

DUNKIN' BRANDS GROUP, INC.

Form 10-Q

August 07, 2017

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FORM 10-Q

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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

For the quarterly period ended July 1, 2017

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 001-35258

DUNKIN' BRANDS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware 20-4145825

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

130 Royall Street

Canton, Massachusetts 02021

(Address of principal executive offices) (zip code)

(781) 737-3000

(Registrants' telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

As of August 3, 2017, 90,241,464 shares of common stock of the registrant were outstanding.

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DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES

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Part I. Financial Information

Item 1. Financial Statements

DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share data)

(Unaudited)

	July 1, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$264,662	361,425
Restricted cash	74,952	69,746
Accounts receivable, net of allowance for doubtful accounts of \$4,646 and \$4,778 as of July 1, 2017 and December 31, 2016, respectively	51,910	44,512
Notes and other receivables, net of allowance for doubtful accounts of \$371 and \$339 as of July 1, 2017 and December 31, 2016, respectively	32,095	40,672
Restricted assets of advertising funds	58,807	40,338
Prepaid income taxes	13,206	20,926
Prepaid expenses and other current assets	37,941	28,739
Total current assets	533,573	606,358
Property and equipment, net of accumulated depreciation of \$131,333 and \$124,675 as of July 1, 2017 and December 31, 2016, respectively	170,013	176,662
Equity method investments	124,679	114,738
Goodwill	888,291	888,272
Other intangible assets, net of accumulated amortization of \$240,684 and \$230,364 as of July 1, 2017 and December 31, 2016, respectively	1,368,026	1,378,720
Other assets	63,336	62,632
Total assets	\$3,147,918	3,227,382
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current portion of long-term debt	\$25,000	25,000
Capital lease obligations	618	589
Accounts payable	19,414	12,682
Liabilities of advertising funds	64,953	52,271
Deferred income	38,714	35,393
Other current liabilities	237,236	298,266
Total current liabilities	385,935	424,201
Long-term debt, net	2,392,732	2,401,998
Capital lease obligations	7,221	7,550
Unfavorable operating leases acquired	10,550	11,378
Deferred income	10,826	12,154
Deferred income taxes, net	453,511	461,810
Other long-term liabilities	72,544	71,549
Total long-term liabilities	2,947,384	2,966,439
Commitments and contingencies (note 9)		
Stockholders' equity (deficit):		
Preferred stock, \$0.001 par value; 25,000,000 shares authorized; no shares issued and outstanding	—	—
	90	91

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Common stock, \$0.001 par value; 475,000,000 shares authorized; 90,512,007 shares issued and 90,485,230 shares outstanding as of July 1, 2017; 91,464,229 shares issued and 91,437,452 shares outstanding as of December 31, 2016

Additional paid-in capital	763,055	807,492
Treasury stock, at cost; 26,777 shares as of July 1, 2017 and December 31, 2016	(1,060)	(1,060)
Accumulated deficit	(929,490)	(945,797)
Accumulated other comprehensive loss	(17,996)	(23,984)
Total stockholders' deficit	(185,401)	(163,258)
Total liabilities and stockholders' deficit	\$3,147,918	3,227,382

See accompanying notes to unaudited consolidated financial statements.

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DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Revenues:				
Franchise fees and royalty income	\$145,066	137,195	275,135	260,978
Rental income	27,408	25,769	51,830	48,994
Sales of ice cream and other products	32,862	33,966	58,159	59,857
Sales at company-operated restaurants	—	4,643	—	10,313
Other revenues	13,186	14,736	24,070	25,943
Total revenues	218,522	216,309	409,194	406,085
Operating costs and expenses:				
Occupancy expenses—franchised restaurants	14,287	13,614	28,425	26,810
Cost of ice cream and other products	22,199	22,827	39,121	40,061
Company-operated restaurant expenses	—	5,297	—	11,790
General and administrative expenses, net	62,382	63,459	123,617	124,654
Depreciation	5,071	5,178	10,155	10,311
Amortization of other intangible assets	5,333	5,568	10,660	11,329
Long-lived asset impairment charges	60	4	107	97
Total operating costs and expenses	109,332	115,947	212,085	225,052
Net income of equity method investments	4,327	3,717	7,146	6,681
Other operating income, net	33	2,062	588	3,760
Operating income	113,550	106,141	204,843	191,474
Other income (expense), net:				
Interest income	425	124	746	273
Interest expense	(24,885)	(24,972)	(49,756)	(49,853)
Other income (losses), net	28	(102)	215	(472)
Total other expense, net	(24,432)	(24,950)	(48,795)	(50,052)
Income before income taxes	89,118	81,191	156,048	141,422
Provision for income taxes	33,414	31,601	52,877	54,678
Net income	\$55,704	49,590	103,171	86,744
Earnings per share:				
Common—basic	\$0.61	0.54	1.13	0.95
Common—diluted	0.60	0.54	1.11	0.94
Cash dividends declared per common share	0.32	0.30	0.65	0.60

See accompanying notes to unaudited consolidated financial statements.

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DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Net income	\$55,704	49,590	103,171	86,744
Other comprehensive income (loss), net:				
Effect of foreign currency translation, net of deferred tax expense (benefit) of \$36 and \$(231) for the three months ended July 1, 2017 and June 25, 2016, respectively, and \$573 and \$(429) for the six months ended July 1, 2017 and June 25, 2016, respectively	(2,768)	312	5,971	2,569
Effect of interest rate swaps, net of deferred tax benefit of \$217 for each of the three months ended July 1, 2017 and June 25, 2016 and \$434 for each of the six months ended July 1, 2017 and June 25, 2016	(318)	(318)	(636)	(636)
Other, net	(1)	(178)	653	(203)
Total other comprehensive income (loss), net	(3,087)	(184)	5,988	1,730
Comprehensive income	\$52,617	49,406	109,159	88,474

See accompanying notes to unaudited consolidated financial statements.

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DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six months ended	
	July 1, 2017	June 25, 2016
Cash flows from operating activities:		
Net income	\$103,171	86,744
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,815	21,640
Amortization of debt issuance costs	3,234	3,134
Deferred income taxes	(8,333)	(7,590)
Provision for bad debt	100	170
Share-based compensation expense	7,247	8,307
Net income of equity method investments	(7,146)	(6,681)
Dividends received from equity method investments	3,950	4,441
Gain on sale of real estate and company-operated restaurants	(29)	(3,754)
Other, net	(1,818)	(829)
Change in operating assets and liabilities:		
Accounts, notes, and other receivables, net	2,696	39,434
Prepaid income taxes, net	7,651	9,436
Prepaid expenses and other current assets	(9,027)	(3,470)
Accounts payable	6,250	(1,142)
Other current liabilities	(61,606)	(68,590)
Liabilities of advertising funds, net	(5,358)	(2,902)
Deferred income	1,956	1,632
Other, net	201	2,156
Net cash provided by operating activities	63,954	82,136
Cash flows from investing activities:		
Additions to property and equipment	(3,624)	(6,775)
Proceeds from sale of real estate and company-operated restaurants	—	7,427
Other, net	(99)	(872)
Net cash used in investing activities	(3,723)	(220)
Cash flows from financing activities:		
Repayment of long-term debt	(12,500)	(12,500)
Dividends paid on common stock	(58,847)	(54,851)
Accelerated share repurchases of common stock	(100,000)	(30,000)
Exercise of stock options	19,928	3,933
Other, net	(799)	(559)
Net cash used in financing activities	(152,218)	(93,977)
Effect of exchange rates on cash, cash equivalents, and restricted cash	398	27
Decrease in cash, cash equivalents, and restricted cash	(91,589)	(12,034)
Cash, cash equivalents, and restricted cash, beginning of period	431,832	333,115
Cash, cash equivalents, and restricted cash, end of period	\$340,243	321,081
Supplemental cash flow information:		
Cash paid for income taxes	\$53,736	53,174
Cash paid for interest	46,751	47,223
Noncash investing activities:		

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Property and equipment included in accounts payable and other current liabilities	1,535	1,096
Purchase of leaseholds in exchange for capital lease obligations	—	389
Noncash financing activity:		
Receivable from exercise of stock options included in notes and other receivables, net	1,385	—
See accompanying notes to unaudited consolidated financial statements.		

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DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

(1) Description of business and organization

Dunkin' Brands Group, Inc. ("DBGI"), together with its consolidated subsidiaries, is one of the world's leading franchisors of restaurants serving coffee and baked goods, as well as ice cream, within the quick service restaurant segment of the restaurant industry. We develop, franchise, and license a system of both traditional and nontraditional quick service restaurants and, in limited circumstances, have owned and operated locations. Through our Dunkin' Donuts brand, we develop and franchise restaurants featuring coffee, donuts, bagels, breakfast sandwiches, and related products. Additionally, we license Dunkin' Donuts brand products sold in certain retail outlets such as retail packaged coffee and Dunkin' K-Cup® pods. Through our Baskin-Robbins brand, we develop and franchise restaurants featuring ice cream, frozen beverages, and related products. Additionally, we distribute Baskin-Robbins ice cream products to Baskin-Robbins franchisees and licensees in certain international markets.

Throughout these unaudited consolidated financial statements, "Dunkin' Brands," "the Company," "we," "us," "our," and "management" refer to DBGI and its consolidated subsidiaries taken as a whole.

(2) Summary of significant accounting policies

(a) Unaudited consolidated financial statements

The consolidated balance sheet as of July 1, 2017, the consolidated statements of operations and comprehensive income for the three and six months ended July 1, 2017 and June 25, 2016, and the consolidated statements of cash flows for the six months ended July 1, 2017 and June 25, 2016 are unaudited.

The accompanying unaudited consolidated financial statements include the accounts of DBGI and its consolidated subsidiaries and have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and footnotes required in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for complete financial statements. All significant transactions and balances between subsidiaries and affiliates have been eliminated in consolidation. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements in accordance with U.S. GAAP have been recorded. Such adjustments consisted only of normal recurring items. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended December 31, 2016, included in the Company's Annual Report on Form 10-K.

(b) Fiscal year

The Company operates and reports financial information on a 52- or 53-week year on a 13-week quarter basis with the fiscal year ending on the last Saturday in December and fiscal quarters ending on the 13th Saturday of each quarter (or 14th Saturday when applicable with respect to the fourth fiscal quarter). The data periods contained within the three- and six-month periods ended July 1, 2017 and June 25, 2016 reflect the results of operations for the 13-week and 26-week periods ended on those dates, respectively. Operating results for the three- and six-month periods ended July 1, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending December 30, 2017.

(c) Cash, cash equivalents, and restricted cash

In accordance with the Company's securitized financing facility, certain cash accounts have been established in the name of Citibank, N.A. (the "Trustee") for the benefit of the Trustee and the noteholders, and are restricted in their use. The Company holds restricted cash which primarily represents (i) cash collections held by the Trustee, (ii) interest, principal, and commitment fee reserves held by the Trustee related to the Company's Notes (see note 4), and (iii) real estate reserves used to pay real estate obligations.

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Pursuant to new accounting guidance for fiscal year 2017, restricted cash is combined with cash and cash equivalents when reconciling the beginning and end of period balances in the consolidated statements of cash flows (see note 2(f)). Cash, cash equivalents, and restricted cash within the consolidated balance sheets that are included in the consolidated statements of cash flows as of July 1, 2017 and December 31, 2016 were as follows (in thousands):

	July 1, 2017	December 31, 2016
Cash and cash equivalents	\$264,662	361,425
Restricted cash	74,952	69,746
Restricted cash, included in Other assets	629	661
Total cash, cash equivalents, and restricted cash	\$340,243	431,832

(d) Fair value of financial instruments

Financial assets and liabilities are categorized, based on the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to the quoted prices in active markets for identical assets and liabilities and lowest priority to unobservable inputs. Observable market data, when available, is required to be used in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

Financial assets and liabilities measured at fair value on a recurring basis as of July 1, 2017 and December 31, 2016 are summarized as follows (in thousands):

	July 1, 2017		December 31, 2016	
	Significant other observable inputs (Level 2)	Total	Significant other observable inputs (Level 2)	Total
Assets:				
Company-owned life insurance	\$10,018	10,018	9,271	9,271
Total assets	\$10,018	10,018	9,271	9,271
Liabilities:				
Deferred compensation liabilities	\$12,534	12,534	11,126	11,126
Total liabilities	\$12,534	12,534	11,126	11,126

The deferred compensation liabilities relate to the Dunkin' Brands, Inc. non-qualified deferred compensation plans ("NQDC Plans"), which allow for pre-tax deferral of compensation for certain qualifying employees and directors. Changes in the fair value of the deferred compensation liabilities are derived using quoted prices in active markets of the asset selections made by the participants. The deferred compensation liabilities are classified within Level 2, as defined under U.S. GAAP, because their inputs are derived principally from observable market data by correlation to hypothetical investments. The Company holds company-owned life insurance policies to partially offset the Company's liabilities under the NQDC Plans. The changes in the fair value of any company-owned life insurance policies are derived using determinable cash surrender value. As such, the company-owned life insurance policies are classified within Level 2, as defined under U.S. GAAP.

The carrying value and estimated fair value of long-term debt as of July 1, 2017 and December 31, 2016 were as follows (in thousands):

	July 1, 2017		December 31, 2016	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
Financial liabilities				
Long-term debt	\$2,417,732	2,459,558	2,426,998	2,460,544

The estimated fair value of our long-term debt is estimated primarily based on current market rates for debt with similar terms and remaining maturities or current bid prices for our long-term debt. Judgment is required to develop these estimates. As such, our long-term debt is classified within Level 2, as defined under U.S. GAAP.

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(e) Concentration of credit risk

The Company is subject to credit risk through its accounts receivable consisting primarily of amounts due from franchisees and licensees for franchise fees, royalty income, and sales of ice cream and other products. In addition, we have note and lease receivables from certain of our franchisees and licensees. The financial condition of these franchisees and licensees is largely dependent upon the underlying business trends of our brands and market conditions within the quick service restaurant industry. This concentration of credit risk is mitigated, in part, by the large number of franchisees and licensees of each brand and the short-term nature of the franchise and license fee and lease receivables. As of July 1, 2017 and December 31, 2016, one master licensee, including its majority-owned subsidiaries, accounted for approximately 20% and 15%, respectively, of total accounts and notes receivable. No individual franchisee or master licensee accounted for more than 10% of total revenues for each of the three and six months ended July 1, 2017. For the three and six months ended June 25, 2016, one master licensee, including its majority-owned subsidiaries, accounted for approximately 11% and 10%, respectively, of total revenues.

Additionally, the Company engages various third parties to manufacture and/or distribute certain Dunkin' Donuts and Baskin-Robbins products under licensing arrangements. As of July 1, 2017, one of these third parties accounted for approximately 11% of total accounts and notes receivable. No individual third party accounted for more than 10% of total accounts and notes receivable as of December 31, 2016.

(f) Recent accounting pronouncements

Recently adopted accounting pronouncements

In January 2017, the Financial Accounting Standards Board (the "FASB") issued new guidance for goodwill impairment which requires only a single-step quantitative test to identify and measure impairment and record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. The option to perform a qualitative assessment first for a reporting unit to determine if a quantitative impairment test is necessary does not change under the new guidance. The Company early adopted this guidance in fiscal year 2017. The adoption of this guidance had no impact on the Company's consolidated financial statements, and we do not expect any impact from this guidance when performing our annual goodwill impairment test as of the first day of the third quarter of fiscal year 2017.

In November 2016, the FASB issued new guidance addressing diversity in practice that exists in the classification and presentation of changes in restricted cash in the statements of cash flows. The Company early adopted this guidance retrospectively in fiscal year 2017. Accordingly, changes in restricted cash that have historically been included within operating and financing activities have been eliminated, and restricted cash is combined with cash and cash equivalents when reconciling the beginning and end of period balances for all periods presented. The adoption of this guidance primarily resulted in an increase of \$289 thousand in net cash provided by operating activities for the six months ended June 25, 2016 and had no impact on the consolidated statements of operations and balance sheets.

In March 2016, the FASB issued new guidance for employee share-based compensation which simplifies several aspects of accounting for share-based payment transactions, including excess tax benefits, forfeiture estimates, statutory tax withholding requirements, and classification in the statements of cash flows. The Company adopted this guidance in fiscal year 2017, which had the following impact on the consolidated financial statements:

On a prospective basis, as required, the Company recorded excess tax benefits of \$660 thousand and \$6.8 million to the provision for income taxes in the consolidated statements of operations for the three and six months ended July 1, 2017, respectively, instead of additional paid-in capital in the consolidated balance sheets. As a result, net income increased \$660 thousand and \$6.8 million, for the three and six months ended July 1, 2017, respectively, and basic and diluted earnings per share increased \$0.01 and \$0.07 for the three and six months ended July 1, 2017, respectively.

Excess tax benefits are presented as operating cash inflows instead of financing cash inflows in the consolidated statements of cash flows, which the Company elected to apply on a retrospective basis. As a result, the Company classified \$6.8 million and \$1.8 million for the six months ended July 1, 2017 and June 25, 2016, respectively, of excess tax benefits as operating cash inflows included within the change in prepaid income taxes, net in the consolidated statements of cash flows. The retrospective reclassification resulted in increases in cash provided by operating activities and cash used in financing activities of \$1.8 million for the six months ended June 25, 2016.

The Company prospectively excluded the excess tax benefits from the assumed proceeds available to repurchase shares in the computation of diluted earnings per share under the treasury stock method, which did not have a material impact on diluted earnings per share for the three and six months ended July 1, 2017.

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Recent accounting pronouncements not yet adopted

Leases

In February 2016, the FASB issued new guidance for lease accounting, which replaces existing lease accounting guidance. The new guidance aims to increase transparency and comparability among organizations by requiring lessees to recognize lease assets and lease liabilities on the balance sheet and requiring disclosure of key information about leasing arrangements. This guidance is effective for the Company in fiscal year 2019 with early adoption permitted, and modified retrospective application is required. The Company expects to adopt this new guidance in fiscal year 2019 and is currently evaluating the impact the adoption of this new guidance will have on the Company's consolidated financial statements and related disclosures. The Company expects that substantially all of its operating lease commitments will be subject to the new guidance and will be recognized as operating lease liabilities and right-of-use assets upon adoption, thereby having a material impact to its consolidated balance sheet.

Revenue from Contracts with Customers

In May 2014, the FASB issued new guidance for revenue recognition related to contracts with customers, except for contracts within the scope of other standards, which supersedes nearly all existing revenue recognition guidance. The new guidance provides a single framework in which revenue is required to be recognized to depict the transfer of goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services.

The new guidance is effective for the Company in fiscal year 2018. The Company intends to adopt this new guidance in fiscal year 2018 using the full retrospective transition method, which will result in restating each prior reporting period presented, fiscal years 2016 and 2017, in the year of adoption. Additionally, a cumulative effect adjustment will be recorded to the opening balance of accumulated deficit as of the first day of fiscal year 2016, the earliest period presented. Based on the expected impacts described below, the Company expects such cumulative effect adjustment to be material to the opening balance of accumulated deficit.

The Company expects the adoption of the new guidance to change the timing of recognition of initial franchise fees, including master license and territory fees for our international business, and renewal fees. Currently, these fees are generally recognized upfront upon either opening of the respective restaurant or when a renewal agreement becomes effective. The new guidance will generally require these fees to be recognized over the term of the related franchise license for the respective restaurant, which we expect will result in a material impact to revenue recognized for initial franchise fees and renewal fees. The Company does not expect this new guidance to materially impact the recognition of royalty income. Additionally, rental income is outside the scope of this new guidance, and therefore will not be impacted.

The Company also expects the adoption of this new guidance to change the reporting of advertising fund contributions from franchisees and the related advertising fund expenditures, which are not currently included in the consolidated statements of operations. The Company expects the new guidance to require these advertising fund contributions and expenditures to be reported on a gross basis in the consolidated statements of operations. For the fiscal year ended December 31, 2016, franchisee contributions to the U.S. advertising funds were \$430.3 million, and therefore we expect this change to have a material impact to our total revenues and expenses. However, we expect such contributions and expenditures to be largely offsetting and therefore do not expect a significant impact on our reported net income.

Though the majority of the assessment phase is complete, the Company continues to evaluate the impact the adoption of this new guidance will have on these and other revenue transactions, in addition to the impact on accounting policies and related disclosures. Additionally, the Company is in the process of implementing new accounting systems, business processes, and internal controls related to revenue recognition to assist in the application of the new guidance.

(g) Subsequent events

Subsequent events have been evaluated through the date these consolidated financial statements were filed.

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(3) Franchise fees and royalty income

Franchise fees and royalty income consisted of the following (in thousands):

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Royalty income	\$134,192	126,838	253,894	240,204
Initial franchise fees and renewal income	10,874	10,357	21,241	20,774
Total franchise fees and royalty income	\$145,066	137,195	275,135	260,978

The changes in franchised and company-operated points of distribution were as follows:

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Systemwide points of distribution:				
Franchised points of distribution in operation—beginning of period	20,109	19,430	20,080	19,308
Franchised points of distribution—opened	319	377	602	678
Franchised points of distribution—closed	(186)	(179)	(440)	(368)
Net transfers from company-operated points of distribution	—	12	—	22
Franchised points of distribution in operation—end of period	20,242	19,640	20,242	19,640
Company-operated points of distribution—end of period	—	29	—	29
Total systemwide points of distribution—end of period	20,242	19,669	20,242	19,669

(4) Debt

Securitized Financing Facility

In January 2015, DB Master Finance LLC (the “Master Issuer”), a limited-purpose, bankruptcy-remote, wholly-owned indirect subsidiary of DBGI, entered into a base indenture and a related supplemental indenture (collectively, the “Indenture”) under which the Master Issuer may issue multiple series of notes. On the same date, the Master Issuer issued Series 2015-1 3.262% Fixed Rate Senior Secured Notes, Class A-2-I (the “Class A-2-I Notes”) with an initial principal amount of \$750.0 million and Series 2015-1 3.980% Fixed Rate Senior Secured Notes, Class A-2-II (the “Class A-2-II Notes”) and, together with the Class A-2-I Notes, the “Class A-2 Notes”) with an initial principal amount of \$1.75 billion. In addition, the Master Issuer also issued Series 2015-1 Variable Funding Senior Secured Notes, Class A-1 (the “Variable Funding Notes”) and, together with the Class A-2 Notes, the “Notes”), which allow the Master Issuer to borrow up to \$100.0 million on a revolving basis. The Variable Funding Notes may also be used to issue letters of credit. The Notes were issued in a securitization transaction pursuant to which most of the Company’s domestic and certain of its foreign revenue-generating assets, consisting principally of franchise-related agreements, real estate assets, and intellectual property and license agreements for the use of intellectual property, are held by the Master Issuer and certain other limited-purpose, bankruptcy-remote, wholly-owned indirect subsidiaries of the Company that act as guarantors of the Notes and that have pledged substantially all of their assets to secure the Notes.

The legal final maturity date of the Class A-2 Notes is in February 2045, but it is anticipated that, unless earlier prepaid to the extent permitted under the Indenture, the Class A-2-I Notes will be repaid in February 2019 and the Class A-2-II Notes will be repaid in February 2022 (the “Anticipated Repayment Dates”). If the Class A-2 Notes have not been repaid or refinanced by their respective Anticipated Repayment Dates, a rapid amortization event will occur in which residual net cash flows of the Master Issuer, after making certain required payments, will be applied to the outstanding principal of the Class A-2 Notes. Various other events, including failure to maintain a minimum ratio of net cash flows to debt service (“DSCR”), may also cause a rapid amortization event. Borrowings under the Class A-2-I and Class A-2-II Notes bear interest at fixed rates equal to 3.262% and 3.980%, respectively. If the Class A-2 Notes are not repaid or refinanced prior to their respective Anticipated Repayment Dates, incremental interest will accrue. Principal payments are required to be made on the Class A-2-I and Class A-2-II Notes equal to \$7.5 million and \$17.5 million, respectively, per calendar year, payable in quarterly installments. No principal payments are required if a

specified leverage ratio, which is a measure of outstanding debt to earnings before interest, taxes, depreciation, and amortization, adjusted for certain items (as specified in the Indenture), is less than or equal to 5.0 to 1.0, though the Company intends to continue to make the scheduled principal payments. Other events and transactions, such as certain asset sales and receipt of various insurance or indemnification proceeds, may trigger additional mandatory prepayments.

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It is anticipated that the principal and interest on the Variable Funding Notes will be repaid in full on or prior to February 2020, subject to two additional one-year extensions. Borrowings under the Variable Funding Notes bear interest at a rate equal to a base rate, a LIBOR rate plus 2.25%, or the lenders' commercial paper funding rate plus 2.25%. If the Variable Funding Notes are not repaid prior to February 2020 or prior to the end of an extension period, if applicable, incremental interest will accrue. In addition, the Company is required to pay a 2.25% fee for letters of credit amounts outstanding and a commitment fee on the unused portion of the Variable Funding Notes which ranges from 0.50% to 1.00% based on utilization.

As of July 1, 2017, approximately \$733.1 million and \$1.71 billion of principal were outstanding on the Class A-2-I Notes and Class A-2-II Notes, respectively. Total debt issuance costs incurred and capitalized in connection with the issuance of the Notes were \$41.3 million. The effective interest rate, including the amortization of debt issuance costs, was 3.5% and 4.3% for the Class A-2-I Notes and Class A-2-II Notes, respectively, as of July 1, 2017.

As of July 1, 2017 and December 31, 2016, \$25.9 million of letters of credit were outstanding against the Variable Funding Notes, which relate primarily to interest reserves required under the Indenture. There were no amounts drawn down on these letters of credit as of July 1, 2017 or December 31, 2016.

The Notes are subject to a series of covenants and restrictions customary for transactions of this type, including (i) that the Master Issuer maintains specified reserve accounts to be used to make required payments in respect of the Notes, (ii) provisions relating to optional and mandatory prepayments, including mandatory prepayments in the event of a change of control as defined in the Indenture and the related payment of specified amounts, including specified make-whole payments in the case of the Class A-2 Notes under certain circumstances, (iii) certain indemnification payments in the event, among other things, the assets pledged as collateral for the Notes are in stated ways defective or ineffective, and (iv) covenants relating to recordkeeping, access to information, and similar matters. As noted above, the Notes are also subject to customary rapid amortization events provided for in the Indenture, including events tied to failure to maintain stated DSCR, failure to maintain an aggregate level of Dunkin' Donuts U.S. retail sales on certain measurement dates, certain manager termination events, an event of default, and the failure to repay or refinance the Class A-2 Notes on the applicable scheduled maturity date. The Notes are also subject to certain customary events of default, including events relating to non-payment of required interest, principal, or other amounts due on or with respect to the Notes, failure to comply with covenants within certain time frames, certain bankruptcy events, breaches of specified representations and warranties, failure of security interests to be effective, and certain judgments.

(5) Other current liabilities

Other current liabilities consisted of the following (in thousands):

	July 1, 2017	December 31, 2016
Gift card/certificate liability	\$150,880	207,628
Gift card breakage liability	7,841	13,301
Accrued payroll and benefits	20,262	25,071
Accrued legal liabilities (see note 9(c))	6,052	5,555
Accrued interest	10,898	10,702
Accrued professional costs	2,806	2,170
Franchisee profit-sharing liability	9,912	11,083
Other	28,585	22,756
Total other current liabilities	\$237,236	298,266

The decrease in the gift card/certificate liability was driven by the seasonality of our gift card program. The franchisee profit-sharing liability represents amounts owed to franchisees from the net profits primarily on the sale of Dunkin' K-Cup® pods and retail packaged coffee in certain retail outlets.

(6) Segment information

The Company is strategically aligned into two global brands, Dunkin' Donuts and Baskin-Robbins, which are further segregated between U.S. operations and international operations. As such, the Company has determined that it has four operating segments, which are its reportable segments: Dunkin' Donuts U.S., Dunkin' Donuts International,

Baskin-Robbins U.S., and Baskin-Robbins International. Dunkin' Donuts U.S., Baskin-Robbins U.S., and Dunkin' Donuts International primarily derive their revenues through royalty income and franchise fees. Baskin-Robbins U.S. also derives revenue through license fees from a third-party license agreement and rental income. Dunkin' Donuts U.S. also derives revenue through rental income. Prior to the sale of all remaining company-operated restaurants in the fourth quarter of fiscal year 2016, Dunkin'

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Donuts U.S. also derived revenue through retail sales at company-operated restaurants. Baskin-Robbins International primarily derives its revenues from sales of ice cream products, as well as royalty income, franchise fees, and license fees. The operating results of each segment are regularly reviewed and evaluated separately by the Company's senior management, which includes, but is not limited to, the chief executive officer. Senior management primarily evaluates the performance of its segments and allocates resources to them based on operating income adjusted for amortization of intangible assets, long-lived asset impairment charges, impairment of our equity method investments, and other infrequent or unusual charges, which does not reflect the allocation of any corporate charges. This profitability measure is referred to as segment profit. When senior management reviews a balance sheet, it is at a consolidated level. The accounting policies applicable to each segment are generally consistent with those used in the consolidated financial statements.

Revenues for all operating segments include only transactions with unaffiliated customers and include no intersegment revenues. Revenues reported as "Other" include revenues earned through certain licensing arrangements with third parties in which our brand names are used, including the licensing fees earned from the Dunkin' K-Cup® pod licensing agreement, revenues generated from online training programs for franchisees, and revenues from the sale of Dunkin' Donuts products in certain international markets, all of which are not allocated to a specific segment. Revenues by segment were as follows (in thousands):

	Revenues			
	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Dunkin' Donuts U.S.	\$157,080	153,660	299,042	292,473
Dunkin' Donuts International	4,495	5,218	9,790	12,468
Baskin-Robbins U.S.	14,347	13,738	24,894	24,299
Baskin-Robbins International	33,978	34,840	60,066	61,674
Total reportable segment revenues	209,900	207,456	393,792	390,914
Other	8,622	8,853	15,402	15,171
Total revenues	\$218,522	216,309	409,194	406,085

Amounts included in "Corporate" in the segment profit table below include corporate overhead costs, such as payroll and related benefit costs and professional services, net of "Other" revenues reported above. Segment profit by segment was as follows (in thousands):

	Segment profit			
	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Dunkin' Donuts U.S.	\$122,548	116,085	230,522	216,529
Dunkin' Donuts International	1,454	1,975	3,343	5,733
Baskin-Robbins U.S.	10,970	10,738	18,307	18,038
Baskin-Robbins International	12,501	11,079	20,480	19,463
Total reportable segments	147,473	139,877	272,652	259,763
Corporate	(28,530)	(28,164)	(57,042)	(56,863)
Interest expense, net	(24,460)	(24,848)	(49,010)	(49,580)
Amortization of other intangible assets	(5,333)	(5,568)	(10,660)	(11,329)
Long-lived asset impairment charges	(60)	(4)	(107)	(97)
Other income (losses), net	28	(102)	215	(472)
Income before income taxes	\$89,118	81,191	156,048	141,422

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Net income of equity method investments is included in segment profit for the Dunkin' Donuts International and Baskin-Robbins International reportable segments. Amounts reported as "Other" in the segment profit table below include the reduction in depreciation and amortization, net of tax, reported by our equity method investees as a result of previously recorded impairment charges. Net income of equity method investments by reportable segment was as follows (in thousands):

	Net income (loss) of equity method investments			
	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
	Dunkin' Donuts International	\$13	304	(77)
Baskin-Robbins International	2,950	2,303	4,976	4,378
Total reportable segments	2,963	2,607	4,899	4,856
Other	1,364	1,110	2,247	1,825
Total net income of equity method investments	\$4,327	3,717	7,146	6,681

(7) Stockholders' deficit

The changes in total stockholders' deficit were as follows (in thousands):

	Total stockholders' deficit
Balance as of December 31, 2016	\$ (163,258)
Net income	103,171
Other comprehensive income	5,988
Dividends paid on common stock	(58,847)
Exercise of stock options	21,313
Accelerated share repurchases of common stock	(100,000)
Share-based compensation expense	7,247
Other, net	(1,015)
Balance as of July 1, 2017	\$ (185,401)

(a) Treasury stock

During the three months ended July 1, 2017, the Company entered into and completed an accelerated share repurchase agreement (the "May 2017 ASR Agreement") with a third-party financial institution. Pursuant to the terms of the May 2017 ASR Agreement, the Company paid the financial institution \$100.0 million in cash and received 1,757,568 shares of the Company's common stock during the three months ended July 1, 2017 based on a weighted average cost per share of \$56.90 over the term of the May 2017 ASR Agreement.

The Company accounts for treasury stock under the cost method based on the cost of the shares on the dates of repurchase and any direct costs incurred. During the three months ended July 1, 2017, the Company retired the 1,757,568 shares of treasury stock repurchased under the May 2017 ASR Agreement. The repurchase and retirement of these shares of treasury stock resulted in a decrease in additional paid-in capital of \$14.6 million and an increase in accumulated deficit of \$85.4 million.

(b) Equity incentive plans

During the six months ended July 1, 2017, the Company granted stock options to purchase 1,172,348 shares of common stock and 78,660 restricted stock units ("RSUs") to certain employees and members of our board of directors. The stock options generally vest in equal annual amounts over a four-year period subsequent to the grant date, and have a maximum contractual term of seven years. The stock options were granted with a weighted average exercise price of \$55.05 per share and have a weighted average grant-date fair value of \$9.88 per share. The RSUs granted to employees and members of our board of directors vest in equal annual amounts over a three-year period and a one-year period, respectively, subsequent to the grant date and have a weighted average grant-date fair value of \$52.71

per share.

In addition, the Company granted 84,024 performance stock units (“PSUs”) to certain employees during the six months ended July 1, 2017. These PSUs are generally eligible to cliff-vest approximately three years from the grant date. Of the total PSUs granted, 36,712 PSUs are subject to a service condition and a market vesting condition linked to the level of total shareholder

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return received by the Company's shareholders during the performance period measured against the companies in the S&P 500 Composite Index ("TSR PSUs"). The remaining 47,312 PSUs granted are subject to a service condition and a performance vesting condition based on the level of adjusted operating income growth achieved over the performance period ("AOI PSUs"). The maximum vesting percentage that could be realized for each of the TSR PSUs and the AOI PSUs is 200% based on the level of performance achieved for the respective awards. All of the PSUs are also subject to a one-year post-vesting holding period. The TSR PSUs were valued based on a Monte Carlo simulation model to reflect the impact of the total shareholder return market condition, resulting in a weighted average grant-date fair value of \$67.59 per share. The probability of satisfying a market condition is considered in the estimation of the grant-date fair value for TSR PSUs and the compensation cost is not reversed if the market condition is not achieved, provided the requisite service has been provided. The AOI PSUs have a weighted average grant-date fair value of \$52.45 per share. Total compensation cost for the AOI PSUs is determined based on the most likely outcome of the performance condition and the number of awards expected to vest based on the outcome.

Total compensation expense related to all share-based awards was \$3.8 million and \$4.2 million for the three months ended July 1, 2017 and June 25, 2016, respectively, and \$7.2 million and \$8.3 million for the six months ended July 1, 2017 and June 25, 2016, respectively, and is included in general and administrative expenses, net in the consolidated statements of operations.

(c) Accumulated other comprehensive loss

The changes in the components of accumulated other comprehensive loss were as follows (in thousands):

	Effect of foreign currency translation	Unrealized gains on interest rate swaps	Other	Accumulated other comprehensive gain (loss)
Balance as of December 31, 2016	\$ (23,019)	1,144	(2,109)	(23,984)
Other comprehensive income (loss), net	5,971	(636)	653	5,988
Balance as of July 1, 2017	\$ (17,048)	508	(1,456)	(17,996)

(d) Dividends

The Company paid a quarterly dividend of \$0.3225 per share of common stock on June 14, 2017 and March 22, 2017, totaling approximately \$29.2 million and \$29.6 million, respectively. On July 27, 2017, the Company announced that its board of directors approved the next quarterly dividend of \$0.3225 per share of common stock payable September 6, 2017 to shareholders of record as of the close of business on August 28, 2017.

(8) Earnings per share

The computation of basic and diluted earnings per common share is as follows (in thousands, except for share and per share data):

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Net income—basic and diluted	\$55,704	49,590	103,171	86,744
Weighted average number of common shares:				
Common—basic	91,207,451	91,504,563	91,432,007	91,594,704
Common—diluted	92,606,522	92,451,913	92,863,378	92,535,091
Earnings per common share:				
Common—basic	\$0.61	0.54	1.13	0.95
Common—diluted	0.60	0.54	1.11	0.94

The weighted average number of common shares in the common diluted earnings per share calculation includes the dilutive effect of 1,399,070 and 947,350 equity awards for the three months ended July 1, 2017 and June 25, 2016, respectively, and includes the dilutive effect of 1,431,371 and 940,387 equity awards for the six months ended July 1, 2017 and June 25, 2016, respectively, using the treasury stock method. The weighted average number of common shares in the common diluted earnings per share calculation for all periods excludes all contingently issuable equity awards for which the contingent vesting criteria were not yet met as of the fiscal period end. As of July 1, 2017 and

June 25, 2016, there were 150,000 restricted shares that were contingently issuable and for which the contingent vesting criteria were not yet met as of the fiscal period end. Additionally, the weighted average number of common shares in the common diluted earnings per share calculation excludes

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1,123,482 and 4,210,753 equity awards for the three months ended July 1, 2017 and June 25, 2016, respectively, and 1,629,480 and 4,361,416 equity awards for the six months ended July 1, 2017 and June 25, 2016, respectively, as they would be antidilutive.

(9) Commitments and contingencies

(a) Supply chain guarantees

The Company has various supply chain agreements that provide for purchase commitments, the majority of which result in the Company being contingently liable upon early termination of the agreement. As of July 1, 2017 and December 31, 2016, the Company was contingently liable under such supply chain agreements for approximately \$122.4 million and \$136.2 million, respectively. For certain supply chain commitments, as product is purchased by the Company's franchisees over the term of the agreement, the amount of the guarantee is reduced. The Company assesses the risk of performing under each of these guarantees on a quarterly basis, and, based on various factors including internal forecasts, prior history, and ability to extend contract terms, we accrued an immaterial amount of reserves related to supply chain commitments as of July 1, 2017 and December 31, 2016.

(b) Letters of credit

As of July 1, 2017 and December 31, 2016, the Company had standby letters of credit outstanding for a total of \$25.9 million. There were no amounts drawn down on these letters of credit.

(c) Legal matters

The Company is engaged in several matters of litigation arising in the ordinary course of its business as a franchisor. Such matters include disputes related to compliance with the terms of franchise and development agreements, including claims or threats of claims of breach of contract, negligence, and other alleged violations by the Company. As of July 1, 2017 and December 31, 2016, \$6.1 million and \$5.6 million, respectively, was included in other current liabilities in the consolidated balance sheets to reflect the Company's estimate of the probable losses which may be incurred in connection with all outstanding litigation.

(10) Related-party transactions

(a) Advertising funds

As of July 1, 2017 and December 31, 2016, the Company had a net payable of \$6.1 million and \$11.9 million, respectively, to the various advertising funds.

To cover administrative expenses of the advertising funds, the Company charges each advertising fund a management fee for items such as facilities, accounting services, information technology, data processing, product development, legal, administrative support services, and other operating expenses, as well as share-based compensation expense for employees that provide services directly to the advertising funds. Management fees totaled \$2.7 million and \$2.5 million for the three months ended July 1, 2017 and June 25, 2016, respectively, and \$5.6 million and \$4.8 million for the six months ended July 1, 2017 and June 25, 2016, respectively. Such management fees are included in the consolidated statements of operations as a reduction in general and administrative expenses, net.

The Company made discretionary contributions to certain advertising funds for the purpose of supplementing national and regional advertising in certain markets of \$2.3 million during the three and six months ended July 1, 2017. An immaterial amount of such contributions were made during the three and six months ended June 25, 2016. Additionally, the Company made contributions to the advertising funds based on retail sales at company-operated restaurants of \$233 thousand and \$514 thousand during the three and six months ended June 25, 2016, which are included in company-operated restaurant expenses in the consolidated statements of operations. No such contributions were made during the three and six months ended July 1, 2017, as the Company did not have any company-operated restaurants during these periods. The Company also funded advertising fund initiatives of \$630 thousand and \$495 thousand during the three months ended July 1, 2017 and June 25, 2016, respectively, and \$1.2 million and \$1.0 million during the six months ended July 1, 2017 and June 25, 2016, respectively, which were contributed from the gift card breakage liability included within other current liabilities in the consolidated balance sheets (see note 5).

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(b) Equity method investments

The Company recognized royalty income from its equity method investees as follows (in thousands):

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
B-R 31 Ice Cream Company., Ltd.	\$ 587	570	876	891
BR-Korea Co., Ltd.	1,035	968	2,052	1,861
	\$ 1,622	1,538	2,928	2,752

As of July 1, 2017 and December 31, 2016, the Company had \$1.2 million and \$1.1 million, respectively, of royalties receivable from its equity method investees, which were recorded in accounts receivable, net of allowance for doubtful accounts, in the consolidated balance sheets.

The Company made net payments to its equity method investees totaling approximately \$742 thousand and \$805 thousand during the three months ended July 1, 2017 and June 25, 2016, respectively, and \$1.8 million and \$1.6 million during the six months ended July 1, 2017 and June 25, 2016, respectively, primarily for the purchase of ice cream products.

The Company recognized \$958 thousand and \$1.3 million during the three months ended July 1, 2017 and June 25, 2016, respectively, and \$2.0 million and \$1.7 million during the six months ended July 1, 2017 and June 25, 2016, respectively, in the consolidated statements of operations from the sale of ice cream and other products to Palm Oasis Ventures Pty. Ltd. ("Australia JV"). As of July 1, 2017 and December 31, 2016, the Company had \$3.0 million and \$2.6 million, respectively, of net receivables from the Australia JV, consisting of accounts and notes receivable, net of current liabilities.

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

Forward-Looking Statements

Certain statements contained herein are not based on historical fact and are "forward-looking statements" within the meaning of the applicable securities laws and regulations. Generally, these statements can be identified by the use of words such as "anticipate," "believe," "could," "estimate," "expect," "feel," "forecast," "intend," "may," "plan," "potential," "predict," or "would," and similar expressions intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. These forward-looking statements include all matters that are not historical facts.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. These risks and uncertainties include, but are not limited to: the ongoing level of profitability of franchisees and licensees; our franchisees' and licensees' ability to sustain same store sales growth; successful westward expansion; changes in working relationships with our franchisees and licensees and the actions of our franchisees and licensees; our master franchisees' relationships with sub-franchisees; the strength of our brand in the markets in which we compete; changes in competition within the quick service restaurant segment of the food industry; changes in consumer behavior resulting from changes in technologies or alternative methods of delivery; economic and political conditions in the countries where we operate; our substantial indebtedness; our ability to protect our intellectual property rights; consumer preferences, spending patterns and demographic trends; the impact of seasonal changes, including weather effects, on our business; the success of our growth strategy and international development; changes in commodity and food prices, particularly coffee, dairy products and sugar, and other operating costs; shortages of coffee; failure of our network and information technology systems; interruptions or shortages in the supply of products to our franchisees and licensees; the impact of food borne-illness or food safety issues or adverse public or media opinions regarding the health effects of consuming our products; our ability to collect royalty payments from our franchisees and licensees; uncertainties relating to litigation; the ability of our franchisees and licensees to open new restaurants and keep existing restaurants in operation; our ability to retain key personnel; any inability to protect consumer credit card data and catastrophic events.

Forward-looking statements reflect management's analysis as of the date of this quarterly report. Important factors that could cause actual results to differ materially from our expectations are more fully described in our other filings with the Securities and Exchange Commission, including under the section headed "Risk Factors" in our most recent annual report on Form 10-K. Except as required by applicable law, we do not undertake to publicly update or revise any of these forward-looking statements, whether as a result of new information, future events or otherwise.

Introduction and overview

We are one of the world's leading franchisors of quick service restaurants ("QSRs") serving hot and cold coffee and baked goods, as well as hard serve ice cream. We franchise restaurants under our Dunkin' Donuts and Baskin-Robbins brands. With more than 20,000 points of distribution in more than 60 countries worldwide, we believe that our portfolio has strong brand awareness in our key markets. QSR is a restaurant format characterized by counter or drive-thru ordering and limited or no table service. As of July 1, 2017, Dunkin' Donuts had 12,350 global points of distribution with restaurants in 41 U.S. states, the District of Columbia, and 45 foreign countries. Baskin-Robbins had 7,892 global points of distribution as of the same date, with restaurants in 43 U.S. states, the District of Columbia, Puerto Rico, and 51 foreign countries.

We are organized into four reporting segments: Dunkin' Donuts U.S., Dunkin' Donuts International, Baskin-Robbins U.S., and Baskin-Robbins International. We generate revenue from four primary sources: (i) royalty income and franchise fees associated with franchised restaurants, (ii) rental income from restaurant properties that we lease or sublease to franchisees, (iii) sales of ice cream and other products to franchisees in certain international markets, and (iv) other income including fees for the licensing of our brands for products sold in certain retail outlets, the licensing of the rights to manufacture Baskin-Robbins ice cream products sold to U.S. franchisees, refranchising gains, transfer fees from franchisees, and online training fees. Prior to completing the sale of all remaining company-operated restaurants in fiscal year 2016, we also generated revenue from retail store sales at our company-operated restaurants. Franchisees fund the vast majority of the cost of new restaurant development. As a result, we are able to grow our system with lower capital requirements than many of our competitors. With no company-operated points of

distribution during fiscal year 2017, we are less affected by store-level costs, profitability, and fluctuations in commodity costs than other QSR operators.

Our franchisees fund substantially all of the advertising that supports both brands. Those advertising funds also fund the cost of our marketing, research and development, and innovation personnel. Royalty payments and advertising fund contributions typically are made on a weekly basis for restaurants in the U.S., which limit our working capital needs. For the six months ended July 1, 2017, franchisee contributions to the U.S. advertising funds were \$216.3 million.

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We operate and report financial information on a 52- or 53-week year on a 13-week quarter basis with the fiscal year ending on the last Saturday in December and fiscal quarters ending on the 13th Saturday of each quarter (or 14th Saturday when applicable with respect to the fourth fiscal quarter). The data periods contained within the three- and six-month periods ended July 1, 2017 and June 25, 2016 reflect the results of operations for the 13-week and 26-week periods ended on those dates. Operating results for the three- and six-month periods ended July 1, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending December 30, 2017.

Selected operating and financial highlights

	Three months ended		Six months ended		
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016	
Financial data (in thousands):					
Total revenues	\$218,522	216,309	409,194	406,085	
Operating income	113,550	106,141	204,843	191,474	
Adjusted operating income	118,943	111,294	215,610	202,536	
Net income	55,704	49,590	103,171	86,744	
Adjusted net income	58,940	52,682	109,631	93,381	
Systemwide sales (in millions):					
Dunkin' Donuts U.S.	\$2,175.0	2,056.9	4,132.1	3,922.2	
Dunkin' Donuts International	169.4	175.0	344.3	342.5	
Baskin-Robbins U.S.	187.5	183.0	316.6	312.9	
Baskin-Robbins International	370.7	360.0	639.5	616.0	
Total systemwide sales	\$2,902.6	2,774.9	5,432.5	5,193.5	
Systemwide sales growth	4.6	% 3.8	% 4.6	% 4.1	%
Comparable store sales growth (decline):					
Dunkin' Donuts U.S.	0.8	% 0.5	% 0.4	% 1.2	%
Dunkin' Donuts International	(2.8))% (3.1))% (1.3))% (2.6))%
Baskin-Robbins U.S.	(0.9))% 0.6	% (1.4))% 2.3	%
Baskin-Robbins International	3.3	% (6.6))% 0.9	% (7.3))%

Our financial results are largely driven by changes in systemwide sales, which include sales by all points of distribution, whether owned by Dunkin' Brands or by our franchisees and licensees, including joint ventures. While we do not record sales by franchisees, licensees, or joint ventures as revenue, and such sales are not included in our consolidated financial statements, we believe that this operating measure is important in obtaining an understanding of our financial performance. We believe systemwide sales information aids in understanding how we derive royalty revenue and in evaluating our performance relative to competitors.

Comparable store sales growth (decline) for Dunkin' Donuts U.S. and Baskin-Robbins U.S. is calculated by including only sales from franchisee- and company-operated restaurants that have been open at least 78 weeks and that have reported sales in the current and comparable prior year week. Comparable store sales growth (decline) for Dunkin' Donuts International and Baskin-Robbins International generally represents the growth in local currency average monthly sales for franchisee-operated restaurants, including joint ventures, that have been open at least 13 months and that have reported sales in the current and comparable prior year month.

Overall growth in systemwide sales of 4.6% for each of the three- and six-month periods ended July 1, 2017 over the same periods in the prior fiscal year resulted from the following:

Dunkin' Donuts U.S. systemwide sales growth of 5.7% and 5.4% for the three and six months ended July 1, 2017 was primarily a result of 375 net new restaurants opened since June 25, 2016 and comparable store sales growth of 0.8% and 0.4%, respectively. The increases in comparable store sales were driven by increased average ticket, offset by a decline in traffic. Growth was primarily driven by sales of breakfast sandwiches. Beverage sales increased for the three months ended July 1, 2017, led by an increase in iced coffee as Cold Brew sales continue to grow, while beverage sales decreased for the six months ended July 1, 2017 due primarily to a decline in hot coffee, offset by an

increase in iced coffee, driven by Cold Brew sales.

Dunkin' Donuts International systemwide sales declined 3.2% for the three months ended July 1, 2017, driven primarily by sales declines in South Korea, Southeast Asia, and Europe, offset by sales growth in South America, the Middle East, and China. Systemwide sales grew 0.5% for the six months ended July 1, 2017, driven primarily by sales

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growth in the Middle East, South America, and China, offset by a decline in South Korea. For both the three- and six-month periods, sales in South Korea were positively impacted by foreign exchange rates, while sales in Southeast Asia were negatively impacted by foreign exchange rates. Additionally, sales in South America for the six months ended July 1, 2017 were positively impacted by foreign exchange rates. On a constant currency basis, systemwide sales decreased by approximately 3% for the three months ended July 1, 2017, while systemwide sales remained flat for the six months ended July 1, 2017. Dunkin' Donuts International comparable store sales declined 2.8% and 1.3% for the three and six months ended July 1, 2017, respectively, due primarily to declines in South Korea, Europe, and the Middle East, offset by growth in South America. Additionally, declines in Southeast Asia contributed to the comparable store sales decline for the three-month period, while growth in Southeast Asia offset the comparable store sales decline for the six-month period.

Baskin-Robbins U.S. systemwide sales growth of 2.5% and 1.2% for the three and six months ended July 1, 2017, respectively, was primarily a result of 21 net new restaurants opened since June 25, 2016. Offsetting the systemwide sales growth were comparable store sales declines of 0.9% and 1.4% for the three and six months ended, respectively, driven by a decline in traffic, offset by increased average ticket. Sales of cups and cones, desserts, and beverages decreased, offset by increased sales in take-home products for the three months ended July 1, 2017. Sales of beverages, soft serve, and sundaes decreased, offset by increased sales in take-home products for the six months ended July 1, 2017.

Baskin-Robbins International systemwide sales growth of 3.0% and 3.8% for the three and six months ended July 1, 2017, respectively, was driven by sales growth in South Korea and Japan, offset by declines in Europe and the Middle East. Also contributing to the systemwide sales growth for the six months ended July 1, 2017 was an increase in sales in Canada, offset by a decline in China. Sales in South Korea were positively impacted by foreign exchange rates, while sales in Japan were negatively impacted by foreign exchange rates. On a constant currency basis, systemwide sales increased by approximately 3% for each of the three- and six-month periods ended July 1, 2017. Baskin-Robbins International comparable store sales growth of 3.3% and 0.9% for the three and six months ended July 1, 2017 was driven primarily by growth in South Korea and Japan, offset by declines in the Middle East.

Changes in systemwide sales are impacted, in part, by changes in the number of points of distribution. Points of distribution and net openings as of and for the three and six months ended July 1, 2017 and June 25, 2016 were as follows:

	July 1, 2017		June 25, 2016	
Points of distribution, at period end:				
Dunkin' Donuts U.S.	8,948	8,573		
Dunkin' Donuts International	3,402	3,368		
Baskin-Robbins U.S.	2,551	2,530		
Baskin-Robbins International	5,341	5,198		
Consolidated global points of distribution	20,242	19,669		
	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Net openings (closings) during the period:				
Dunkin' Donuts U.S.	64	73	120	142
Dunkin' Donuts International	(1)	35	(28)	49
Baskin-Robbins U.S.	12	12	13	1
Baskin-Robbins International	58	78	57	120
Consolidated global net openings	133	198	162	312

Total revenues increased \$2.2 million, or 1.0%, and \$3.1 million, or 0.8%, for the three and six months ended July 1, 2017, respectively, due primarily to increased royalty income as a result of systemwide sales growth, as well as an increase in rental income due to an increase in the number of leases for franchised locations. These increases in

revenues were offset by a decrease in sales at company-operated restaurants as there were no company-operated points of distribution during 2017. Also offsetting the increases in revenues was a decrease in other revenues due primarily to decreases in transfer fees and refranchising gains, as well as a decrease in sales of ice cream and other products due to a decline in sales of ice cream and other products to the Middle East.

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Operating income and adjusted operating income for the three months ended July 1, 2017 increased \$7.4 million, or 7.0%, and \$7.6 million, or 6.9%, respectively, from the prior year period. Operating income and adjusted operating income for the six months ended July 1, 2017 increased \$13.4 million, or 7.0%, and \$13.1 million, or 6.5%, respectively, from the prior year period. The increases were primarily a result of the increase in royalty income, an increase in rental margin, and a decrease in general and administrative expenses. Additionally, the prior year periods were unfavorably impacted by the operating results of company-operated restaurants. The increases in operating income and adjusted operating income were offset by a gain recognized in connection with the sale of company-operated restaurants in the prior year periods, as well as the decrease in other revenues.

Net income and adjusted net income for the three months ended July 1, 2017 increased \$6.1 million, or 12.3%, and \$6.3 million, or 11.9%, respectively, primarily as a result of the increases in operating income and adjusted operating income, offset by an increase in tax expense.

Net income and adjusted net income for the six months ended July 1, 2017 increased \$16.4 million, or 18.9%, and \$16.3 million, or 17.4%, respectively, primarily as a result of the increases in operating income and adjusted operating income, as well as a decrease in tax expense. Tax expense for the six months ended July 1, 2017 included \$6.8 million of excess tax benefits from share-based compensation, which are now included in the provision for income taxes as a result of the required adoption of a new accounting standard in the first quarter (see note 2(f) to the unaudited consolidated financial statements included herein).

Adjusted operating income and adjusted net income are non-GAAP measures reflecting operating income and net income adjusted for amortization of intangible assets, long-lived asset impairments, impairment of our equity method investments, and other non-recurring, infrequent, or unusual charges, net of the tax impact of such adjustments in the case of adjusted net income. We use adjusted operating income and adjusted net income as key performance measures for the purpose of evaluating performance internally. We also believe adjusted operating income and adjusted net income provide our investors with useful information regarding our historical operating results. These non-GAAP measurements are not intended to replace the presentation of our financial results in accordance with GAAP. Use of the terms adjusted operating income and adjusted net income may differ from similar measures reported by other companies.

Adjusted operating income and adjusted net income are reconciled from operating income and net income, respectively, determined under GAAP as follows:

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
	(In thousands)			
Operating income	\$ 113,550	106,141	204,843	191,474
Adjustments:				
Amortization of other intangible assets	5,333	5,568	10,660	11,329
Long-lived asset impairment charges	60	4	107	97
Transaction-related costs ^(a)	—	9	—	64
Bertico and related litigation	—	(428)	—	(428)
Adjusted operating income	\$ 118,943	111,294	215,610	202,536
Net income	\$ 55,704	49,590	103,171	86,744
Adjustments:				
Amortization of other intangible assets	5,333	5,568	10,660	11,329
Long-lived asset impairment charges	60	4	107	97
Transaction-related costs ^(a)	—	9	—	64
Bertico and related litigation	—	(428)	—	(428)
Tax impact of adjustments ^(b)	(2,157)	(2,061)	(4,307)	(4,425)
Adjusted net income	\$ 58,940	52,682	109,631	93,381

(a) Represents non-capitalizable costs incurred as a result of the securitized financing facility.

(b) Tax impact of adjustments calculated at a 40% effective tax rate.

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Earnings per share

Earnings per share and diluted adjusted earnings per share were as follows:

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Earnings per share:				
Common—basic	\$ 0.61	0.54	1.13	0.95
Common—diluted	0.60	0.54	1.11	0.94
Diluted adjusted earnings per share	0.64	0.57	1.18	1.01

Diluted adjusted earnings per share is calculated using adjusted net income, as defined above, and diluted weighted average shares outstanding. Diluted adjusted earnings per share is not a presentation made in accordance with GAAP, and our use of the term diluted adjusted earnings per share may vary from similar measures reported by others in our industry due to the potential differences in the method of calculation. Diluted adjusted earnings per share should not be considered as an alternative to earnings per share derived in accordance with GAAP. Diluted adjusted earnings per share has important limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of our results as reported under GAAP. Because of these limitations, we rely primarily on our GAAP results. However, we believe that presenting diluted adjusted earnings per share is appropriate to provide investors with useful information regarding our historical operating results.

The following table sets forth the computation of diluted adjusted earnings per share:

	Three months ended		Six months ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Adjusted net income	\$58,940	52,682	109,631	93,381
Weighted average number of common shares—diluted	92,606,522	92,451,913	92,863,378	92,535,091
Diluted adjusted earnings per share	\$0.64	0.57	1.18	1.01

Results of operations

Consolidated results of operations

	Three months ended			Six months ended		
	July 1, 2017	June 25, 2016	Increase (Decrease) \$ %	July 1, 2017	June 25, 2016	Increase (Decrease) \$ %
Franchise fees and royalty income	\$145,066	137,195	7,871 5.7 %	\$	\$	

(In thousands, except percentages)