APPLEBEES INTERNATIONAL INC
Form 10-Q
July 27, 2006

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 June 25, 2006

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, 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 ____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer X Accelerated filer ____ Non-accelerated filer ____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ____ No X

The number of shares of the registrant's common stock outstanding as of July 24, 2006 was 74,427,928.

1.

APPLEBEE'S INTERNATIONAL, INC.
FORM 10-Q
FISCAL QUARTER ENDED JUNE 25, 2006
INDEX

2.

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	June 25, 2006
ASSETS	
Current assets:	
Cash and cash equivalents	$ 6,896
Short-term investments, at market value	289
Receivables (less allowance of $325 in 2006 and $340 in 2005)	37,706
Receivables related to captive insurance subsidiary	503
Inventories	12,525
Prepaid income taxes	55
Prepaid and other current assets	18,339
Total current assets	76,313
Property and equipment, net	619,638
Goodwill	139,111
Restricted assets related to captive insurance subsidiary	17,267
Other intangible assets, net	6,713
Other assets, net	33,712
	$ 892,754
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Current portion of long-term debt	$ 283
Notes payable	4,400
Accounts payable	41,773
Accrued expenses and other current liabilities	83,661
Loss reserve related to captive insurance subsidiary	7,103
Accrued dividends	--
Accrued income taxes	275
Total current liabilities	137,495

Non-current liabilities:	
Long-term debt, less current portion	197,066
Deferred income taxes	34,235
Other non-current liabilities	55,784
Total non-current liabilities	287,085
Total liabilities	424,580
Commitments and contingencies (Note 3)	
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 - 108,503,243 shares	1,085
Additional paid-in capital	248,656
Unearned compensation	--
Retained earnings	757,832
	1,007,573
Treasury stock - 34,133,112 shares in 2006 and 34,304,693 shares in 2005, at cost	(539,399
Total stockholders' equity	468,174
	$ 892,754

See notes to condensed consolidated financial statements.

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

	13 Weeks Ended	
	June 25, 2006	June 26, 2005
Operating revenues:		
Company restaurant sales	$ 296,128	$ 272,703
Franchise royalties and fees	34,306	32,493
Other franchise income	539	1,424
Total operating revenues	330,973	306,620
Cost of company restaurant sales:		
Food and beverage	78,433	72,565
Labor	100,296	90,115
Direct and occupancy	80,411	71,038
Pre-opening expense	1,157	1,268

Total cost of company restaurant sales......	260,297	234,986
Cost of other franchise income......................	281	1,229
General and administrative expenses.................	32,320	27,980
Amortization of intangible assets...................	204	226
Impairment and other restaurant closure costs........	3,000	--
Loss on disposition of property and equipment........	430	564
Operating earnings.................................	34,441	41,635
Other income (expense):		
Investment income (loss).......................	(285)	449
Interest expense...............................	(2,985)	(634)
Other income...................................	101	584
Total other income (expense)...............	(3,169)	399
Earnings before income taxes.......................	31,272	42,034
Income taxes.......................................	10,868	14,544
Net earnings.......................................	$ 20,404	$ 27,490
Basic net earnings per common share.................	$ 0.28	$ 0.34
Diluted net earnings per common share...............	$ 0.27	$ 0.34
Basic weighted average shares outstanding...........	74,112	79,897
Diluted weighted average shares outstanding.........	75,083	81,360

See notes to condensed consolidated financial statements.

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

	Common Stock		Additional Paid-In	Unearned	R
	Shares	Amount	Capital	Compensation	E
Balance, December 25, 2005	108,503	$ 1,085	$234,988	$ (2,614)	$
Net earnings..............................	--	--	--	--	
Purchases of treasury stock................	--	--	--	--	
Reclassification of unearned compensation related to the adoption of Statement of					

Financial Accounting Standards No. 123(R) (Note 2)	--	--	(2,614)	2,614	
Stock options exercised and related tax benefit	--	--	4,664	--	
Shares issued under employee benefit plans	--	--	1,188	--	
Nonvested shares awarded under equity incentive plans	--	--	(982)	--	
Stock-based compensation expense related to employee-based awards	--	--	11,412	--	
Balance, June 25, 2006	108,503	$ 1,085	$248,656	$ --	$

See notes to condensed consolidated financial statements.

5.

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

	26 Weeks En
	June 25, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings	$ 47,555
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization	31,577
Amortization of intangible assets	408
Stock-based compensation	11,412
Other amortization	156
Deferred income tax benefit	(1,046)
Impairment and other restaurant closure costs	4,600
Loss on disposition of property and equipment	1,007
Income tax benefit from stock-based compensation	1,403
Changes in assets and liabilities, exclusive of effect of acquisitions:	
Receivables	148
Receivables related to captive insurance subsidiary	1,209
Inventories	7,906
Income taxes	3,708
Prepaid and other current assets	(7,262)
Accounts payable	(18,985)
Accrued expenses and other current liabilities	(17,509)
Loss reserve and unearned premiums related to	

captive insurance subsidiary	(3,132)
Other non-current liabilities	4,138
Other	(1,461)
NET CASH PROVIDED BY OPERATING ACTIVITIES	65,832
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(59,976)
Change in restricted assets related to captive insurance subsidiary	2,062
Acquisition of restaurants	(8,040)
Proceeds from sale of property and equipment	242
NET CASH USED BY INVESTING ACTIVITIES	(65,712)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Purchases of treasury stock	(16,134)
Dividends paid	(14,840)
Issuance of common stock upon exercise of stock options	7,856
Shares issued under employee benefit plans	2,318
Excess tax benefits from stock-based compensation	1,154
Net debt proceeds	13,382
NET CASH USED BY FINANCING ACTIVITIES	(6,264)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(6,144)
CASH AND CASH EQUIVALENTS, beginning of period	13,040
CASH AND CASH EQUIVALENTS, end of period	$ 6,896

See notes to condensed consolidated financial statements.

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

	26 Wee
	June 25, 2006
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
Cash paid during the 26 week period for:	
Income taxes	$ 19,388
Interest	$ 5,616

SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

We issued nonvested shares (previously referred to as restricted stock prior to fiscal 2006) with grant date fair values of $2,447,000 for the 26 weeks ended June 25, 2006 and nonvested shares, net of forfeitures, of $2,601,000 for the 26 weeks ended June 26, 2005.

In 2002, we entered into a rabbi trust agreement to protect the assets of the nonqualified deferred compensation plan for certain of our associates. The plan investments are included in other assets and the offsetting obligation is included in other non-current liabilities in our consolidated balance sheets. We had non-cash increases in these balances of $566,000 and $2,094,000 for the 26 weeks ended June 25, 2006 and June 26, 2005, respectively.

We had property and equipment purchases accrued in accounts payable of approximately $11,600,000 as of June 25, 2006.

See notes to condensed consolidated financial statements.

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

1. Basis of Presentation

Our condensed consolidated financial statements included in this Form 10-Q have been prepared without audit 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 condensed 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 25, 2005.

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.

2. Stock-Based Compensation

Our Board of Directors has approved the Amended and Restated 1995 Equity Incentive Plan ("1995 Plan") and the 1999 Employee Incentive Plan ("1999 Plan") which allow the granting of stock options, stock appreciation rights ("SARs"), nonvested shares, performance units and performance shares to eligible participants. Grants of stock options may be either incentive or nonqualified. There are 19,900,000 and 2,473,875 shares authorized under the 1995 Plan and the 1999 Plan, respectively. As of June 25, 2006, we had 3,368,993 shares available for grant under the 1995 Plan. We will not make additional grants under the 1999

Plan. We issue shares out of our treasury for stock option exercises, SARs exercises and nonvested share issuances.

Prior to fiscal 2006, we accounted for these stock-based compensation awards under the intrinsic method of Accounting Principles Board ("APB") Opinion No. 25. Opinion No. 25 required compensation cost to be recognized based on the excess, if any, between the quoted market price of the stock at the date of grant and the amount an employee must pay to acquire the stock. All options awarded under both of our plans were granted with an exercise price equal to the fair market value on the date of the grant and, accordingly, no compensation expense was recognized for stock option awards. In addition, we adopted the disclosure provisions of Statements of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." The Statement required prominent disclosures in financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

Under APB Opinion No. 25, pro forma expense for stock-based compensation was calculated using a graded vesting schedule over the explicit vesting period. The following table presents the effect on our net earnings and earnings per share had we adopted the fair value method of accounting for stock-based compensation under SFAS No. 123, "Accounting for Stock-Based Compensation" for the 13 weeks and 26 weeks ended June 26, 2005 (in thousands, except for per share amounts).

	13 Weeks Ended June 26, 2005	26
Net earnings, as reported	$ 27,490	$
Add: Stock-based compensation expense included in net earnings, net of related taxes	373	
Less: Total stock-based employee compensation expense determined under fair value-based methods for all awards, net of related taxes (1)	1,735	
Pro forma net earnings	$ 26,128	$
Basic net earnings per common share, as reported	$ 0.34	$
Basic net earnings per common share, as adjusted	$ 0.33	$
Diluted net earnings per common share, as reported	$ 0.34	$
Diluted net earnings per common share, as adjusted	$ 0.32	$

We adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment" ("SFAS 123(R)") at the beginning of fiscal year 2006. SFAS 123(R) requires all stock-based compensation, including grants of employee stock options, to be recognized in the statement of earnings based on fair value. With limited exceptions, the amount of compensation cost will be measured based on the fair value on the grant date of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service for that award. We adopted this accounting treatment using the modified prospective transition method; therefore, results for prior periods have not been restated.

Beginning in fiscal 2006, we changed our method of determining the fair value of stock-based awards from the Black-Scholes model to a binomial model. The binomial model considers a range of assumptions relative to volatility, risk-free interest rates and employee exercise behavior, which more accurately models actual employee behaviors. We believe the binomial model provides a fair value that is more representative of actual and future experience.

9.

Compensation costs for the 13 weeks ended June 25, 2006 ("2006 quarter") and the 26 weeks ended June 25, 2006 ("2006 year-to-date period") have been recognized for all new awards granted in fiscal 2006 and those awards granted prior to fiscal 2006 that have yet to reach the end of their service period. As required by SFAS 123(R), we began recognizing expense for employee stock-based compensation over the shorter of the vesting period or the period from the date of the grant until the date the employee becomes eligible for retirement. We recognize expense for stock-based compensation over the graded vesting period. We recognized stock-based compensation in the condensed consolidated financial statements as follows:

	2006 Quarter	2005 Quarter	2006 Year-to-D Period
Labor..	$ 243	$ --	$ 487
General and administrative expenses.................	5,004	571	10,925
Income taxes.......................................	(1,769)	(197)	(3,933
Stock-based compensation expense included in net earnings, net of related tax..............	$ 3,478	$ 374	$ 7,479

As of June 25, 2006, we had unrecognized compensation expense for stock options and SARs of $20,200,000 to be recognized over a weighted average period of 2.2 years.

As required by SFAS 123(R), unearned compensation of $2,614,000, which was previously reflected as a reduction to stockholders' equity as of December 25, 2005, was reclassified as a reduction to additional paid-in capital upon our adoption of this Statement.

Stock Options

Prior to fiscal 2005, we granted substantially all of our awards through stock options once per year. These stock options generally vest over three years and expire ten years from the date of the grant.

In fiscal 2005, we granted substantially all of our awards through quarterly stock options grants. Grants issued in the first quarter of each year vest three years from the date of the grant. Grants issued in subsequent quarters vest on the same date as the first quarterly stock option grant of that year. In fiscal 2005, we also granted certain employees stock options with 25% of the grant vesting four years from the grant date and the remaining 75% of the grant vesting five years from the grant date. Beginning in fiscal 2005, option grants expire six to seven years from the date of the grant. In the first quarter of fiscal 2006, we issued grants to certain employees and members of the board of directors which vest either one or three years from the date of the grant. As part of their compensation package, the outside members of the board of directors receive a grant of options in the first quarter of every year which expire 10 years from the grant date.

10.

Transactions for stock options relative to both plans for the 2006 year-to-date period were as follows:

	1995 Plan			
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag Intri
				(in
Options outstanding at December 25, 2005............	7,365,933	$ 21.33	6.5 years	
Granted..................	335,510	$ 22.30		
Exercised................	(496,950)	$ 12.20		$
Expired..................	(120)	$ 8.30		
Forfeited................	(247,686)	$ 25.74		
Options outstanding at June 25, 2006................	6,956,687	$ 21.87	6.2 years	$
Options exercisable at June 25, 2006................	2,354,237	$ 15.16	5.7 years	$

	1999 Plan			
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag Intri

(in

Options outstanding at December 25, 2005............	664,656	$ 13.73	6.0 years	
Granted...................	--	--		
Exercised.................	(131,324)	$ 14.49		$
Expired...................	--	--		
Forfeited.................	(505)	$ 13.22		
Options outstanding at June 25, 2006................	532,827	$ 13.54	5.4 years	$
Options exercisable at June 25, 2006...............	528,327	$ 13.52	5.4 years	$

The aggregate intrinsic value was calculated using the difference between the current market price and the grant price for only those awards that have a grant price that is less than the current market price.

We derived the following weighted-average assumptions using the binomial model in the 2006 quarter and the 2006 year-to-date period and the Black-Scholes model for the 2005 quarter and the 2005 year-to-date period for stock options:

	2006 Quarter	2005 Quarter	2006 Year-to-Date Period
	(Binomial)	(Black-Scholes)	(Binomial)
Expected term in years....................	5.2	4.2	4.8
Expected stock price volatility...........	31.6%	31.2%	31.3%
Expected dividend yield...................	1.0%	0.3%	0.9%
Risk-free interest rate...................	5.0%	3.7%	4.6%
Fair value of options granted.............	$ 6.61	$ 8.28	$ 6.89

Stock Appreciation Rights

Beginning in the first quarter of 2006, we began granting substantially all of our awards through quarterly nonvested share and SAR grants which are exercisable in shares of our common stock. Grants issued for the first quarter of each year vest three years from the date of the grant. Grants issued in subsequent quarters vest on the same date as the first quarterly stock option grant of that year. The SARs granted in the 2006 year-to-date period expire six to seven years from the date of the grant.

	1995 Plan	
	Weighted	Weighted Average

	Number of SARs	Average Exercise Price	Remaining Contractual Life	Ag Intri
				(in
SARs outstanding at				
December 25, 2005............	--	--		
Granted(1)................	665,350	$ 21.96		
Exercised.................	--	--		
Expired...................	--	--		
Forfeited................	(10,175)	$ 23.57		
SARs outstanding at				
June 25, 2006................	655,175	$ 21.94	6.7 years	
SARs exercisable at				
June 25, 2006..............	--			

12.

We derived the following weighted-average assumptions for SARs using the binomial model:

	2006 Quarter	2006 Year-to-Date Period
Expected term in years	4.2	4.2
Expected stock price volatility	31.6%	31.5%
Expected dividend yield	1.0%	0.9%
Risk-free interest rate	5.0%	4.8%
Fair value of SARs granted	$ 5.90	$ 6.31

Assumptions

We determined our assumptions for stock options and SAR grants based on the following methodology:

Expected term: We have determined the expected term based upon the assumption that all outstanding options and SARs will be exercised at the midpoint of the current holding period and the full contractual term.

Expected volatility: We have determined the expected volatility based on a weighted average of Applebee's volatility over the expected term, historical volatility of certain peer group restaurant volatilities and Applebee's implied volatility.

Expected dividend yield: We have determined the expected dividend yield based upon our expected dividends as a percentage of our current stock price.

Risk-free interest rate: We have determined the risk-free interest rate using the U.S. Treasury yield curve in effect at the time of the grant for the expected term of the award.

Nonvested Shares

We grant nonvested shares under our 1995 Plan. Nonvested shares vest either one, two or three years after the date of the grant. The fair value of nonvested shares granted is equal to the market price of the stock at the date of grant. The weighted average fair value of nonvested shares granted was $20.34 in the 2006 quarter, and $22.08 and $28.05 in the 2006 year-to-date period and the 2005 year-to-date period, respectively. There were no nonvested shares granted in the 2005 quarter. Transactions during the 2006 year-to-date period were as follows (in thousands, except fair values):

	Number of Awards	W Fa
Nonvested share awards outstanding as of December 25, 2005................	257,813	
Granted...	110,820	
Vested..	(88,179)	
Forfeited...	(4,506)	
Nonvested share awards outstanding as of June 25, 2006....................	275,948	

As of June 25, 2006, we had unrecognized compensation expense related to nonvested share awards of approximately $2,500,000 which will be recognized over a weighted average period of 1.3 years.

Employee stock purchase plan

Our Board of Directors has authorized an employee stock purchase plan that allows associates to purchase shares of our common stock at a 15% discount through a payroll deduction. We record compensation for this plan using the Black-Scholes valuation model in the quarter that the purchase occurs. As of June 25, 2006, 239,614 shares of the 1,850,000 shares which were authorized under this plan were available for purchase.

3. Commitments and Contingencies

Litigation, claims and disputes: We are subject from time to time to lawsuits, claims and governmental inspections or audits arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. In the opinion of management, these matters are adequately covered by insurance, or if not so covered, are without merit or are of such a nature or involve amounts that would not have a material adverse impact on our business or consolidated financial position.

Lease guarantees and contingencies: 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 June 25, 2006, we have outstanding lease guarantees of approximately $16,300,000. In addition, we or our subsidiaries are contingently liable for various leases that we have assigned in connection with the sale of restaurants to franchisees and other parties, in the potential amount of $13,200,000. These leases expire at various times with the final lease agreement expiring in 2018. We have not recorded a liability related to these contingent lease liabilities as of June 25, 2006 or December 25, 2005.

In 2004, we arranged for a third-party financing company to provide up to $250,000,000 to qualified franchisees for loans to fund development of new restaurants through October 2007, subject to our approval. We will provide a limited guarantee of 10% of certain loans advanced under this program. We will be released from our guarantee if certain operating results are met after the restaurant has been open for at least two years. As of June 25, 2006, there were loans outstanding to six franchisees for approximately $55,900,000 under this program. The fair value of our guarantees under this financing program is approximately $110,000 and is recorded in non-current liabilities in our consolidated balance sheet as of June 25, 2006.

Severance agreements: We have severance and employment agreements with certain officers providing for severance payments to be made in the event the associate resigns or is terminated not related to a change in control, some of which require payments to be made only if we enforce certain terms in the agreements. If the severance payments had been due as of June 25, 2006, we would have been required to make payments totaling approximately $13,200,000. In addition, we have severance and employment agreements with certain officers which contain severance provisions related to a change in control. The agreements define the circumstances which will constitute a change in control. Those provisions would have required additional aggregate payments of approximately $7,400,000 if such officers had been terminated as of June 25, 2006.

14.

4. Net Earnings Per Share

We compute basic net earnings per common share by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted net earnings per common 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 equity-based compensation 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 net earnings per share. All amounts in the chart, except per share amounts, are expressed in thousands.

	2006 Quarter	2005 Quarter	2006 Year-to-D Period
Net earnings..	$ 20,404	$ 27,490	$ 47,55
Basic weighted average shares outstanding...........	74,112	79,897	74,11
Dilutive effect of stock options and equity-based compensation.......................	971	1,463	1,04
Diluted weighted average shares outstanding..........	75,083	81,360	75,16

Basic net earnings per common share.................	$ 0.28	$ 0.34	$ 0.6
Diluted net earnings per common share...............	$ 0.27	$ 0.34	$ 0.6

We excluded stock options and SARs with exercise prices greater than the average market price of our common stock for the applicable periods from the computation of diluted weighted average shares outstanding as the effect would be anti-dilutive. We excluded approximately 4,900,000 and 600,000 of these options and SARs from our diluted weighted average share computation for the 2006 quarter and the 2005 quarter, respectively, and approximately 5,000,000 and 300,000 of these options and SARs for the 2006 year-to-date period and 2005 year-to-date period, respectively.

5. Acquisitions

All of our acquisitions discussed below have been accounted for using the purchase method of accounting and, accordingly, our condensed consolidated financial statements reflect the results of operations for each acquisition subsequent to the date of acquisition. The assets acquired and liabilities assumed are recorded at estimates of fair value as determined by management based upon information available. We finalize the allocation of purchase price to the fair value of assets acquired and liabilities assumed when we obtain information sufficient to complete the allocation, but in each case, no longer than one year after the acquisition date.

In January 2006, we completed the acquisition of four Applebee's restaurants in the Houston market for approximately $8,200,000. The purchase price was allocated to the fair value of property and equipment of $7,400,000, goodwill of approximately $600,000, reacquired franchise rights of approximately $100,000, and other net assets of approximately $100,000. In connection with this acquisition, we paid approximately $8,000,000 in the 2006 year-to-date period.

In May 2005, we completed the acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas, which included one restaurant under construction, for approximately $39,500,000 in cash. The purchase price was allocated to the fair value of property and equipment of $17,500,000, goodwill of $21,500,000, reacquired franchise rights of approximately $300,000, and other net assets of approximately $200,000.

The following table is comprised of actual company restaurant sales for the two restaurant acquisitions above, which are included in our condensed consolidated financial statements for each period presented, and proforma company restaurant sales assuming the acquisitions occurred at the beginning of the preceding fiscal year for each acquisition (in thousands):

	2006 Quarter	2005 Quarter	2006 Year-to-Date Period
Actual company restaurant sales for acquired restaurants....................................	$ 1,800	$ 2,800	$ 3,300

Pro forma company restaurant sales for acquired restaurants	$ 1,800	$ 8,200	$ 4,000

In April 2005, we completed the acquisition of eight Applebee's restaurants in the Memphis market, which were closed in 2004 by a former franchisee, for approximately $8,800,000 payable in cash. In connection with this acquisition, we paid approximately $800,000 in 2004 and $8,000,000 in 2005. The purchase price of $8,800,000 was allocated to the fair value of property and equipment of approximately $8,200,000 and goodwill of approximately $600,000. We have remodeled and opened seven restaurants and the remaining restaurant was sold to a third party.

6. Goodwill and Other Intangible Assets

Changes in goodwill are summarized below (in thousands):

	June 25, 2006	Decembe 200
Carrying amount, beginning of the year	$ 138,443	$ 116
Goodwill acquired during the period	668	22
Goodwill amount, end of the period	$ 139,111	$ 138

Intangible assets subject to amortization pursuant to SFAS No. 142, "Goodwill and Other Intangible Assets," are summarized below (in thousands):

	June 25, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Va
Amortized intangible assets:			
Franchise interest and rights	$ 6,371	$ 6,034	$
Lease acquisition costs (1)	3,867	966	
Noncompete agreement	350	153	
Total	$ 10,588	$ 7,153	$

	December 25, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Va
Amortized intangible assets:			

Franchise interest and rights.......	$ 6,371	$ 5,896	$
Lease acquisition costs (1).........	4,939	743	
Noncompete agreement................	350	109	
Total................................	$ 11,660	$ 6,748	$

We expect annual amortization expense for amortizable other assets for the next five fiscal years to range from approximately $200,000 to $700,000.

Intangible assets not subject to amortization are summarized below (in thousands):

	June 25, 2006	Decemb 20
Carrying amount, beginning of the year.................	$ 3,138	$
Nonamortizable intangible assets acquired during the period................................	140	
Nonamortizable intangible assets amount, end of the period................................	$ 3,278	$

In connection with our acquisition of four Applebee's restaurants in Houston from a franchisee in January 2006, we recorded approximately $100,000 of reacquired franchise rights (Note 5).

In connection with our acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas from a franchisee in May 2005, we recorded approximately $300,000 of reacquired franchise rights (Note 5).

The amount allocated to reacquired franchise rights is based upon the initial franchise fees received from these franchisees. This intangible asset has an indefinite life and, accordingly, will not be amortized but tested for impairment at least annually.

7. Captive Insurance Subsidiary

In 2002, we formed Neighborhood Insurance, Inc., a Vermont corporation and a wholly-owned captive insurance subsidiary to provide Applebee's International, Inc. and qualified franchisees with workers' compensation and general liability insurance. In 2005, we reduced the types of insurance coverage plans offered which resulted in fewer franchisee participants in our captive insurance program. Through 2005, Applebee's International, Inc. and covered franchisees made premium payments to the captive insurance company which pays administrative fees and insurance claims, subject to individual and aggregate maximum claim limits under the captive insurance company's reinsurance policies. Franchisee premium amounts billed by the captive insurance company were established based upon third-party actuarial estimates of settlement costs for incurred and anticipated claims and administrative fees. Franchisee premiums were included in other franchise income ratably over the policy year and the related offsetting expenses were included in cost of other franchise income. In 2006, we discontinued writing any new coverage. Franchise premium adjustments will be included in other franchise income and cost of other franchise income when audited. Cost of other franchise income includes costs related to the resolution of claims arising from franchisee participation in our captive insurance program. We do not expect franchisee participation in the captive insurance company to have a material impact on our net earnings. Our consolidated balance sheets include the following balances related to the captive insurance subsidiary:

- Franchise premium receivables of approximately $500,000 and $1,700,000 as of June 25, 2006 and December 25, 2005, respectively, included in receivables related to captive insurance subsidiary.
- Cash equivalent and other long-term investments restricted for the payment of claims of approximately $16,600,000 and $18,600,000 as of June 25, 2006 and December 25, 2005, respectively, included in restricted assets related to captive insurance subsidiary.
- Loss reserve related to captive insurance subsidiary of approximately $17,100,000 and $20,700,000 as of June 25, 2006 and December 25, 2005, respectively. Approximately $8,000,000 and $10,500,000 for June 25, 2006 and December 25, 2005, respectively, is included in other non-current liabilities.

8. Impairment and Other Restaurant Closure Costs

In connection with the review of long-lived assets during our preparation of the 2006 quarter condensed consolidated financial statements, we recorded an asset impairment charge of $3,000,000 for two restaurants that are not performing as expected. The impairment charge consisted of approximately $1,900,000 write-down of the carrying value of the property and equipment and approximately $1,100,000 write-off for lease acquisition costs. In the first quarter of fiscal 2006, we recorded an asset impairment charge of approximately $900,000 consisting of the write-down of the carrying value of the property and equipment of two other restaurants that are not performing as expected and we recorded approximately $700,000 relating to remaining lease obligations for two restaurants that were closed in the first quarter of fiscal 2006. The total expense of $3,000,000 and $4,600,000 for the 2006 quarter and the 2006 year-to-date period, respectively, is included in impairment and other restaurant closure costs in the consolidated statements of earnings.

In assessing restaurants for impairment, we use current and historical operating results to estimate future cash flows on a restaurant by restaurant basis. The asset impairment charges for the 2006 year-to-date period were calculated by comparing the carrying value of the restaurants' assets to the estimated future cash flow projections.

9. Treasury Shares

As of June 25, 2006, we had approximately 34,133,000 shares held in treasury. A reconciliation of our treasury shares for the 2006 year-to-date period is provided below (shares in thousands):

	Treasury Shares
Balance as of December 25, 2005........................	34,305

Purchases of treasury stock..........................	687
Stock options exercised..............................	(625)
Shares issued under employee benefit plans............	(123)
Nonvested shares awarded under equity incentive plans..	(111)
Balance as of June 25, 2006...........................	34,133

10. New Accounting Pronouncements

In March 2006, the Emerging Issues Task Force ("EITF") issued EITF Issue 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)." A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes. The guidance is effective for periods beginning after December 15, 2006. We present company sales net of sales taxes. This issue will not impact the method for recording these sales taxes in our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 is effective for fiscal years beginning after December 15, 2006. We are evaluating the impact the adoption of FIN 48 will have on our consolidated financial statements.

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

Forward-Looking Statements

The statements contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations section regarding restaurant development, comparable sales, revenue growth, restaurant margins, commodity costs, general and administrative expenses, capital expenditures, return on equity and financial commitments 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, our ability and the ability of our franchisees to open and operate additional restaurants profitably, the ability of our franchisees to obtain financing, the continued growth of our franchisees, our ability to attract and retain qualified franchisees, the impact of intense competition in the casual dining segment of the restaurant industry, the impact of economic factors on consumer spending 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 risk factors in Item 1A of our 2005 Annual Report on Form 10-K. We disclaim any obligation to update forward-looking statements.

General

We operate on a 52 or 53 week fiscal year ending on the last Sunday in December. Our fiscal years and fiscal periods are as follows:

Fiscal Year	Fiscal Year End	Number of Weeks
2005	December 25, 2005	52
2006	December 31, 2006	53
2007	December 30, 2007	52

Fiscal Period	Fiscal Period End	Number of Weeks
2005 Quarter	June 26, 2005	13
2006 Quarter	June 25, 2006	13
2005 Year-to-date period	June 26, 2005	26
2006 Year-to-date period	June 25, 2006	26

Our revenues are generated from three primary sources:

- Company restaurant sales (food and beverage sales)
- Franchise royalties and fees
- Other franchise income

Beverage sales consist of sales of alcoholic beverages, while non-alcoholic beverages are included in food sales. Franchise royalties are generally 4% of each franchise restaurant's monthly gross sales. Franchise fees typically range from $30,000 to $35,000 for each restaurant opened. Other franchise income includes revenue from information technology products and services provided to certain franchisees. In 2005, other franchise income also included insurance premiums for the current year and premium audit adjustments for prior years from franchisee participation in our captive insurance program. In 2006, we discontinued writing any new coverage. Franchise premium adjustments will be included in other franchise income when audited.

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

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

Cost of other franchise income includes costs related to information technology products and services provided to certain franchisees. In 2005, cost of other franchise income included the costs related to franchisee participation in our captive insurance program. In fiscal 2006, we discontinued writing any new coverage. Cost of other franchise income will include costs related to the resolution of claims arising from franchisee participation in our captive insurance program.

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

Overview

Applebee's International, Inc. and our subsidiaries develop, franchise and operate casual dining restaurants under the name "Applebee's Neighborhood Grill & Bar," which is the largest casual dining concept in the world with over 1,800 system-wide restaurants open as of June 25, 2006. The casual dining segment of the restaurant industry is highly competitive and there are many factors that affect our profitability. Our industry is susceptible to changes in economic conditions, trends in lifestyles, fluctuating costs, government regulation, availability of resources, and consumer perceptions. When evaluating and assessing our financial performance, we believe there are five key factors:

- Development - the number of new company and franchise restaurants opened during the period. As the largest casual dining concept in the world, Applebee's has a unique opportunity to leverage our brand, system size and scale to optimize our future growth. Our expansion strategy has been to cluster restaurants in targeted markets, thereby increasing consumer awareness and convenience, and enabling us to take advantage of operational, distribution and advertising efficiencies. We currently expect that the Applebee's system will encompass at least 3,000 restaurants in the United States, as well as the potential for at least 1,000 restaurants internationally. In the 2006 quarter and the 2006 year-to-date period, we and our franchisees opened 35 and 64 restaurants, respectively. Together, we have opened at least 100 restaurants system-wide each year for the past 13 fiscal years. In 2006, we currently expect to open approximately 125 restaurants system-wide, comprised of approximately 35 company and at least 90 franchise restaurants. Development costs, which include construction costs, fixtures and equipment and land costs, continue to increase as a result of increased demand for material, labor and commercial real estate. We are evaluating the impact of rising development costs, as well as slower sales trends, on the pipeline of future openings. We currently expect fiscal year 2007 company openings to be fewer than fiscal year 2006.

- Comparable restaurant sales - a year-over-year comparison of sales for restaurants open at least 18 months. Changes in comparable restaurant sales are driven by changes in the average guest check and/or changes in guest traffic. Average guest check changes result from menu price changes and/or changes in menu mix. Although we may have changes in our average guest check from period to period, our main focus has been increasing guest traffic as we view this component to be more indicative of the long-term health of the Applebee's brand. We are constantly seeking to increase guest traffic by focusing on operations and improving our menu with new food and beverage offerings. In 2006, we began implementation of a plan to substantially improve the quality and flavor profile of our food and beverage offerings as a result of comprehensive consumer research we completed in 2005. In the 2006 quarter, company comparable sales decreased 2.0% while domestic franchise and domestic system-wide comparable sales decreased 1.7% and 1.8%, respectively. In the 2006 year-to-date period, company comparable sales decreased 0.4%, while domestic franchise and domestic system-wide comparable sales increased 0.7% and 0.4%, respectively. We believe our sales and traffic growth have been negatively impacted by multiple factors. Lower income households, which represent a significant portion of our guests, have been impacted by higher energy costs and interest rates. The bar and grill category of the restaurant industry has been negatively impacted by increased trade-down to quick-service restaurants. In addition, the supply growth of the category has outpaced demand contributing to weaker sales trends. We believe less effective advertising has also impacted traffic in fiscal 2006. As a result of these factors, we currently expect system-wide comparable sales for the remainder of the year to be in a range from flat to down 4.0%.

- Company restaurant margins - company restaurant sales, less food and beverage, labor, direct and occupancy restaurant costs and pre-opening expenses, expressed as a percentage of company restaurant sales. Company restaurant margins were 12.1% and 13.4% in the 2006 quarter and the 2006 year-to-date period, respectively, and 13.8% and 14.8% in the 2005 quarter and the 2005 year-to-date period, respectively. We currently expect fiscal 2006 company restaurant margins, which will be dependent on comparable sales performance at company restaurants, to be less than fiscal 2005. Company restaurant margins are susceptible to fluctuations in commodity costs, labor costs and other operating costs such as utilities. We attempt to negotiate contracts for the majority of our food products in order to mitigate the impact of rising commodity costs. In 2006, we currently expect net commodity costs to be flat, including the negative impact of fuel surcharges. In addition, the improved menu offerings may increase food costs, as a percentage of sales, when compared to other menu offerings. We expect labor costs to continue to be negatively impacted by health insurance costs and the impact of wage rate increases. In addition, higher energy costs, including utilities and the cost of materials used in the production of packaging, will have a negative impact on company restaurant margins, but will be partially offset by the favorable impact of a change in accounting convention for smallwares that was implemented in the 2006 quarter.

o General and administrative expenses - general and administrative expenses expressed as a percentage of total operating revenues. General and administrative expenses were 9.8% and 9.1% in the 2006 quarter and the 2005 quarter, respectively, and 10.1% and 9.0% for the 2006 year-to-date period and the 2005 year-to-date period, respectively. Stock-based compensation included in general and administrative expenses was 1.5% and 0.2% in the 2006 quarter and the 2005 quarter, respectively, and 1.6% and 0.2% in the 2006 year-to-date period and the 2005 year-to-date period, respectively. General and administrative expenses, as a percentage of operating revenues, for fiscal 2006 are expected to be in the low-to-mid 10 percent range, including the impact of stock-based compensation.

o Return on equity - net earnings expressed as a percent of average stockholders' equity. We believe this is an important indicator as it allows us to evaluate our ability to create value for our shareholders. We have exceeded our stated goal of at least 20% return on equity for the past seven years, and we are a leader in the casual dining industry in this category.

22.

Application of Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our condensed consolidated financial statements, which were prepared in accordance with accounting principles generally accepted in the United States of America. These principles require us to make estimates and assumptions that affect the reported amounts in the condensed consolidated financial statements and notes thereto. Actual results may differ from these estimates, and such differences may be material to our condensed consolidated financial statements. We believe that the following significant accounting policies involve a significant degree of judgment or complexity.

Inventory valuation: We state inventories at the lower of cost, using the first-in, first-out method, or market. Market is determined based upon our estimates of the net realizable value.

We purchase and maintain inventories of certain specialty products to ensure sufficient supplies to the system, to ensure continuity of supply, and to control food costs. We review and make quality control inspections of our inventories to determine obsolescence on an ongoing basis. These reviews require management to make certain estimates and judgments regarding projected usage which may change in the future and may require us to record an inventory impairment.

Property and equipment: We report property and equipment at historical cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the related asset. The useful lives of the assets are based upon management's expectations. We periodically review the assets for changes in circumstances which may impact their useful lives. If there are changes in circumstances that revise an asset's useful life, we will adjust the depreciation expense accordingly for that asset in future periods.

Stock-based compensation: Beginning in 2006, we account for stock-based compensation in accordance with SFAS No. 123(R). As required by SFAS No. 123(R), stock-based compensation is estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using a binomial model. The binomial model requires various highly judgmental assumptions including the expected life, stock price volatility and the forfeiture rate. If any of the assumptions used in the model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

Impairment of long-lived assets: We periodically review restaurant property and equipment for impairment on a restaurant-by-restaurant basis using certain market and restaurant operating indicators including historical cash flows as well as current estimates of future cash flows and/or appraisals. We review other long-lived assets at least annually and when events or circumstances indicate that the carrying value of the asset may not be recoverable. The recoverability is assessed in most instances by comparing the carrying value to its undiscounted cash flows. This assessment process requires the use of estimates and assumptions regarding future cash flows and estimated useful lives, which are subject to a significant degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

Income taxes: We record valuation allowances against our deferred tax assets, when necessary, in accordance with SFAS No. 109, "Accounting for Income Taxes." Realization of deferred tax assets is dependent on future taxable earnings and is therefore uncertain. We assess the likelihood that our deferred tax assets in each of the jurisdictions in which we operate will be recovered from future taxable income. Deferred tax assets do not include future tax benefits that we deem likely not to be realized.

We are periodically audited by foreign and domestic tax authorities for both income and sales and use taxes. We record accruals when we determine it is probable that we have an exposure in a matter relating to an audit. The accruals may change in the future due to new developments in each matter.

Legal and insurance reserves: We are periodically involved in various legal actions. We are required to assess the probability of any adverse judgments as well as the potential range of loss. We determine the required accruals after a review of the facts of each legal action.

We use estimates in the determination of the appropriate liabilities for general liability, workers' compensation and health insurance. The estimated liability is established based upon historical claims data and third-party actuarial estimates of settlement costs for incurred claims. Unanticipated changes in these factors may require us to revise our estimates.

We periodically reassess our assumptions and judgments and make adjustments when significant facts and circumstances dictate. A change in any of the above estimates could impact our consolidated statements of earnings and the related asset or liability recorded in our consolidated balance sheets would be adjusted accordingly. Historically, actual results have not been materially different than the estimates that are described above.

Acquisitions

All of our acquisitions discussed below have been accounted for using the purchase method of accounting and, accordingly, our condensed consolidated financial statements reflect the results of operations for each acquisition subsequent to the date of acquisition. The assets acquired and liabilities assumed are recorded at estimates of fair value as determined by management based upon information available. We finalize the allocation of purchase price to the fair value of assets acquired and liabilities assumed when we obtain information sufficient to complete the allocation, but in each case, no longer than one year after the acquisition date.

In January 2006, we completed the acquisition of four Applebee's restaurants in the Houston market for approximately $8,200,000. The purchase price was allocated to the fair value of property and equipment of $7,400,000, goodwill of approximately $600,000, reacquired franchise rights of approximately $100,000, and other net assets of approximately $100,000. In connection with this acquisition, we paid approximately $8,000,000 in the 2006 year-to-date period.

In May 2005, we completed the acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas, which included one restaurant under construction, for approximately $39,500,000 in cash. The purchase price was allocated to the fair value of property and equipment of $17,500,000, goodwill of $21,500,000, reacquired franchise rights of approximately $300,000, and other net assets of approximately $200,000.

The following table is comprised of actual company restaurant sales for the two restaurant acquisitions above, which are included in our condensed consolidated financial statements for each period presented, and pro forma company restaurant sales assuming the acquisitions occurred at the beginning of the preceding fiscal year for each acquisition (in thousands):

	2006 Quarter	2005 Quarter	2006 Year-to-Date Period
Actual company restaurant sales for acquired restaurants....................................	$ 1,800	$ 2,800	$ 3,300
Pro forma company restaurant sales for acquired restaurants..................................	$ 1,800	$ 8,200	$ 4,000

In April 2005, we completed the acquisition of eight Applebee's restaurants in the Memphis market, which were closed in 2004 by a former franchisee, for approximately $8,800,000 payable in cash. In connection with this acquisition, we paid approximately $800,000 in 2004 and $8,000,000 in 2005. The purchase price of $8,800,000 was allocated to the fair value of property and equipment of approximately $8,200,000 and goodwill of approximately $600,000. We have remodeled and opened seven restaurants and the remaining restaurant was sold to a third party.

Captive Insurance Subsidiary

In 2002, we formed Neighborhood Insurance, Inc., a Vermont corporation and a wholly-owned captive insurance subsidiary to provide Applebee's International, Inc. and qualified franchisees with workers' compensation and general liability insurance. In 2005, we reduced the types of insurance coverage plans offered which resulted in fewer franchisee participants in our captive insurance program. Through 2005, Applebee's International, Inc. and covered franchisees made premium payments to the captive insurance company which pays administrative fees and insurance claims, subject to individual and aggregate maximum claim limits under the captive insurance company's reinsurance policies. Franchisee premium amounts billed by the captive insurance company were established based upon third-party actuarial estimates of settlement costs for incurred and anticipated claims and administrative fees. Franchisee premiums were included in other franchise income ratably over the policy year and the related offsetting expenses were included in cost of other franchise income. In 2006, we discontinued writing any new coverage. Franchise premium adjustments will be included in other franchise income and cost of other franchise income when audited. Cost of other franchise income includes costs related to the resolution of claims arising from franchisee participation in our captive insurance program. We do not expect franchisee participation in the captive insurance company to have a material impact on our net earnings. Our consolidated balance sheets include the following balances related to the captive insurance subsidiary:

- Franchise premium receivables of approximately $500,000 and $1,700,000 as of June 25, 2006 and December 25, 2005, respectively, included in receivables related to captive insurance subsidiary.
- Cash equivalent and other long-term investments restricted for the payment of claims of approximately $16,600,000 and $18,600,000 as of June 25, 2006 and December 25, 2005, respectively, included in restricted assets related to captive insurance subsidiary.
- Loss reserve related to captive insurance subsidiary of approximately $17,100,000 and $20,700,000 as of June 25, 2006 and December 25, 2005, respectively. Approximately $8,000,000 and $10,500,000 for June 25, 2006 and December 25, 2005, respectively, is included in other non-current liabilities.

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.

2006

	2006 Quarter	2005 Quarter	Year-t Date Perio
Operating revenues:			
Company restaurant sales	89.5%	88.9%	89.5
Franchise royalties and fees	10.4	10.6	10.4
Other franchise income	0.2	0.5	0.1
Total operating revenues	100.0%	100.0%	100.0
Cost of sales (as a percentage of company restaurant sales):			
Food and beverage	26.5%	26.6%	26.6
Labor	33.9	33.0	33.3
Direct and occupancy	27.2	26.0	26.4
Pre-opening expense	0.4	0.5	0.3
Total cost of sales	87.9%	86.2%	86.6
Cost of other franchise income (as a percentage of other franchise income)	52.1%	86.3%	106.4
General and administrative expenses	9.8	9.1	10.1
Amortization of intangible assets	0.1	0.1	0.1
Impairment and other restaurant closure costs	0.9	--	0.7
Loss on disposition of property and equipment	0.1	0.2	0.1
Operating earnings	10.4	13.6	11.4
Other income (expense):			
Investment income (loss)	(0.1)	0.1	0.1
Interest expense	(0.9)	(0.2)	(0.8
Other income	--	0.2	--
Total other income (expense)	(1.0)	0.1	(0.7
Earnings before income taxes	9.4	13.7	10.7
Income taxes	3.3	4.7	3.6
Net earnings	6.2%	9.0%	7.0

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

	2006 Quarter	2005 Quarter	20 Year Da Per
Number of restaurants:			
Company:			

Beginning of period	497	437	
Restaurant openings	10	14	
Restaurants closings	--	--	
Restaurants acquired from franchisees	--	11	
End of period	507	462	
Franchise:			
Beginning of period	1,332	1,257	1,
Restaurant openings	25	16	
Restaurants closings	(4)	(2)	
Restaurants acquired from franchisees	--	(11)	
End of period	1,353	1,260	1,
Total:			
Beginning of period	1,829	1,694	1,
Restaurant openings	35	30	
Restaurants closings	(4)	(2)	
End of period	1,860	1,722	1,
Weighted average weekly sales per restaurant:			
Company	$ 45,245	$ 46,800	$ 46,
Domestic franchise	$ 50,127	$ 51,056	$ 51,
Domestic total	$ 48,736	$ 49,894	$ 50,
Change in comparable restaurant sales:(1)			
Company	(2.0)%	(1.2)%	(0.
Domestic franchise	(1.7)%	2.3 %	0.
Domestic total	(1.8)%	1.4 %	0.
Total operating revenues (in thousands):			
Company restaurant sales	$ 296,128	$ 272,703	$ 604,
Franchise royalties and fees(2)	34,306	32,493	70,
Other franchise income(3)	539	1,424	
Total	$ 330,973	$ 306,620	$ 675,

27.

2006 Quarter Compared With 2005 Quarter and 2006 Year-to-Date Period Compared With 2005 Year-to-Date Period

Company Restaurant Sales. Total company restaurant sales increased $23,425,000 (9%) from $272,703,000 in the 2005 quarter to $296,128,000 in the 2006 quarter and increased $60,866,000 (11%) from $543,161,000 in the 2005 year-to-date period to $604,027,000 in the 2006 year-to-date period. The percentage increase in total company restaurant sales was due to an increase in the number of restaurant weeks open of approximately 12% in the 2006 quarter and 13% in the 2006 year-to-date period, which was partially offset by a decline in weighted average weekly sales in the 2006 quarter and the 2006 year-to-date period, respectively.

Comparable restaurant sales at company restaurants decreased by 2.0% and 0.4% in the 2006 quarter and the 2006 year-to-date period, respectively. Weighted average weekly sales at company restaurants decreased 3.3% from $46,800 in the

2005 quarter to $45,245 in the 2006 quarter and decreased 1.8% from $47,483 in the 2005 year-to-date period to $46,650 in the 2006 year-to-date period. The decrease in average weekly sales was due to a reduction in guest traffic in 2006 as compared to 2005. These decreases were partially offset by an increase in the average guest check resulting from menu price increases of approximately 2.5% in 2005. In both periods, we experienced more significant guest count declines in New England, Virginia and Michigan where approximately 40% of our company restaurants are located. Lower income households, which represent a significant portion of our guests, have been impacted by higher energy costs and interest rates. The bar and grill category of the restaurant industry has been negatively impacted by increased trade-down to quick-service restaurants. In addition, the supply growth of the category has outpaced demand contributing to weaker sales trends. We believe less effective advertising has also impacted traffic in fiscal 2006. Weighted average weekly sales declined more than comparable sales declined due to weaker new restaurant opening volumes primarily in St. Louis, New England, and Virginia for both periods and Minnesota for the 2006 year-to-date period.

Franchise Royalties and Fees. Franchise royalties and fees increased $1,813,000 (6%) from $32,493,000 in the 2005 quarter to $34,306,000 in the 2006 quarter and increased $4,740,000 (7%) from $65,501,000 in the 2005 year-to-date period to $70,241,000 in the 2006 year-to-date period due primarily to the increased number of franchise restaurants operating during both periods as compared to the prior year. In addition, the increase in the 2006 year-to-date period was due partially to increases in franchisee comparable restaurant sales. Domestic franchise weighted average weekly sales and comparable restaurant sales decreased 1.8% and 1.7%, respectively, in the 2006 quarter and increased by 0.6% and 0.7%, respectively, in the 2006 year-to-date period.

Other Franchise Income. Other franchise income decreased $885,000 (62%) from $1,424,000 in the 2005 quarter to $539,000 in the 2006 quarter and decreased $1,505,000 (60%) from $2,489,000 in the 2005 year-to-date period to $984,000 in the 2006 year-to-date period due primarily to the decision to discontinue writing new coverage in our captive insurance program. In 2005, franchisee premiums were included in other franchise income ratably over the policy year.

Cost of Company Restaurant Sales. Food and beverage costs decreased slightly from 26.6% in the 2005 quarter to 26.5% in the 2006 quarter and increased slightly from 26.5% in the 2005 year-to-date period to 26.6% in the 2006 year-to-date period. Food and beverage costs in both periods were negatively impacted by food costs associated with our improved menu, a shift in menu mix and higher alcoholic beverage costs, as a percentage of sales, related to our late-night value strategy. These increases were offset by menu price increases of 2.5% and improved management of food spoilage and waste in both periods.

Labor costs increased from 33.0% in the 2005 quarter to 33.9% in the 2006 quarter and increased from 32.9% in the 2005 year-to-date period to 33.3% in the 2006 year-to-date period due primarily to higher hourly and management wage rates, payroll taxes and the impact of lower sales volumes, as a percentage of sales, which were partially offset by lower workers' compensation expense and incentive compensation expense.

Direct and occupancy costs increased from 26.0% in the 2005 quarter to 27.2% in the 2006 quarter and increased from 25.3% in the 2005 year-to-date period to 26.4% in the 2006 year-to-date period due primarily to higher utilities and unfavorable year-over-year comparisons for depreciation, as a percentage of sales, due to their relatively fixed nature, which were partially offset by the favorable impact of a change in accounting convention for smallwares that was implemented in the 2006 quarter.

Cost of Other Franchise Income. Cost of other franchise income decreased $948,000 (77%) from $1,229,000 in the 2005 quarter to $281,000 in the 2006 quarter and decreased $1,001,000 (49%) from $2,048,000 in the 2005 year-to-date period to $1,047,000 in the 2006 year-to-date period due to the decision to discontinue writing new coverage in our captive insurance program, which was partially offset by $500,000 recorded for estimated insurance losses from franchise participants in the first quarter of 2006.

General and Administrative Expenses. General and administrative expenses increased from 9.1% in the 2005 quarter to 9.8% in the 2006 quarter and increased from 9.0% in the 2005 year-to-date period to 10.1% in the 2006 year-to-date period due primarily to an increase in stock-based compensation related to adoption of SFAS 123(R), higher compensation expense due to staffing levels and a shift in the timing of our general manager meeting in the 2006 year-to-date period. Stock-based compensation included in general and administrative expenses was 1.5% and 0.2% in the 2006 quarter and the 2005 quarter, respectively, and 1.6% and 0.2% in the 2006 year-to-date period and the 2005 year-to-date period, respectively. The increase in both periods was partially offset by the absorption of general and administrative costs over a larger revenue base as well as decreases in the return on investments of our nonqualified deferred compensation plan and lower accrued incentive compensation.

Impairment and Other Restaurant Closure Costs. Impairment and other restaurant closure costs were $3,000,000 in the 2006 quarter and $4,600,000 in the 2006 year-to-date period. These costs consisted of $1,900,000 impairment of the carrying value of the property and equipment and approximately $1,100,000 for the write-off of lease acquisition costs in the 2006 quarter. In addition, we recorded an impairment of $900,000 of the carrying value of the property and equipment and $700,000 of lease obligations for closed restaurants in the first quarter of fiscal 2006.

Investment Income (Loss). Investment income decreased from income of $449,000 in the 2005 quarter to a loss of $285,000 in the 2006 quarter due to a decrease in the return on investments in our nonqualified deferred compensation plan. Investment income increased from $408,000 in the 2005 year-to-date period to $460,000 in the 2006 year-to-date period.

Interest Expense. Interest expense increased from $634,000 in the 2005 quarter to $2,985,000 in the 2006 quarter and from $971,000 in the 2005 year-to-date period to $5,539,000 in the 2006 year-to-date period due primarily to higher interest rates and increased borrowings used for capital expenditure funding, repurchases of our common stock, and acquisitions.

Income Taxes. The effective income tax rate, as a percentage of earnings before income taxes, increased from 34.6% in the 2005 quarter to 34.8% in the 2006 quarter and decreased from 34.6% in the 2005 year-to-date period to 34.1% in the 2006 year-to-date period. Both periods were impacted by favorable hourly employment tax credits and the resolution of state tax matters.

Liquidity and Capital Resources

Our primary sources of liquidity are cash provided by operations and borrowings under our credit facility. Our need for capital resources historically has resulted from the construction and acquisition of restaurants, the repurchase of our common stock, and investment in information technology systems. In the past, we have obtained capital through our ongoing operations and debt financing. Cash flows from our ongoing operations primarily include cash generated from company and franchise operations, management of credit from trade suppliers, decisions to enter into restaurant operating leases, and cash received from the exercise of employee stock options. In addition, we have assumed debt or issued new debt in connection with certain mergers and acquisitions. The following table presents a summary of our cash flows for the 2006 year-to-date period and the 2005 year-to-date period (in thousands):

	2006 Year-to-Date Period	2005 Year-to-Date Period
Net cash provided by operating activities.........	$ 65,832	$ 107,790
Net cash used by investing activities............	(65,712)	(108,116)
Net cash used by financing activities............	(6,264)	(9,655)
Net decrease in cash and cash equivalents.........	$ (6,144)	$ (9,981)

Capital expenditures were $59,922,000 in the 2005 year-to-date period and $59,976,000 in the 2006 year-to-date period. In 2006, we currently expect to open approximately 35 company restaurants, and capital expenditures, excluding franchise acquisitions, are expected to be between $135,000,000 and $145,000,000.

Future capital expenditures will primarily be for the development of new restaurants, refurbishment and capital replacement for existing restaurants, and the enhancement of information systems. Because we expect to continue to purchase a portion of our restaurant sites, the amount of actual capital expenditures will be dependent upon, among other things, the proportion of leased versus owned properties. If we construct more or fewer restaurants than we currently anticipate, or acquire additional restaurants, our capital requirements will increase or decrease accordingly.

In fiscal 2006, we expect to incur approximately $16,000,000 in costs associated with the construction of our new corporate headquarters including $4,500,000 for land, which we paid in January 2006. We will incur additional construction costs in fiscal 2007, the amount of which has yet to be determined.

In January 2006, we completed the acquisition of four Applebee's restaurants in the Houston area for approximately $8,200,000. In connection with this acquisition, we paid approximately $8,000,000 in the 2006 year-to-date period.

In May 2005, we completed the acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas, which included one restaurant under construction, for approximately $39,500,000 in cash.

In April 2005, we completed the acquisition of eight Applebee's restaurants in the Memphis market, which were closed in 2004 by a former franchisee, for approximately $8,800,000 in cash. In connection with this acquisition, we paid approximately $800,000 in 2004 and $8,000,000 in 2005.

In December 2004, we completed the refinancing of our $150,000,000 unsecured revolving credit facility. The new bank credit agreement provided for a $150,000,000 five-year unsecured revolving credit facility, of which $40,000,000 may be used for the issuance of letters of credit. The facility is subject to various covenants and restrictions which, among other things, require the maintenance of stipulated fixed charge, leverage and indebtedness to capitalization ratios, as defined. There is no limit on cash dividends provided that the declaration and payment of such dividend does not cause a default of any other covenant contained in the agreement. The facility is subject to other standard terms, conditions, covenants and fees. In September 2005, we entered into an amendment to our credit facility which increased the revolving credit commitment available from $150,000,000 to $200,000,000. In October 2005, we entered into a second amendment to our credit facility which increased the revolving credit commitment available from $200,000,000 to $250,000,000 and provided for an additional $75,000,000 of revolving credit upon satisfaction of the conditions set forth in the credit facility. As of June 25, 2006, we were in compliance with the covenants contained in our credit agreement. As of June 25, 2006, we had borrowings of $196,400,000, standby letters of credit of $16,400,000 outstanding and approximately $37,200,000 available under our revolving credit facility.

In October 2005, our Board of Directors approved a $175,000,000 authorization to repurchase our common stock, subject to market conditions. During the 2006 year-to-date period, we repurchased 687,200 shares of our common stock at an average price of $23.48 for an aggregate cost of $16,134,000. As of June 25, 2006, we had $112,833,000 remaining under our repurchase authorization.

In October 2005, the Board of Directors declared an annual dividend of $0.20 per share payable to shareholders of record on December 23, 2005. We paid approximately $14,800,000 in January 2006 related to this dividend.

As of June 25, 2006, our liquid assets totaled $7,185,000. These assets consisted of cash and cash equivalents in the amount of $6,896,000 and short-term investments in the amount of $289,000. The working capital deficit decreased from $107,400,000 as of December 25, 2005 to $61,182,000 as of June 25, 2006. This decrease was due primarily to the redemption of gift cards in the 2006 quarter sold in 2005 and decreases in accounts payable and accrued dividends.

We believe that our liquid assets and cash generated from operations, combined with available borrowings, will provide sufficient funds for capital expenditures, repurchases of our common stock, the payment of dividends and other such operating activities for at least the next 12 months and thereafter for the foreseeable future.

The following table shows our debt amortization schedule, future capital lease commitments (including principal and interest payments), future operating lease commitments and future purchase obligations as of June 25, 2006 (in thousands):

Certain Contractual Obligations	Total	Payments due by period Less than 1 year	1-3 years	
Long-term Debt (excluding capital lease obligations) (1)..................	$ 197,756	$ 4,521	$ 86	$ 19

Capital Lease Obligations.................	7,940	808	1,701	
Operating Leases (2)......................	393,789	28,351	56,850	5
Purchase Obligations - Company(3)..........	233,319	62,462	137,510	3
Purchase Obligations - Franchise(4)........	574,252	123,389	361,872	8

Other Contractual Obligations

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 June 25, 2006, we have outstanding lease guarantees of approximately $16,300,000. In addition, we or our subsidiaries are contingently liable for various leases that we have assigned in connection with the sale of restaurants to franchisees and other parties, in the potential amount of $13,200,000. These leases expire at various times with the final lease agreement expiring in 2018. We have not recorded a liability related to these contingent lease liabilities as of June 25, 2006 or December 25, 2005.

In 2004, we arranged for a third-party financing company to provide up to $250,000,000 to qualified franchisees for loans to fund development of new restaurants through October 2007, subject to our approval. We will provide a limited guarantee of 10% of certain loans advanced under this program. We will be released from our guarantee if certain operating results are met after the restaurant has been open for at least two years. As of June 25, 2006, there were loans outstanding to six franchisees for approximately $55,900,000 under this program. The fair value of our guarantees under this financing program is approximately $110,000 and is recorded in non-current liabilities in our consolidated balance sheet as of June 25, 2006.

We have severance and employment agreements with certain officers providing for severance payments to be made in the event the associate resigns or is terminated not related to a change in control, some of which require payments to be made only if we enforce certain terms in the agreements. If the severance payments had been due as of June 25, 2006, we would have been required to make payments totaling approximately $13,200,000. In addition, we have severance and employment agreements with certain officers which contain severance provisions related to a change in control. The agreements define the circumstances which will constitute a change in control. Those provisions would have required additional aggregate payments of approximately $7,400,000 if such officers had been terminated as of June 25, 2006.

New Accounting Pronouncements

In March 2006, the Emerging Issues Task Force ("EITF") issued EITF Issue 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)." A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes that are recognized on a gross basis. The guidance is effective for periods beginning after December 15, 2006. We present company sales net of sales taxes. This issue will not impact the method for recording these sales taxes in our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 is effective for fiscal years beginning after December 15, 2006. We are evaluating the impact the adoption of FIN 48 will have on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from fluctuations in interest rates and changes in commodity prices. Our revolving credit facility bears interest at either the bank's prime rate or LIBOR plus 0.75%, at our option. As of June 25, 2006, the total amount of debt subject to interest rate fluctuations was $196,400,000, which was outstanding on our revolving credit facility. A 1% change in interest rates would result in an increase or decrease in interest expense of $1,964,000 per year. We may from time to time enter into interest rate swap agreements to manage the impact of interest rate changes on our earnings. A substantial portion of the food products and utilities we purchase are subject to price volatility due to factors that are outside of our control such as weather, seasonality and fuel costs. As part of our strategy to moderate this volatility, we have entered into fixed price purchase commitments.

Item 4. Controls and Procedures

As of June 25, 2006, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision and with the participation of the principal executive officer and Chief Financial Officer ("CFO"). Based on this evaluation, our management, including the principal executive officer and CFO, concluded that our disclosure controls and procedures are effective.

During the 2006 quarter, there have been no changes in our internal control over financial reporting that occurred that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are subject from time to time to lawsuits, claims and governmental inspections or audits arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. In the opinion of management, these matters are adequately covered by insurance, or if not so covered, are without merit or are of such a nature or involve amounts that would not have a material adverse impact on our business or consolidated financial position.

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our 2005 Annual Report on Form 10-K.

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

(c) Issuer Purchases of Equity Securities.

Purchases of Equity Securities(1)				
	(a)	(b)	(c)	(d
Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Doll Shares that Purchased Plans or (in thou
March 27, 2006 through April 23, 2006	256,700	$23.37	256,700	$117,
April 24, 2006 through May 21, 2006	212,300	$23.39	212,300	$112,
May 22, 2006 through June 25, 2006	--	--	--	$112,
Total	469,000		469,000	

35.

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

Our Annual Meeting of Stockholders was held on May 11, 2006. The stockholders voted on the following matters:

Proposal I. Election of six directors.
Proposal II. Approve the Applebee's International, Inc. 2001 Senior Executive Bonus Plan, as amended.
Proposal III. Ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the 2006 fiscal year.
Proposal IV. Act on a shareholder proposal to require us to issue quarterly reports in 2006 detailing the progress made toward accelerating the development of an alternative method of poultry slaughter.

The results of the voting were as follows:

Proposal	Affirmative Votes	Negative/ Withheld Votes	Abstentions

I (Boswell)	68,637,606	327,981	--
I (Goebel)	68,300,086	665,501	--
I (Conant)	66,696,411	2,269,176	--
I (Curran)	68,350,630	614,957	--
I (Lumpkin)	67,187,199	1,778,388	--
I (Rebolledo)	68,681,772	283,815	--
II	64,584,445	1,193,592	3,187,550
III	68,783,912	110,705	70,970
IV	2,383,094	51,937,081	5,363,347

Proposals I, II, and III received the required affirmative votes and were adopted by the stockholders. Proposal IV did not receive the required affirmative votes.

Item 6. Exhibits

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

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: July 26, 2006

By: /s/ David L. Goebel

David L. Goebel
Director, President and
Chief Operating Officer
(principal executive officer)

Date: July 26, 2006

By: /s/ Steven K. Lumpkin

Steven K. Lumpkin
Director, Executive Vice President,
Chief Financial Officer and Treasurer
(principal financial officer)

Date: July 26, 2006

By: /s/ Beverly O. Elving

Beverly O. Elving
Vice President and Controller
(principal accounting officer)

APPLEBEE'S INTERNATIONAL, INC.
EXHIBIT INDEX

Exhibit Number	Description of Exhibit
10.1	2001 Senior Executive Bonus Plan, as amended (incorporated by reference to the Registrant's Form 8-K filed on May 16, 2006).
10.2	Separation Agreement, Release and Waiver dated May 17, 2006 by and between the Company and John C. Cywinski (incorporated by reference to the Registrant's Form 8-K filed on May 18, 2006).
10.3	Amendment to the Amended and Restated 1995 Equity Incentive Plan.
31.1	Certification of Principal Executive Officer Pursuant to SEC Rule 13a-14(a).
31.2	Certification of Chief Financial Officer Pursuant to SEC Rule 13a-14(a).
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.