year-to-date was primarily the result of lease expirations.

Costs of franchise and license revenue increased \$18.8 million, or 183.6%, for the quarter and \$37.6 million, or 188.2%, year-to-date. These increases were primarily related to the increase in advertising costs related to the implementation of Topic 606, as advertising revenue is no longer netted with advertising expense. Occupancy costs decreased \$0.9 million, or 14.1%, for the quarter and \$1.6 million, or 12.3%, year-to-date primarily resulting from lease expirations. The increase in other direct costs primarily related to the implementation of Topic 606, as certain other franchise expenses are no longer netted with the related fees received from franchisees. As a result, costs of franchise and license revenue as a percentage of franchise and license revenue increased to 53.2% for the quarter from 29.3% for the prior year quarter and 53.0% year-to-date from 28.9% for the prior year period.

Other Operating Costs and Expenses

Other operating costs and expenses such as general and administrative expenses and depreciation and amortization expense relate to both company and franchise operations.

General and administrative expenses were comprised of the following:

| | Quarter Ended | | Two Quarters Ended | |
|---|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Share-based compensation | \$1,211 | \$2,080 | \$2,561 | \$4,053 |
| Other general and administrative expenses | 14,386 | 14,501 | 29,596 | 30,037 |
| Total general and administrative expenses | \$15,597 | \$16,581 | \$32,157 | \$34,090 |

Share-based compensation decreased \$0.9 million for the quarter and \$1.5 million year-to-date primarily resulting from decreases in the expected performance of certain share-based compensation awards. Other general and administrative expenses decreased by \$0.1 million for the quarter and \$0.4 million year-to-date. The decreases for the quarter and year-to-date periods primarily resulted from market valuation changes in our non-qualified deferred compensation plan liabilities. Offsetting losses on the underlying deferred compensation plan investments are included as a component of other non-operating income, net.

Depreciation and amortization was comprised of the following:

| | Quarter Ended | | Two Quarters Ended | |
|---|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Depreciation of property and equipment | \$4,591 | \$4,233 | \$9,071 | \$8,450 |
| Amortization of capital lease assets | 1,018 | 996 | 2,089 | 1,990 |
| Amortization of intangible and other assets | 1,082 | 570 | 2,045 | 1,095 |
| Total depreciation and amortization expense | \$6,691 | \$5,799 | \$13,205 | \$11,535 |

The increase in amortization of intangible and other assets was primarily due to the increase in reacquired franchise rights related to acquisitions of franchised restaurants during the current and prior year.

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

| | Quarter Ended | | Two Quarters Ended | |
|--|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Software implementation costs | — | 1,544 | — | 3,668 |
| (Gains) losses on sales of assets and other, net | (27) | 205 | (64) | (1,235) |
| Restructuring charges and exit costs | 408 | 297 | 768 | 396 |
| Impairment charges | 81 | — | 118 | — |
| Operating (gains), losses and other charges, net | \$462 | \$ 2,046 | \$822 | \$ 2,829 |

Software implementation costs of \$3.7 million for the two quarters ended June 28, 2017 were the result of our investment in a new cloud-based Enterprise Resource Planning system. Gains on sales of assets and other, net of \$1.2 million for the two quarters ended June 28, 2017 primarily related to real estate sold to a franchisee.

Restructuring charges and exit costs were comprised of the following:

| | Quarter Ended | | Two Quarters Ended | |
|---|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Exit costs | \$275 | \$ 295 | \$299 | \$ 326 |
| Severance and other restructuring charges | 133 | 2 | 469 | 70 |
| Total restructuring and exit costs | \$408 | \$ 297 | \$768 | \$ 396 |

Operating income was \$19.0 million for the quarter and \$35.4 million year-to-date compared to \$17.0 million and \$33.3 million, respectively, for the prior year periods.

Interest expense, net was comprised of the following:

| | Quarter Ended | | Two Quarters Ended | |
|--|----------------|---------------|--------------------|---------------|
| | June 27, 2018 | June 28, 2017 | June 27, 2018 | June 28, 2017 |
| | (In thousands) | | | |
| Interest on credit facilities | \$3,021 | \$1,757 | \$5,611 | \$3,255 |
| Interest on interest rate swaps | 226 | 38 | 86 | 146 |
| Interest on capital lease liabilities | 1,570 | 1,423 | 3,174 | 2,816 |
| Letters of credit and other fees | 338 | 303 | 658 | 583 |
| Interest income | (49) | (49) | (78) | (64) |
| Total cash interest | 5,106 | 3,472 | 9,451 | 6,736 |
| Amortization of deferred financing costs | 151 | 149 | 303 | 297 |
| Interest accretion on other liabilities | 128 | 119 | 256 | 248 |
| Total interest expense, net | \$5,385 | \$3,740 | \$10,010 | \$7,281 |

Interest expense, net increased by \$1.6 million for the quarter and \$2.7 million year-to-date primarily due to increases in the balance of our credit facility and related interest rates.

Other nonoperating income, net was \$0.6 million for the quarter and \$0.4 million year-to-date compared to \$0.4 million and \$0.8 million, respectively, for the prior year periods. The income for the 2018 periods related to positive valuation adjustments on our self-insured insurance liabilities, which resulted from an increased discount rate, gains on lease terminations and gains on deferred compensation plan investments. The income for the 2017 periods primarily resulted from gains on deferred compensation plan investments.

Provision for income taxes was \$2.6 million for the quarter and \$4.4 million year-to-date compared to \$4.9 million and \$9.7 million, respectively, for the prior year periods. The effective tax rate was 18.1% for the quarter and 17.1% year-to-date compared to 36.0% and 36.1%, respectively, for the prior year periods. The 2018 periods were impacted by the Tax Act. In addition, the 2018 quarterly and year-to-date rates benefited from a discrete item relating to share-based compensation of 5.2% and 4.6%, respectively. The Tax Act reduces the U.S. statutory tax rate from 35% to 21% for years after 2017. We revalued our deferred taxes during fiscal 2017 to reflect the reduced rate that will apply in future periods when these deferred taxes are realized. The implementation of the Tax Act resulted in certain stranded tax effects in accumulated other comprehensive income. Due to the immateriality of the stranded tax effects, we have elected not to reclassify these amounts from accumulated other comprehensive income to retained earnings. We expect the 2018 fiscal year effective tax rate to be between 16% and 19%. The annual effective tax rate cannot be determined until the end of the fiscal year; therefore, the actual rate could differ from our current estimates.

Net income was \$11.6 million for the quarter and \$21.4 million year-to-date compared with \$8.7 million and \$17.1 million, respectively, for the prior year periods.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash generated from operations and borrowings under our credit facility (as described below). Principal uses of cash are operating expenses, capital expenditures and the repurchase of shares of our common stock.

The following table presents a summary of our sources and uses of cash and cash equivalents for the periods indicated:

| | Two Quarters Ended | |
|---|-----------------------|------------------|
| | June 27, 2018 | June 28, 2017 |
| | (In thousands) | |
| Net cash provided by operating activities | \$26,096 | \$32,818 |
| Net cash used in investing activities | (20,458) | (12,686) |
| Net cash used in financing activities | (6,871) | (21,056) |
| Decrease in cash and cash equivalents | \$(1,233) | \$(924) |

Net cash flows provided by operating activities were \$26.1 million for the two quarters ended June 27, 2018 compared to \$32.8 million for the two quarters ended June 28, 2017. The decrease in cash flows provided by operating activities was primarily due to the reduction in payables and accruals during the two quarters ended June 27, 2018. We believe that our estimated cash flows from operations for 2018, 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 12 months.

Net cash flows used in investing activities were \$20.5 million for the two quarters ended June 27, 2018. These cash flows were primarily comprised of capital expenditures of \$9.5 million, acquisitions of restaurants and real estate of

\$10.4 million and note receivable issuances of \$2.5 million. Cash flows for acquisitions included \$8.1 million for the acquisition of six franchised restaurants, \$1.8 million for real estate and \$0.5 million related to a prior year acquisition. Net cash flows used in investing activities were \$12.7 million for the two quarters ended June 28, 2017. These cash flows were primarily comprised of capital expenditures of \$8.2 million and acquisitions of restaurants and real estate of \$6.9 million. Cash flows for acquisitions in the prior year included \$2.4 million of real estate associated with relocating a high-performing company restaurant due to the impending loss of property control and \$4.5 million for the reacquisition of six franchised restaurants.

Our principal capital requirements have been largely associated with the following:

| | Two Quarters Ended June 27, June 28, 2018 2017 (In thousands) | |
|---|---|----------|
| Facilities | \$4,462 | \$ 3,605 |
| New construction | 808 | 2,400 |
| Remodeling | 865 | 884 |
| Information technology | 1,336 | 221 |
| Other | 2,041 | 1,098 |
| Capital expenditures (excluding acquisitions) | \$9,512 | \$ 8,208 |

Capital expenditures and acquisitions for fiscal 2018 are expected to be approximately \$33 to \$35 million, including the above mentioned acquisition of franchised restaurants, a planned company restaurant opening later in the year, remodels from recent franchise acquisitions, restaurant offsets and on-going maintenance capital.

Cash flows used in financing activities were \$6.9 million for the two quarters ended June 27, 2018, which included cash payments for stock repurchases of \$29.0 million, partially offset by net long-term debt borrowings of \$21.4 million. Cash flows used in financing activities were \$21.1 million for the two quarters ended June 28, 2017, which included cash payments for stock repurchases of \$35.6 million, partially offset by net long-term debt borrowings of \$14.9 million.

Our working capital deficit was \$44.5 million at June 27, 2018 compared to \$53.6 million at December 27, 2017. The decrease in working capital deficit was primarily related to reduction of payables, accrued advertising and gift cards during the two quarters ended June 27, 2018. We are able to operate with a substantial working capital deficit because (1) restaurant operations and most food service operations are conducted primarily on a cash (and cash equivalent) basis with a low level of accounts receivable, (2) rapid turnover allows a limited investment in inventories, and (3) accounts payable for food, beverages and supplies usually become due after the receipt of cash from the related sales.

Credit Facility

As of June 27, 2018, we had outstanding revolver loans of \$282.0 million and outstanding letters of credit under the senior secured revolver of \$20.8 million. These balances resulted in availability of \$97.2 million under the credit facility. The credit facility includes an accordion feature that would allow us to increase the size of the revolver to \$450 million. Prior to considering the impact of our interest rate swaps, described below, the weighted-average interest rate on outstanding revolver loans was 4.30% as of June 27, 2018. Taking into consideration our interest rate swaps, the weighted-average interest rate of outstanding revolver loans was 4.57% as of June 27, 2018.

A commitment fee is paid on the unused portion of the credit facility and was 0.35% as of June 27, 2018. Borrowings under the credit facility bear a tiered interest rate, which is based on our consolidated leverage ratio and was set at LIBOR plus 225 basis points as of June 27, 2018. The maturity date for the credit facility is October 26, 2022.

The credit facility is available for working capital, capital expenditures and other general corporate purposes. The credit facility is guaranteed by Denny's and its material subsidiaries and is secured by assets of Denny's and its subsidiaries, including the stock of its subsidiaries. It includes negative covenants that are usual for facilities and transactions of this type. The credit facility also includes certain financial covenants with respect to a maximum

consolidated leverage ratio and a minimum consolidated fixed charge coverage ratio. We were in compliance with all financial covenants as of June 27, 2018.

Interest Rate Hedges

We have interest rate swaps to hedge a portion of the forecasted cash flows of our floating rate debt. We designated the interest rate swaps as cash flow hedges of our exposure to variability in future cash flows attributable to payments of LIBOR due on forecasted notional debt obligations.

Under the interest rate swaps, we pay a fixed rate on the notional amount in addition to the current interest rate as determined by our consolidated leverage ratio in effect at the time. A summary of our interest rate swaps as of June 27, 2018 is as follows:

| Trade Date | Effective Date | Maturity Date | Notional Amount (In thousands) | Fixed Rate |
|-------------------|----------------|-------------------|-----------------------------------|----------------------|
| March 20, 2015 | March 29, 2018 | March 31, 2025 | \$ 120,000 | 2.44% |
| October 1, 2015 | March 29, 2018 | March 31, 2026 | 50,000 | 2.46% |
| February 15, 2018 | March 31, 2020 | December 31, 2033 | 80,000 | ⁽¹⁾ 3.19% |

⁽¹⁾ The notional amount of the swaps entered into on February 15, 2018 increases annually beginning September 28, 2020 until they reach the maximum notional amount of \$425.0 million on September 26, 2029.

As of June 27, 2018, the fair value of the interest rate swaps was a net liability of \$1.8 million, which is comprised of assets of \$3.3 million recorded as a component of other noncurrent assets and liabilities of \$5.2 million recorded as a component of other noncurrent liabilities in our Condensed Consolidated Balance Sheets.

Implementation of New Accounting Standards

Information regarding the implementation of new accounting standards is incorporated by reference from Note 2 to our unaudited condensed consolidated financial statements set forth in Part I, Item 1 of this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

During the quarter ended June 27, 2018, the previous interest rate swap terminated and two new swaps became effective. As of June 27, 2018, interest rate swaps effectively increased our ratio of fixed rate debt from approximately 10% of total debt to approximately 64% of total debt. We expect to reclassify approximately \$0.8 million from accumulated other comprehensive loss related to our interest rate swaps during the next twelve months. This amount will be included as a component of interest expense in our Condensed Consolidated Statements of Income. For additional information related to our interest rate swaps, including changes in the fair value, refer to Notes 8, 9 and 14 to our unaudited condensed consolidated financial statements in Part I, Item 1 of this report.

With the exception of the items noted above, there have been no material changes in our quantitative and qualitative market risks since the prior reporting period.

Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our management conducted an evaluation (under the supervision and with the participation of our President and Chief Executive Officer, John C. Miller, and our Executive Vice President, Chief Administrative Officer and Chief Financial Officer, F. Mark Wolfinger) as of the end of the period covered by this Quarterly Report on Form 10-Q, of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based on that evaluation, Messrs. Miller and Wolfinger each concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) is accumulated and communicated to our management, including Messrs. Miller and Wolfinger, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during our last fiscal quarter that have

materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding legal proceedings is incorporated by reference from Note 15 to our unaudited condensed consolidated financial statements set forth in Part I, Item 1 of this report.

Item 1A. Risk Factors

There have been no material changes in the risk factors set forth in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 27, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities by the Issuer

The table below provides information concerning repurchases of shares of our common stock during the quarter ended June 27, 2018.

| Period | Total Number of Shares Purchased | Average Price Paid Per Share ⁽¹⁾ | Total | Approximate |
|---------------------------------|--|--|--|--|
| | | | Number of Shares Purchased as Part of Publicly Announced Programs ⁽²⁾ | Dollar Value of Shares that May Yet be Purchased Under the Programs ⁽²⁾ |
| March 29, 2018 - April 25, 2018 | 380 | \$ 16.24 | 380 | \$ 173,950 |
| April 26, 2018 - May 23, 2018 | 275 | 15.92 | 275 | \$ 169,567 |
| May 24, 2018 - June 27, 2018 | 136 | 15.39 | 136 | \$ 167,469 |
| Total | 791 | \$ 15.98 | 791 | |

(1) Average price paid per share excludes commissions.

On October 27, 2017, we announced that our Board of Directors approved a new share repurchase program, authorizing us to repurchase up to an additional \$200 million of our common stock (in addition to prior authorizations). Such repurchases may take place from time to time in the open market (including pre-arranged (2) stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Exchange Act) or in privately negotiated transactions, subject to market and business conditions. During the quarter ended June 27, 2018, we purchased 791,119 shares of our common stock for an aggregate consideration of approximately \$12.7 million pursuant to the share repurchase program.

Item 6. Exhibits

The following are included as exhibits to this report:

| Exhibit No. | Description |
|----------------|---|
| 31.1 | <u>Certification of John C. Miller, President and Chief Executive Officer of Denny's Corporation, pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | <u>Certification of F. Mark Wolfinger, Executive Vice President, Chief Administrative Officer and Chief Financial Officer of Denny's Corporation, pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1 | <u>Certification of John C. Miller, President and Chief Executive Officer of Denny's Corporation, and F. Mark Wolfinger, Executive Vice President, Chief Administrative Officer and Chief Financial Officer of Denny's Corporation, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |

31

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DENNY'S CORPORATION

Date: July 30, 2018 By: /s/ F. Mark Wolfinger
F. Mark Wolfinger
Executive Vice President,
Chief Administrative Officer and
Chief Financial Officer

Date: July 30, 2018 By: /s/ Jay C. Gilmore
Jay C. Gilmore
Vice President,
Chief Accounting Officer and
Corporate Controller