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APPLEBEES INTERNATIONAL INC

Form 10-Q

August 01, 2002

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2002

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 000-17962

Applebee's International, Inc.

(Exact name of registrant as specified in its charter)

Delaware

43-1461763

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

4551 W. 107th Street, Suite 100, Overland Park, Kansas 66207

(Address of principal executive offices and zip code)

(913) 967-4000

(Registrant's telephone number, including area code)

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

The number of shares of the registrant's common stock outstanding as of July 26, 2002 was 55,995,834.

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APPLEBEE'S INTERNATIONAL, INC.  
FORM 10-Q  
FISCAL QUARTER ENDED JUNE 30, 2002  
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APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)  
(in thousands, except share amounts)

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June 30,  
2002

ASSETS

Current assets:

Cash and cash equivalents.....	\$ 7,778
Short-term investments, at market value (amortized cost of \$478 in 2002 and \$677 in 2001).....	495
Receivables (less allowance for bad debts of \$5,177 in 2002 and \$4,343 in 2001).....	23,706
Inventories.....	10,653
Prepaid and other current assets.....	10,161
Total current assets.....	52,793
Property and equipment, net.....	343,048
Goodwill, net.....	78,614
Franchise interest and rights, net.....	1,634
Other assets.....	21,050
	\$ 497,139

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Current portion of long-term debt.....	\$ 47
Accounts payable.....	25,588
Accrued expenses and other current liabilities.....	61,021
Accrued dividends.....	--
Accrued income taxes.....	6,546
Total current liabilities.....	93,202
Non-current liabilities:	
Long-term debt - less current portion.....	32,524
Franchise deposits.....	1,258
Deferred income taxes.....	1,974
Total non-current liabilities.....	35,756
Total liabilities.....	128,958

Commitments and contingencies (Note 2)

Stockholders' equity:

Preferred stock - par value \$0.01 per share: authorized - 1,000,000 shares; no shares issued.....	--
Common stock - par value \$0.01 per share: authorized - 125,000,000 shares; issued - 72,336,788 shares.....	723
Additional paid-in capital.....	185,481
Retained earnings.....	396,657
Accumulated other comprehensive income, net of income taxes.....	11
	582,872
Treasury stock - 16,369,087 shares in 2002 and 16,522,099 shares in 2001, at cost.....	(214,691)
Total stockholders' equity.....	368,181
	\$ 497,139

See notes to consolidated financial statements.

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

	13 Weeks Ended		26 Weeks Ended
	June 30, 2002	July 1, 2001	June 30, 2002
Revenues:			
Company restaurant sales.....	\$178,893	\$162,035	\$353,866
Franchise income.....	25,484	23,885	50,324
Total operating revenues.....	204,377	185,920	404,190
Cost of company restaurant sales:			
Food and beverage.....	47,073	43,633	94,480
Labor.....	58,881	51,533	116,338
Direct and occupancy.....	44,291	41,104	87,163
Pre-opening expense.....	305	132	640
Total cost of company restaurant sales...	150,550	136,402	298,621
General and administrative expenses.....	19,553	18,085	38,799
Amortization of intangible assets.....	52	1,462	190
Loss on disposition of restaurants and equipment.	727	571	1,021
Operating earnings.....	33,495	29,400	65,559
Other income (expense):			
Investment income.....	381	415	778
Interest expense.....	(555)	(2,043)	(1,188)
Other income.....	482	385	583
Total other income (expense).....	308	(1,243)	173
Earnings before income taxes.....	33,803	28,157	65,732
Income taxes.....	12,338	10,361	23,992
Net earnings.....	\$ 21,465	\$ 17,796	\$ 41,740
Basic net earnings per common share.....	\$ 0.38	\$ 0.32	\$ 0.75
Diluted net earnings per common share.....	\$ 0.37	\$ 0.31	\$ 0.73
Basic weighted average shares outstanding.....	55,872	55,370	55,874

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Diluted weighted average shares outstanding.....	57,374	56,808	57,352
	=====	=====	=====

See notes to consolidated financial statements.

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

	Common Stock		Additional	Retained	Accumulated
	Shares	Amount	Paid-In Capital	Earnings	Other Comprehensive Income
Balance, December 30, 2001.....	72,336,788	\$ 723	\$ 180,802	\$ 354,950	\$
Comprehensive income:					
Net earnings.....	--	--	--	41,740	
Change in unrealized gain on short-term investments, net of income taxes.....	--	--	--	--	
Total comprehensive income.....	--	--	--	41,740	
Purchases of treasury stock.....	--	--	--	--	
Stock options exercised and related tax benefit.....	--	--	1,830	--	
Shares issued under employee stock and 401(k) plans.....	--	--	2,083	--	
Restricted shares awarded under equity incentive plan, net of cancellations.....	--	--	(20)	--	
Unearned compensation relating to restricted shares.....	--	--	295	--	
Repayments of notes receivable from officers for stock sales.....	--	--	491	--	
Dividends paid for fractional shares	--	--	--	(33)	
Balance, June 30, 2002.....	72,336,788	\$ 723	\$ 185,481	\$ 396,657	\$
	=====	=====	=====	=====	=====

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See notes to consolidated financial statements.

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

	26 Wee
	June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings.....	\$ 41,740
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization.....	16,953
Amortization of intangible assets.....	190
Amortization of deferred financing costs.....	96
Deferred income tax provision (benefit).....	617
Loss on disposition of restaurants and equipment.....	1,021
Income tax benefit from exercise of stock options.....	1,359
Changes in assets and liabilities:	
Receivables.....	(879)
Inventories.....	(488)
Prepaid and other current assets.....	2,016
Accounts payable.....	3,392
Accrued expenses and other current liabilities.....	(8,336)
Accrued income taxes.....	5,567
Franchise deposits.....	(257)
Other.....	801
NET CASH PROVIDED BY OPERATING ACTIVITIES.....	63,792
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment.....	(29,545)
Proceeds from sale of restaurants and equipment.....	3
Purchases of short-term investments.....	(100)
Maturities and sales of short-term investments.....	300
NET CASH USED BY INVESTING ACTIVITIES.....	(29,342)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Purchases of treasury stock.....	(8,324)
Dividends paid.....	(3,010)
Issuance of common stock upon exercise of stock options.....	3,630
Shares sold under employee stock purchase plan.....	984
Payments on long-term debt.....	(42,000)
NET CASH USED BY FINANCING ACTIVITIES.....	(48,720)
NET DECREASE IN CASH AND CASH EQUIVALENTS.....	(14,270)
CASH AND CASH EQUIVALENTS, beginning of period.....	22,048

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CASH AND CASH EQUIVALENTS, end of period.....	----- \$ 7,778 =====
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See notes to consolidated financial statements.

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

	26 Wee
	----- June 30, 2002 -----
Supplemental disclosures of cash flow information:	
Cash paid during the 26 week period for:	
Income taxes.....	\$ 13,534
	=====
Interest.....	\$ 891
	=====

### Disclosure of Accounting Policy:

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

See notes to consolidated financial statements.

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

### 1. Basis of Presentation

Our consolidated financial statements included in this Form 10-Q have been prepared without audit (except that the balance sheet information as of December

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30, 2001 has been derived from consolidated financial statements which were audited) in accordance with the rules and regulations of the Securities and Exchange Commission. Although certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, we believe that the disclosures are adequate to make the information presented not misleading. The accompanying consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2001.

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

We have made certain reclassifications to the consolidated financial statements to conform to the 2002 presentation.

### 2. Commitments and Contingencies

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

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

**Lease guaranties:** In connection with the sale of restaurants to franchisees and other parties, we have, in certain cases, remained contingently liable for the remaining lease payments. As of June 30, 2002, the aggregate amount of these lease payments totaled approximately \$26,600,000. The buyers have indemnified us from any losses related to these guaranties.

**Severance agreements:** We have severance and employment agreements with certain officers providing for severance payments to be made in the event the employee resigns or is terminated related to a change in control. The agreements define the circumstances which will constitute a change in control. If the severance payments had been due as of June 30, 2002, we would have been required to make payments totaling approximately \$7,700,000. In addition, we have severance and employment agreements with certain officers which contain severance provisions not related to a change in control. Those provisions would have required aggregate payments of approximately \$4,900,000 if such officers had been terminated as of June 30, 2002.

### 3. Earnings Per Share

We compute basic earnings per share by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if holders of options or other contracts to issue common stock

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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 earnings per share. All amounts in the chart, except per share amounts, are expressed in thousands.

	13 Weeks Ended		26
	June 30, 2002	July 1, 2001	June 30 2002
Net earnings.....	\$ 21,465	\$ 17,796	\$ 41,74
Basic weighted average shares outstanding.....	55,872	55,370	55,87
Dilutive effect of stock options and performance shares.....	1,502	1,438	1,47
Diluted weighted average shares outstanding.....	57,374	56,808	57,35
Basic net earnings per common share.....	\$ 0.38	\$ 0.32	\$ 0.7
Diluted net earnings per common share.....	\$ 0.37	\$ 0.31	\$ 0.7

#### 4. Stock Split

On May 9, 2002, we declared a three-for-two stock split, effected in the form of a 50% stock dividend, to shareholders of record on May 24, 2002, payable on June 11, 2002. We issued approximately 24,100,000 shares of common stock as a result of the stock split. All references to the number of shares and per share amounts of common stock have been restated to reflect the stock split. We have reclassified an amount equal to the par value of the number of shares issued to common stock from retained earnings.

#### 5. Goodwill

We adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets", effective December 31, 2001. SFAS No. 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This Statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. In the first quarter of fiscal 2002, we completed the first step of the required two-step goodwill impairment testing and ceased amortization of goodwill. The first step of the impairment test required us to compare the fair value of each reporting unit to its carrying value to determine whether there was an indication that an impairment existed. If there had been an indication of impairment, we would have allocated the fair value of the reporting unit to its assets and liabilities as if the reporting unit had been acquired in a business combination. No impairment losses were recorded upon the initial adoption of SFAS No. 142.

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The effect of the adoption of SFAS No. 142 on net income and earnings per share is as follows (in thousands, except per share amounts):

	13 Weeks Ended		
	June 30, 2002	July 1, 2001	June 2002
Net earnings, as reported.....	\$ 21,465	\$ 17,796	\$ 41
Goodwill amortization (net of income taxes).....	--	838	
Net earnings, as adjusted.....	21,465	18,634	41
=====			
Basic net earnings per common share, as reported.....	\$ 0.38	\$ 0.32	\$
Goodwill amortization (net of income taxes).....	--	0.02	
Basic net earnings per common share, as adjusted.....	\$ 0.38	\$ 0.34	\$
=====			
Diluted net earnings per common share, as reported.....	\$ 0.37	\$ 0.31	\$
Goodwill amortization (net of income taxes).....	--	0.02	
Diluted net earnings per common share, as adjusted.....	\$ 0.37	\$ 0.33	\$
=====			

Intangible assets subject to amortization pursuant to SFAS No. 142 consist primarily of franchise interest and rights and are summarized below (in thousands):

	June 30, 2002	December 30, 2001
Gross carrying amount	\$6,371	\$6,371
Accumulated amortization	4,737	4,571
Net	\$1,634	\$1,800
	=====	=====

We expect annual amortization expense for all intangible assets for the next five fiscal years to range from approximately \$280,000 to \$380,000.

## 6. New Accounting Pronouncement

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In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets", which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and the accounting and reporting provisions of APB No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that Statement. We adopted SFAS No. 144 effective December 31, 2001. The adoption of SFAS No. 144 did not have a material impact on our consolidated financial statements.

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### 7. Subsequent Event

On July 16, 2002, we reached an agreement with an existing franchisee to acquire the assets of 21 Applebee's restaurants located in the Washington, D.C. area for \$32.8 million in cash, subject to adjustment. The agreement also provides for additional payments if the restaurants achieve cash flows in excess of historical levels. As a condition of this agreement, the franchisee filed a voluntary Chapter 11 petition for bankruptcy protection in the United States Bankruptcy Court for the Southern District of Florida. The sale is subject to normal bankruptcy court bidding procedures, obtaining operating licenses and other third-party consents. On July 30, 2002, the bankruptcy court established the procedures to control the bidding and sale process for the restaurants and confirmed September 13th as the date for the final sale approval hearing. If bankruptcy approval is received, we anticipate closing on this purchase during the fourth quarter of 2002.

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

### General

Our revenues are generated from two primary sources:

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

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

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

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

Other expenses, such as general and administrative and amortization expenses,

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relate to both company operated restaurants and franchise operations.

We operate on a 52 or 53 week fiscal year ending on the last Sunday in December. Our fiscal quarters ended June 30, 2002 and July 1, 2001 each contained 13 weeks and are referred to hereafter as the "2002 quarter" and the "2001 quarter", respectively. Our 26 week periods ended June 30, 2002 and July 1, 2001 are referred to hereafter as the "2002 year-to-date period" and the "2001 year-to-date period," respectively.

### Application of Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our 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 consolidated financial statements and notes thereto. Actual results may differ from these estimates, and such differences may be material to the consolidated financial statements. We have identified the following accounting policies as critical to the understanding of our consolidated financial statements (see Note 2 of our Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 30, 2001 for a complete discussion of our significant accounting policies).

**Franchise income:** Franchise income is deferred until we have performed substantially all of our obligations as franchisor. Franchise income consists of franchise royalties and franchise fees. We recognize royalties on a franchisee's sales in the period in which the sales occur. We also receive a franchise fee for each restaurant that a franchisee opens. This franchise fee is recognized as income when the restaurant opens.

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**Property and equipment:** Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets. The useful lives of the assets are based upon management's best expectations. We periodically review the assets for changes in circumstances which may impact their useful lives.

**Impairment of long-lived assets:** We periodically review property and equipment for impairment using historical cash flows as well as current estimates of future cash flows and/or appraisals. This assessment process requires the use of estimates and assumptions which are subject to a significant degree of judgement. In addition, we periodically assess the recoverability of goodwill and other intangible assets, which requires us to make assumptions regarding the future cash flows and other factors to determine the fair value of the assets. If these assumptions change in the future, we may be required to record impairment charges for these assets.

**Legal and insurance reserves:** We are periodically involved in various legal actions arising in the normal course of business. We are required to assess the probability of any adverse judgements as well as the potential ranges of any losses. We determine the required accruals after a careful review of the facts of each legal action. Our accruals may change in the future due to new developments in these matters.

We use estimates in the determination of the required accruals for general liability, workers' compensation and health insurance. These estimates are based upon a third party's detailed examination of historical and industry claims experience. These estimates may change in the future and may require us to

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revise these accruals.

Employee incentive compensation plans: We have various long-term employee incentive compensation plans which require us to make estimates to determine our liability. If performance against the criteria in each plan changes in the future, we will be required to adjust our liability accordingly.

Receivables: We continually assess the collectibility of our franchise receivables based on several factors, using estimates based upon specific information available to us at the time. The allowance for bad debts may change in the future due to new developments.

We periodically reassess our assumptions and judgements 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 the consolidated balance sheets would be adjusted accordingly. Historically, actual results have not been materially different than the estimates that are described above.

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### Results of Operations

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

	13 Weeks Ended		26
	June 30,	July 1,	June
	2002	2001	200
Revenues:			
Company restaurant sales.....	87.5%	87.2%	87
Franchise income.....	12.5	12.8	12
Total operating revenues.....	100.0%	100.0%	100
Cost of sales (as a percentage of company restaurant sales):			
Food and beverage.....	26.3%	26.9%	26
Labor.....	32.9	31.8	32
Direct and occupancy.....	24.8	25.4	24
Pre-opening expense.....	0.2	0.1	0
Total cost of sales.....	84.2%	84.2%	84
General and administrative expenses.....	9.6%	9.7%	9
Amortization of intangible assets.....	--	0.8	--
Loss on disposition of restaurants and equipment.....	0.4	0.3	0
Operating earnings.....	16.4	15.8	16
Other income (expense):			

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Investment income.....	0.2	0.2	0
Interest expense.....	(0.3)	(1.1)	(0)
Other income.....	0.2	0.2	0
	-----	-----	-----
Total other income (expense).....	0.2	(0.7)	--
	-----	-----	-----
Earnings before income taxes.....	16.5	15.1	16
Income taxes.....	6.0	5.6	5
	-----	-----	-----
Net earnings.....	10.5%	9.6%	10
	=====	=====	=====

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

	13 Weeks Ended		
	June 30, 2002	July 1, 2001	June 2, 2000
	-----	-----	-----
Number of restaurants:			
Company:			
Beginning of period.....	314	287	
Restaurant openings.....	4	2	
	-----	-----	-----
End of period.....	318	289	
	-----	-----	-----
Franchise:			
Beginning of period.....	1,090	1,012	
Restaurant openings.....	15	24	
Restaurant closings.....	(2)	(1)	
	-----	-----	-----
End of period.....	1,103	1,035	
	-----	-----	-----
Total:			
Beginning of period.....	1,404	1,299	
Restaurant openings.....	19	26	
Restaurant closings.....	(2)	(1)	
	-----	-----	-----
End of period.....	1,421	1,324	
	=====	=====	=====
Weighted average weekly sales per restaurant:			
Company.....	\$ 43,558	\$ 43,291	\$
Franchise.....	\$ 44,566	\$ 42,924	\$
Total.....	\$ 44,340	\$ 43,004	\$
Change in comparable restaurant sales: (1)			
Company.....	1.4%	3.1%	
Franchise.....	3.7%	3.1%	
Total.....	3.2%	3.1%	

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Total system sales (in thousands).....	\$ 812,707	\$ 732,491	\$ 1,
----------------------------------------	------------	------------	-------

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 (1) When computing comparable restaurant sales, restaurants open for at least 18 months are compared from period to period.

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Company Restaurant Sales. Total company restaurant sales increased \$16,858,000 (10%) from \$162,035,000 in the 2001 quarter to \$178,893,000 in the 2002 quarter and increased \$31,688,000 (10%) from \$322,178,000 in the 2001 year-to-date period to \$353,866,000 in the 2002 year-to-date period due primarily to company restaurant openings and increases in comparable restaurant sales.

Comparable restaurant sales at company restaurants increased by 1.4% and 1.5% in the 2002 quarter and the 2002 year-to-date period, respectively. Weighted average weekly sales at company restaurants increased 0.6% from \$43,291 in the 2001 quarter to \$43,558 in the 2002 quarter and also increased 0.6% from \$43,130 in the 2001 year-to-date period to \$43,398 in the 2002 year-to-date period. These increases were due primarily to an increase in the average guest check resulting from the company's food promotions.

Franchise Income. Overall franchise income increased \$1,599,000 (7%) from \$23,885,000 in the 2001 quarter to \$25,484,000 in the 2002 quarter and increased \$4,205,000 (9%) from \$46,119,000 in the 2001 year-to-date period to \$50,324,000 in the 2002 year-to-date period. These increases were due primarily to the increased number of franchise Applebee's restaurants operating during the 2002 quarter and 2002 year-to-date period and increases in comparable restaurant sales. Weighted average weekly sales at franchise restaurants increased 3.8% and 4.0% in the 2002 quarter and 2002 year-to-date period, respectively, and franchise comparable restaurant sales increased 3.7% and 3.9% in the 2002 quarter and 2002 year-to-date period, respectively.

Cost of Company Restaurant Sales. Food and beverage costs decreased from 26.9% in the 2001 quarter to 26.3% in the 2002 quarter and from 27.0% in the 2001 year-to-date period to 26.7% in the 2002 year-to-date period. The decreases in both the 2002 quarter and 2002 year-to-date period were due to lower commodity costs relating to our food promotions and the benefit of certain supply chain management initiatives implemented in 2001.

Labor costs increased from 31.8% in both the 2001 quarter and the 2001 year-to-date period to 32.9% in both the 2002 quarter and 2002 year-to-date period. These increases were due primarily to higher costs related to improved management staffing levels, higher management incentive compensation relating to a new restaurant management bonus program and higher insurance costs.

Direct and occupancy costs decreased from 25.4% in both the 2001 quarter and the 2001 year-to-date period to 24.8% in the 2002 quarter and 24.6% in the 2002 year-to-date period. The decreases in both periods were due primarily to lower utility costs as well as a decrease in advertising costs, as a percentage of sales. The decrease in the 2002 quarter was partially offset by higher packaging costs relating to our To Go initiative.

General and Administrative Expenses. General and administrative expenses

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decreased from 9.7% in the 2001 quarter to 9.6% in the 2002 quarter and were 9.6% in both the 2001 year-to-date period and the 2002 year-to-date period. General and administrative expenses were impacted in both the 2002 quarter and 2002 year-to-date period by higher legal fees and expenses related to certain litigation and higher incentive compensation. General and administrative expenses were lower in both the 2002 quarter and 2002 year-to-date period as a result of costs incurred in 2001 associated with our purchasing supply chain and strategic brand assessment projects and the absorption of general and administrative expenses over a larger revenue base.

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**Amortization of Intangible Assets:** Amortization of intangible assets decreased from \$1,462,000 in the 2001 quarter to \$52,000 in the 2002 quarter and decreased from \$2,925,000 in the 2001 year-to date period to \$190,000 in the 2002 year-to-date period. These decreases were due to the elimination of goodwill amortization in accordance with SFAS No. 142.

**Interest Expense:** Interest expense decreased in both the 2002 quarter and the 2002 year-to-date period due primarily to a reduction in our debt levels and lower interest rates in both periods.

**Income Taxes.** The effective income tax rate, as a percentage of earnings before income taxes, decreased from 36.8% in both the 2001 quarter and 2001 year-to-date period to 36.5% in both the 2002 quarter and the 2002 year-to-date period.

### Liquidity and Capital Resources

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

Capital expenditures were \$50,086,000 in fiscal year 2001 and \$29,545,000 in the 2002 year-to-date period. We currently expect to open approximately 25 restaurants, and capital expenditures are expected to be between \$60,000,000 and \$65,000,000 in fiscal 2002, excluding the potential acquisition discussed below. These expenditures will primarily be for the development of new restaurants, refurbishment and capital replacement for existing restaurants, and the enhancement of information systems including a new accounting and human resource information system. Because we expect to continue to purchase a portion of our sites, the amount of actual capital expenditures will be dependent upon, among other things, the proportion of leased versus owned properties. In addition, if we open more restaurants than we currently anticipate or acquire additional restaurants, our capital requirements will increase accordingly.

On July 16, 2002, we reached an agreement with an existing franchisee to acquire the assets of 21 Applebee's restaurants located in the Washington, D.C. area for \$32.8 million in cash, subject to adjustment. The agreement also provides for additional payments if the restaurants achieve cash flows in excess of historical levels. As a condition of this agreement, the franchisee filed a voluntary Chapter 11 petition for bankruptcy protection in the United States Bankruptcy Court for the Southern District of Florida. The sale is subject to normal bankruptcy court bidding procedures, obtaining operating licenses and

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other third-party consents. On July 30, 2002, the bankruptcy court established the procedures to control the bidding and sale process for the restaurants and confirmed September 13th as the date for the final sale approval hearing. If bankruptcy approval is received, we anticipate closing on this purchase during the fourth quarter of 2002.

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Our bank credit agreement provides for a \$150,000,000 three-year unsecured revolving credit facility, of which \$25,000,000 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, and limit additional indebtedness and capital expenditures in excess of specified amounts. Cash dividends are limited to \$10,000,000 annually. The facility is subject to standard other terms, conditions, covenants, and fees. We are currently in compliance with the covenants contained in our credit agreement.

In February 2001, our Board of Directors authorized the repurchase of up to \$55,000,000 of our common stock through 2001, subject to market conditions and applicable restrictions imposed by our then-current credit agreement. As of December 30, 2001, we had \$20,600,000 remaining on this authorization. In February 2002, our Board of Directors extended the 2001 authorization through 2002. During the 2002 year-to-date period, we repurchased 375,000 shares of our common stock at an average price of \$22.20 for an aggregate cost of \$8,324,000. In May 2002, our Board of Directors authorized an additional repurchase of \$75,000,000 of our common stock through May 2005. As of June 30, 2002, we had \$87,300,000 remaining under these authorizations.

As of June 30, 2002, our liquid assets totaled \$8,273,000. These assets consisted of cash and cash equivalents in the amount of \$7,778,000 and short-term investments in the amount of \$495,000. The working capital deficit increased from \$29,747,000 as of December 30, 2001 to \$40,409,000 as of June 30, 2002. This increase was due primarily to decreases in cash and cash equivalents due to payments on long-term debt which were partially offset by the redemption of gift certificates in 2002 sold in 2001. As of June 30, 2002, we had borrowings of \$28,000,000 and standby letters of credit of \$5,260,000 outstanding under our \$150,000,000 revolving credit facility. We also had a standby letter of credit for \$827,000 outstanding with another financial institution.

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

The following table shows our bank debt amortization schedule, our future capital lease commitments and our future operating lease commitments as of June 30, 2002:

Financial Commitments (in thousands)					
	2002	2003	2004	2005	2006
Bank Debt.....	\$ --	\$ --	\$ 28,000	\$ --	\$ --
Capital Lease Obligations.....	\$ 351	\$ 715	\$ 741	\$ 767	\$ 794

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Operating Leases.....	\$	11,112	\$	14,470	\$	13,537	\$	12,856	\$	12,290
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Financial commitments for 2002 include only payments to be made for the remaining 26 weeks of fiscal 2002. In addition, we have lease guarantees of approximately \$26,600,000 as of June 30, 2002 (see Note 2 to our Consolidated Financial Statements).

### Inflation

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

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

### New Accounting Pronouncement

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets", which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and the accounting and reporting provisions of APB No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that Statement. We adopted SFAS No. 144 effective December 31, 2001. The adoption of SFAS No. 144 did not have a material impact on our consolidated financial statements.

### Forward-Looking Statements

The statements contained in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section regarding restaurant development, costs and expenses, capital expenditures 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 the impact of intense competition in the casual dining segment of the restaurant industry and our ability to control restaurant operating costs which are impacted by market changes, minimum wage and other employment laws, food costs and inflation. For a more detailed discussion of the principal factors that could cause actual results to be materially different, you should read our current report on Form 8-K which we filed with the Securities and Exchange Commission on July 16, 2002. We disclaim any obligation to update forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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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 1.0%, at our option. As of June 30, 2002, the total amount of debt subject to interest rate fluctuations was \$28,000,000 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 \$280,000 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.

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### PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

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

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

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

Our Annual Meeting of Stockholders was held on May 9, 2002. The Stockholders voted on the following matters:

- Proposal I. Elect Erline Belton, Eric L. Hansen and Mark S. Hansen as directors to serve a three-year term expiring in 2005.
- Proposal II. Approve an amendment to the Applebee's International, Inc. Employee Stock Purchase Plan.
- Proposal III. Ratify Deloitte & Touche LLP as our independent auditors for the 2002 fiscal year.

The results of the voting were as follows:

Proposal	Affirmative Votes	Negative Votes	Abstentions
-----	-----	-----	-----
I (Erline Belton)	33,416,528	89,123	--
I (Eric Hansen)	33,416,528	89,123	--
I (Mark Hansen)	33,416,528	89,123	--
II	33,075,794	372,435	57,421
III	32,428,125	1,051,177	25,899

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

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### Item 6. Exhibits and Reports on Form 8-K

- (a) The Exhibits listed on the accompanying Exhibit Index are filed as part of this report.
- (b) We furnished a report on Form 8-K on April 8, 2002 announcing our presentation at the Banc of America Securities Consumer Conference.

We filed a report on Form 8-K on April 11, 2002 clarifying comments made at the Banc of America Securities Consumer Conference.

We furnished a report on Form 8-K on April 11, 2002 announcing our presentation at the SunTrust Robinson Humphrey Institutional Conference.

We furnished a report on Form 8-K on April 19, 2002 announcing our broadcast of the first quarter 2002 earnings conference call over the Internet.

We filed a report on Form 8-K on April 25, 2002 reporting first quarter 2002 earnings.

We filed a report on Form 8-K on April 30, 2002 reporting April comparable sales.

We filed a report on Form 8-K on May 9, 2002 announcing a three-for-two stock split.

We furnished a report on Form 8-K on May 13, 2002 announcing the webcast of the Investor Conferences in New York and Boston.

We furnished a report on Form 8-K on May 15, 2002 outlining our future growth strategies and long-term EPS growth expectations. We also announced that we have increased the domestic potential of the Applebee's concept.

We filed a report on Form 8-K on May 29, 2002 reporting May comparable sales.

We furnished a report on Form 8-K on June 11, 2002 announcing our presentation at the U.S. Bancorp Piper Jaffray Consumer Conference.

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## SIGNATURES

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

APPLEBEE'S INTERNATIONAL, INC.  
(Registrant)

Date: July 31, 2002  
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By: /s/ Lloyd L. Hill  
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Lloyd L. Hill  
Chairman and Chief Executive Officer  
(principal executive officer)

Date: July 31, 2002  
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By: /s/ Steven K. Lumpkin  
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Steven K. Lumpkin  
Executive Vice President and  
Chief Financial Officer  
(principal financial and accounting officer)

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APPLEBEE'S INTERNATIONAL, INC.  
EXHIBIT INDEX

Exhibit Number	Description of Exhibit
10.1	Amendment to Employee Stock Purchase Plan.

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