APPLEBEES INTERNATIONAL INC
Form 10-Q
August 02, 2001

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

# FORM 10-Q

(Mark One)
[ X ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 1, 2001

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: 000-17962

Applebee's International, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 43-1461763 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

4551 W. 107th Street, Suite 100, Overland Park, Kansas 66207
(Address of principal executive offices and zip code)

(913) 967-4000
(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 X No

The number of shares of the registrant's common stock outstanding as of July 27, 2001 was 36,863,529.

APPLEBEE'S INTERNATIONAL, INC.
FORM 10-Q
FISCAL QUARTER ENDED JULY 1, 2001
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|---|---|
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APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share amounts)

| | July 1, 2001 |
|---|---|
| **ASSETS** | |
| Current assets: | |
| Cash and cash equivalents | $ 7,202 |
| Short-term investments, at market value (amortized cost of $925 in 2001 and $1,250 in 2000) | 960 |
| Receivables (less allowance for bad debts of $2,547 in 2001 and $2,295 in 2000) | 19,426 |
| Inventories | 9,379 |
| Prepaid and other current assets | 7,156 |
| Total current assets | 44,123 |
| Property and equipment, net | 316,845 |
| Goodwill, net | 80,615 |
| Franchise interest and rights, net | 2,699 |
| Other assets | 21,959 |
| | $ 466,241 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | |
| Current liabilities: | |
| Current portion of long-term debt | $ 816 |
| Accounts payable | 26,190 |
| Accrued expenses and other current liabilities | 57,659 |
| Accrued dividends | -- |
| Accrued income taxes | 2,874 |
| Total current liabilities | 87,539 |
| Non-current liabilities: | |
| Long-term debt - less current portion | 83,121 |
| Deferred income taxes | 1,603 |
| Other non-current liabilities | 3,342 |
| Total non-current liabilities | 88,066 |
| Total liabilities | 175,605 |
| Commitments and contingencies (Note 2) | |
| Stockholders' equity: | |
| Preferred stock - par value $0.01 per share: authorized - 1,000,000 shares; no shares issued | -- |
| Common stock - par value $0.01 per share: authorized - 125,000,000 shares; issued - 48,225,358 shares | 482 |
| Additional paid-in capital | 177,105 |
| Retained earnings | 328,344 |
| Accumulated other comprehensive income (loss), net of income taxes | (1,183 |
| | 504,748 |
| Treasury stock - 11,375,206 shares in 2001 and 10,395,795 shares in 2000, at cost | (214,112 |
| Total stockholders' equity | 290,636 |
| | $ 466,241 |

See notes to consolidated financial statements.



APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)
(in thousands, except per share amounts)

| | 13 Weeks Ended | | 26 We |
|---|---|---|---|
| | July 1, 2001 | June 25, 2000 | July 1, 2001 |
| Revenues: | | | |
| Company restaurant sales.................... | $162,035 | $147,909 | $ 322,178 |
| Franchise income............................ | 23,885 | 20,736 | 46,119 |
| Total operating revenues................. | 185,920 | 168,645 | 368,297 |
| Cost of company restaurant sales: | | | |
| Food and beverage........................... | 43,633 | 39,323 | 86,938 |
| Labor....................................... | 51,533 | 46,954 | 102,433 |
| Direct and occupancy........................ | 41,104 | 36,095 | 81,863 |
| Pre-opening expense......................... | 132 | 213 | 267 |
| Total cost of company restaurant sales... | 136,402 | 122,585 | 271,501 |
| General and administrative expenses............. | 18,085 | 16,338 | 35,251 |
| Amortization of intangible assets............... | 1,462 | 1,455 | 2,925 |
| Loss on disposition of restaurants and equipment. | 571 | 322 | 758 |
| Operating earnings.............................. | 29,400 | 27,945 | 57,862 |
| Other income (expense): | | | |
| Investment income........................... | 415 | 367 | 772 |
| Interest expense............................ | (2,043) | (2,267) | (4,400) |
| Other income................................ | 385 | 303 | 475 |
| Total other expense...................... | (1,243) | (1,597) | (3,153) |
| Earnings before income taxes.................... | 28,157 | 26,348 | 54,709 |
| Income taxes.................................... | 10,361 | 9,696 | 20,132 |
| Net earnings.................................... | $ 17,796 | $ 16,652 | $ 34,577 |
| Basic net earnings per common share............. | $ 0.48 | $ 0.42 | $ 0.93 |
| Diluted net earnings per common share........... | $ 0.47 | $ 0.41 | $ 0.92 |
| Basic weighted average shares outstanding........ | 36,914 | 40,035 | 37,015 |
| Diluted weighted average shares outstanding...... | 37,872 | 40,550 | 37,774 |

See notes to consolidated financial statements.



APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(in thousands, except share amounts)

| | Common Stock | | Additional | | Accumul |
|---|---|---|---|---|---|
| | | | | | Othe |
| | | | Paid-In | Retained | Comprehe |
| | Shares | Amount | Capital | Earnings | Income ( |
| Balance, December 31, 2000........ | 48,225,358 | $ 482 | $ 172,037 | $ 293,772 | $ |
| Comprehensive income: | | | | | |
| Net earnings................. | -- | -- | -- | 34,577 | - |
| Change in unrealized gain on short-term investments, net of income taxes........ | -- | -- | -- | -- | ( |
| Transition adjustment related to financial instruments, net of taxes.............. | -- | -- | -- | -- | (2 |
| Net loss on financial instruments, net of taxes.. | -- | -- | -- | -- | (9 |
| Total comprehensive income..... | -- | -- | -- | 34,577 | (1,2 |
| Purchases of treasury stock.... | -- | -- | -- | -- | - |
| Stock options exercised and related tax benefit.......... | -- | -- | 4,079 | -- | - |
| Shares issued under employee stock and 401(k) plans....... | -- | -- | 636 | -- | - |
| Restricted stock shares awarded under equity incentive plan, net of cancellations......... | -- | -- | (164) | -- | - |
| Unearned compensation relating to restricted shares......... | -- | -- | 148 | -- | - |
| Notes receivable from officers for stock sales............. | -- | -- | 369 | -- | - |
| Dividends paid for fractional shares...................... | -- | -- | -- | (5) | - |

| | | | | | |
|---|---|---|---|---|---|
| Balance, July 1, 2001............ | 48,225,358 | $ 482 | $ 177,105 | $ 328,344 | $ (1,1 |

See notes to consolidated financial statements.



APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

| | 26 Wee |
|---|---|
| | July 1, 2001 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net earnings.................................................... | $ 34,577 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | |
| Depreciation and amortization................................ | 15,561 |
| Amortization of intangible assets............................ | 2,925 |
| Amortization of deferred financing costs..................... | 362 |
| Deferred income tax provision (benefit)...................... | (3,095) |
| Loss on disposition of restaurants and equipment.............. | 758 |
| Changes in assets and liabilities: | |
| Receivables.................................................. | 334 |
| Inventories.................................................. | 3,237 |
| Prepaid and other current assets............................. | 545 |
| Accounts payable............................................. | (366) |
| Accrued expenses and other current liabilities................ | (3,824) |
| Accrued income taxes......................................... | 1,774 |
| Other non-current liabilities................................ | (161) |
| Other........................................................ | (1,381) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES..................... | 51,246 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Purchases of property and equipment.............................. | (18,836) |
| Purchases of short-term investments.............................. | (49) |
| Maturities and sales of short-term investments................... | 375 |
| Equity investment in unaffiliated company........................ | -- |
| Proceeds from sale of restaurants and equipment.................. | 16 |
| NET CASH USED BY INVESTING ACTIVITIES......................... | (18,494) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Purchases of treasury stock...................................... | (39,578) |
| Dividends paid................................................... | (2,779) |
| Issuance of common stock upon exercise of stock options........... | 12,934 |

| | |
|---|---|
| Shares sold under employee stock purchase plan | 540 |
| Payments on long-term debt | (7,430) |
| NET CASH USED BY FINANCING ACTIVITIES | (36,313) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (3,561) |
| CASH AND CASH EQUIVALENTS, beginning of period | 10,763 |
| CASH AND CASH EQUIVALENTS, end of period | $ 7,202 |

See notes to consolidated financial statements.

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APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS - (Continued)
(Unaudited)
(in thousands)

| | 26 Wee |
|---|---|
| | July 1, 2001 |
| Supplemental disclosures of cash flow information: | |
| Cash paid during the 26 week period for: | |
| Income taxes | $ 19,256 |
| Interest | $ 4,029 |

Disclosure of Accounting Policy:

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

See notes to consolidated financial statements.



APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Our consolidated financial statements included in this Form 10-Q have been prepared without audit (except that the balance sheet information as of December 31, 2000 has been derived from consolidated financial statements which were audited) in accordance with the rules and regulations of the Securities and Exchange Commission. Although certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, we believe that the disclosures are adequate to make the information presented not misleading. The accompanying consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

We believe that all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented have been made. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

We have made certain reclassifications to the consolidated financial statements to conform to the 2001 presentation.

2. Commitments and Contingencies

Litigation, claims and disputes: We are involved in various legal actions arising in the normal course of business. These matters include, without limitation, such matters as employment law related claims and disputes with certain international franchisees regarding disclosures we allegedly made or omitted. In each instance, we believe that we have meritorious defenses to the allegations made and we are vigorously defending these claims.

While the resolution of the matters described above may have an impact on the financial results for the period in which they are resolved, we believe that the ultimate disposition of these matters will not, in the aggregate, have a material adverse effect upon our business or consolidated financial position.

Franchise financing: In 1992, we entered into an agreement with a financing source to provide up to $75,000,000 of financing to our franchisees to fund development of new franchise restaurants. We provided a limited guaranty of loans made under the agreement. Our maximum recourse obligation for each long-term loan is 10% of the amount funded, and this is gradually reduced beginning in the second year of each loan. After the seventh year of each loan, it decreases to zero. Approximately $49,000,000 was funded through this financing source. Of this, approximately $2,600,000 was outstanding as of July 1, 2001. This agreement expired on December 31, 1994 and was not renewed.

Lease guaranties: In connection with the sale of restaurants to franchisees and other parties, we have, in certain cases, remained contingently liable for the remaining lease payments. As of July 1, 2001, the aggregate amount of these lease payments totaled approximately $29,100,000. The buyers have indemnified us from any losses related to these guaranties.



Philadelphia divestiture: In connection with the sale of the Philadelphia restaurants, we provided a guarantee to a franchise group totaling $1,250,000. As of July 1, 2001, $595,000 remains outstanding.

Severance agreements: We have severance and employment agreements with certain officers providing for severance payments to be made in the event the employee resigns or is terminated related to a change in control. The agreements define the circumstances which will constitute a change in control. If the severance payments had been due as of July 1, 2001, we would have been required to make payments totaling approximately $6,700,000. In addition, we have severance and employment agreements with certain officers which contain severance provisions not related to a change in control. Those provisions would have required aggregate payments of approximately $4,300,000 if such officers had been terminated as of July 1, 2001.

3. Earnings Per Share

We compute basic earnings per share by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if holders of options or other contracts to issue common stock exercised or converted their holdings into common stock. Outstanding stock options and performance shares represent the only dilutive effects on weighted average shares. The chart below presents a reconciliation between basic and diluted weighted average shares outstanding and the related earnings per share. All amounts in the chart except per share amounts are expressed in thousands.

| | 13 Weeks Ended | | 26 |
|---|---|---|---|
| | July 1, 2001 | June 25, 2000 | July 1 2001 |
| Net earnings....................................... | $ 17,796 | $ 16,652 | $ 34,57 |
| Basic weighted average shares outstanding........... | 36,914 | 40,035 | 37,01 |
| Dilutive effect of stock options and performance shares.............................. | 958 | 515 | 75 |
| Diluted weighted average shares outstanding......... | 37,872 | 40,550 | 37,77 |
| Basic net earnings per common share................. | $ 0.48 | $ 0.42 | $ 0.9 |
| Diluted net earnings per common share............... | $ 0.47 | $ 0.41 | $ 0.9 |

4. Stock Split

On May 10, 2001, we declared a three-for-two stock split, effected in the form of a 50% stock dividend, to shareholders of record on May 25, 2001, payable on June 12, 2001. We issued approximately 16,100,000 shares of common stock as a result of the stock split. All references to the number of shares and per share amounts of common stock have been restated to reflect the stock split. We have reclassified an amount equal to the par value of the number of shares issued to common stock from retained earnings.



5. New Accounting Pronouncements

Effective January 1, 2001, we adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" issued by the Financial Accounting Standards Board. SFAS No. 133, as amended by SFAS Nos. 137 and 138, establishes accounting and reporting standards for derivative instruments and hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet. The statement also requires changes in the fair value of the derivative instruments to be recorded in either net earnings or other comprehensive income depending on their intended use.

We have interest rate swap agreements to manage our exposure to interest rate fluctuations. The swap agreements effectively fix the underlying three-month LIBOR interest rate on $75,000,000 of our senior credit facilities to rates ranging from 5.91% to 6.05%. The estimated fair value of these agreements at July 1, 2001 was a net payable of $1,907,000 and is included in other non-current liabilities on the accompanying balance sheets. Our interest rate swap agreements meet the criteria for hedge accounting under SFAS No. 133 and accordingly, the cumulative after-tax fair value of the interest rate hedges is included as a reduction in other comprehensive income.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for using the purchase method of accounting and requires separate recognition of intangible assets that meet certain criteria. This statement applies to all business combinations after June 30, 2001.

SFAS No. 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. SFAS No. 142 is effective for fiscal periods beginning after December 15, 2001. We will continue to amortize existing goodwill through the remainder of fiscal 2001, at which time amortization will cease and we will perform a transitional goodwill impairment test. We are currently evaluating the impact of the new accounting standards on existing goodwill and other intangible assets. The ultimate impact of the new accounting standards has not yet been determined. Goodwill amortization expense for the twenty-six weeks ended July 1, 2001 was $2,650,000.



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

General

Our revenues are generated from two primary sources:

- o Company restaurant sales (food and beverage sales)
- o Franchise income

Franchise income consists of franchise restaurant royalties (generally 4% of each franchise restaurant's monthly gross sales) and franchise fees (which typically range from $30,000 to $35,000 for each restaurant opened). Beverage sales include sales of alcoholic beverages, while non-alcoholic beverages are included in food sales.

Certain expenses relate only to company operated restaurants. These include:

- o Food and beverage costs
- o Labor costs
- o Direct and occupancy costs
- o Pre-opening expenses

Other expenses, such as general and administrative and amortization expenses, relate to both company operated restaurants and franchise operations.

We operate on a 52 or 53 week fiscal year ending on the last Sunday in December. Our fiscal quarters ended July 1, 2001 and June 25, 2000 each contained 13 weeks and are referred to hereafter as the "2001 quarter" and the "2000 quarter", respectively. Our 26 week periods ended July 1, 2001 and June 25, 2000 are referred to hereafter as the "2001 year-to-date period" and the "2000 year-to-date period," respectively.



Results of Operations

The following table contains information derived from our consolidated statements of earnings expressed as a percentage of total operating revenues, except where otherwise noted. Percentages may not add due to rounding.

| | 13 Weeks Ended | | 2 |
|---|---|---|---|
| | July 1, 2001 | June 25, 2000 | July 20 |
| Revenues: | | | |
| Company restaurant sales.............................. | 87.2% | 87.7% | 87. |
| Franchise income...................................... | 12.8 | 12.3 | 12. |
| Total operating revenues............................ | 100.0% | 100.0% | 100. |
| Cost of sales (as a percentage of company restaurant sales): | | | |
| Food and beverage..................................... | 26.9% | 26.6% | 27. |
| Labor................................................. | 31.8 | 31.7 | 31. |
| Direct and occupancy.................................. | 25.4 | 24.4 | 25. |

| | | | |
|---|---|---|---|
| Pre-opening expense | 0.1 | 0.1 | 0. |
| Total cost of sales | 84.2% | 82.9% | 84. |
| General and administrative expenses | 9.7% | 9.7% | 9. |
| Amortization of intangible assets | 0.8 | 0.9 | 0. |
| Loss on disposition of restaurants and equipment | 0.3 | 0.2 | 0. |
| Operating earnings | 15.8 | 16.6 | 15. |
| Other income (expense): | | | |
| Investment income | 0.2 | 0.2 | 0. |
| Interest expense | (1.1) | (1.3) | (1. |
| Other income | 0.2 | 0.2 | 0. |
| Total other expense | (0.7) | (0.9) | (0. |
| Earnings before income taxes | 15.1 | 15.6 | 14. |
| Income taxes | 5.6 | 5.7 | 5. |
| Net earnings | 9.6% | 9.9% | 9. |

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The following table sets forth certain unaudited financial information and other restaurant data relating to company and franchise restaurants, as reported to us by franchisees:

| | 13 Weeks Ended | | |
|---|---|---|---|
| | July 1, 2001 | June 25, 2000 | July 200 |
| Number of restaurants: | | | |
| Company(1): | | | |
| Beginning of period | 287 | 266 | |
| Restaurant openings | 2 | 3 | |
| Restaurant closings | -- | (1) | |
| End of period | 289 | 268 | |
| Franchise: | | | |
| Beginning of period | 1,012 | 919 | 1 |
| Restaurant openings | 24 | 26 | |
| Restaurant closings | (1) | (3) | |
| End of period | 1,035 | 942 | 1 |
| Total: | | | |
| Beginning of period | 1,299 | 1,185 | 1 |
| Restaurant openings | 26 | 29 | |
| Restaurant closings | (1) | (4) | |

| | | | |
|---|---|---|---|
| End of period | 1,324 | 1,210 | 1 |
| Weighted average weekly sales per restaurant: | | | |
| Company(1) | $ 43,291 | $ 42,600 | $ 43 |
| Franchise | $ 42,924 | $ 41,969 | $ 42 |
| Total | $ 43,004 | $ 42,110 | $ 42 |
| Change in comparable restaurant sales:(2) | | | |
| Company(1) | 3.1% | 1.6% | |
| Franchise | 3.1% | 1.2% | |
| Total | 3.1% | 1.3% | |
| Total system sales (in thousands) | $732,491 | $655,123 | $ 1,445 |



Company Restaurant Sales Total company restaurant sales increased $14,126,000 (10%) from $147,909,000 in the 2000 quarter to $162,035,000 in the 2001 quarter and increased $28,818,000 (10%) from $293,360,000 in the 2000 year-to-date period to $322,178,000 in the 2001 year-to-date period due primarily to company restaurant openings and increases in comparable restaurant sales.

Comparable restaurant sales at company restaurants increased by 3.1% and 3.3% in the 2001 quarter and the 2001 year-to-date period, respectively. Weighted average weekly sales at company restaurants increased 1.6% from $42,600 in the 2000 quarter to $43,291 in the 2001 quarter and increased 1.5% from $42,485 in the 2000 year-to-date period to $43,130 in the 2001 year-to-date period. These increases were due primarily to an increase in the average guest check resulting from the company's food promotions and menu price increases of approximately 2.0%.

Franchise Income. Overall franchise income increased $3,149,000 (15%) from $20,736,000 in the 2000 quarter to $23,885,000 in the 2001 quarter and increased $5,584,000 (14%) from $40,535,000 in the 2000 year-to-date period to $46,119,000 in the 2001 year-to-date period. These increases were due primarily to the increased number of franchise Applebee's restaurants operating during the 2001 quarter and 2001 year-to-date period and increases in comparable restaurant sales. Weighted average weekly sales at franchise restaurants increased 2.3% and 2.2% in the 2001 quarter and 2001 year-to-date period, respectively and franchise comparable restaurant sales increased 3.1% in both the 2001 quarter and 2001 year-to-date periods.

Cost of Company Restaurant Sales. Food and beverage costs increased from 26.6% in the 2000 quarter to 26.9% in the 2001 quarter and decreased from 27.1% in the 2000 year-to-date period to 27.0% in the 2001 year-to-date period. The increase in the 2001 quarter was due to higher costs relating to the implementation of a new menu in the fourth quarter of 2000 and higher product costs relating to our food promotions. Both the 2001 quarter and the 2001 year-to-date periods were favorably impacted by menu price increases in 2001.

Labor costs increased from 31.7% in both the 2000 quarter and the 2000 year-to-date period to 31.8% in the 2001 quarter and 2001 year-to-date period. These increases were due primarily to higher group insurance costs and continued pressure on management costs due to low unemployment as well as the highly competitive nature of the restaurant industry.

Direct and occupancy costs increased from 24.4% in the 2000 quarter to 25.4% in the 2001 quarter and from 24.5% in the 2000 year-to-date period to 25.4% in the 2001 year-to-date period. The increases in both periods were due primarily to higher utility costs and repairs and maintenance expense. The increase in the 2001 quarter was also due to an increase in advertising costs, as a percentage of sales, due to the timing of food promotions.

General and Administrative Expenses. General and administrative expenses were 9.7% in both the 2000 quarter and 2001 quarter and decreased from 9.7% in the 2000 year-to-date period to 9.6% in the 2001 year-to-date period. General and administrative expenses were impacted in both the 2001 quarter and 2001 year-to-date period by costs associated with our purchasing supply chain and strategic brand assessment projects. These costs were offset by the absorption of general and administrative expense over a larger revenue base.

Income Taxes. The effective income tax rate, as a percentage of earnings before income taxes, was 36.8% in both the 2000 quarter and 2000 year-to-date period, as well as the 2001 quarter and the 2001 year-to-date period.



Liquidity and Capital Resources

Our need for capital resources historically has resulted from the construction and acquisition of restaurants. For the foreseeable future, this should continue to be the case. In the past, we have obtained capital through public stock offerings, debt financing, and our ongoing operations. Income from our ongoing operations includes cash generated from company and franchise operations, credit from trade suppliers, real estate lease financing, and landlord contributions to leasehold improvements. We have also used our common stock as consideration in the acquisition of restaurants. In addition, we have assumed debt or issued new debt in connection with certain mergers and acquisitions.

Capital expenditures were $46,220,000 in fiscal year 2000 and $18,836,000 in the 2001 year-to-date period. We currently expect to open approximately 25 restaurants in 2001. Capital expenditures are expected to be between $50,000,000 and $55,000,000 in fiscal 2001. These expenditures will primarily be for the development of new restaurants, refurbishment and capital replacement in existing restaurants, and the enhancement of information systems. Because we expect to continue to purchase a portion of our sites, the amount of actual capital expenditures will be dependent upon, among other things, the proportion of leased versus owned properties. In addition, if we open more restaurants than we currently anticipate or acquire additional restaurants, our capital requirements will increase accordingly.

Our senior term loan and working capital facilities are subject to various covenants and restrictions which, among other things, require the maintenance of stipulated fixed charge, interest coverage and leverage ratios, as defined, and limit additional indebtedness and capital expenditures in excess of specified amounts. The credit agreement permits annual cash dividends of the greater of $5,000,000 or 50% of consolidated net income. In addition, in April 2000, the credit agreement was amended to permit additional repurchases of common stock of up to $50,000,000 through December 31, 2001. We are currently in compliance with the covenants contained in our credit agreement.

In February 2001, our Board of Directors authorized the repurchase of up to $55,000,000 of our common stock through 2001, subject to market conditions and applicable restrictions imposed by our credit agreement. We repurchased 1,714,000 shares of our common stock at an average price of $23.09 per share for an aggregate cost of $39,578,000 in the 2001 year-to-date period, including $28,965,000 under this authorization and $10,613,000 under previous authorizations.

As of July 1, 2001, our liquid assets totaled $8,162,000. These assets consisted of cash and cash equivalents in the amount of $7,202,000 and short-term investments in the amount of $960,000. The working capital deficit increased from $42,995,000 as of December 31, 2000 to $43,416,000 as of July 1, 2001. As of July 1, 2001, $4,000,000 was outstanding under our working capital and line of credit facilities, and standby letters of credit totaling $6,267,000 were outstanding under our letter of credit facilities.

We believe that our liquid assets and cash generated from operations, combined with borrowings available under our credit facilities, will provide sufficient funds for our operating, capital and other requirements for the foreseeable future.



Inflation

Substantial increases in costs and expenses could impact our operating results to the extent such increases cannot be passed along to customers. In particular, increases in food, supplies, labor and operating expenses could have a significant impact on our operating results. We do not believe that inflation has materially affected our operating results during the past three years.

A majority of our employees are paid hourly rates related to federal and state minimum wage laws and various laws that allow for credits to that wage. The Federal government continues to consider an increase in the minimum wage. Several state governments have increased the minimum wage and other state governments are also discussing an increased minimum wage. In the past, we have been able to minimize the effect of these increases through food and beverage price increases or improvements in efficiency and productivity, and we will attempt to do so in the future. We cannot guarantee, however, that all future cost increases can be reflected in our prices or that increased prices will be absorbed by customers without at least somewhat diminishing customer spending in our restaurants.

New Accounting Pronouncements

Effective January 1, 2001, we adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" issued by the Financial Accounting Standards Board. SFAS No. 133, as amended by SFAS Nos. 137 and 138, establishes accounting and reporting standards for derivative instruments and hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet. The statement also requires changes in the fair value of the derivative instruments to be recorded in either net earnings or other comprehensive income depending on their intended use.

We have interest rate swap agreements to manage our exposure to interest rate fluctuations. The swap agreements effectively fix the underlying three-month LIBOR interest rate on $75,000,000 of our senior credit facilities to rates ranging from 5.91% to 6.05%. The estimated fair value of these agreements at July 1, 2001 was a net payable of $1,907,000 and is included in other non-current liabilities on the accompanying balance sheets. Our interest rate swap agreements meet the criteria for hedge accounting under SFAS No. 133 and accordingly, the cumulative after-tax fair value of the interest rate hedges is included as a reduction in other comprehensive income.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for using the purchase method of accounting and requires separate recognition of intangible assets that meet certain criteria. This statement applies to all business combinations after June 30, 2001.

SFAS No. 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. SFAS No. 142 is effective for fiscal periods beginning after December 15, 2001. We will continue to amortize existing goodwill through the remainder of fiscal 2001, at which time amortization will cease and we will perform a transitional goodwill impairment test. We are currently evaluating the impact of the new accounting standards on existing goodwill and other intangible assets. The ultimate impact of the new accounting standards has not yet been determined. Goodwill amortization expense for the twenty-six weeks ended July 1, 2001 was $2,650,000.

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Forward-Looking Statements

The statements contained in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section regarding restaurant development and capital expenditures are forward-looking and based on current expectations. There are several risks and uncertainties that could cause actual results to differ materially from those described. These risks include but are not limited to the impact of intense competition in the casual dining segment of the restaurant industry and our ability to control restaurant operating costs which are impacted by market changes, minimum wage and other employment laws, food costs and inflation. For a more detailed discussion of the principal factors that could cause actual results to be materially different, you should read our current report on Form 8-K which we filed with the Securities and Exchange Commission on February 13, 2001. We disclaim any obligation to update forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our senior term loan bears interest at either the bank's prime rate plus 1.25% or LIBOR plus 2.25%, at our option. Our working capital facility bears interest at either the bank's prime rate plus 0.125% or LIBOR plus 1.125%, at our option. The interest rate on the working capital facility is subject to change based upon our leverage ratio.

We have interest rate swap agreements in place to manage our exposure to interest rate fluctuations. The swap agreements effectively fix the underlying three-month LIBOR interest rate on $75,000,000 of the senior credit facilities to rates ranging from 5.91% to 6.05%.

As of July 1, 2001, the total amount of debt subject to interest rate fluctuations was $4,372,000. This amount was comprised of $372,000 under the term loan and $4,000,000 under the working capital facility. A 1% change in interest rates would result in an increase or decrease in interest expense of $44,000 per year.



PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As of July 1, 2001, we were using assets owned by a former franchisee in the operation of one restaurant. That restaurant remains under a purchase rights agreement that required us to make certain payments to the franchisee's lender. In 1991, a dispute arose between the lender and us over the amount of the payments due the lender under that agreement and over whether we had agreed to guarantee the franchisee's debt. Based upon a then-current independent appraisal, we offered to settle the dispute and purchase the assets of the three then-existing restaurants for $1,000,000 in 1991. In November 1992, the FDIC declared the lender insolvent, and the lender has since been liquidated. We closed one of the three restaurants in 1994 and one of the two remaining restaurants in February 1996. In the fourth quarter of 1996, we received information indicating that a third party had acquired the franchisee's indebtedness to the FDIC. In June 1997, the third party filed a lawsuit against us seeking approximately $3,800,000. In April 1999, the district court awarded summary judgment to the third party. In June 2000, the court of appeals reversed the summary judgment and remanded the case to the district court for further action. The third party appealed the court's decision but its appeal was denied. In May 2001, we reached an agreement to settle this matter within our established reserves. There was no impact on our consolidated statements of earnings.

We are involved in various legal actions arising in the normal course of business. These matters include without limitation, such matters as employment law related claims and disputes with certain international franchisees regarding disclosures we allegedly made or omitted. In each instance, we believe that we have meritorious defenses to the allegations made and we are vigorously defending these claims.

While the resolution of the matters described above may have an impact on the financial results for the period in which they are resolved, we believe that the ultimate disposition of these matters will not, in the aggregate, have a material adverse effect upon our business or consolidated financial position



Item 4. Submission of Matters to a Vote of Security Holders

Our Annual Meeting of Stockholders was held on May 10, 2001. The Stockholders voted on the following matters:

Proposal I. Elect Lloyd L.Hill, Jack P. Helms and Burton M. Sack as directors to serve a three-year term expiring in 2004.

Proposal II. Approve the Applebee's International, Inc. 2001 Senior Executive Bonus Plan.

Proposal III. Ratify Deloitte & Touche LLP as our independent auditors for the 2001 fiscal year.

The results of the voting were as follows:

| Proposal | Affirmative Votes | Negative Votes | Abstentions |
|---|---|---|---|
| I (Hill) | 21,784,654 | 80,078 | -- |
| I (Helms) | 21,778,698 | 86,034 | -- |
| I (Sack) | 19,360,628 | 2,504,104 | -- |
| II | 21,120,752 | 692,680 | 51,296 |
| III | 21,769,202 | 80,012 | 15,515 |

Each Proposal received the required affirmative votes and was affirmatively adopted by the Stockholders.

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Item 6. Exhibits and Reports on Form 8-K

(a) The Exhibits listed on the accompanying Exhibit Index are filed as part of this report.

(b) We filed a report on Form 8-K on May 2, 2001 reporting first quarter earnings and April comparable sales.

We filed a report on Form 8-K on May 10, 2001 announcing a three-for-two stock split.

We filed a report on June 6, 2001 under Item 5 reporting May comparable sales.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLEBEE'S INTERNATIONAL, INC.
(Registrant)

| | |
|---|---|
| Date: August 1, 2001 | By: /s/ Lloyd L. Hill |
| | Lloyd L. Hill<br>Chairman and Chief Executive Officer<br>(principal executive officer) |
| Date: August 1, 2001 | By: /s/ George D. Shadid |
| | George D. Shadid<br>Executive Vice President and<br>Chief Financial Officer<br>(principal financial officer) |
| Date: August 1, 2001 | By: /s/ Mark A. Peterson |
| | Mark A. Peterson<br>Vice President and Controller<br>(principal accounting officer) |



APPLEBEE'S INTERNATIONAL, INC.
EXHIBIT INDEX

| Exhibit Number | Description of Exhibit |
|---|---|
| 10.1 | Amendment to Development and Franchise Agreements. |
| 10.2 | New Form of Change in Control Agreement and schedule of parties thereto. |