DENNYS CORP
Form 10-Q
October 28, 2008

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

FORM 10-Q

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

For the Quarterly Period Ended September 24, 2008

Commission File Number 0-18051
DENNY'S CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	13-3487402
(State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)

203 East Main Street
Spartanburg, South Carolina 29319-0001
(Address of principal executive offices)
(Zip Code)

(864) 597-8000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days

Yes [X] No [ ]

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

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

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

Yes [ ] No [X]

As of October 24, 2008, 95,713,102 shares of the registrant's common stock, par value $.01 per share, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Denny's Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Quarter Ended		Three Quarters Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands, except per share amounts)			
Revenue:				
Company restaurant sales	$ 160,608	$ 216,792	$ 493,434	$ 650,909
Franchise and license revenue	28,667	24,617	82,109	68,193
Total operating revenue	189,275	241,409	575,543	719,102
Costs of company restaurant sales:				
Product costs	38,811	55,520	119,790	166,969
Payroll and benefits	65,582	88,341	208,331	273,141
Occupancy	9,475	13,193	30,003	39,345
Other operating expenses	25,384	33,842	75,322	95,937
Total costs of company restaurant sales	139,252	190,896	433,446	575,392
Costs of franchise and license revenue	8,757	6,858	25,448	20,266
General and administrative expenses	14,894	15,974	46,046	49,067
Depreciation and amortization	9,977	12,117	30,110	37,475
Operating gains, losses and other charges, net	(4,294)	(316)	(9,980)	(14,890)
Total operating costs and expenses	168,586	225,529	525,070	667,310
Operating income	20,689	15,880	50,473	51,792
Other expenses:				
Interest expense, net	8,761	10,489	26,845	32,783
Other nonoperating expense (income), net	677	34	4,436	(391)
Total other expenses, net	9,438	10,523	31,281	32,392
Net income before income taxes	11,251	5,357	19,192	19,400
Provision for income taxes	689	407	1,355	2,780
Net income	$ 10,562	$ 4,950	$ 17,837	$ 16,620
Net income per share:				
Basic net income per share	$ 0.11	$ 0.05	$ 0.19	$ 0.18
Diluted net income per share	$ 0.11	$ 0.05	$ 0.18	$ 0.17
Weighted average shares outstanding:				
Basic	95,333	93,915	95,059	93,674
Diluted	98,332	98,605	99,191	98,770

See accompanying notes to unaudited condensed consolidated financial statements.

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Denny’s Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	September 24, 2008	December 26, 2007
	(In thousands)	
Assets		
Current Assets:		
Cash and cash equivalents	$ 21,422	$ 21,565
Receivables, net	11,408	13,585
Inventories	5,419	6,485
Assets held for sale	3,032	6,712
Prepaid and other current assets	12,893	9,526
Total Current Assets	54,174	57,873
Property, net of accumulated depreciation of $293,770 and $307,047, respectively	167,910	184,610
Other Assets:		
Goodwill	40,634	42,439
Intangible assets, net	59,770	62,657
Deferred financing costs, net	4,188	5,078
Other assets	31,003	24,699
Total Assets	$ 357,679	$ 377,356
Liabilities and Shareholders' Deficit		
Current Liabilities:		
Current maturities of notes and debentures	$ 4,555	$ 2,085
Current maturities of capital lease obligations	3,637	4,051
Accounts payable	31,041	43,262
Other	73,202	82,069
Total Current Liabilities	112,435	131,467
Long-Term Liabilities:		
Notes and debentures, less current maturities	307,504	325,971
Capital lease obligations, less current maturities	22,252	20,845
Liability for insurance claims, less current portion	24,480	27,148
Deferred income taxes	12,115	11,579
Other noncurrent liabilities and deferred credits	38,573	42,578
Total Long-Term Liabilities	404,924	428,121
Total Liabilities	517,359	559,588
Commitments and contingencies		
Total Shareholders’ Deficit	(159,680)	(182,232)
Total Liabilities and Shareholders’ Deficit	$ 357,679	$ 377,356

See accompanying notes to unaudited condensed consolidated financial statements.

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Denny’s Corporation and Subsidiaries
Condensed Consolidated Statement of Shareholders’ Deficit and Comprehensive Loss
(Unaudited)

	Common Stock				Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Paid-in Capital	Deficit	Loss, Net	Deficit
			(In thousands)			
Balance, December 26, 2007	94,626	$ 946	$ 533,612	$ (700,284)	$ (13,144)	$ (178,870)
Goodwill adjustment (Note 3)	—	—	—	(3,362)	—	(3,362)
Balance, December 26, 2007	94,626	$ 946	$ 533,612	$ (703,646)	$ (13,144)	$ (182,232)
Comprehensive income:						
Net income	—	—	—	17,837	—	17,837
Recognition of unrealized loss on hedge transactions, net of tax	—	—	—	—	852	852
Comprehensive income	—	—	—	17,837	852	18,689
Share-based compensation on equity classified awards	—	—	2,591	—	—	2,591
Issuance of common stock for share-based compensation	385	4	288	—	—	292
Exercise of common stock options	675	7	973	—	—	980
Balance, September 24, 2008	95,686	$ 957	$ 537,464	$ (685,809)	$ (12,292)	$ (159,680)

See accompanying notes to unaudited condensed consolidated financial statements.

Denny’s Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Quarters Ended September 24, 2008	Three Quarters Ended September 26, 2007
	(In thousands)	
Cash Flows from Operating Activities:		
Net income	$ 17,837	$ 16,620
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation and amortization	30,110	37,475
Operating gains, losses and other charges, net	(9,980)	(14,890)
Amortization of deferred financing costs	827	886
Loss (gain) on early extinguishment of debt	(30)	207
Loss on change in the fair value of interest rate swap	3,094	—
Deferred income tax expense	565	2,381
Share-based compensation	2,511	3,000
Changes in assets and liabilities, net of effects of acquisitions and dispositions:		
Decrease (increase) in assets:		
Receivables	3,009	3,216
Inventories	1,066	506
Other current assets	(3,367)	(495)
Other assets	(2,909)	(2,644)
Increase (decrease) in liabilities:		
Accounts payable	(9,416)	(2,530)
Accrued salaries and vacations	(8,225)	(5,696)
Accrued taxes	794	119
Other accrued liabilities	(8,310)	2,991
Other noncurrent liabilities and deferred credits	(9,622)	(5,702)
Net cash flows provided by operating activities	7,954	35,444
Cash Flows from Investing Activities:		
Purchase of property	(21,173)	(18,807)
Proceeds from disposition of property	31,391	35,017
Acquisition of restaurant units	—	(2,208)
Net cash flows provided by investing activities	10,218	14,002
Cash Flows from Financing Activities:		
Long-term debt payments	(19,208)	(46,468)
Deferred financing costs paid	—	(401)
Proceeds from exercise of stock options	980	918
Net bank overdrafts	(87)	(646)
Net cash flows used in financing activities	(18,315)	(46,597)
Increase (decrease) in cash and cash equivalents	(143)	2,849
Cash and Cash Equivalents at:		

Beginning of period		21,565		26,226
End of period	$	21,422	$	29,075

See accompanying notes to unaudited condensed consolidated financial statements.

Denny's Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Introduction and Basis of Presentation

Denny's Corporation, through its wholly owned subsidiaries, Denny's Holdings, Inc. and Denny's, Inc., owns and operates the Denny's restaurant brand, or Denny's.

Our unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Therefore, certain information and notes normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. In our opinion, all adjustments considered necessary for a fair presentation of the interim periods presented have been included. Such adjustments are of a normal and recurring nature. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates, including those for the above-described items, are reasonable.

These interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 26, 2007 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the fiscal year ended December 26, 2007. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire fiscal year ending December 31, 2008.

Note 2. Summary of Significant Accounting Policies

Effective December 27, 2007, the first day of fiscal 2008, we adopted Statement of Financial Accounting Standards No. 159 ("SFAS 159"), "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. We did not elect the fair value reporting option for any assets and liabilities not previously recorded at fair value.

Effective December 27, 2007, the first day of fiscal 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157 ("SFAS 157"), "Fair Value Measurements" for financial assets and liabilities, as well as any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the Financial Accounting Standards Board ("FASB") having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. We also applied the provisions of FSP FAS 157-2, "Effective Date of FASB Statement 157," which defers the provisions of SFAS 157 for nonfinancial assets and liabilities to the first fiscal period beginning after November 15, 2008. The deferred nonfinancial assets and liabilities include items such as goodwill and other nonamortizable intangibles. We are required to adopt SFAS 157 for nonfinancial assets and liabilities in the first quarter of fiscal 2009 and are still evaluating the impact on our Condensed Consolidated Financial Statements.

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements as of September 24, 2008				
September 24, 2008	Quoted Prices in	Significant Other	Significant Unobservable	Valuation Technique

		Active Markets for Identical Assets/Liabilities (Level 1)	Observable Inputs (Level 2)	Inputs (Level 3)	
		(In thousands)			
Deferred compensation plan investments	$ 6,132	$ 6,132	$ —	$ —	market approach
Interest rate swap liability	(2,603)	—	(2,603)	—	income approach
Total	$ 3,529	$ 6,132	$ (2,603)	$ —	

There have been no other material changes to our significant accounting policies and estimates from the information provided in Note 2 of our Consolidated Financial Statements included in our Form 10-K for the fiscal year ended December 26, 2007, except as noted in Note 3.

Note 3. Adjustments Related to Goodwill

In March 2008, we recorded adjustments to correct an error in accounting for goodwill in relation to the sale of restaurant operations during the quarters ending March 28, 2007, June 27 2007, September 26, 2007 and December 26, 2007. Historically, we did not write-off goodwill when we sold restaurant units to franchisees. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" requires that a portion of the entity level goodwill should be written off based on the relative fair values of the restaurant unit being sold and the remaining value of the entity, in our case, Denny's. The adjustments had no impact on previously reported cash flows.

The following line items on the Consolidated Statements of Operations for the quarter and three quarters ended September 26, 2007 and the fiscal year ended December 26, 2007 were impacted by the adjustments:

	Quarter Ended September 26, 2007			Three Quarters Ended September 26, 2007			Fiscal Year Ended December 26, 2007		
	Unadjusted	Adjustment	Adjusted	Unadjusted	Adjustment	Adjusted	Unadjusted	Adjustment	Adjusted
	(In thousands, except per share amounts)								
Operating gains, losses and other charges, net	$ (747)	$ 431	$ (316)	$ (16,427)	$ 1,537	$ (14,890)	$ (34,828)	3,746	(31,082)
Total operating costs and expenses	225,098	431	225,529	665,773	1,537	667,310	855,838	3,746	859,584
Operating income	16,311	(431)	15,880	53,329	(1,537)	51,792	83,530	(3,746)	79,784
Net income before taxes	5,788	(431)	5,357	20,937	(1,537)	19,400	39,905	(3,746)	36,159
Provision for income taxes	451	(44)	407	2,937	(157)	2,780	5,192	(384)	4,808
Net income	5,337	(387)	4,950	18,000	(1,380)	16,620	34,713	(3,362)	31,351

Basic net income per share	$	0.06	$	(0.01)	$	0.05	$	0.19	$	(0.01)	$	0.18	$	0.37	$	(0.04)	$	0.33
Diluted net income per share	$	0.05	$	(0.00)	$	0.05	$	0.18	$	(0.01)	$	0.17	$	0.35	$	(0.03)	$	0.32

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The following line items on the Consolidated Balance Sheet as of December 26, 2007 were impacted by the adjustments:

	December 26, 2007	Adjustment	Adjusted December 26, 2007
		(In thousands)	
Goodwill	$ 46,185	$ (3,746)	$ 42,439
Total assets	381,102	(3,746)	377,356
Deferred income taxes	11,963	(384)	11,579
Total long-term liabilities	428,505	(384)	428,121
Total liabilities	559,972	(384)	559,588
Total shareholders' deficit	(178,870)	(3,362)	(182,232)
Total liabilities and shareholders' deficit	381,102	(3,746)	377,356

The following reflects the adjusted quarterly data for fiscal 2007:

	Fiscal Year Ended December 26, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
Company restaurant sales	$ 215,801	$ 218,316	$ 216,792	$ 193,712
Franchise and licensing revenue	20,950	22,626	24,617	26,554
Total operating revenue	236,751	240,942	241,409	220,266
Total operating costs and expenses	224,165	217,616	225,529	192,274
Operating income	$ 12,586	$ 23,326	$ 15,880	$ 27,992
Net income	$ 1,087	$ 10,583	$ 4,950	$ 14,731
Basic net income per share (a)	$ 0.01	$ 0.11	$ 0.05	$ 0.16
Diluted net income per share (a)	$ 0.01	$ 0.11	$ 0.05	$ 0.15

(a) Per share amounts do not necessarily sum to the total year amounts due to changes in shares outstanding and rounding.

Note 4. Assets Held for Sale

Assets held for sale of $3.0 million and $6.7 million, as of September 24, 2008 and December 26, 2007, respectively, include restaurants to be sold to franchisees and certain real estate properties. We expect to sell each of these assets within 12 months. Our Credit Facility (defined in Note 7) requires us to make mandatory prepayments to reduce outstanding indebtedness with the net cash proceeds from the sale of specified real estate properties and restaurant operations to franchisees. As a result, we classified a corresponding $3.0 million and $0.4 million of our long-term debt as a current liability in our Consolidated Balance Sheet as of September 24, 2008 and December 26, 2007, respectively. This amount represents the net book value of the specified properties as of the balance sheet date.

Note 5. Goodwill and Other Intangible Assets

The changes in carrying amounts of goodwill for the three quarters ended September 24, 2008 are as follows:

		(In thousands)
Balance at December 26, 2007	$	42,439
Write-offs associated with sale of restaurants		(1,777)
Reversal of valuation allowance related to deferred tax assets (Note 11)		(28)
Balance at September 24, 2008	$	40,634

The following table reflects goodwill and intangible assets as of September 24, 2008 and December 26, 2007:

	September 24, 2008		December 26, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Goodwill	$ 40,634	$ —	$ 42,439	$ —
Intangible assets with indefinite lives:				
Trade names	$ 42,432	$ —	$ 42,395	$ —
Liquor licenses	262	—	279	—
Intangible assets with definite lives:				
Franchise and license agreements	55,551	38,581	61,903	42,036
Foreign license agreements	241	135	241	125
Intangible assets	$ 98,486	$ 38,716	$ 104,818	$ 42,161
Other assets with definitive lives:				
Software development costs	$ 31,845	$ 25,974	$ 30,853	$ 24,560

Note 6. Operating Gains, Losses and Other Charges, Net

Operating gains, losses and other charges, net are comprised of the following:

	Quarter Ended		Three Quarters Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands)			
Gains on sales of assets and other, net	$ (5,290)	$ (4,197)	$ (18,214)	$ (20,841)
Restructuring charges and exit costs	752	3,701	7,506	5,531
Impairment charges	244	180	728	420
Operating gains, losses and other charges, net	$ (4,294)	$ (316)	$ (9,980)	$ (14,890)

Gains on Sales of Assets

Proceeds and gains on sales of assets for the quarters ended September 24, 2008 and September 26, 2007 were comprised of the following:

	Quarter Ended September 24, 2008		Quarter Ended September 26, 2007	
	Net Proceeds	Gains	Net Proceeds	Gains
	(In thousands)			
Sales of restaurant operations and related real estate to franchisees	$ 8,242	$ 3,496	$ 8,748	$ 2,394
Sales of other real estate assets	2,198	1,764	353	353
Recognition of deferred gains	—	30	—	1,450
Total	$ 10,440	$ 5,290	$ 9,101	$ 4,197

Proceeds and gains on sales of assets for the three quarters ended September 24, 2008 and September 26, 2007 were comprised of the following:

	Three Quarters Ended September 24, 2008		Three Quarters Ended September 26, 2007	
	Net Proceeds	Gains	Net Proceeds	Gains
	(In thousands)			
Sales of restaurant operations and related real estate to franchisees	$ 30,241	$ 15,439	$ 30,601	$ 15,350
Sales of other real estate assets	3,820	2,683	5,388	3,495
Recognition of deferred gains	—	92	—	1,996
Total	$ 34,061	$ 18,214	$ 35,989	$ 20,841

Restructuring Charges and Exit Costs

Restructuring charges and exit costs were comprised of the following:

	Quarter Ended		Three Quarters Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands)			
Exit costs	$ 821	$ 276	$ 2,476	$ 1,011
Severance and other restructuring charges	(69)	3,425	5,030	4,520
Total restructuring and exit costs	$ 752	$ 3,701	$ 7,506	$ 5,531

Severance and other restructuring charges of $5.0 million for the three quarters ended September 24, 2008 primarily resulted from severance costs of $4.3 million recognized during the second quarter related to the reorganization to support our ongoing transition to a franchise-focused business model, which led to the elimination of approximately 50 positions.

The components of the change in accrued exit cost liabilities are as follows:

		(In thousands)
Balance, beginning of year	$	8,339
Provisions for units closed during the year (1)		728
Changes in estimates of accrued exit costs, net (1)		1,748
Payments, net		(2,533)
Interest accretion		615
Balance, end of quarter		8,897
Less current portion included in other current liabilities		2,038
Long-term portion included in other noncurrent liabilities	$	6,859

(1) Included as a component of operating gains, losses and other charges, net.

Estimated net cash payments related to exit cost liabilities in the next five years are as follows:

		(In thousands)
Remainder of 2008	$	843
2009		2,499
2010		1,768
2011		1,458
2012		1,153
Thereafter		3,101
Total		10,822
Less imputed interest		1,925
Present value of exit cost liabilities	$	8,897

As of September 24, 2008 and December 26, 2007, we had accrued severance and other restructuring charges of $1.5 million and $1.3 million, respectively. The balance as of September 24, 2008 is expected to be paid during the next 12 months.

Note 7. Long-Term Debt

Credit Facility

Our subsidiaries, Denny's, Inc. and Denny's Realty, LLC (the "Borrowers"), have a senior secured credit agreement consisting of a $50 million revolving credit facility (including up to $10 million for a revolving letter of credit facility), a $136.7 million term loan and an additional $37 million letter of credit facility (together, the "Credit Facility"). At September 24, 2008, we had outstanding letters of credit of $35.4 million (comprised of $35.2 million under our letter of credit facility and $0.2 million under our revolving facility). There were no revolving loans outstanding at September 24, 2008. These balances result in availability of $1.8 million under our letter of credit facility and $49.8 million under the revolving facility.

The revolving facility matures on December 15, 2011. The term loan and the $37 million letter of credit facility mature on March 31, 2012. The term loan amortizes in equal quarterly installments at a rate equal to approximately 1% per annum with all remaining amounts due on the maturity date. The Credit Facility is available for working capital, capital expenditures and other general corporate purposes. We will be required to make mandatory prepayments under certain circumstances (such as required payments related to asset sales) typical for this type of credit facility and may make certain optional prepayments under the Credit Facility. We believe that our estimated cash flows from operations for 2008, combined with our capacity for additional borrowings under our Credit Facility, will enable us to meet our anticipated cash requirements and fund capital expenditures over the next twelve months.

The Credit Facility is guaranteed by Denny's Corporation and its other subsidiaries and is secured by substantially all of the assets of Denny's and its subsidiaries. In addition, the Credit Facility is secured by first-priority mortgages on 118 company-owned real estate assets. The Credit Facility contains certain financial covenants (i.e., maximum total debt to EBITDA (as defined under the Credit Facility) ratio requirements, maximum senior secured debt to EBITDA ratio requirements, minimum fixed charge coverage ratio requirements and limitations on capital expenditures), negative covenants, conditions precedent, material adverse change provisions, events of default and other terms, conditions and provisions customarily found in credit agreements for facilities and transactions of this type. We were in compliance with the terms of the Credit Facility as of September 24, 2008.

A commitment fee of 0.5% is paid on the unused portion of the revolving credit facility. Interest on loans under the revolving facility is payable at per annum rates equal to LIBOR plus 250 basis points and will adjust over time based on our leverage ratio. Interest on the term loan and letter of credit facility is payable at per annum rates equal to LIBOR plus 200 basis points. Prior to considering the impact of the interest rate swap described below, the weighted-average interest rate under the term loan was 4.8% and 7.1% as of September 24, 2008 and September 26, 2007, respectively.

Interest Rate Swap

During the second quarter of fiscal 2007, we entered into an interest rate swap with a notional amount of $150 million to hedge a portion of the cash flows of our variable rate debt. We designated the interest rate swap as a cash flow hedge of our exposure to variability in future cash flows attributable to interest payments on the first $150 million of floating rate debt. Under the terms of the swap, we pay a fixed rate of 4.8925% on the $150 million notional amount and receive payments from the counterparties based on the 3-month LIBOR rate for a term ending on March 30, 2010, effectively resulting in a fixed rate of 6.8925% on the $150 million notional amount at the inception of the swap. Interest rate differentials paid or received under the swap agreement are recognized as adjustments to interest expense.

Prior to December 26, 2007, to the extent the swap was effective in offsetting the variability of the hedged cash flows, changes in the fair value of the swap were not included in current earnings, but were reported as adjustments to other comprehensive income. At December 26, 2007, we determined that a portion of the underlying cash flows related to the swap (i.e., interest payments on $150 million of floating rate debt) were no longer probable of occurring over the term of the interest rate swap as a result of the probability of paying the debt down below $150 million through scheduled repayments and prepayments with cash from the sale of company-owned restaurant operations to franchisees. As a result, we discontinued hedge accounting treatment. The losses related to the fair value of the swap included in accumulated other comprehensive income as of December 26, 2007 will be amortized to other nonoperating expense over the remaining term of the interest rate swap. Additionally, changes in the fair value of the swap are recorded in other nonoperating expense.

The changes in accumulated other comprehensive income related to the swap for the quarter and three quarters ended September 24, 2008 are as follows:

	Quarter Ended	Three Quarters

	September 24, 2008	Ended September 24, 2008
	(In thousands)	
Accumulated Other Comprehensive Income, beginning of period	$ (1,794)	$ (2,353)
Amortization of unrealized losses related to the interest rate swap (recorded in other nonoperating expense)	293	852
Accumulated Other Comprehensive Income, end of period	$ (1,501)	$ (1,501)

The changes in fair value of the interest rate swap for the quarter and three quarters ended September 24, 2008 are as follows:

	Quarter Ended September 24, 2008	Three Quarters Ended September 24, 2008
	(In thousands)	
Fair value of the interest rate swap, beginning of period	$ (2,850)	$ (2,753)
Change in the fair value of the interest rate swap (recorded in other nonoperating expense)	247	(2,242)
Termination of a portion of the swap	—	2,392
Fair value of the interest rate swap, end of period	$ (2,603)	$ (2,603)

On March 26, 2008, we terminated $50 million notional amount of the interest rate swap. The termination resulted in a $2.4 million cash payment, which was made during the quarter ended June 25, 2008.

By using a derivative instrument to hedge exposures to changes in interest rates, we expose ourselves to credit risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. We minimize the credit risk by entering into transactions with high-quality counterparties whose credit rating is evaluated on a quarterly basis.

Note 8. Defined Benefit Plans

The components of net pension cost of our pension plan and other defined benefit plans as determined under Statement of Financial Accounting Standards No. 87, “Employers’ Accounting for Pensions,” as amended by Statement of Financial Accounting Standards No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans," are as follows:

	Pension Plan Quarter Ended		Other Defined Benefit Plans Quarter Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands)			
Service cost	$ 88	$ 88	$ —	$ —
Interest cost	847	786	49	48
Expected return on plan assets	(969)	(883)	—	—
Amortization of net loss	151	221	4	5
Net periodic benefit cost	$ 117	$ 212	$ 53	$ 53

	Pension Plan Three Quarters Ended		Other Defined Benefit Plans Three Quarters Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands)			
Service cost	$ 263	$ 263	$ —	$ —
Interest cost	2,541	2,358	146	143
Expected return on plan assets	(2,908)	(2,647)	—	—
Amortization of net loss	451	662	14	17
Net periodic benefit cost	$ 347	$ 636	$ 160	$ 160

We made contributions of $1.3 million and $2.8 million to our qualified pension plan during the three quarters ended September 24, 2008 and September 26, 2007, respectively. We made contributions of $0.7 million and $0.2 million to our other defined benefit plans during the three quarters ended September 24, 2008 and September 26, 2007, respectively. We expect to contribute $0.1 million to our qualified pension plan and $0.1 million to our other defined benefit plans during the remainder of fiscal 2008.

Additional minimum pension liability of $10.8 million is reported as a component of accumulated other comprehensive loss in the Condensed Consolidated Statement of Shareholders' Deficit and Comprehensive Loss as of September 24, 2008 and December 26, 2007.

Note 9. Share-Based Compensation

Total share-based compensation included as a component of net income was as follows:

	Quarter Ended		Three Quarters Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands)			
Share-based compensation related to liability classified restricted stock units	$ (119)	$ (24)	$ (80)	$ 658
Share based compensation related to equity classified awards:				
Stock options	$ 396	$ 448	$ 1,321	$ 1,067
Restricted stock units	511	176	1,086	1,034
Board deferred stock units	61	81	184	241
Total share-based compensation related to equity classified awards	968	705	2,591	2,342
Total share-based compensation	$ 849	$ 681	$ 2,511	$ 3,000

Additionally, during the three quarters ended September 24, 2008, we issued approximately 97,000 shares of common stock in lieu of cash to pay approximately $0.3 million of incentive compensation.

Stock Options

During the three quarters ended September 24, 2008, we granted approximately 1.5 million stock options to certain employees and approximately 0.2 million stock options to the non-employee members of our Board of Directors. These stock options vest evenly over 3 years and have a 10-year contractual life.

The weighted average fair value per option of options granted during the three quarters ended September 24, 2008 was $1.18. The fair value of the stock options granted in the period ended September 24, 2008 was estimated at the date of grant using the Black-Scholes option pricing model. Use of this option pricing model requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them ("expected term"), the estimated volatility of our common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements ("forfeitures"). Changes in the subjective assumptions can materially affect the estimate of the fair value of share-based compensation and consequently, the related amount recognized in the Consolidated Statements of Operations.

We used the following weighted average assumptions for the stock option grants for the three quarters ended September 24, 2008:

Dividend yield	0.0%
Expected volatility	50.1%
Risk-free interest rate	2.7%
Weighted-average expected term	4.6 years

The dividend yield assumption was based on our dividend payment history and expectations of future dividend payments. The expected volatility was based on the historical volatility of our stock for a period approximating the expected life. The risk-free interest rate was based on published U.S. Treasury spot rates in effect at the time of grant with terms approximating the expected life of the option. The weighted average expected term of the options represents the period of time the options are expected to be outstanding based on historical trends.

As of September 24, 2008, there was approximately $2.4 million of unrecognized compensation cost related to unvested stock option awards outstanding, which is expected to be recognized over a weighted average of 2.0 years.

Restricted Stock Units

In July 2008, we granted approximately 0.3 million restricted stock units under the 2004 Omnibus Plan and approximately 0.9 million restricted stock units under the 2008 Omnibus Plan to certain employees. The awards (which are equity classified) have a grant date fair value of $2.57 per share. These restricted units will be earned and vest in 1/3 increments (from 50% to 120% of the target award for each such increment) based on the appreciation/(depreciation) of our common stock from the date of grant to each of three vesting periods (July 16, 2009, July 16, 2010 and July 16, 2011). Subsequent to the vesting periods, the earned restricted stock units will be paid to the holder in shares of common stock, provided the holder is then still employed with Denny's or an affiliate. As these restricted stock units contain a market condition, the compensation expense is based on the Monte Carlo valuation method, which utilizes multiple input variables to determine the probability of the Company achieving the market condition and the fair value of the award. The awards granted to our named executive officers also contain a performance condition based on certain operating measures for the four fiscal quarters ending prior to July 16, 2009.

During the quarter ended September 24, 2008, we made payments of $0.5 million (before taxes) in cash and issued 0.2 million shares of common stock related to the restricted stock unit awards that vested as of June 30, 2008. In addition, we made payments of less than $0.1 million (before taxes) in cash related to the restricted stock unit awards that vested as of July 9, 2008. During the first quarter of 2008, we made payments of $0.4 million (before taxes) in cash and issued 0.1 million shares of common stock related to the restricted stock unit awards that vested as of December 26, 2007.

Accrued compensation expense included as a component of the Condensed Consolidated Balance Sheet was as follows:

	September 24, 2008	December 26, 2007
	(In thousands)	
Liability classified restricted stock units:		
Other current liabilities	$ 2,042	$ 1,170
Other noncurrent liabilities	$ 924	$ 2,828
Equity classified restricted stock units:		
Additional paid-in capital	$ 4,179	$ 3,925

As of September 24, 2008, we had approximately $4.7 million of unrecognized compensation cost (approximately $0.7 million for liability classified units and approximately $4.0 million for equity classified units) related to all unvested restricted stock unit awards outstanding, which is expected to be recognized over a weighted average of 1.7 years.

Board Deferred Stock Units

During the three quarters ended September 24, 2008, we granted approximately 0.1 million deferred stock units (which are equity classified) with a weighted-average grant date fair value of $3.27 per unit to non-employee members of our Board of Directors. These awards are restricted in that they may not be converted to shares until the recipient has ceased serving as a member of the Board of Directors for Denny's Corporation at which time the awards automatically convert to shares. During the second quarter of 2008, one board member did not stand for reelection. As a result, the board member's deferred stock units were converted into shares of common stock.

Note 10. Accumulated Other Comprehensive Income (Loss)

Total comprehensive income was $18.7 million and $19.2 million for the three quarters ended September 24, 2008 and September 26, 2007, respectively.

The components of Accumulated Other Comprehensive Income (Loss) in the Condensed Consolidated Statement of Shareholder’s Deficit are as follows:

	September 24, 2008	December 26, 2007
	(In thousands)	
Additional minimum pension liability	$ (10,791)	$ (10,791)
Unrealized gain on hedged transaction	(1,501)	(2,353)
Accumulated other comprehensive income (loss)	$ (12,292)	$ (13,144)

Note 11. Income Taxes

The provision for income taxes was $0.7 million and $1.4 million for the quarter and three quarters ended September 24, 2008, respectively, compared with $0.4 million and $2.8 million for the quarter and three quarters ended September 26, 2007, respectively. The provision for income taxes for the first three quarters of 2008 and 2007 was determined using our effective rate estimated for the entire fiscal year. The quarter and three quarters ended September 24, 2008 also included the recognition of $0.6 million of current tax benefits. This item resulted from the enactment of certain federal laws that benefited us during the third quarter of 2008. The three quarters ended

September 26, 2007 also included the recognition of $0.3 million of current tax benefits and a $0.6 million reduction to the valuation allowance. These items resulted from the enactment of certain federal and state laws that benefited us during the second quarter of 2007.

We have provided valuation allowances related to any benefits from income taxes resulting from the application of a statutory tax rate to our net operating losses (“NOL”) generated in previous periods. In addition, during 2008 and 2007, we utilized certain federal and state NOL carryforwards whose valuation allowances were established in connection with fresh start reporting on January 7, 1998. Accordingly, federal and state deferred tax expense was recorded in connection with fresh start reporting on January 7, 1998 with a corresponding adjustment to goodwill. The amounts recognized were an increase of approximately $0.1 million and a decrease of approximately $0.0 million for the quarter and three quarters ended September 24, 2008, respectively, and decreases of $0.4 million and $2.9 million for the quarter and three quarters ended September 26, 2007, respectively.

The reduction in our effective tax rate for the three quarters ended September 24, 2008 was due primarily to the utilization of federal net operating loss carryforwards from periods prior to fresh start reporting on January 7, 1998. These federal net operating loss carryforwards were fully utilized during fiscal 2007. We still have certain state net operating loss carryforwards from periods prior to fresh start reporting that have been utilized in both fiscal 2007 and 2008.

Note 12. Net Income Per Share

	Quarter Ended		Three Quarters Ended	
	September 24, 2008	September 26, 2007	September 24, 2008	September 26, 2007
	(In thousands, except for per share amounts)			
Numerator:				
Numerator for basic and diluted net income per share - net income	$ 10,562	$ 4,950	$ 17,837	$ 16,620
Denominator:				
Denominator for basic net income per share – weighted average shares	95,333	93,915	95,059	93,674
Effect of dilutive securities:				
Options	2,056	3,737	2,517	4,073
Restricted stock units and awards	943	953	1,615	1,023
Denominator for diluted net income per share - adjusted weighted average shares and assumed conversions of dilutive securities	98,332	98,605	99,191	98,770
Basic net income per share	$ 0.11	$ 0.05	$ 0.19	$ 0.18
Diluted net income per share	$ 0.11	$ 0.05	$ 0.18	$ 0.17
Stock options excluded (1)	3,670	2,109	3,409	1,861

(1) Excluded from diluted weighted-average shares outstanding as the impact would have been antidilutive.

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Note 13. Supplemental Cash Flow Information

	Three Quarters Ended	
	September 24, 2008	September 26, 2007