DENNYS CORP
Form 10-Q
October 30, 2018

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

FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 26, 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 incorporation or organization | (I.R.S. Employer Identification No.) |

203 East Main Street
Spartanburg, South Carolina 29319-0001
(Address of principal executive offices)
(Zip Code)

(864) 597-8000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).
Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 filer | þ | Accelerated filer | ¨ | Non-accelerated filer | ¨ | Smaller reporting company | ¨ | Emerging growth 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 þ

As of October 24, 2018, 62,587,274 shares of the registrant’s common stock, par value $0.01 per share, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | September 26, 2018 | December 27, 2017 |
|---|---|---|
| | (In thousands) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,871 | $ 4,983 |
| Investments | 1,709 | — |
| Receivables, net | 17,186 | 21,384 |
| Inventories | 3,051 | 3,134 |
| Assets held for sale | 193 | — |
| Prepaid and other current assets | 10,495 | 11,788 |
| Total current assets | 34,505 | 41,289 |
| Property, net of accumulated depreciation of $248,062 and $243,325, respectively | 143,459 | 139,856 |
| Goodwill | 39,843 | 38,269 |
| Intangible assets, net | 59,907 | 57,109 |
| Deferred financing costs, net | 2,487 | 2,942 |
| Deferred income taxes | 15,595 | 16,945 |
| Other noncurrent assets | 32,962 | 27,372 |
| Total assets | $ 328,758 | $ 323,782 |
| | | |
| Liabilities | | |
| Current liabilities: | | |
| Current maturities of capital lease obligations | $ 3,282 | $ 3,168 |
| Accounts payable | 20,327 | 32,487 |
| Other current liabilities | 53,911 | 59,246 |
| Total current liabilities | 77,520 | 94,901 |
| Long-term liabilities: | | |
| Long-term debt, less current maturities | 278,000 | 259,000 |
| Capital lease obligations, less current maturities | 27,305 | 27,054 |
| Liability for insurance claims, less current portion | 12,025 | 12,236 |
| Other noncurrent liabilities | 43,888 | 27,951 |
| Total long-term liabilities | 361,218 | 326,241 |
| Total liabilities | 438,738 | 421,142 |
| | | |
| Commitments and contingencies | | |
| | | |
| Shareholders' equity (deficit) | | |
| Common stock $0.01 par value; shares authorized - 135,000; September 27, 2018: 108,493 shares issued and 62,905 shares outstanding; December 27, 2017: 107,740 shares issued and 64,589 shares outstanding | $ 1,085 | $ 1,077 |
| Paid-in capital | 597,344 | 594,166 |
| Deficit | (317,917 ) | (334,661 ) |

| | | |
|---|---|---|
| Accumulated other comprehensive income (loss), net of tax | 2,541 | (2,316 ) |
| Shareholders’ equity before treasury stock | 283,053 | 258,266 |
| Treasury stock, at cost, 45,588 and 43,151 shares, respectively | (393,033 ) | (355,626 ) |
| Total shareholders' deficit | (109,980 ) | (97,360 ) |
| Total liabilities and shareholders' deficit | $328,758 | $ 323,782 |

See accompanying notes

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

| | Quarter Ended | | Three Quarters Ended | |
|---|---|---|---|---|
| | September 26, 2018 | September 27, 2017 | September 26, 2018 | September 27, 2017 |
| | (In thousands, except per share amounts) | | | |
| Revenue: | | | | |
| Company restaurant sales | $103,609 | $ 97,915 | $307,543 | $ 290,049 |
| Franchise and license revenue | 54,414 | 34,469 | 163,087 | 103,621 |
| Total operating revenue | 158,023 | 132,384 | 470,630 | 393,670 |
| Costs of company restaurant sales: | | | | |
| Product costs | 25,303 | 24,896 | 75,292 | 72,798 |
| Payroll and benefits | 41,041 | 37,332 | 123,332 | 113,221 |
| Occupancy | 6,083 | 5,054 | 17,165 | 15,291 |
| Other operating expenses | 15,419 | 14,040 | 45,490 | 39,544 |
| Total costs of company restaurant sales | 87,846 | 81,322 | 261,279 | 240,854 |
| Costs of franchise and license revenue | 28,174 | 9,493 | 85,779 | 29,483 |
| General and administrative expenses | 15,981 | 16,446 | 48,138 | 50,536 |
| Depreciation and amortization | 6,760 | 5,958 | 19,965 | 17,493 |
| Operating (gains), losses and other charges, net | 793 | 630 | 1,615 | 3,459 |
| Total operating costs and expenses, net | 139,554 | 113,849 | 416,776 | 341,825 |
| Operating income | 18,469 | 18,535 | 53,854 | 51,845 |
| Interest expense, net | 5,314 | 4,067 | 15,324 | 11,348 |
| Other nonoperating income, net | (460) | (286) | (877) | (1,053) |
| Net income before income taxes | 13,615 | 14,754 | 39,407 | 41,550 |
| Provision for income taxes | 2,810 | 5,429 | 7,217 | 15,103 |
| Net income | $10,805 | $ 9,325 | $32,190 | $ 26,447 |
| | | | | |
| Basic net income per share | $0.17 | $ 0.14 | $0.50 | $ 0.38 |
| Diluted net income per share | $0.16 | $ 0.13 | $0.49 | $ 0.37 |
| | | | | |
| Basic weighted average shares outstanding | 63,246 | 66,873 | 63,774 | 69,095 |
| Diluted weighted average shares outstanding | 65,522 | 69,210 | 66,122 | 71,377 |

See accompanying notes

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

| | Quarter Ended | | Three Quarters Ended | |
|---|---|---|---|---|
| | September 26, 2018 | September 27, 2017 | September 26, 2018 | September 27, 2017 |
| | (In thousands) | | | |
| Net income | $ 10,805 | $ 9,325 | $ 32,190 | $ 26,447 |
| Other comprehensive income, net of tax: | | | | |
| Minimum pension liability adjustment, net of tax of $7, $9, $20 and $27, respectively | 21 | 14 | 64 | 42 |
| Recognition of unrealized gain (loss) on hedge transactions, net of tax of $1,583, $133, $1,673 and $(1,249), respectively | 4,537 | 209 | 4,793 | (1,958) |
| Other comprehensive income (loss) | 4,558 | 223 | 4,857 | (1,916) |
| Total comprehensive income | $ 15,363 | $ 9,548 | $ 37,047 | $ 24,531 |

See accompanying notes

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

| | Common Stock | | Treasury Stock | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Paid-in Capital | Deficit | Accumulated Other Comprehensive Income (Loss), Net | Total Shareholders’ Deficit |
| | (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 | — | — | — | — | — | 32,190 | — | 32,190 |
| Other comprehensive income | — | — | — | — | — | — | 4,857 | 4,857 |
| Share-based compensation on equity classified awards, net | — | — | — | — | 2,128 | — | — | 2,128 |
| Purchase of treasury stock | — | — | (2,437) | (37,407) | — | — | — | (37,407) |
| Issuance of common stock for share-based compensation | 447 | 5 | — | — | (5) | — | — | — |
| Exercise of common stock options | 306 | 3 | — | — | 1,055 | — | — | 1,058 |
| Balance, September 26, 2018 | 108,493 | $ 1,085 | (45,588) | $ (393,033) | $ 597,344 | $ (317,917) | $ 2,541 | $ (109,980) |

See accompanying notes

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

| | Three Quarters Ended September 26, 2018 | | | September 27, 2017 | | |
|---|---|---|---|---|---|---|
| | (In thousands) | | | | | |
| Cash flows from operating activities: | | | | | | |
| Net income | $ | 32,190 | | $ | 26,447 | |
| Adjustments to reconcile net income to cash flows provided by operating activities: | | | | | | |
| Depreciation and amortization | 19,965 | | | 17,493 | | |
| Operating (gains), losses and other charges, net | 1,615 | | | 3,459 | | |
| Amortization of deferred financing costs | 455 | | | 446 | | |
| (Gain) loss on early extinguishments of debt and leases | (159 | | ) | 68 | | |
| Deferred income tax expense | 5,044 | | | 9,936 | | |
| Share-based compensation | 3,661 | | | 6,546 | | |
| Changes in assets and liabilities: | | | | | | |
| Decrease (increase) in assets: | | | | | | |
| Receivables | 3,582 | | | 3,279 | | |
| Inventories | 83 | | | (55 | | ) |
| Other current assets | 1,292 | | | 834 | | |
| Other assets | (565 | | ) | (5,068 | | ) |
| Increase (decrease) in liabilities: | | | | | | |
| Accounts payable | (11,948 | | ) | (5,121 | | ) |
| Accrued salaries and vacations | (858 | | ) | (9,094 | | ) |
| Accrued taxes | 1,974 | | | 1,474 | | |
| Other accrued liabilities | (7,733 | | ) | (4,834 | | ) |
| Other noncurrent liabilities | (2,339 | | ) | (2,285 | | ) |
| Net cash flows provided by operating activities | 46,259 | | | 43,525 | | |
| Cash flows from investing activities: | | | | | | |
| Capital expenditures | (17,294 | | ) | (13,558 | | ) |
| | (10,416 | | ) | (10,043 | | ) |

| | | | | |
|---|---|---|---|---|
| Acquisition of restaurants and real estate | | | | |
| Proceeds from disposition of property | 969 | | 2,318 | |
| Investment purchases | (1,709 | ) | — | |
| Collections on notes receivable | 2,478 | | 3,773 | |
| Issuance of notes receivable | (2,525 | ) | (2,278 | ) |
| Net cash flows used in investing activities | (28,497 | ) | (19,788 | ) |
| Cash flows from financing activities: | | | | |
| Revolver borrowings | 91,000 | | 105,900 | |
| Revolver payments | (72,000 | ) | (62,600 | ) |
| Long-term debt payments | (2,429 | ) | (2,467 | ) |
| Proceeds from exercise of stock options | 1,058 | | 173 | |
| Tax withholding on share-based payments | (1,714 | ) | — | |
| Purchase of treasury stock | (37,108 | ) | (65,951 | ) |
| Net bank overdrafts | 319 | | 279 | |
| Net cash flows used in financing activities | (20,874 | ) | (24,666 | ) |
| Decrease in cash and cash equivalents | (3,112 | ) | (929 | ) |
| Cash and cash equivalents at beginning of period | 4,983 | | 2,592 | |
| Cash and cash equivalents at end of period | $ 1,871 | | $ 1,663 | |

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 September 26, 2018, the Denny's brand consisted of 1,715 restaurants, 1,534 of which were franchised/licensed restaurants and 181 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 a company 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 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 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 of the 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 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.

Effective September 26, 2018, we early adopted ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement”, which modifies the disclosure requirements on fair value measurements. The adoption of this guidance did not have any impact on our disclosures.

Effective September 26, 2018, we early adopted ASU 2018-14, “Compensation—Retirement Benefits—Defined Benefit Plans—General (Topic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans”, which modifies the disclosure requirements for defined benefit pension plans and other postretirement plans. The adoption of this guidance will have an immaterial impact on our annual disclosures.

Effective September 26, 2018, we early adopted ASU 2018-15, “Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force)”, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The guidance was adopted on a prospective basis and did not have a material impact on our Consolidated Financial Statements.

Additional new accounting guidance became effective for us as of December 28, 2017 that we reviewed and concluded was either not applicable to our operations or had no material effect on the our Consolidated Financial Statements and related disclosures.

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 and ASU 2018-11 in July 2018 to provide clarification and further guidance around areas identified as potential implementation issues and to allow an alternative transition method. The alternative transition method allows entities to initially apply the new leases standard at the adoption date by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than retroactive restatement of all periods presented. All of the 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 the alternative transition method.

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 | | Three Quarters Ended | |
|---|---|---|---|---|
| | September 26, 2018 | September 27, 2017 (1) | September 26, 2018 | September 27, 2017 (1) |
| | (Dollars in thousands) | | | |
| Company restaurant sales | $103,609 | $97,915 | $307,543 | $290,049 |
| Franchise and license revenue: | | | | |
| Royalties | 25,518 | 25,174 | 75,875 | 75,056 |
| Advertising revenue | 19,546 | — | 58,386 | — |
| Initial and other fees | 1,415 | 507 | 4,642 | 1,579 |
| Occupancy revenue | 7,935 | 8,788 | 24,184 | 26,986 |
| Franchise and license revenue | 54,414 | 34,469 | 163,087 | 103,621 |
| Total operating revenue | $158,023 | $132,384 | $470,630 | $393,670 |

(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.

Under franchise agreements we provide franchisees with a license of our brand's symbolic intellectual property, administration of advertising programs (including local co-operatives), and other ongoing support functions. These services are highly interrelated so we do not consider them to be individually distinct performance obligations, 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.

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 obligation 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"). 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.

Initial and other fees also includes revenue that are distinct from the franchise agreement and are separate performance obligations. 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).

Financial Statement Impact of Adoption

The following tables summarize the impact of adopting Topic 606 on our financial statement line items as of September 26, 2018 and for the quarter and three quarters ended September 26, 2018.

| | Quarter ended September 26, 2018 | | |
|---|---|---|---|
| Consolidated Balance Sheet | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands) | | |
| Prepaid and other current assets | $10,495 | $ 509 | $11,004 |
| Deferred income taxes | 15,595 | (5,040) | 10,555 |
| Other current liabilities | 53,911 | (360) | 53,551 |
| Other noncurrent liabilities | 43,888 | (18,618) | 25,270 |
| Deficit | (317,917) | 14,447 | (303,470) |

| Consolidated Statement of Income | Quarter ended September 26, 2018 | | | Three quarters ended September 26, 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 | $54,414 | $ (20,397) | $34,017 | $163,087 | $ (61,653) | $101,434 |
| Costs of franchise and license revenue | 28,174 | (20,007) | 8,167 | 85,779 | (60,306) | 25,473 |
| Provision for income taxes | 2,810 | (101) | 2,709 | 7,217 | (348) | 6,869 |
| Net income | 10,805 | (289) | 10,516 | 32,190 | (999) | 31,191 |
| Basic net income per share | $0.17 | $ — | $0.17 | $0.50 | $ (0.01) | $0.49 |
| Diluted net income per share | $0.16 | $ — | $0.16 | $0.49 | $ (0.02) | $0.47 |

| Consolidated Statement of Comprehensive Income | Quarter ended September 26, 2018 | | | Three quarters ended September 26, 2018 | | |
|---|---|---|---|---|---|---|
| | As Reported | Adjustments | Amounts without adoption of Topic 606 | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands) | | | | | |
| Net income | $10,805 | $ (289) | $10,516 | $32,190 | $ (999) | $31,191 |
| Total comprehensive income | 15,363 | (289) | 15,074 | 37,047 | (999) | 36,048 |

| Consolidated Statement of Cash Flow | Three quarters ended September 26, 2018 | | |
|---|---|---|---|
| | As Reported | Adjustments | Amounts without adoption of Topic 606 |
| | (In thousands) | | |
| Net income | $32,190 | $ (999) | $31,191 |
| Deferred income tax expense | 5,044 | (348) | 4,696 |
| Changes in assets and liabilities: | | | |
| Other current assets | 1,292 | (509) | 783 |
| Other accrued liabilities | (7,733) | 621 | (7,112) |
| Other noncurrent liabilities | (2,339) | 1,235 | (1,104) |
| Net cash flows provided by operating activities | 46,259 | — | 46,259 |

The following significant changes impacted our financial statement line items as of September 26, 2018 and for the quarter and three quarters ended September 26, 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 $58.4 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 $1.4 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 $0.5 million for the quarter and $1.9 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 sales-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 | 795 |
| Revenue recognized [1] | (2,628 ) |
| Balance, September 26, 2018 | 20,786 |
| Less current portion included in other current liabilities | 2,168 |
| Deferred franchise revenue included in other noncurrent liabilities | $ 18,618 |

(1) Of this amount $2.6 million was included in either the deferred franchise revenue balance as of December 27, 2017 or the cumulative effect adjustment.

As of September 26, 2018, the deferred franchise revenue expected to be recognized in the future is as follows:

| | (In thousands) |
|---|---|
| Remainder of 2018 | $ 546 |
| 2019 | 2,114 |
| 2020 | 1,967 |
| 2021 | 1,783 |
| 2022 | 1,675 |
| Thereafter | 12,701 |
| Deferred franchise revenue | $ 20,786 |

Deferred gift card liabilities consist of the unredeemed portion of gift cards sold in company restaurants and at third party locations. We recognize 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 September 26, 2018 and December 27, 2017 was $4.1 million and $6.5 million, respectively. During the three quarters ended September 26, 2018, we recognized revenue of $1.4 million from gift card redemptions at company restaurants.

Note 4. Receivables

Receivables were comprised of the following:

| | September 26, 2018 | December 27, 2017 |
|---|---|---|
| | (In thousands) | |
| Receivables, net: | | |
| Trade accounts receivable from franchisees | $9,267 | $ 10,688 |
| Financing receivables from franchisees | 3,559 | 5,084 |
| Vendor receivables | 2,039 | 3,256 |
| Credit card receivables | 1,030 | 1,870 |
| Other | 1,566 | 762 |
| Allowance for doubtful accounts | (275 ) | (276 ) |
| Total receivables, net | $17,186 | $ 21,384 |
| | | |
| Other noncurrent assets: | | |
| Financing receivables from franchisees | $1,110 | $ 427 |

During the three quarters ended September 26, 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 acquisitions | 1,574 |
| Balance, September 26, 2018 | $ 39,843 |

Other intangible assets were comprised of the following:

| | September 26, 2018 | | December 27, 2017 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| | (In thousands) | | | |
| Intangible assets with indefinite lives: | | | | |
| Trade names | $44,087 | $ — | $44,080 | $ — |
| Liquor licenses | 166 | — | 166 | — |
| Intangible assets with definite lives: | | | | |
| Reacquired franchise rights | 20,121 | 4,467 | 15,252 | 2,389 |
| Intangible assets, net | $64,374 | $ 4,467 | $59,498 | $ 2,389 |

During the three quarters ended September 26, 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:

| | September 26, 2018 | December 27, 2017 |
|---|---|---|
| | (In thousands) | |
| Accrued payroll | $ 20,214 | $ |