LACROSSE FOOTWEAR INC
Form 10-Q
July 22, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 28, 2008

or

o **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 0-238001

LaCrosse Footwear, Inc.

(Exact name of Registrant as specified in its charter)

Wisconsin	**39-1446816**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

17634 NE Airport Way
Portland, Oregon 97230

(Address, zip code of principal executive offices)

(503) 262-0110

(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 o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company þ
		(Do not check if a smaller reporting company)	

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, $.01 par value, outstanding as of July 21, 2008: 6,222,484 shares

LACROSSE FOOTWEAR, INC.
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PART I CONDENSED CONSOLIDATED FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

LACROSSE FOOTWEAR, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)	June 28, 2008 *(unaudited)*	December 31, 2007	June 30, 2007 *(unaudited)*
Assets:			
Current Assets:			
Cash and cash equivalents	$ 13,268	$ 15,385	$ 13,854
Trade and other accounts receivable, net	19,597	22,593	18,254
Inventories (Note 2)	26,343	27,131	27,094
Prepaid expenses	1,177	1,068	1,150
Deferred tax assets	1,259	1,201	1,366
Total current assets	61,644	67,378	61,718
Property and equipment, net	4,761	4,963	5,165
Goodwill	10,753	10,753	10,753
Other assets	432	453	465
Total assets	$ 77,590	$ 83,547	$ 78,101
Liabilities and Shareholders Equity:			
Current Liabilities:			
Accounts payable	$ 7,517	$ 7,456	$ 10,176
Accrued compensation	2,076	3,324	1,760
Other accruals	1,962	1,982	1,777
Total current liabilities	11,555	12,762	13,713
Long-term debt	338	394	450
Deferred revenue	113	131	150
Compensation and benefits (Note 6)	1,702	1,993	3,593
Deferred tax liabilities	2,380	2,282	1,338
Total liabilities	16,088	17,562	19,244
Shareholders Equity:			
Common stock, par value $.01 per share; authorized 50,000,000 shares; issued 6,717,627 shares	67	67	67
Additional paid-in capital	27,845	27,473	26,903
Accumulated other comprehensive loss	(1,011)	(1,011)	(1,684)
Retained earnings (Note 7)	36,781	42,328	36,609
	(2,180)	(2,872)	(3,038)

Less cost of 495,768, 600,362 and 621,872 shares of treasury stock, respectively						
Total shareholders equity		61,502		65,985		58,857
Total liabilities and shareholders equity	$	77,590	$	83,547	$	78,101

See notes to interim unaudited condensed consolidated financial statements.

LACROSSE FOOTWEAR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	Quarter Ended		First Half Year Ended	
(in thousands, except per share data)	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Net sales	$ 27,810	$ 24,929	$ 52,542	$ 48,619
Cost of goods sold	16,568	15,160	31,239	29,240
Gross profit	11,242	9,769	21,303	19,379
Selling and administrative expenses	8,938	8,335	17,906	17,114
Operating income	2,304	1,434	3,397	2,265
Non-operating income (expense)	(48)	93	111	213
Income before income taxes	2,256	1,527	3,508	2,478
Income tax expense (Note 4)	820	551	1,293	898
Net income	$ 1,436	$ 976	$ 2,215	$ 1,580
Net income per common share (Note 1):				
Basic	$ 0.23	$ 0.16	$ 0.36	$ 0.26
Diluted	$ 0.22	$ 0.15	$ 0.35	$ 0.25
Weighted average number of common shares outstanding:				
Basic	6,217	6,082	6,191	6,069
Diluted	6,400	6,349	6,405	6,323

See notes to interim unaudited condensed consolidated financial statements.

LACROSSE FOOTWEAR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	First Half Year Ended	
(in thousands)	June 28, 2008	June 30, 2007
Cash flows from operating activities:		
Net income	$ 2,215	$ 1,580
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	896	854
Loss on disposal of property and equipment	2	65
Stock-based compensation expense (Note 5)	332	295
Deferred income taxes	40	(93)
Changes in operating assets and liabilities:		
Trade and other accounts receivable	2,996	1,658
Inventories	788	(5,056)
Accounts payable	61	4,749
Accrued expenses and other	(1,668)	(1,691)
Net cash provided by operating activities	5,662	2,361
Cash flows from investing activities:		
Purchases of property and equipment	(749)	(706)
Cash flows from financing activities:		
Cash dividends paid (Note 7)	(7,762)	(914)
Purchase of treasury stock	(95)	
Proceeds from exercise of stock options	827	411
Net cash used in financing activities	(7,030)	(503)
Net increase (decrease) in cash and cash equivalents	(2,117)	1,152
Cash and cash equivalents:		
Beginning of period	15,385	12,702
End of period	$ 13,268	$ 13,854
Supplemental information:		
Cash payments for income taxes	$ 1,237	$ 877

See notes to interim unaudited condensed consolidated financial statements.

LACROSSE FOOTWEAR, INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements

NOTE 1. INTERIM FINANCIAL REPORTING

Basis of Presentation LaCrosse Footwear, Inc. (NASDAQ: BOOT) is referred to as we , us , or our in this report. Th accompanying condensed consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, we have condensed or omitted certain information and footnote disclosures that are included in our annual financial statements. These condensed unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the year ended December 31, 2007. These condensed consolidated financial statements reflect, in the opinion of management, all adjustments (which consist of normal, recurring adjustments) necessary for a fair presentation of the financial position and results of operations and cash flows for the periods presented.

These condensed consolidated financial statements include the accounts of LaCrosse Footwear, Inc., and our wholly owned subsidiaries, Danner, Inc., and LaCrosse International, Inc. All material inter-company accounts and transactions have been eliminated in consolidation.

We report our quarterly interim financial information based on 13-week periods. The nature of the 13-week calendar requires that all periods end on a Saturday, and that the year end on December 31. As a result, every first quarter and every fourth quarter have a unique number of days. The results of the interim periods are not necessarily indicative of the results for the full year. Historically, our net sales and operating income have been more heavily weighted to the second half of the year. For the quarters and first half years ended June 28, 2008 and June 30, 2007, comprehensive income was the same as net income.

Use of Estimates We are required to make certain estimates and assumptions which affect the amounts of assets, liabilities, revenues and expenses we have reported, and our disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ materially from these estimates and assumptions.

Net Income per Common Share We present our net income on a per share basis for both basic and diluted common shares. Basic net income per common share excludes all dilutive stock options and is computed using the weighted average number of common shares outstanding during the period. The diluted net income per common share calculation assumes that all stock options were exercised or converted into common stock at the beginning of the period, unless their effect would be anti-dilutive. A reconciliation of the shares used in the basic and diluted net income per common share is as follows:

	Quarter Ended		First Half Year Ended	
(in thousands)	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Basic weighted average shares outstanding	6,217	6,082	6,191	6,069
Dilutive stock options	183	267	214	254
Diluted weighted average shares outstanding	6,400	6,349	6,405	6,323

NOTE 2. INVENTORIES
A summary of inventories is presented below:

(in thousands)	June 28, 2008	December 31, 2007	June 30, 2007
Raw materials	$ 1,907	$ 1,691	$ 1,446
Work in process	249	183	232
Finished goods	24,707	25,631	26,273
Subtotal	26,863	27,505	27,951
Less: provision for slow-moving inventory	(520)	(374)	(857)
Total	$ 26,343	$ 27,131	$ 27,094

NOTE 3. PRODUCT WARRANTY
We provide a limited warranty for the replacement of defective products. Our limited warranty requires us to repair or replace defective products at no cost to the consumer within a specified time period after sale. We estimate the costs that may be incurred under our limited warranty and record a liability in the amount of such costs at the time product revenue is recognized. Factors that affect our estimate of warranty liability include sales volume, and historical and anticipated future rates of warranty claims. Changes in the accrued product warranty costs during the quarters and first half years ended June 28, 2008 and June 30, 2007, which are included in other accruals on our balance sheet, are summarized as follows:

	Quarter Ended		First Half Year Ended	
(in thousands)	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Balance, beginning of period	$ 1,020	$ 772	$ 941	$ 772
Accruals for products sold	574	487	1,330	1,109
Warranty claims	(497)	(422)	(1,174)	(1,044)
Balance, end of period	$ 1,097	$ 837	$ 1,097	$ 837

NOTE 4. INCOME TAXES
On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we refine our estimate based on the facts and circumstances by each tax jurisdiction. The effective tax rate for the quarters ended June 28, 2008 and June 30, 2007 were 36.3% and 36.1%, respectively. The year to date effective tax rates for the first half years ended June 28, 2008 and June 30, 2007 were 36.9% and 36.2%, respectively. The increase in the tax rate from 2007 is primarily due to federal research and experimentation credits which have not yet been enacted beyond 2007.
Effective January 1, 2007, we adopted FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. On adoption, we recognized a $10,000 reduction in our liability for unrecognized tax benefits, which was accounted for as an adjustment to the January 1, 2007 retained earnings balance. At June 28, 2008, we had $218,000 of net uncertain tax benefit positions that would reduce the company s effective income tax rate if recognized. Due to statute expiration, a decrease could occur with respect to our FIN 48 reserve of less than $100,000 in the next twelve months. This reserve, including associated interest, relates to federal and state research tax credits taken in prior years. Our policy is to accrue interest related to potential underpayment of income taxes within the provision for income taxes. The liability for accrued interest as of June 28, 2008, December 31, 2007, and as of the adoption of FIN 48 was

$37,000, $30,000 and $18,000, respectively. Interest is computed on the difference between our uncertain tax benefit positions under FIN 48 and the amount deducted or expected to be deducted in our tax returns.

We file a consolidated U.S. federal income tax return as well as state tax returns on a consolidated, combined, or stand-alone basis (depending upon the jurisdiction). We are no longer subject to U.S. federal income tax examinations by tax authorities for years prior to the tax year ended December 2003. Depending on the jurisdiction, we are no longer subject to state examinations by tax authorities for years prior to the December 2002 and 2003 tax years.

NOTE 5. STOCK-BASED COMPENSATION

We recognized $0.3 million of stock-based compensation expense for each of the first half year periods ended June 28, 2008 and June 30, 2007. To calculate the stock-based compensation expense under SFAS 123R, we use the Black-Scholes option-pricing model. Our determination of fair value of option-based awards on the date of grant using the Black-Scholes model is affected by various assumptions regarding certain subjective variables. These variables include, but are not limited to, our expected dividend yield, our expected stock price volatility over the expected term of the awards, the risk-free interest rates, the estimated forfeiture rates, and the expected life of the options. The risk-free interest rate assumption is based on treasury instruments whose terms are consistent with the expected life of the stock options granted. The expected dividend yield, volatility, life of options, and forfeiture of options assumptions are based on historical experience.

The following table lists the assumptions we used in determining the fair value of stock options and the resulting weighted average fair value of options granted:

	First Half Year Ended	
	June 28, 2008	June 30, 2007
Expected dividend yield	2.9%	0%
Expected stock price volatility	31%	42%
Risk-free interest rate	3.2%	4.7%
Expected life of options	4.5 years	3.2 years
Estimated forfeiture rate	16%	16%
Weighted average fair value of options granted	$3.96	$ 4.51

The following table represents stock option activity for the quarter ended June 28, 2008:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life
Outstanding options at beginning of period	828,653	$10.98	
Granted	1,500	13.95	
Exercised	(7,744)	8.68	
Canceled	(7,450)	16.52	
Outstanding options at end of period	814,959	$10.96	5.6 years
Outstanding exercisable at end of period	376,468	$ 7.88	5.0 years

At June 28, 2008, the aggregate intrinsic value of options outstanding was $3.8 million, and the aggregate intrinsic value of exercisable options was $2.7 million. The intrinsic value of options exercised during the quarter ended June 28, 2008 was $0.1 million.

NOTE 6. COMPENSATION AND BENEFIT AGREEMENTS

We have a defined benefit pension plan covering eligible past employees and approximately 10% of current employees. We also sponsor an unfunded defined benefit postretirement death benefit plan that covers eligible past employees. Information relative to these two plans is presented below.

	Pension Benefits Quarter Ended		Other Benefits Quarter Ended	
(in thousands)	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Cost (benefit) recognized during the quarter:				
Interest cost	$ 238	$ 234	$4	$4
Expected return on plan assets	(274)	(257)		
Amortization of prior loss		25		
Amortization of prior service cost	4	4		
Net period cost (benefit)	$ (32)	$ 6	$4	$4

	Pension Benefits First Half Year Ended		Other Benefits First Half Year Ended	
(in thousands)	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Cost (benefit) recognized during the first half year:				
Interest cost	$ 476	$ 468	$8	$8
Expected return on plan assets	(548)	(514)		
Amortization of prior loss		50		
Amortization of prior service cost	8	8		
Net period cost (benefit)	$ (64)	$ 12	$8	$8

We contributed $0.2 million to our defined benefit pension plan during the first half of 2008 and anticipate contributing an additional $0.2 million during the remainder of 2008.

NOTE 7. CASH DIVIDENDS

On February 4, 2008, we announced a special cash dividend of one dollar ($1.00) per share of common stock and a first quarter cash dividend of twelve and one-half cents ($0.125) per share of our common stock. These dividends were paid together ($1.125 per share) on March 18, 2008 to shareholders of record as of the close of business on February 22, 2008. The total cash payment for this dividend was $7.0 million.

The Board of Directors, while not declaring future dividends to be paid, established a quarterly dividend policy reflecting its intent to declare and pay a quarterly dividend of $0.125 per share of common stock (approximately $0.8 million per quarter) for the balance of 2008.

On April 28, 2008, we announced a second quarter cash dividend of twelve and one-half cents ($0.125) per share of our common stock. This dividend was paid on June 18, 2008 to shareholders of record as of the close of business on May 22, 2008. The total cash payment for this dividend was $0.8 million.

NOTE 8. EXIT COSTS FOR DISTRIBUTION CENTERS

On June 19, 2008, we announced that we will be relocating our two distribution centers located in La Crosse, Wisconsin to a new distribution center in Indianapolis, Indiana. We will operate these two distributions centers through April 30, 2009. We expect to incur costs related to compensation incentives and other costs of approximately \$0.3 million through the exit time. In accordance with SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146), these costs will be expensed ratably from June 2008 through April 2009.

NOTE 9. RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R), which replaces FASB Statement No. 141 and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (SFAS 160). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R and SFAS 160 are effective as of the beginning of an entity s fiscal year beginning after December 15, 2008.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial instruments for fiscal years beginning after November 15, 2007 and for nonfinancial instruments for fiscal years beginning after November 15, 2008. We have adopted the fair value accounting provisions of SFAS 157 for financial instruments as of January 1, 2008 without any significant impact on our financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option For Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 is effective for fiscal years beginning after November 15, 2007. This Statement became effective for us on January 1, 2008 but has no impact on our financial statements presented herein.

NOTE 10. SUBSEQUENT EVENT

On July 21, 2008, we announced the formation of LaCrosse Europe ApS, a new subsidiary based in Copenhagen, Denmark. In establishing this company, LaCrosse Europe ApS purchased certain assets for $3.2 million in cash from our former European distributor, Gateway Footgear. The acquired assets included inventory and sales order backlog.

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

All statements, other than statements of historical facts, included in this quarterly report on Form 10-Q, including without limitation, statements regarding our future financial position, business strategy, budgets, projected costs, goals and plans and objectives of management for future operations, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, expect, intend, estimate, anticipate, project, believe, continue, or target or the negative thereof or variations thereon or simila terminology. All forward-looking statements made in this quarterly report on Form 10-Q are based on information presently available to our management. Although we believe that the expectations reflected in forward-looking statements have a reasonable basis, we can give no assurance that these expectations will prove to be correct. Forward-looking statements are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. These risks and uncertainties include, but are not limited to:

§ Our product costs are subject to risks associated with foreign currency fluctuations (particularly with respect to the Euro and Chinese Renminbi), oil price increases and higher foreign and domestic labor costs. If we are unable to sufficiently increase our selling prices to offset such product cost increases, our product margins, revenues and earnings would be negatively impacted.

§ Failure to efficiently import foreign sourced products could result in decreased margins, cancelled orders and unanticipated inventory accumulation. Because we rely primarily on two third party manufacturers, we have a concentration of risk in areas such as disruptions in the supply of products, higher production costs and defective products.

§ The continued consolidation of domestic retailers, and their increased capital requirements to fund growth and operations, increases and concentrates our credit risk. Additionally, certain of our domestic retailers have announced significantly lower growth expectations and in some cases are reducing the number of stores in operation. Both the contraction in consumer spending and the tightening of the credit markets have created an unfavorable business environment for our partners, especially the partners who use debt to finance their inventory purchases and other operating capital requirements. If our retail partners are unable to obtain financing for their inventory purchases and to fund their operations, it could result in delayed payment or non-payment of amounts owed to us and/or a reduction in the number of sales we make to such retailers, either of which could have a material adverse effect on our results of operations.

§ A decline in consumer spending due to unfavorable economic and consumer credit conditions could hinder our product revenues and earnings.

§ Our business is substantially affected by the weather, and sustained periods of warm and/or dry weather can negatively impact our sales. Such weather conditions may also negatively affect our inventory levels and subsequent period sales.

§ We plan to close our two distribution centers in La Crosse, Wisconsin and open our new distribution center in Indianapolis, Indiana during early 2009. If we are unable to adequately staff these facilities or if construction at the new facility is delayed, we may experience disruptions or increased costs in shipping products to our customers.

§ Our newly established European subsidiary, LaCrosse Europe ApS, will increase our exposure to risks associated with foreign operations, such as compliance with foreign laws and currency risks. Additionally, if we fail to successfully transition our European customer base from our former European distributor to our newly established subsidiary, we could lose existing customers or be required to grant additional customer incentives which are less favorable than the incentives we provided to our prior distribution partner. Also, our distribution center for Europe is owned and managed by an independent third party which increases our risks associated with inventory management and timely and accurate customer shipments.

§ We conduct a significant portion of our manufacturing activities, and a certain portion of our net sales occur outside the U.S., and, therefore, we are subject to the risks of international commerce including customs and duties compliance and foreign currency.

- § The majority of our third party manufacturers are concentrated in China. Any adverse political, or governmental relations, including duties, and quotas, internally within China or externally with the United States could result in material adverse disruptions in our supply of product to customers.
- § Because we depend on third party manufacturers, we face challenges in maintaining a timely supply of goods to meet sales demand, and we may experience delay or interruptions in our supply chain. Any shortfall or delastyle="font-family:inherit;font-size:10pt;">

264,481

691,291

833,019

Segment Expenses:

Franchise expenses
27,148

25,006

81,126

78,656

Company restaurant expenses
68,541

113,976

232,298

363,021

Rental expenses
24,237

24,521

73,075

73,734

Financing expenses
15

425

1,586

6,001

Total segment expenses
119,941

163,928

388,085

521,412

Gross segment profit
96,377

100,553

303,206

311,607

General and administrative expenses
48,737

38,733

125,608

115,152

Interest expense
28,896

32,170

88,767

101,343

Impairment and closure charges
420

193

1,264

26,947

Amortization of intangible assets
3,072

3,075

9,222

9,225

(Gain) loss on disposition of assets
(73,650
)

1,176

(89,642
)

(21,287
)
Loss on extinguishment of debt
2,306

—

4,917

7,885

Debt modification costs
—

(21
)

—

4,103

Income before income taxes
86,596

25,227

163,070

68,239

Provision for income taxes
(26,023
)

(8,702
)

(54,215
)

(21,667
)

Net income
60,573

16,525

108,855

46,572

Other comprehensive income:

Adjustment to unrealized loss on available-for-sale investments
—

—

140

—

Foreign currency translation adjustment
5

(50
)

4

(30
)
Total comprehensive income
$
60,578

$
16,475

$
108,999

$
46,542

Net income available to common stockholders:

Net income
$
60,573

$
16,525

$
108,855

$
46,572

Less: Accretion of Series B Convertible Preferred Stock
(688
)

(647
)

(2,033
)

(1,915
)
Less: Net income allocated to unvested participating restricted stock
(1,187
)

(359
)

(2,477
)

(1,212
)
Net income available to common stockholders
$
58,698

$
15,519

$
104,345

$
43,445

Net income available to common stockholders per share:

Basic
$
3.26

$
0.86

$
5.84

$
2.43

Diluted

$
3.14

$
0.85

$
5.66

$
2.38

Weighted average shares outstanding:

Basic
18,006

17,968

17,859

17,912

Diluted
18,924

18,243

18,801

18,268

See the accompanying Notes to Consolidated Financial Statements.

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DineEquity, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2012	2011
Cash flows from operating activities:		
Net income	$108,855	$46,572
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation and amortization	30,756	38,599
Non-cash interest expense	4,547	4,582
Loss on extinguishment of debt	4,917	7,885
Impairment and closure charges	991	26,729
Deferred income taxes	(20,361)	1,866
Non-cash stock-based compensation expense	8,799	6,913
Tax benefit from stock-based compensation	6,334	6,085
Excess tax benefit from share-based compensation	(4,757)	(5,713)
Gain on disposition of assets	(89,642)	(21,287)
Other	(1,768)	(217)
Changes in operating assets and liabilities:		
Receivables	41,422	25,360
Prepaid expenses	7,414	1,247
Current income tax receivables and payables	12,512	21,519
Accounts payable	2,080	(3,992)
Accrued employee compensation and benefits	(6,490)	(9,099)
Gift card liability	(62,841)	(56,906)
Other accrued expenses	25,298	4,928
Cash flows provided by operating activities	68,066	95,071
Cash flows from investing activities:		
Additions to property and equipment	(13,477)	(20,829)
Proceeds from sale of property and equipment and assets held for sale	137,449	60,188
Principal receipts from notes, equipment contracts and other long-term receivables	10,276	9,922
Other	964	(558)
Cash flows provided by investing activities	135,212	48,723
Cash flows from financing activities:		
Borrowings under revolving credit facilities	50,000	25,000
Repayments under revolving credit facilities	(50,000)	(25,000)
Repayment of long-term debt (including premiums)	(184,237)	(153,437)
Principal payments on capital lease and financing obligations	(8,246)	(10,296)
Purchase of DineEquity common stock	—	(21,170)
Payment of debt modification and issuance costs	—	(12,307)
Repurchase of restricted stock	(1,690)	(4,802)
Proceeds from stock options exercised	5,443	6,326
Excess tax benefit from share-based compensation	4,757	5,713
Change in restricted cash	(8,158)	(1,590)
Other	—	(600)
Cash flows used in financing activities	(192,131)	(192,163)

Net change in cash and cash equivalents	11,147	(48,369)
Cash and cash equivalents at beginning of period	60,691	102,309
Cash and cash equivalents at end of period	$71,838	$53,940
Supplemental disclosures:		
Interest paid in cash	$77,758	$95,867
Income taxes paid in cash	$58,339	$15,685

See the accompanying Notes to Consolidated Financial Statements.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. General

The accompanying unaudited consolidated financial statements of DineEquity, Inc. (the “Company”) have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The operating results for the nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the twelve months ending December 31, 2012.

The consolidated balance sheet at December 31, 2011 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

2. Basis of Presentation

The Company’s fiscal quarters end on the Sunday closest to the last day of each quarter. For convenience, the fiscal quarters are reported as ending on March 31, June 30, September 30 and December 31. The first, second and third fiscal quarters of 2012 ended on April 1, 2012, July 1, 2012 and September 30, 2012, respectively; the first, second and third fiscal quarters of 2011 ended on April 3, 2011, July 3, 2011 and October 2, 2011, respectively.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries that are consolidated in accordance with U.S. GAAP. All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with U.S. GAAP requires the Company’s management to make assumptions and estimates that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to provisions for doubtful accounts, legal contingencies, income taxes, long-lived assets, goodwill and intangible assets. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Restricted Assets

Restricted Cash
The Company receives funds from Applebee's franchisees pursuant to franchise agreements, usage of which is restricted to advertising activities. Cash balances restricted for this purpose as of September 30, 2012 and December 31, 2011 totaled $9.3 million and $1.2 million, respectively. The balances were included as other current assets in the consolidated balance sheets.
Other Restricted Assets

As of September 30, 2012 and December 31, 2011, restricted assets related to a captive insurance subsidiary totaled $2.0 million and $3.6 million, respectively, and were included in other assets in the consolidated balance sheets. The captive insurance subsidiary, which has not underwritten coverage since January 2006, was formed to provide insurance coverage to Applebee's and its franchisees. These restricted assets are primarily investments, use of which is restricted to the payment of insurance claims for incidents that occurred during the period coverage had been provided.

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Reclassifications

Amounts previously reported as inventories at December 31, 2011 have been restated to conform to current classifications. Inventories at company restaurants are now included in "other current assets" and inventories of unactivated gift cards are now included in "prepaid gift cards."

	As Originally Reported	As Currently Reported
	(In thousands)	
Inventories	$ 12,031	$ —
Prepaid gift cards	$ 36,643	$ 45,412
Other current assets	$ 8,051	$ 11,313

3. Accounting Policies

Recently Adopted Accounting Standards

In June 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-05, Comprehensive Income — Presentation of Comprehensive Income (“ASU 2011-05”). ASU 2011-05 requires the presentation of the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 did not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor did it affect how earnings per share is calculated or presented. The Company adopted ASU 2011-05 retrospectively in the first quarter of 2012 and adoption did not have a material impact on the Company’s consolidated financial statements.

Newly Issued Accounting Standards

In July 2012, the FASB issued ASU No. 2012-02, Intangibles — Testing Indefinite Lived Intangibles for Impairment (“ASU 2012-02”). ASU 2012-02 allows an entity the option to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. An entity electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on the qualitative assessment, that it is more likely than not that the asset is impaired. The guidance is effective for impairment tests for fiscal years beginning after September 15, 2012, however, earlier adoption is allowed. As the guidance does not change the underlying principle that the carrying amount of an indefinite-lived intangible asset should not exceed its fair value, the adoption of ASU 2012-02 is not anticipated to have a material impact on the Company's consolidated financial statements.

The Company reviewed all other newly issued accounting pronouncements and concluded that they either are not applicable to the Company’s operations or that no material effect is expected on the consolidated financial statements as a result of future adoption.

4. Assets Held for Sale

The Company classifies assets as held for sale and ceases the depreciation and amortization of the assets when there is a plan for disposal of the assets and those assets meet the held for sale criteria, as defined in applicable U.S. GAAP. The assets held for sale are carried at the lower of cost or fair value less cost of disposal. The balance of assets held for sale at December 31, 2011 of $9.4 million consisted of 17 Applebee's company-operated restaurants located in a six-state market area geographically centered around Memphis, Tennessee, one parcel of land on which a refranchised Applebee's restaurant is situated and three parcels of land previously intended for future restaurant development.

In April 2012, the Company entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 39 Applebee's company-operated restaurants located in Virginia. In May 2012, the Company entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 33 Applebee's company-operated restaurants located primarily in Missouri and Indiana. In July 2012, the Company entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 65 Applebee's company-operated restaurants located in Michigan. Accordingly, $54.7 million, representing the net book value of the assets related to these 137 restaurants, was transferred to assets held for sale.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Assets sold of $45.2 million during the nine months ended September 30, 2012, consisted of: the 17 Applebee's company-operated restaurants located in a six-state market area geographically centered around Memphis, Tennessee, the 33 Applebee's company-operated restaurants located primarily in Missouri and Indiana, the 65 Applebee's company-operated restaurants located in Michigan and two parcels of land previously intended for future restaurant development. Additionally, the one parcel of land on which a refranchised Applebee's restaurant is situated was transferred out of assets held for sale as the Company no longer intends to sell that asset.

Assets held for sale at September 30, 2012 of $16.4 million consisted of 39 Applebee's company-operated restaurants located primarily in Virginia (see Note 15) and one parcel of land previously intended for future restaurant development.

The following table summarizes changes in assets held for sale during the nine months ended September 30, 2012:

	(In millions)
Balance, December 31, 2011	$9.4
Assets transferred to held for sale	54.7
Assets sold	(45.2)
Other	(2.5)
Balance, September 30, 2012	$16.4

5. Long-Term Debt

Long-term debt consisted of the following components:

	September 30, 2012	December 31, 2011
	(In millions)	
Senior Secured Credit Facility, due October 2017, at a variable interest rate of 4.25% as of September 30, 2012 and December 31, 2011	$503.8	$682.5
Senior Notes due October 2018, at a fixed rate of 9.5%	760.8	765.8
Discount	(24.5)	(29.5)
Total long-term debt	1,240.1	1,418.8
Less current maturities	(7.4)	(7.4)
Long-term debt, less current maturities	$1,232.7	$1,411.4

For a description of the respective instruments, refer to Note 8 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

Debt Modification Costs

On February 25, 2011, the Company entered into Amendment No. 1 (the "Amendment") to the Credit Agreement dated as of October 8, 2010. For a description of the Amendment, refer to Note 8 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. Fees of $4.1 million paid to third parties in connection with the Amendment were included as “Debt modification costs” in the Consolidated Statement of Income for the nine months ended September 30, 2011.

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Loss on Extinguishment of Debt

During the nine months ended September 30, 2012 and 2011, the Company recognized the following losses on the extinguishment of debt:

Quarter Ended	Instrument Repaid/Retired	Face Amount Repaid/Retired	Cash Paid	Loss [1]
		(In millions)		
March 2012	Term Loans	$ 70.5	$ 70.5	$ 1.9
March 2012	Senior Notes	5.0	5.5	0.7
September 2012	Term Loans	108.2	108.2	2.3
	Total 2012	183.7	184.2	4.9
March 2011	Term Loans	$ 110.0	$ 110.0	$ 2.7
March 2011	Senior Notes	32.3	35.3	4.3
June 2011	Senior Notes	7.5	8.2	0.9
	Total 2011	$ 149.8	$ 153.5	$ 7.9

[1] Including write-off of the discount and deferred financing costs related to the debt retired.

Compliance with Covenants and Restrictions

The Company was in compliance with all the covenants and restrictions related to its Senior Secured Credit Facility and Senior Notes as of September 30, 2012.

6. Financing Obligations

As of September 30, 2012, future minimum lease payments under financing obligations during the initial terms of the leases related to sale-leaseback transactions are as follows:

Fiscal Years	(In millions)	
Remainder of 2012	$ 2.7	(1)
2013	10.8	
2014	10.9	
2015	11.9	(1)
2016	11.0	
Thereafter	133.2	
Total minimum lease payments	180.5	
Less: interest	(84.4	)
Total financing obligations	96.1	

Less: current portion	(2.3	)(2)
Long-term financing obligations	$93.8	

(1) Due to the varying closing dates of the Company's fiscal years, 11 monthly payments will be made in fiscal 2012 and 13 monthly payments will be made in fiscal 2015.
(2) Included in "current maturities of capital lease and financing obligations" on the consolidated balance sheet.

During the nine months ended September 30, 2012, the Company's continuing involvement with 41 properties subject to financing obligations was ended by assignment of the lease obligations to a qualified franchisee. As a result, the Company's financing obligations were reduced by $67.9 million.

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

7. Impairment and Closure Charges

The Company assesses tangible long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The following table summarizes the components of impairment and closure charges for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Impairment and closure charges:				
Impairment	$—	$0.1	$0.4	$4.9
Lenexa lease termination	—	—	—	21.3
Closure charges	0.4	0.1	0.9	0.7
Total impairment and closure charges	$0.4	$0.2	$1.3	$26.9

Impairment and closure charges for the nine months ended September 30, 2012 totaled $1.3 million. The impairment charge related to a parcel of land previously intended for future restaurant development. The closure charges primarily related to several individually insignificant closures of franchise restaurants.

Impairment and closure charges for the nine months ended September 30, 2011 totaled $26.9 million and primarily related to termination of the Company's sublease of the commercial space previously occupied by the Applebee's Restaurant Support Center in Lenexa, Kansas. The Company recognized $21.3 million for the termination fee and other closing costs in the second quarter of 2011. The Company recognized a $4.5 million impairment charge in the quarter ended March 31, 2011 related to furniture, fixtures and leasehold improvements at the facility whose book value was not realizable as the result of the termination of the sublease. The closure charges related to several individually insignificant closures of franchise restaurants.

8. Income Taxes

The effective tax rate was 33.2% for the nine months ended September 30, 2012 as compared to 31.8% for the nine months ended September 30, 2011. In 2012, the effective tax rate was impacted by a discrete $6.3 million state benefit in the third quarter related to a reduction in state deferred taxes as a result of the refranchising and sale of Applebee's company-operated restaurants. In 2011, the effective tax rate was lower due to a $3.2 million reduction in income tax expense for the release of liabilities for unrecognized tax benefits related to gift card income deferral as a result of the issuance of guidance by the U.S. Internal Revenue Service.

At September 30, 2012, the Company had a liability for unrecognized tax benefits, including potential interest and penalties net of related tax benefit, totaling $7.0 million, of which approximately $0.9 million is expected to be paid within one year. For the remaining liability, due to the uncertainties related to these tax matters, the Company is unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur.

As of September 30, 2012, accrued interest and penalties were $1.9 million and $0.4 million, respectively, excluding any related income tax benefits. As of December 31, 2011, accrued interest and penalties were $3.0 million and $0.3 million, respectively, excluding any related income tax benefits. The decrease of $1.1 million of accrued interest is primarily related to the decrease of unrecognized tax benefits due to settlements with taxing authorities, partially offset by the accrual of interest during the nine months ended September 30, 2012. The Company recognizes interest accrued related to unrecognized tax benefits and penalties as a component of income tax expense, which is recognized in the Consolidated Statements of Income.

The Company and its subsidiaries file federal income tax returns as well as income tax returns in various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to federal, state or non-United States tax examinations by tax authorities for years before 2008. The Internal Revenue Service commenced examination of the Company's U.S. federal income tax return for the tax years 2008 to 2010 in the first quarter of 2012. The examination is anticipated to be completed by the first quarter of 2013.

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

9. Stock-Based Compensation

From time to time, the Company has granted nonqualified stock options, restricted stock, cash-settled and stock-settled restricted stock units and performance units to officers, other employees and non-employee directors of the Company. Currently, the Company is authorized to grant nonqualified stock options, stock appreciation rights, restricted stock, cash-settled and stock-settled restricted stock units and performance units to officers, other employees and nonemployee directors under the DineEquity, Inc. 2011 Stock Incentive Plan (the "2011 Plan"). The 2011 Plan was approved by stockholders on May 17, 2011 and permits the issuance of up to 1,500,000 shares of the Company's common stock. The 2011 Plan will expire in May 2021.

The nonqualified stock options generally vest over a three-year period and have a term of ten years from the effective issuance date. Option exercise prices equal the closing price of the Company's common stock on the New York Stock Exchange on the date of grant. Restricted stock and restricted stock units are issued at no cost to the holder and vest over terms determined by the Compensation Committee of the Company's Board of Directors, generally three years.

The following table summarizes the components of the Company's stock-based compensation expense included in general and administrative expenses in the consolidated financial statements:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Pre-tax compensation expense	$4.2	$1.6	$11.2	$8.0
Tax provision	(1.6)	(0.6)	(4.3)	(3.2)
Total stock-based compensation expense, net of tax	$2.6	$1.0	$6.9	$4.8

As of September 30, 2012, total unrecognized compensation cost (including estimated forfeitures) of $9.3 million related to restricted stock and restricted stock units and $8.2 million related to stock options is expected to be recognized over a weighted average period of 1.9 years for restricted stock and restricted stock units and 1.9 years for stock options.

The estimated fair values of the options granted during the nine months ended September 30, 2012 were calculated using a Black-Scholes option pricing model. The following summarizes the assumptions used in the Black-Scholes model:

Risk-free interest rate	0.86 %
Weighted average historical volatility	83.6 %
Dividend yield	—
Expected years until exercise	4.66
Forfeitures	11.0 %
Weighted average fair value of options granted	$33.11

Option balances as of September 30, 2012 and activity related to the Company's stock options during the nine months then ended were as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2011	1,318,640	$32.06		
Granted	147,674	$51.63		
Exercised	(352,266)	$16.20		
Forfeited	(50,778)	$44.49		
Outstanding at September 30, 2012	1,063,270	$39.44	6.47	$17,740,000
Vested at September 30, 2012 and Expected to Vest	1,022,929	$39.07	6.38	$17,447,000
Exercisable at September 30, 2012	690,212	$35.49	5.37	$14,220,000

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the closing stock price of the Company's common stock on the last trading day of the third quarter of 2012 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2012. The aggregate intrinsic value will change based on the fair market value of the Company's common stock and the number of in-the-money options.

A summary of restricted stock activity for the nine months ended September 30, 2012 is presented below:

	Restricted Stock	Weighted Average Grant Date Fair Value	Restricted Stock Units	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2011	486,533	$31.25	18,000	$29.32
Granted	126,006	$51.75	19,152	$52.23
Released	(176,521)	$13.55	(3,910)	$40.58
Forfeited	(84,325)	$44.09	—	—
Outstanding at September 30, 2012	351,693	$44.28	33,242	$41.19

The Company has issued 44,957 shares of cash-settled restricted stock units to members of the Board of Directors, of which 37,184 were outstanding at September 30, 2012. As these instruments can only be settled in cash, they are recorded as liabilities based on the closing price of the Company's common stock as of September 30, 2012. For the nine months ended September 30, 2012 and 2011, $0.6 million and $0.3 million, respectively, were included in pretax stock-based compensation expense for the cash-settled restricted stock units.

10. Segments

The Company's revenues and expenses are recorded in four segments: franchise operations, company restaurant operations, rental operations and financing operations.

As of September 30, 2012, the franchise operations segment consisted of (i) 1,954 restaurants operated by Applebee's franchisees in the United States, one U.S. territory and 15 countries outside the United States; and (ii) 1,548 restaurants operated by IHOP franchisees and area licensees in the United States, two U.S. territories and four countries outside the United States. Franchise operations revenue consists primarily of franchise royalty revenues, sales of proprietary products, certain franchise advertising fees and the portion of the franchise fees allocated to intellectual property. Franchise operations expenses include advertising expense, the cost of proprietary products, pre-opening training expenses and costs related to intellectual property provided to certain franchisees.

As of September 30, 2012, the company restaurant operations segment consisted of 62 Applebee's company-operated restaurants and 17 IHOP company-operated restaurants, all located in the United States. Company restaurant sales are retail sales at company-operated restaurants. Company restaurant expenses are operating expenses at company-operated restaurants and include food, labor, benefits, utilities, rent and other restaurant operating costs.

Rental operations revenue includes revenue from operating leases and interest income from direct financing leases. Rental operations expenses are costs of operating leases and interest expense on capital leases on franchisee-operated restaurants.

Financing operations revenue primarily consists of interest income from the financing of franchise fees and equipment leases, as well as sales of equipment associated with refranchised IHOP restaurants and a portion of franchise fees for restaurants taken back from franchisees not allocated to IHOP intellectual property. Financing expenses are primarily the cost of restaurant equipment.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Information on segments was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Revenues from External Customers				
Franchise operations	$102.7	$97.7	$313.5	$300.8
Company restaurants	79.6	131.6	274.3	421.0
Rental operations	30.9	31.2	92.1	95.0
Financing operations	3.2	4.0	11.4	16.3
Total	$216.3	$264.5	$691.3	$833.0
Interest Expense				
Company restaurants	$0.1	$0.1	$0.3	$0.4
Rental operations	4.2	4.4	12.8	13.6
Corporate	28.9	32.2	88.8	101.3
Total	$33.2	$36.7	$101.9	$115.3
Depreciation and amortization				
Franchise operations	$2.5	$2.3	$7.4	$7.4
Company restaurants	1.6	4.0	6.4	13.5
Rental operations	3.4	3.5	10.3	10.5
Corporate	2.3	2.5	6.7	7.2
Total	$9.8	$12.3	$30.8	$38.6
Income (loss) before income taxes				
Franchise operations	$75.5	$72.7	$232.4	$222.1
Company restaurants	11.0	17.6	42.0	57.9
Rental operations	6.7	6.7	19.0	21.3
Financing operations	3.2	3.6	9.8	10.3
Corporate	(9.8)	(75.4)	(140.1)	(243.4)
Total	$86.6	$25.2	$163.1	$68.2

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

11. Net Income per Share

The computation of the Company's basic and diluted net income per share was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except per share data)			
Numerator for basic and dilutive income per common share:				
Net income	$60,573	$16,525	$108,855	$46,572
Less: Accretion of Series B Convertible Preferred Stock	(688)	(647)	(2,033)	(1,915)
Less: Net income allocated to unvested participating restricted stock	(1,187)	(359)	(2,477)	(1,212)
Net income available to common stockholders - basic	58,698	15,519	104,345	43,445
Effect of unvested participating restricted stock in two-class calculation	57	5	121	22
Accretion of Series B Convertible Preferred Stock	688	—	2,033	—
Net income available to common stockholders - diluted	$59,443	$15,524	$106,499	$43,467
Denominator:				
Weighted average outstanding shares of common stock - basic	18,006	17,968	17,859	17,912
Dilutive effect of:				
Stock options	246	275	270	356
Series B Convertible Preferred Stock	672	—	672	—
Weighted average outstanding shares of common stock - diluted	18,924	18,243	18,801	18,268
Net income per common share:				
Basic	$3.26	$0.86	$5.84	$2.43
Diluted	$3.14	$0.85	$5.66	$2.38

For the three months and nine months ended September 30, 2011, the diluted income per common share was computed excluding 633,600 shares of common stock equivalents from the conversion of Series B Convertible Preferred Stock that were antidilutive.

12. Fair Value Measurements

The Company does not have a material amount of financial instruments, non-financial assets or non-financial liabilities that are required under U.S. GAAP to be measured on a recurring basis at fair value. The Company has not elected to use fair value measurement, as provided under U.S. GAAP, for any assets or liabilities for which fair value measurement is not presently required.

The Company believes the fair values of cash equivalents, accounts receivable, accounts payable and the current portion of long-term debt approximate the carrying amounts due to their short duration.

The fair values of non-current financial liabilities at September 30, 2012 and December 31, 2011, determined based on Level 2 inputs, were as follows:

	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in millions)			
Long-term debt, less current maturities	$1,232.7	$1,359.1	$1,411.4	$1,486.2

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

13. Commitments and Contingencies

Litigation, Claims and Disputes

The Company is subject to various lawsuits, administrative proceedings, audits, and claims arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. The Company is required to record an accrual for litigation loss contingencies that are both probable and reasonably estimable. Legal fees and expenses associated with the defense of all of the Company's litigation are expensed as such fees and expenses are incurred. Management regularly assesses the Company's insurance deductibles, analyzes litigation information with the Company's attorneys and evaluates its loss experience in connection with pending legal proceedings. While the Company does not presently believe that any of the legal proceedings to which the Company is currently a party will ultimately have a material adverse impact on the Company, there can be no assurance that the Company will prevail in all the proceedings the Company is party to, or that the Company will not incur material losses from them.

Gerald Fast v. Applebee's

As previously disclosed, the Company has been defending a collective action in the United States District Court for the Western District of Missouri, Central Division that commenced in July 2006. In this case, the plaintiffs claimed that tipped servers and bartenders in Applebee's company-operated restaurants spent more than 20% of their time performing general preparation and maintenance duties, or “non-tipped work,” for which they should be compensated at the minimum wage. Under this action, plaintiffs sought unpaid wages and other relief of up to $17 million plus plaintiffs' attorneys' fees and expenses. The Company has vigorously challenged both the merits of the lawsuit and the allegation that the case should be certified as a collective action. However, in light of the cost and uncertainty involved in this lawsuit, the parties executed a settlement agreement on September 25, 2012. Under the proposed settlement, which is awaiting approval by the court, the Company agreed to pay $9.0 million. The settlement of the lawsuit is not an admission by the Company of any wrongdoing.

Lease Guarantees

In connection with the sale of Applebee’s restaurants or previous brands to franchisees and other parties, the Company has, in certain cases, guaranteed or had potential continuing liability for lease payments totaling $432.0 million as of September 30, 2012. This amount represents the maximum potential liability for future payments under these leases. These leases have been assigned to the buyers and expire at the end of the respective lease terms, which range from 2012 through 2048. In the event of default, the indemnity and default clauses in our sale or assignment agreements govern our ability to pursue and recover damages incurred. No material liabilities have been recorded as of September 30, 2012.

14. Consolidating Financial Information

Certain of the Company's subsidiaries have guaranteed the Company's obligations under the Senior Secured Credit Facility. The following presents the condensed consolidating financial information separately for: (i) the parent

Company, the issuer of the guaranteed obligations; (ii) the guarantor subsidiaries, on a combined basis, as specified in the Credit Agreement; (iii) the non-guarantor subsidiaries, on a combined basis; (iv) consolidating eliminations and reclassifications; and (v) DineEquity, Inc. and Subsidiaries, on a consolidated basis.

Each guarantor subsidiary is 100% owned by the Company at the date of each balance sheet presented. The notes are fully and unconditionally guaranteed on a joint and several basis by each guarantor subsidiary. Each entity in the consolidating financial information follows the same accounting policies as described in the consolidated financial statements.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Supplemental Condensed Consolidating Balance Sheet
September 30, 2012
(In millions[(1)])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$45.0	$26.2	$0.6	$—	$71.8
Receivables, net	1.1	82.1	0.4	(8.0)	75.5
Prepaid expenses and other current assets	140.2	55.9	—	(140.6)	55.5
Deferred income taxes	(2.6)	25.4	0.9	—	23.7
Assets held for sale	—	15.4	0.9	—	16.4
Intercompany	(376.8)	371.2	5.6	—	—
Total current assets	(193.2)	576.2	8.5	(148.6)	242.9
Long-term receivables	—	214.8	—	—	214.8
Property and equipment, net	24.7	321.0	—	—	345.6
Goodwill	—	697.5	—	—	697.5
Other intangible assets, net	—	809.2	—	—	809.2
Other assets, net	19.3	92.5	—	—	111.8
Investment in subsidiaries	1,697.6	—	—	(1,697.6)	—
Total assets	$1,548.4	$2,711.1	$8.5	$(1,846.2)	$2,421.8
Liabilities and Stockholders' Equity					
Current Liabilities					
Current maturities of long-term debt	$15.4	$—	$—	$(8.0)	$7.4
Accounts payable	1.8	30.2	—		32.0
Accrued employee compensation and benefits	7.1	12.6	—		19.7
Gift card liability	—	84.1	—		84.1
Income taxes payable	(46.4)	187.0	—	(140.6)	—
Other accrued expenses	42.4	26.8	0.5		69.7
Total current liabilities	20.3	340.7	0.5	(148.6)	212.9
Long-term debt	1,232.7	—	—		1,232.7
Financing obligations	—	93.8	—		93.8
Capital lease obligations	—	127.2	—	—	127.2
Deferred income taxes	6.6	360.2	(0.2)		366.5
Other liabilities	5.5	99.2	0.8		105.6
Total liabilities	1,265.1	1,021.1	1.1	(148.6)	2,138.7
Total stockholders' equity	283.3	1,690.0	7.4	(1,697.6)	283.1

Total liabilities and stockholders' equity	$1,548.4	$2,711.1	$8.5	$(1,846.2)	$2,421.8

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Supplemental Condensed Consolidating Balance Sheet
December 31, 2011
(In millions[(1)])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$9.9	$50.4	$0.4	$ —	$60.7
Receivables, net	0.6	121.0	0.1	(6.0)	115.7
Prepaid expenses and other current assets	85.3	56.7	—	(71.3)	70.6
Deferred income taxes	1.5	19.0	0.1	—	20.6
Assets held for sale	—	7.3	2.1	—	9.4
Intercompany	(300.2)	294.5	5.7	—	—
Total current assets	(202.9)	548.7	8.4	(77.3)	276.9
Long-term receivables	—	226.5	—	—	226.5
Property and equipment, net	24.6	449.6	—	—	474.2
Goodwill	—	697.5	—	—	697.5
Other intangible assets, net	—	822.4	—	—	822.4
Other assets, net	23.2	93.5	0.1	—	116.8
Investment in subsidiaries	1,697.6	—	—	(1,697.6)	—
Total assets	$1,542.5	$2,838.2	$8.5	$ (1,774.9)	$2,614.3
Liabilities and Stockholders' Equity					
Current Liabilities					
Current maturities of long-term debt	$13.4	$—	$—	$ (6.0)	$7.4
Accounts payable	2.8	26.2	—	—	29.0
Accrued employee compensation and benefits	6.7	19.5	—	—	26.2
Gift card liability	—	147.0	—	—	147.0
Other accrued expenses	(61.6)	180.6	0.4	(71.3)	48.1
Total current liabilities	(38.7)	373.3	0.4	(77.3)	257.6
Long-term debt	1,411.4	—	—	—	1,411.4
Financing obligations	—	162.7	—	—	162.7
Capital lease obligations	—	134.4	—	—	134.4
Deferred income taxes	8.9	375.3	(0.4)	—	383.8
Other liabilities	5.4	102.6	1.1	—	109.1
Total liabilities	1,387.0	1,148.3	1.1	(77.3)	2,459.1
Total stockholders' equity	155.5	1,689.9	7.4	(1,697.6)	155.2
Total liabilities and stockholders' equity	$1,542.5	$2,838.2	$8.5	$ (1,774.9)	$2,614.3

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Supplemental Condensed Consolidating Statement of Operations
For the Three Months Ended September 30, 2012
(In millions[(1)])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$0.7	$101.7	$0.3	$—	$102.7
Restaurant sales	—	79.6	—	—	79.6
Rental revenues	—	30.9	—	—	30.9
Financing revenues	—	3.2	—	—	3.2
Total revenue	0.7	215.4	0.3	—	216.3
Franchise expenses	0.6	26.6	—	—	27.1
Restaurant expenses	—	68.6	—	—	68.6
Rental expenses	—	24.2	—	—	24.2
Financing expenses	—	—	—	—	—
General and administrative	15.8	32.5	0.4	—	48.7
Interest expense	26.5	2.4	—	—	28.9
Impairment and closure	—	0.2	0.2	—	0.4
Amortization of intangible assets	—	3.1	—	—	3.1
Loss (gain) on disposition of assets	—	(73.3)	(0.4)	—	(73.7)
Loss on extinguishment of debt	2.3	—	—	—	2.3
Intercompany dividend	(88.7)	—	—	88.7	—
Income (loss) before income taxes	44.2	131.1	0.1	(88.7)	86.6
Benefit (provision) for income taxes	16.5	(42.5)	—	—	(26.0)
Net (loss) income	$60.6	$88.6	$0.1	$(88.7)	$60.6
Total comprehensive income	$60.6	$88.6	$0.1	$(88.7)	$60.6

Supplemental Condensed Consolidating Statement of Operations
For the Three Months Ended September 30, 2011
(In millions[(1)])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$0.6	$96.9	$0.2	$—	$97.7

Restaurant sales	—	131.2	0.4	—	131.6
Rental revenues	—	31.2	—	—	31.2
Financing revenues	—	4.0	—	—	4.0
Total revenue	0.6	263.3	0.6	—	264.5
Franchise expenses	0.6	24.5	—	—	25.0
Restaurant expenses	—	113.7	0.2	—	114.0
Rental expenses	—	24.4	0.1	—	24.5
Financing expenses	—	0.4	—	—	0.4
General and administrative	6.5	31.8	0.5	—	38.7
Interest expense	28.2	4.0	—	—	32.2
Impairment and closure	—	(0.1)	0.2	—	0.2
Amortization of intangible assets	—	3.1	—	—	3.1
Loss on disposition of assets	—	1.2	—	—	1.2
Loss on extinguishment of debt	—	—	—	—	—
Debt modification costs	—	—	—	—	—
Other (income) expense	(37.0)	0.4	(0.4)	37.1	—
Income (loss) before income taxes	2.3	59.9	—	(37.1)	25.2
Benefit (provision) for income taxes	14.3	(23.2)	0.2	—	(8.7)
Net (loss) income	$16.6	$36.7	$0.3	$(37.1)	$16.5
Total comprehensive income	$16.6	$36.7	$0.3	$(37.1)	$16.5

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Supplemental Condensed Consolidating Statement of Operations
For the Nine Months Ended September 30, 2012
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$1.9	$310.8	$0.8	$—	$313.5
Restaurant sales	—	274.3	—	—	274.3
Rental revenues	—	92.1	—	—	92.1
Financing revenues	—	11.4	—	—	11.4
Total revenue	1.9	688.6	0.8	—	691.3
Franchise expenses	1.8	79.3	—	—	81.1
Restaurant expenses	—	232.3	—	—	232.3
Rental expenses	—	73.1	—	—	73.1
Financing expenses	—	1.6	—	—	1.6
General and administrative	28.9	95.2	1.4	—	125.6
Interest expense	80.9	7.9	—	—	88.8
Impairment and closure	—	0.7	0.6	—	1.3
Amortization of intangible assets	—	9.2	—	—	9.2
Gain on disposition of assets	—	(88.5)	(1.2)	—	(89.6)
Loss on extinguishment of debt	4.9	—	—	—	4.9
Intercompany dividend	(179.7)	—	—	179.7	—
Income (loss) before income taxes	65.1	277.8	—	(179.7)	163.1
Benefit (provision) for income taxes	43.6	(97.9)	—	—	(54.2)
Net (loss) income	$108.7	$179.9	$—	$(179.7)	$108.9
Total comprehensive income	$108.8	$180.0	$—	$(179.7)	$109.0

Supplemental Condensed Consolidating Statement of Operations
For the Nine Months Ended September 30, 2011
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$1.9	$298.2	$0.7	$—	$300.8

Restaurant sales	—	419.8	1.2	—	420.9
Rental revenues	—	94.9	0.1	—	95.0
Financing revenues	—	16.3	—	—	16.3
Total revenue	1.9	829.2	2.0	—	833.0
Franchise expenses	1.6	77.1	—	—	78.7
Restaurant expenses	—	362.3	0.7	—	363.0
Rental expenses	—	73.6	0.1	—	73.7
Financing expenses	—	6.0	—	—	6.0
General and administrative	20.1	93.4	1.7	—	115.2
Interest expense	89.2	12.1	—	—	101.3
Impairment and closure	—	26.6	0.3	—	26.9
Amortization of intangible assets	—	9.2		—	9.2
Gain on disposition of assets	—	(21.2)	—	—	(21.3)
Loss on extinguishment of debt	7.9	—		—	7.9
Debt modification costs	4.1	—	—	—	4.1
Other (income) expense	(86.0)	20.9	(1.4)	66.5	—
Income (loss) before income taxes	(35.0)	169.2	0.6	(66.5)	68.2
Benefit (provision) for income taxes	47.8	(69.3)	(0.2)	—	(21.7)
Net (loss) income	$12.8	$99.9	$0.4	$(66.5)	$46.6
Total comprehensive income	$12.8	$99.9	$0.4	$(66.5)	$46.5

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Supplemental Condensed Consolidating Statement of Cash Flows
For the Nine Months Ended September 30, 2012
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Cash flows provided by (used in) operating activities	$(74.5)	$142.3	$0.2	—	$68.1
Investing cash flows					
Additions to property and equipment	(4.7)	(8.8)	—		(13.5)
Principal receipts from long-term receivables	—	10.3	—	—	10.3
Proceeds from sale of assets	—	137.4	—	—	137.4
Other	—	1.0	—	—	1.0
Cash flows provided by (used in) investing activities	(4.7)	139.9	—	—	135.2
Financing cash flows					
Revolving credit borrowings	50.0	—	—	—	50.0
Revolving credit repayments	(50.0)	—	—	—	(50.0)
Payment of debt	(184.2)	(8.2)	—	—	(192.5)
Payment of debt issuance costs	—	—	—	—	—
Purchase of common stock	—	—	—	—	—
Restricted cash	—	(8.2)	—	—	(8.2)
Other	7.4	1.2	—	—	8.5
Intercompany transfers	291.1	(291.1)	—	—	—
Cash flows provided by (used in) financing activities	114.2	(306.3)	—	—	(192.2)
Net change	35.1	(24.1)	0.2	—	11.1
Beginning cash and equivalents	9.9	50.4	0.4	—	60.7
Ending cash and equivalents	$45.0	$26.2	$0.6	—	$71.8

Supplemental Condensed Consolidating Statement of Cash Flows
For the Nine Months Ended September 30, 2011
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
	$(90.4)	$184.7	$0.8	—	$95.1

Cash flows provided by (used in) operating activities					
Investing cash flows					
Additions to property and equipment	(5.8)	(15.0)	—	—	(20.8)
Principal receipts from long-term receivables	—	9.9	—	—	9.9
Proceeds from sale of assets	—	60.2	—	—	60.2
Other	—	(0.6)	—	—	(0.6)
Cash flows provided by (used in) investing activities	(5.8)	54.5	—	—	48.7
Financing cash flows					
Revolving credit borrowings	25.0	—	—	—	25.0
Revolving credit repayments	(25.0)				(25.0)
Payment of debt	(153.4)	(10.3)	—	—	(163.7)
Payment of debt issuance costs	(12.3)	—	—	—	(12.3)
Purchase of common stock	(21.2)	—	—	—	(21.2)
Restricted cash	—	(1.6)	—	—	(1.6)
Other	6.2	0.4	—	—	6.6
Intercompany transfers	288.2	(286.4)	(1.8)	—	—
Cash flows provided by (used in) financing activities	107.5	(297.9)	(1.8)	—	(192.2)
Net change	11.3	(58.7)	(1.0)	—	(48.4)
Beginning cash and equivalents	23.4	77.3	1.6	—	102.3
Ending cash and equivalents	$34.7	$18.6	$0.6	—	$53.9

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

15. Subsequent Event

On October 3, 2012, the Company completed the refranchising and sale of related restaurant assets of 39 Applebee's company-operated restaurants located in Virginia. A gain on disposition of assets of approximately $14 million will be recognized in the fourth quarter of fiscal 2012.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Cautionary Statement Regarding Forward-Looking Statements

Statements contained in this report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties and other factors, which may cause actual results to be materially different from those expressed or implied in such statements. You can identify these forward-looking statements by words such as “may,” “will,” “should,” “expect,” “anticipate,” “believe,” “estimate,” “intend,” “plan” and other similar expressions. You should consider our forward-looking statements in light of the risks discussed under the heading “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. The forward-looking statements contained in this report are made as of the date hereof and the Company assumes no obligation to update or supplement any forward-looking statements.

You should read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with the consolidated financial statements and the related notes that appear elsewhere in this report.

Overview

The following discussion and analysis provides information we believe is relevant to an assessment and understanding of our consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report and the audited consolidated financial statements and notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Except where the context indicates otherwise, the words “we,” “us,” “our” and the “Company” refer to DineEquity, Inc., together with its subsidiaries that are consolidated in accordance with United States generally accepted accounting principles (“U.S. GAAP”).

The Company was incorporated under the laws of the State of Delaware in 1976. The first International House of Pancakes® (“IHOP”) restaurant opened in 1958 in Toluca Lake, California. Since that time, the Company or its predecessors have engaged in the development, operation, franchising and licensing of IHOP restaurants. In November 2007, we acquired Applebee’s International, Inc. (“Applebee’s”), which became a wholly-owned subsidiary of the Company. Through various IHOP and Applebee’s subsidiaries, we own, franchise and operate two restaurant concepts in the casual dining and family dining categories of the food service industry: Applebee’s Neighborhood Grill and Bar® and IHOP®. DineEquity, Inc. is the parent of the IHOP and Applebee’s subsidiaries. References herein to Applebee’s and IHOP restaurants are to these two restaurant concepts, whether operated by franchisees, area licensees or the Company. References herein to “system-wide sales” include retail sales at restaurants that are owned by franchisees and area licensees and are not attributable to the Company, as well as retail sales at company-operated restaurants.

Domestically, IHOP restaurants are located in all 50 states and the District of Columbia while Applebee's restaurants are located in every state except Hawaii. Internationally, IHOP restaurants are located in two United States territories and four foreign countries; Applebee's restaurants are located in one United States territory and 15 foreign countries. With nearly 3,600 franchised and company-operated restaurants combined, we are one of the largest full-service restaurant companies in the world.

Franchise Business Model

As of September 30, 2012, our system-wide restaurant portfolio was 97.8% franchised and consisted of the following:

	September 30, 2012		
	Applebee's	IHOP	Total
Domestic:			
Franchise/area license restaurants	1,810	1,509	3,319
Company-operated restaurants	62	17	79
International:			
Franchise/area license restaurants	144	39	183
Total	2,016	1,565	3,581
Percentage franchised	96.9 %	98.9 %	97.8 %

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Since the completion of the Applebee’s acquisition, we have been pursuing a strategy to transition Applebee's from a system that was 74% franchised at the time of the acquisition to a 99% franchised Applebee's system, similar to IHOP’s 99% franchised system. We believe a highly franchised business model requires less capital investment and general and adminstative overhead, generates higher gross profit margins and reduces the volatility of free cash flow performance over time, as compared to a model based on operating a significant number of company restaurants. During the nine months ended September 30, 2012, we completed the refranchising and sale of related restaurant assets of 115 Applebee's company-operated restaurants, comprised as follows: 17 restaurants in a six-state market area geographically centered around Memphis, Tennessee; 33 restaurants located primarily in Missouri and Indiana; and 65 restaurants located in Michigan. In October 2012, we completed the refranchising and sale of related restaurant assets of 39 Applebee's company-operated restaurants located in Virginia. With the completion of the Virginia transaction, we have refranchised all Applebee's company-operated restaurants, except for 23 restaurants the Company currently retains as company-operated restaurants in the Kansas City area. As of October 3, 2012, 99% of DineEquity's restaurants are now franchised.

Key Performance Indicators

In evaluating and assessing the performance of our business units, we consider our key operating performance indicators to be: (i) percentage change in domestic system-wide same-restaurant sales for Applebee's and IHOP; (ii) net franchise restaurant development and restaurants refranchised for Applebee's and IHOP; and (iii) Applebee's company-operated restaurant operating margin. An overview of these metrics for the nine months ended September 30, 2012 is as follows:

	Applebee's	IHOP
Percentage change in domestic system-wide same-restaurant sales	1.3%	(1.3)%
Net franchise restaurant development	(3)	15
Restaurants refranchised	115	4
Restaurant operating margin	16.8%	n/a

n/a - not applicable given relatively small number and test-market nature of IHOP company restaurants

With the completion of our Applebee's refranchising strategy, we will no longer consider restaurants refranchised and restaurant operating margin to be key indicators in assessing operating performance.

We consider cash from operations and free cash flow (cash provided by operating activities, plus receipts from notes, equipment contracts and other long-term receivables, less additions to property and equipment) to be key indicators of consolidated performance. Cash from operations and free cash flow for the nine months ended September 30, 2012 were $68.1 million and $64.9 million, respectively.

Additional information on each of these metrics is presented under the captions "Restaurant Data," "Restaurant Development Activity," "Company Restaurant Operations" and "Liquidity and Capital Resources" that follow.

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Restaurant Data

The following table sets forth, for the three and nine months ended September 30, 2012 and 2011, the number of effective restaurants in the Applebee’s and IHOP systems and information regarding the percentage change in sales at those restaurants compared to the same periods in the prior year. “Effective restaurants” are the number of restaurants in a given period, adjusted to account for restaurants open for only a portion of the period. Information is presented for all effective restaurants in the Applebee’s and IHOP systems, which includes restaurants owned by the Company, as well as those owned by franchisees and area licensees. Sales at restaurants that are owned by franchisees and area licensees are not attributable to the Company. However, we believe that presentation of this information is useful in analyzing our revenues because franchisees and area licensees pay us royalties and advertising fees that are generally based on a percentage of their sales, and, where applicable, rental payments under leases that are usually based on a percentage of their sales. Management also uses this information to make decisions about future plans for the development of additional restaurants as well as evaluation of current operations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012 (unaudited)	2011	2012	2011
Applebee's Restaurant Data				
Effective restaurants(a)				
Franchise	1,871	1,766	1,861	1,757
Company	144	243	156	253
Total	2,015	2,009	2,017	2,010
System-wide(b)				
Sales percentage change(c)	2.4 %	(0.1)%	1.7 %	2.6 %
Domestic same-restaurant sales percentage change(d)	2.0 %	(0.3)%	1.3 %	2.3 %
Franchise(b)(f)				
Sales percentage change(c)	8.4 %	(1.3)%	7.0 %	1.8 %
Domestic same-restaurant sales percentage change(d)	2.2 %	(0.4)%	1.2 %	2.5 %
Average weekly domestic unit sales (in thousands)	$45.1	$44.2	$47.4	$47.0
Company (f)				
Sales percentage change(c)	(42.2)%	1.4 %	(36.7)%	1.0 %
Same-restaurant sales percentage change(d)	0.5 %	0.1 %	2.7 %	0.5 %
Average weekly domestic unit sales (in thousands)	$39.3	$40.2	$42.5	$41.3

IHOP Restaurant Data				
Effective restaurants(a)				
Franchise	1,377	1,347	1,375	1,339
Area license	165	163	165	163
Company	17	10	15	10
Total	1,559	1,520	1,555	1,512
System-wide(b)				
Sales percentage change(c)	0.9 %	2.6 %	1.9 %	1.7 %
Domestic same-restaurant sales percentage change(d)	(2.0)%	(1.5)%	(1.3)%	(2.4)%
Franchise(b)				
Sales percentage change(c)	0.4 %	2.5 %	1.6 %	1.6 %
Domestic same-restaurant sales percentage change(d)	(2.0)%	(1.5)%	(1.2)%	(2.4)%

Average weekly domestic unit sales (in thousands)	$ 33.8	$ 34.4	$ 34.2	$ 34.6
Company (e)	n/m	n/m	n/m	n/m
Area License(b)				
Sales percentage change(c)	4.0 %	4.4 %	3.5 %	2.5 %

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(a) “Effective restaurants” are the number of restaurants in a given fiscal period adjusted to account for restaurants open for only a portion of the period. Information is presented for all effective restaurants in the Applebee’s and IHOP systems, which includes restaurants owned by the Company as well as those owned by franchisees and area licensees.

(b) “System-wide” sales are retail sales at Applebee’s restaurants operated by franchisees and IHOP restaurants operated by franchisees and area licensees, as reported to the Company, in addition to retail sales at company-operated restaurants. Sales at restaurants that are owned by franchisees and area licensees are not attributable to the Company. Applebee's domestic franchise restaurant sales, IHOP franchise restaurant sales and IHOP area license restaurant sales for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In millions)			
Reported sales (unaudited)				
Applebee's franchise restaurant sales	$ 1,011.4	$ 932.6	$ 3,165.4	$ 2,957.2
IHOP franchise restaurant sales	$ 604.8	$ 602.7	$ 1,834.6	$ 1,805.5
IHOP area license restaurant sales	$ 57.3	$ 55.1	$ 178.1	$ 172.0

(c) “Sales percentage change” reflects, for each category of restaurants, the percentage change in sales in any given fiscal period compared to the prior fiscal period for all restaurants in that category.

(d) “Domestic same-restaurant sales percentage change” reflects the percentage change in sales, in any given fiscal period, compared to the same weeks in the prior year for domestic restaurants that have been operated throughout both fiscal periods that are being compared and have been open for at least 18 months. Because of new unit openings and restaurant closures, the domestic restaurants open throughout both fiscal periods being compared may be different from period to period. Same-restaurant sales percentage change does not include data on IHOP area license restaurants located in Florida.

(e) Sales percentage changes and domestic same-restaurant sales percentage change for IHOP company-operated restaurants are not meaningful (“n/m”) because there are few such restaurants, consisting of 10 restaurants in a single test market, along with a variable, small number of restaurants that are reacquired from franchisees from time-to-time and temporarily operated by the Company.

(f) The sales percentage change for the three and nine months ended September 30, 2012 and 2011 for Applebee’s franchise and company-operated restaurants was impacted by the refranchising of 115 company-operated restaurants in 2012 and 132 company-operated restaurants during 2011.

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Restaurant Development Activity

The following table summarizes Applebee’s restaurant development and franchising activity:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(unaudited)			
Applebee’s Restaurant Development Activity				
Beginning of period	2,018	2,012	2,019	2,010
New openings				
Franchise	5	4	14	12
Total new openings	5	4	14	12
Closings				
Franchise	(7)	(6)	(17)	(12)
Total closings	(7)	(6)	(17)	(12)
End of period	2,016	2,010	2,016	2,010
Summary - end of period				
Franchise	1,954	1,767	1,954	1,767
Company	62	243	62	243
Total	2,016	2,010	2,016	2,010
Restaurant Franchising Activity				
Domestic franchise openings	4	2	7	8
International franchise openings	1	2	7	4
Refranchised	98	1	115	66
Total restaurants franchised	103	5	129	78
Closings				
Domestic franchise	(2)	(1)	(6)	(3)
International franchise	(5)	(5)	(11)	(9)
Total franchise closings	(7)	(6)	(17)	(12)
Net franchise restaurant (reductions) additions	96	(1)	112	66

In 2012, we expect Applebee's franchisees to open a total of 30 to 40 new Applebee's restaurants, approximately half of which are expected to be opened domestically. We currently do not plan to open any Applebee's company-operated restaurants. The actual number of openings may differ from both our expectations and development commitments due to various factors, including economic conditions, franchisee access to capital, and the impact of currency fluctuations on our international franchisees. The timing of new restaurant openings also may be affected by various factors including weather-related and other construction delays and difficulties in obtaining regulatory approvals.

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The following table summarizes IHOP restaurant development and franchising activity:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(unaudited)			
IHOP Restaurant Development Activity				
Beginning of period	1,557	1,522	1,550	1,504
New openings				
Franchise	12	13	27	36
Area license	—	1	1	3
Total new openings	12	14	28	39