

IHOP CORP  
Form 10-K405  
March 11, 2002

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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-K

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

For the fiscal year ended December 31, 2001

Commission file number 0-8360

### IHOP CORP.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**95-3038279**  
(I.R.S. Employer  
Identification No.)

**450 North Brand Boulevard, Glendale, California**  
(Address of principal executive offices)

**91203-2306**  
(Zip Code)

**Registrant's telephone number, including area code: (818) 240-6055**

#### Securities registered pursuant to Section 12(b) of the Act:

| Title of each class                  | Name of each exchange on which registered |
|--------------------------------------|---|
| <b>Common Stock, \$.01 Par Value</b> | <b>New York Stock Exchange, Inc.</b>      |

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. /x/

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of January 31, 2002: \$567 million.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

| Class                         | Outstanding as of January 31, 2002 |
|-------------------------------|------------------------------------|
| Common Stock, \$.01 par value | 20,715,201                         |

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for Annual Meeting of Shareholders to be held on Tuesday, May 14, 2002, (the "2002 Proxy Statement") are incorporated by reference into Part III.

## PART I

### General Development of Business

#### Item 1. Business.

IHOP Corp. and its subsidiaries ("IHOP" or the "Company") develop, operate and franchise International House of Pancakes restaurants, one of America's best-known, national, family restaurant chains. At December 31, 2001, there were 1,017 IHOP restaurants. Franchisees operated 823 of these restaurants, area licensees operated 122 restaurants, and IHOP operated 72 restaurants. Franchisees and area licensees are independent third parties who operate their restaurants under legal agreements with IHOP. IHOP restaurants are located in 41 states and Canada.

IHOP Corp. was incorporated under the laws of the State of Delaware in 1976. In July 1991, we completed an initial public offering of common stock. There were no significant changes to our corporate structure during 2001, and no material changes to our methods of conducting business.

### Financial Information about Industry Segments

IHOP is engaged in the development, operation and franchising of International House of Pancakes restaurants primarily in the United States. Information about our revenues, operating profits and assets is contained in Part II, Item 6 of this Annual Report on Form 10-K.

### Narrative Description of Business

IHOP restaurants feature table service and moderately priced, high-quality food and beverage items in an attractive and comfortable atmosphere. Although the restaurants are best known for their award-winning pancakes, omelets and other breakfast specialties, IHOP restaurants offer a broad array of lunch, dinner and snack items as well. They are open throughout the day and evening hours, and some operate 24 hours a day.

Franchisees and area licensees operate more than 90% of IHOP restaurants. Our approach to franchising is founded on the franchisees' active involvement in the day-to-day operations of their respective restaurants. We are selective in granting franchises and we prefer to franchise to those who intend to be active in the management of their restaurant(s), rather than to passive investors or investment groups. We believe that they provide a quality of management and dedication that, in our view, is generally unmatched by salaried employees or absentee owners.

IHOP develops most new restaurants prior to franchising them. When the restaurant is franchised, we then become the franchisee's landlord. This landlord/tenant relationship provides us with enhanced profits and greater control over our franchise system. Some franchisees develop their own IHOP restaurants under our Investor and Conversion Programs for franchisees. In those instances, IHOP approves the site for development but does not contribute capital or become the franchisee's landlord. Area licensees located in Canada and Florida operate 12% of IHOP restaurants. We provide support to these area licensees, but we are not actively involved in developing new restaurants in these areas.

We seek to increase our revenues and profits by focusing on several areas of our business. These areas include: (1) development and franchising of new IHOP restaurants, (2) marketing, advertising and product development programs aimed at attracting new guests and retaining our existing customers, and (3) implementation of restaurant-level operating changes designed to improve sales and profitability.

### Restaurant Development

New restaurants are developed after a stringent site selection process supervised by our senior management. In 2001, we developed 76 new restaurants and our franchisees and area licensees developed an additional 17 new restaurants.

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We intend to continue to add restaurants to the IHOP system primarily by developing new restaurants in major markets where we already have a core customer base. We believe that concentrating growth in existing markets allows us to achieve economies of scale in our supervisory and advertising functions. At times, we acquire existing restaurants and convert them to IHOP restaurants.

IHOP also looks to strategically develop new markets in which we have no presence or our presence is limited. This occurs primarily where these new markets are geographically near to existing markets and present significant business opportunities. At times, we have acquired several existing restaurants in new markets for conversion to IHOP restaurants. We evaluate such opportunities on a case-by-case basis.

Our development involves obtaining rights to land either through a purchase of fee property, or through ground or "build to suit" leases. A "build to suit" lease is one in which the landlord provides the capital to construct and equip the restaurant. Fee and ground lease properties are developed with our own capital. Some time after the restaurant is franchised and leased to the franchisee, the Company raises additional capital for further development, most often via sale and leaseback transactions involving the land and building on fee properties or leasehold improvements on ground leases. Timing of financing activities is dictated by cash flow requirements, not franchising activities. The mix of fee properties, ground leases and "build to suit" leases is not predictable. However, our recent experience has increasingly been to obtain rights to land via ground leases.

In 2001, we built two general types of new restaurant buildings. The larger format restaurant is approximately 4,900 square feet in size and contains 176 seats. The second building type is designed for use in smaller, high-potential markets. It is approximately 4,000 square feet in size and seats about 132 people. We also purchased and converted existing buildings into IHOP restaurants. The square footage and number of seats in a restaurant conversion vary by location. In 2001, restaurant conversions averaged 163 seats per restaurant. Our older A-Frame style restaurants, which have not been built since 1985, contain approximately 3,000 square feet and about 100 seats. Of the 76 new IHOP restaurants we developed in 2001, 17 were the larger format building, 46 were the smaller format building and 13 were restaurant conversions or leased spaces in multi-tenant buildings.

To the greatest extent possible, subject to local zoning restrictions, we continue to use our familiar signature blue color on the roof, awnings and other exterior decor of our restaurants.

The table below sets forth our average development cost per restaurant in 2001. For leased restaurants the discounted present value of the lease and any additional sums paid to acquire the lease have been allocated to land, building and site improvements and other costs, as appropriate.

|                                   | <b>Average Per<br/>Restaurant</b> |
|-----------------------------------|-----------------------------------|
| Land                              | \$ 667,000                        |
| Building                          | 800,000                           |
| Equipment                         | 341,000                           |
| Site improvements and other costs | 185,000                           |
| <b>Total</b>                      | <b>\$ 1,993,000</b>               |

New IHOP restaurants that opened in 2000 realized average sales of approximately \$1,559,000 per restaurant in their first twelve full months of operations.

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### Franchising

IHOP's approach to franchising is somewhat different from that of most of our franchising competitors in the foodservice industry. In most franchise systems, the franchisee is called upon to pay a modest initial fee to the franchisor. The franchisee then uses his/her own capital to acquire a site, build and equip the business and fund working capital needs. While we offer programs to certain experienced franchisees that allow them to fund the development of their own restaurants, typically approximately 85% of IHOP restaurants are developed directly by us.

When we develop a restaurant, we identify the site for the new restaurant, purchase the site or lease it from a third party, and build the restaurant and equip it with all required equipment. We then select the franchisee and train the franchisee and supervisory personnel who will run the restaurant. In addition, we finance approximately 80% of the franchise fee and lease the restaurant and equipment to the franchisee. After

the franchisee is operating the restaurant, we provide continuing support with respect to operations, marketing and new product development.

Our involvement in the development of new restaurants allows IHOP to command a substantial franchise and development fee. In addition, we derive income from the financing of the franchise and development fee and from the leasing of property and equipment to franchisees. However, we also incur substantial obligations in the development, franchising and start-up operations of new restaurants. IHOP's involvement in site selection and development, the training and supervision of franchisees, as well as our control over restaurant property, products and services, are an integral part of our operating philosophy.

IHOP franchisees are predominantly owner/operators, not passive investors. The majority of franchisees own only one restaurant and only 20 franchisees currently own more than six restaurants. We believe that franchisees who are actively involved in the operation of their restaurants provide a quality of management and commitment to our guests that cannot be matched by salaried managers.

A substantial majority of new restaurants are franchised to current franchisees or restaurant managers who already understand IHOP's approach to the restaurant business. In the past five years, sales to existing franchisees and IHOP employees, or to their immediate families, constituted approximately 91% of franchise sales transactions.

An initial franchise fee of approximately \$200,000 to \$375,000 or more is generally required for a newly developed restaurant, depending on the site. The franchisee typically pays approximately 20% of the initial franchise fee in cash, and we finance the remaining amount over five to eight years. We also receive continuing revenues from the franchisee as follows: (1) a royalty equal to 4.5% of the restaurant's sales; (2) income from the leasing of the restaurant and related equipment; (3) revenue from the sale of certain proprietary products, primarily pancake mixes; (4) a local advertising fee equal to about 2% of the restaurant's sales, which is usually paid to a local advertising cooperative; and (5) a national advertising fee equal to 1% of the restaurant's sales. Franchise agreements for restaurants developed directly by franchisees under our Investor and Conversion Programs provide for an initial franchise fee of \$50,000, revenue from the sale of certain proprietary products, and royalties and advertising fees as described above.

We have entered into long-term area licensing agreements covering the state of Florida and the Southern-most counties of Georgia and the province of British Columbia, Canada. These agreements provide for royalties ranging from 0.5% to 2% of sales, and advertising fees of 0.25% of sales. We also derive revenue from the sale of proprietary products to these area licensees. We treat the revenues from our area licensees as franchise operations revenues for financial reporting purposes. Area licensing arrangements may be used in the future for domestic and/or international expansion.

## **Restaurant Operations and Support**

It is our goal to make every dining experience at an IHOP restaurant a satisfying one. Our franchisees and managers of company-operated restaurants strive always to exceed guests' expectations. We hold firm to the belief that a satisfied customer will both be a return customer and will tell others about our restaurants. To ensure that our guests' expectations are fulfilled, all restaurants are operated in accordance with uniform operating standards and specifications relating to the quality and preparation of menu items, selection of menu items, maintenance, repair and cleanliness of premises, and the appearance and conduct of employees.

Our Operations Department is charged with ensuring that these high standards are met at all times. We have developed our operating standards in consultation with our franchisee operators. These standards are detailed in our Manual of Standard Operating Procedures.

Each restaurant is assigned an Operations Consultant. He or she regularly visits and evaluates the restaurant to ensure that it remains in compliance with the operating guidelines and procedures. At least twice per year, the Operations Consultant conducts a comprehensive written evaluation of every aspect of the restaurant's operations. The Operations Consultant then meets with the franchisee or manager to discuss the results of the evaluation and develop a plan to address any areas needing improvement.

The IHOP menu offers a large selection of high-quality, moderately priced products designed to appeal to a broad customer base. These include a wide variety of pancakes, waffles, omelets and breakfast specialties, chicken, steak, sandwiches, salads and lunch and dinner specialties. Most IHOP restaurants offer special items for children and seniors at reduced prices. In recognition of local tastes, IHOP restaurants typically offer regional specialties that complement the IHOP core menu. Our Research and Development Department works together with franchisees and our Operations and Marketing Departments to continually develop new menu ideas. These new menu items are thoroughly evaluated in our test kitchen and in limited regional tests before being introduced throughout the system. The purpose of adding new items to our menu is to be responsive to our guests' needs and requests, and to keep the menu fresh and appealing to our customers.

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Training is ongoing at all IHOP restaurants. Prospective franchisees are required to participate in an extensive training program before he or she is first sold a franchise. The training program involves classroom study and hands-on operational training in one of our regional training restaurants. Each franchisee learns to cook, wait on tables, serve as a host, wash dishes and perform each of the other tasks necessary to operate a successful restaurant. New restaurant opening teams provide on-site instruction to restaurant employees to assist in the opening of all new IHOP restaurants.

The Company offers additional training courses from time to time on subjects such as suggestive selling, improving service, managing people and diversity.

### **Marketing and Advertising**

Most IHOP franchisees and company-operated restaurants contribute about 2% of their sales to local advertising cooperatives. We also provide additional funding to these cooperatives. The advertising co-ops use these funds to purchase television advertising time and place advertisements in printed media or direct mail. In addition to television advertising, IHOP encourages local area marketing by its franchisees. These marketing programs include discounts and specials aimed at increasing customer traffic and encouraging repeat business.

### **Company-Operated Restaurants**

Company-operated restaurants are those restaurants newly developed by IHOP that have not yet been franchised and those restaurants reacquired by us through negotiation or franchisee defaults. The

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type and number of company-operated restaurants varies from time to time as we develop new restaurants, reacquire franchised restaurants and franchise new and reacquired restaurants.

Restaurants that we reacquire from franchisees typically require investment in remodeling and rehabilitation before being refranchised. They may remain as company-operated restaurants for a substantial period of time. As a consequence, a significant number of company-operated restaurants are likely to incur operating losses during the initial period of their rehabilitation.

### **Remodeling and Refranchising Program**

Restaurants that we reacquire are often underperforming as a result of having been poorly operated and physically neglected. When we reacquire a restaurant, we begin a multi-step rehabilitation program for that restaurant. First these restaurants are physically rehabilitated, then we hire and train the restaurant staff. After these first steps are completed, we implement new marketing and operations programs designed to regain the business of former guests and attract new patrons. After a restaurant has been rehabilitated and its sales volume reaches acceptable levels, the restaurant is refranchised to a qualified franchisee. In the past five years IHOP reacquired a total of 85 restaurants from franchisees and subsequently closed 15 of those restaurants. In those same years, a total of 46 restaurants were refranchised.

We also require most of our franchisees, and strongly encourage all of our franchisees, to periodically remodel their restaurants.

### **Purchasing**

IHOP has entered into supply contracts and pricing agreements for various products, such as pancake mixes, pork products, coffee, soft drinks and juices to ensure the availability of quality products at competitive prices. We also have negotiated agreements with food distribution companies to limit markups charged on food and restaurant supplies purchased by individual IHOP restaurants.

### **Competition and Markets**

The restaurant business is highly competitive and is affected by, among other things, changes in eating habits and preferences, local, regional and national economic conditions, population trends and traffic patterns. The principal bases of competition in the industry are the type, quality and price of the food products served. Additionally, restaurant location, quality and speed of service, advertising, name identification and attractiveness of facilities are important.

The acquisition of sites is also highly competitive. We are often competing with other restaurant chains and retail businesses for suitable sites for the development of new restaurants.

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Foodservice chains in the United States include the following segments: quick-service sandwich, chicken, pizza, family restaurant, dinner house, grill-buffet, hotel restaurant and contract/catering. Differentiated chains competing within their segments against each other and local, single-outlet operators characterize the current structure of the U.S. restaurant and institutional foodservice market.

Information published in 2001 by *The Nations Restaurant News* ranked IHOP 27<sup>th</sup> out of the top 100 foodservice chains based on estimated fiscal 2000 system-wide sales in the United States. The same publication included eleven family restaurant chains in its top 100 chains, and IHOP ranked second in this segment. During December 2001, based on a nationwide sample of IHOP company-operated and franchised restaurants, the approximate guest check average per IHOP customer was \$7.00.

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### Trademarks and Service Marks

We have registered our trademarks and service marks with the United States Patent and Trademark Office. These include "International House of Pancakes," "IHOP" and variations of each, as well as "Any Time's a Good Time for IHOP," "The Home of the Never Empty Coffee Pot," "Rooty Tooty Fresh 'N Fruity," and "Harvest Grain 'N Nut." We also register new trademarks and service marks from time to time. We are not aware of any infringing uses that could materially affect our business or any prior claim to these marks that would prevent us from using or licensing the use thereof for restaurants in any area of the United States. We have also registered our trademarks and service marks and variations thereof in Japan and Canada for use by our current licensees. Where feasible and appropriate, we register our trademarks and service marks in other nations for future use. Our current registered trademarks and service marks will expire, unless renewed, at various dates from 2002 to 2012. We routinely apply to renew our active trademarks prior to their expiration.

### Seasonality

IHOP's business, like that of most restaurant companies, is somewhat seasonal. Our restaurants generally experience greater customer traffic and sales in the summer months and during various holidays when children are out of school and family vacations are more frequent. Restaurants in some resort areas and warm weather climates tend to experience greater customer traffic and sales in the winter months.

### Government Regulation

IHOP is subject to various federal, state and local laws affecting our business as well as a variety of regulatory provisions relating to zoning of restaurant sites, sanitation, health and safety. As a franchisor, we are subject to state and federal laws regulating various aspects of franchise operations and sales. These laws impose registration and disclosure requirements on franchisors in the offer and sale of franchises. In certain cases, they also apply substantive standards to the relationship between franchisor and franchisee, including primarily defaults, termination, non-renewal of franchises, and the potential impact of new IHOP restaurants on sales levels at existing IHOP restaurants.

Various federal and state labor laws govern our relationships with our employees. These include such matters as minimum wage requirements, overtime and other working conditions. Environmental requirements have not had a material effect on the operations of our company-operated restaurants or the restaurants of our franchisees. Significant additional government-imposed increases in minimum wages, paid leaves of absence, mandated health benefits or increased tax reporting and tax payment requirements with respect to employees who receive gratuities could, however, be detrimental to the economic viability of franchisee-operated and company-operated IHOP restaurants.

### Employees

At December 31, 2001, we employed 3,921 persons, of whom 278 were full-time, non-restaurant, corporate personnel.

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## Item 2. Properties.

The table below shows the location and status of the 1,017 IHOP restaurants as of December 31, 2001:

| Location | Franchise | Total |
|----------|-----------|-------|
|----------|-----------|-------|

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|                      |            | Company-<br>Operated | Area<br>License |              |
|----------------------|------------|----------------------|-----------------|--------------|
| <b>United States</b> |            |                      |                 |              |
| Alabama              | 12         | 4                    | 0               | 16           |
| Arizona              | 23         | 1                    | 0               | 24           |
| Arkansas             | 8          | 0                    | 0               | 8            |
| California           | 190        | 6                    | 0               | 196          |
| Colorado             | 25         | 0                    | 0               | 25           |
| Connecticut          | 8          | 0                    | 0               | 8            |
| Delaware             | 1          | 0                    | 0               | 1            |
| Florida              | 0          | 0                    | 121             | 121          |
| Georgia              | 40         | 3                    | 1               | 44           |
| Hawaii               | 1          | 0                    | 0               | 1            |
| Idaho                | 3          | 1                    | 0               | 4            |
| Illinois             | 30         | 5                    | 0               | 35           |
| Indiana              | 6          | 2                    | 0               | 8            |
| Iowa                 | 2          | 0                    | 0               | 2            |
| Kansas               | 9          | 0                    | 0               | 9            |
| Louisiana            | 9          | 0                    | 0               | 9            |
| Maine                | 1          | 0                    | 0               | 1            |
| Maryland             | 23         | 5                    | 0               | 28           |
| Massachusetts        | 13         | 0                    | 0               | 13           |
| Michigan             | 5          | 7                    | 0               | 12           |
| Mississippi          | 7          | 0                    | 0               | 7            |
| Missouri             | 15         | 2                    | 0               | 17           |
| Nebraska             | 4          | 1                    | 0               | 5            |
| Nevada               | 17         | 0                    | 0               | 17           |
| New Hampshire        | 2          | 0                    | 0               | 2            |
| New Jersey           | 30         | 3                    | 0               | 33           |
| New Mexico           | 5          | 0                    | 0               | 5            |
| New York             | 37         | 2                    | 0               | 39           |
| North Carolina       | 26         | 2                    | 0               | 28           |
| Oklahoma             | 15         | 0                    | 0               | 15           |
| Oregon               | 8          | 5                    | 0               | 13           |
| Pennsylvania         | 12         | 2                    | 0               | 14           |
| Rhode Island         | 2          | 0                    | 0               | 2            |
| South Carolina       | 15         | 2                    | 0               | 17           |
| Tennessee            | 18         | 4                    | 0               | 22           |
| Texas                | 126        | 0                    | 0               | 126          |
| Utah                 | 10         | 0                    | 0               | 10           |
| Virginia             | 37         | 1                    | 0               | 38           |
| Washington           | 14         | 13                   | 0               | 27           |
| Wisconsin            | 2          | 1                    | 0               | 3            |
| Wyoming              | 1          | 0                    | 0               | 1            |
| <b>International</b> |            |                      |                 |              |
| Canada(1)            | 11         | 0                    | 0               | 11           |
| <b>Totals</b>        | <b>823</b> | <b>72</b>            | <b>122</b>      | <b>1,017</b> |

(1) IHOP reports restaurants in Canada as franchise restaurants although the restaurants are operated under an area license agreement.

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As of December 31, 2001, 8 of the 72 company-operated restaurants were located on sites owned by IHOP and 64 were located on sites leased by IHOP from third parties; of the 823 franchisee-operated restaurants, 45 were located on sites owned by IHOP, 636 were located on sites leased by IHOP from third parties and 142 were located on sites owned or leased by franchisees; and all of the restaurants operated by area licensees were located on sites owned or leased by the area licensees.

IHOP's leases with its landlords generally provide for an initial term of 15 to 25 years, with most having one or more five-year renewal options in favor of IHOP. The leases typically provide for payment of rentals in an amount equal to the greater of a fixed amount or a specified percentage of gross sales and for payment by IHOP of taxes, insurance premiums, maintenance expenses and certain other costs. Historically, we generally have been successful at renewing those leases that expire without further renewal options. However, from time to time we choose not to renew a lease or are unsuccessful in negotiating satisfactory renewal terms. When this occurs, the restaurant is closed and possession of the premises is returned to the landlord.

We currently lease our principal corporate offices in Glendale, California under a lease having a remaining term of approximately nine years. We also lease regional offices in Lyndhurst, New Jersey; Norcross, Georgia; Lombard, Illinois; Dallas, Texas; Portland, Oregon; Fredericksburg, Virginia; and Greenwood Village, Colorado.

### Item 3. Legal Proceedings.

IHOP is subject to various claims and legal actions that arise in the ordinary course of business, many of which are covered by insurance. We believe such claims and legal actions, individually or in the aggregate, will not have a material adverse effect on the business or either the financial condition, results of operations, or cash flows of our company.

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

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

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## PART II

### Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters.

Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "IHP". The Company's common stock began trading on the New York Stock Exchange on September 17, 1999. Prior to commencing trading on the New York Stock Exchange, our common stock was traded on the Nasdaq Stock Market National Market. As of January 31, 2002, there were approximately 4,554 stockholders, including the beneficial owners of shares held in "street name."

The following table sets forth the high and low prices of IHOP's common stock for each quarter of 2001 and 2000 as reported by the NYSE.

| <u>Quarter Ended</u> | <u>High</u> | <u>Low</u> | <u>Quarter Ended</u> | <u>High</u> | <u>Low</u> |
|----------------------|-------------|------------|----------------------|-------------|------------|
| March 31, 2001       | \$ 24.00    | \$ 18.90   | March 31, 2000       | \$ 18.19    | \$ 13.63   |
| June 30, 2001        | 27.40       | 19.10      | June 30, 2000        | 18.00       | 14.00      |
| September 30, 2001   | 29.15       | 21.03      | September 30, 2000   | 20.09       | 15.75      |
| December 31, 2001    | 31.03       | 24.40      | December 31, 2000    | 22.63       | 17.75      |

We have not paid any dividends on our common stock in the last five years and have no plans to do so in 2002. Any future determination to declare dividends will depend on our earnings, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors. The purchase agreements governing our 7.79% senior notes, our 7.42% senior notes, and our credit agreement with our bank limit the amount of retained earnings available for dividends and investments. At December 31, 2001, approximately \$105 million of retained earnings were potentially free of restriction as to distribution of dividends.

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### Item 6. Selected Financial Data.



## Five-Year Financial Summary

Year Ended December 31,

|   | 2001(a)          | 2000(a)          | 1999(a)          | 1998(a)          | 1997(a)          |
|---|------------------|------------------|------------------|------------------|------------------|
| (In thousands, except per share amounts)  |                  |                  |                  |                  |                  |
| <b>Income Statement Data</b>              |                  |                  |                  |                  |                  |
| Revenues                                  |                  |                  |                  |                  |                  |
| Franchise operations                      | \$ 208,630       | \$ 183,361       | \$ 163,486       | \$ 145,955       | \$ 123,842       |
| Sales of franchises and equipment         | 46,996           | 47,065           | 39,545           | 40,347           | 28,864           |
| Company operations                        | 68,810           | 72,818           | 70,204           | 69,906           | 61,839           |
| <b>Total revenues</b>                     | <b>324,436</b>   | <b>303,244</b>   | <b>273,235</b>   | <b>256,208</b>   | <b>214,545</b>   |
| Costs and expenses                        |                  |                  |                  |                  |                  |
| Franchise operations                      | 86,136           | 72,394           | 64,189           | 58,539           | 51,137           |
| Cost of sales of franchises and equipment | 31,086           | 30,944           | 23,958           | 26,628           | 17,814           |
| Company operations                        | 66,330           | 70,085           | 66,016           | 65,711           | 58,001           |
| Field, corporate and administrative       | 40,621           | 36,481           | 34,531           | 32,381           | 28,409           |
| Depreciation and amortization             | 14,818           | 13,562           | 12,310           | 11,271           | 10,029           |
| Interest                                  | 21,107           | 21,751           | 19,391           | 17,417           | 14,649           |
| Other (income) expense, net               | (123)            | 567              | 604              | 1,456            | 220              |
| <b>Total costs and expenses</b>           | <b>259,975</b>   | <b>245,784</b>   | <b>220,999</b>   | <b>213,403</b>   | <b>180,259</b>   |
| Income before income taxes                | 64,461           | 57,460           | 52,236           | 42,805           | 34,286           |
| Provision for income taxes                | 24,173           | 22,122           | 20,111           | 16,694           | 13,372           |
| <b>Net income</b>                         | <b>\$ 40,288</b> | <b>\$ 35,338</b> | <b>\$ 32,125</b> | <b>\$ 26,111</b> | <b>\$ 20,914</b> |
| Net income per share(b)                   |                  |                  |                  |                  |                  |
| Basic                                     | \$ 1.98          | \$ 1.77          | \$ 1.61          | \$ 1.33          | \$ 1.09          |
| Diluted                                   | \$ 1.94          | \$ 1.74          | \$ 1.58          | \$ 1.30          | \$ 1.07          |
| Weighted average shares outstanding(b)    |                  |                  |                  |                  |                  |
| Basic                                     | 20,398           | 20,017           | 19,983           | 19,659           | 19,192           |
| Diluted                                   | 20,762           | 20,263           | 20,358           | 20,033           | 19,486           |
| <b>Balance Sheet Data (end of period)</b> |                  |                  |                  |                  |                  |
| Cash and cash equivalents                 | \$ 6,252         | \$ 7,208         | \$ 4,176         | \$ 2,294         | \$ 2,789         |
| Property and equipment, net               | 238,026          | 193,624          | 177,743          | 161,689          | 142,751          |
| Total assets                              | 641,429          | 562,212          | 520,402          | 443,032          | 379,418          |
| Long-term debt                            | 50,209           | 36,363           | 41,218           | 49,765           | 54,950           |
| Capital lease obligations                 | 168,105          | 167,594          | 165,557          | 129,861          | 102,578          |
| Stockholders' equity(c)                   | 312,430          | 259,995          | 226,480          | 187,868          | 156,184          |

- (a) Fiscal 1998 is comprised of 53 weeks (371 days); all other years are comprised of 52 weeks (364 days).
- (b) All share and per-share amounts have been restated to reflect the stock split on May 27, 1999 (see Note 1 to the Consolidated Financial Statements).
- (c) We have not paid any dividends on our common stock in the last five years and have no plans to do so in 2002. Any future determination to declare dividends will depend on our earnings, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### **Forward-Looking Statements**

The following discussion and analysis provides information we believe is relevant to an assessment and understanding of IHOP's consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and notes thereto. Certain forward-looking statements are contained in this report. They use such words as "may," "will," "expect," "believe," "plan," or other similar terminology. These statements involve known and unknown risks, uncertainties and other factors that may cause the actual results to be materially different than those expressed or implied in such statements. These factors include, but are not limited to: availability of suitable locations and terms for the sites designated for development; legislation and government regulation, including the ability to obtain satisfactory regulatory approvals; conditions beyond IHOP's control such as weather, natural disasters or acts of war or terrorism; availability and cost of materials and labor; cost and availability of capital; competition; continuing acceptance of the International House of Pancakes brand and concept by guests and franchisees; IHOP's overall marketing, operational and financial performance; economic and political conditions; adoption of new, or changes in, accounting policies and practices and other factors discussed from time to time in our Press Releases, Public Statements and/or filings with the Securities and Exchange Commission. Forward-looking information is provided by us pursuant to the safe harbor established under the Private Securities Litigation Reform Act of 1995 and should be evaluated in the context of these factors. In addition, we disclaim any intent or obligation to update these forward-looking statements.

### **General**

IHOP's revenues are recorded in three categories: franchise operations, sales of franchises and equipment, and company operations.

Franchise operations includes payments from franchisees of rents, royalties and advertising fees, proceeds from the sale of proprietary products to distributors, franchisees and area licensees, interest income received in connection with the financing of franchise and development fees and equipment sales, interest income received from direct financing leases on franchised restaurant buildings, and payments from area licensees of royalties and advertising fees.

Revenues from the sale of franchises and equipment and the associated costs of such sales are affected by the number and mix of restaurants franchised. We franchise four kinds of restaurants: restaurants newly developed by IHOP, restaurants developed by franchisees, restaurants developed by area licensees, and restaurants that have been previously reacquired from franchisees. Franchise rights for restaurants newly developed by IHOP normally sell for a franchise fee of \$200,000 to \$375,000 or more, have little if any associated franchise cost of sales, and include an equipment sale in excess of \$300,000 that is usually at a price that includes little or no profit margin. Franchise rights for restaurants developed by franchisees normally sell for a franchise fee of \$50,000, have minor associated franchise cost of sales, and do not include an equipment sale. Area license rights are normally granted in return for a one-time development fee that is recognized ratably as restaurants are developed in the area. Previously reacquired franchises normally sell for a franchise fee of \$100,000 to \$375,000 or more, include an equipment sale, and may have substantial costs of sales associated with both the franchise and the equipment. The timing of sales of franchises is affected by the timing of new restaurant openings, number of restaurants in our inventory of restaurants that are available for refranchising and the level of interest among potential franchisees.

Company operations revenues are retail sales at IHOP-operated restaurants.

We report separately those expenses that are attributable to franchise operations, the cost of sales of franchises and equipment and company operations. Expenses recorded under field, corporate and

administrative, depreciation and amortization, and interest relate to franchise operations, sales of franchises and equipment, and company operations.

Other (income) expense, net consists of revenues and expenses not related to IHOP's core business operations. These include gains and losses realized from closing and selling restaurants and are unpredictable in timing and amount.

Our results of operations are impacted by the timing of additions of new restaurants, and by the timing of the franchising of those restaurants. When a restaurant is franchised, we no longer include in our revenues the retail sales from such restaurant, but recognize a one-time franchise and development fee, periodic interest on the portion of such fee financed by us, and recurring payments from franchisees as described above and recorded under franchise operations revenues.

## Results of Operations

The following table sets forth certain operating data for IHOP restaurants.

|  | Year Ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2001                    | 2000         | 1999         |
|  | (Dollars in Thousands)  |              |              |
| <b>Restaurant Data</b>                     |                         |              |              |
| Effective restaurants(a)(d)                |                         |              |              |
| Franchise                                  | 767                     | 696          | 638          |
| Company                                    | 72                      | 76           | 74           |
| Area license                               | 131                     | 150          | 147          |
| Total                                      | 970                     | 922          | 859          |
| <b>System-wide</b>                         |                         |              |              |
| Sales(b)(d)                                | \$ 1,345,757            | \$ 1,246,177 | \$ 1,126,624 |
| Percent increase                           | 8.0%                    | 10.6%        | 8.3%         |
| Average sales per effective restaurant(d)  | \$ 1,387                | \$ 1,352     | \$ 1,312     |
| Percent increase                           | 2.6%                    | 3.0%         | 1.2%         |
| Comparable average sales per restaurant(c) | \$ 1,451                | \$ 1,424     | \$ 1,375     |
| Percent increase                           | 0.8%                    | 0.8%         | 1.1%         |
| <b>Franchise</b>                           |                         |              |              |
| Sales                                      | \$ 1,146,124            | \$ 1,026,783 | \$ 920,957   |
| Percent increase                           | 11.6%                   | 11.5%        | 10.2%        |
| Average sales per effective restaurant     | \$ 1,494                | \$ 1,475     | \$ 1,444     |
| Percent increase                           | 1.3%                    | 2.1%         | 1.0%         |
| Comparable average sales per restaurant(c) | \$ 1,493                | \$ 1,467     | \$ 1,424     |
| Percent increase                           | 0.9%                    | 1.1%         | 1.0%         |
| <b>Company</b>                             |                         |              |              |
| Sales                                      | \$ 68,810               | \$ 72,818    | \$ 70,204    |
| Percent change                             | (5.5%)                  | 3.7%         | 0.4%         |

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Year Ended December 31,

|  | Year Ended December 31, |            |            |
|--|-------------------------|------------|------------|
| Average sales per effective restaurant | \$ 956                  | \$ 958     | \$ 949     |
| Percent change                         | (0.2%)                  | 0.9%       | (2.3%)     |
| <b>Area License</b>                    |                         |            |            |
| Sales                                  | \$ 130,823              | \$ 146,576 | \$ 135,463 |
| Percent change                         | (10.7%)                 | 8.2%       | 0.8%       |
| Average sales per effective restaurant | \$ 999                  | \$ 977     | \$ 922     |
| Percent change                         | 2.3%                    | 6.0%       | (0.5%)     |

- (a) "Effective restaurants" are the number of restaurants in a given fiscal period adjusted to account for restaurants open for only a portion of the period.
- (b) "System-wide sales" are retail sales of franchisees, area licensees and company-operated restaurants, as reported to IHOP.
- (c) "Comparable average sales" reflect sales for restaurants that are operated for the entire fiscal period in which they are being compared. Because of new unit openings and store closures, the restaurants opened for an entire fiscal period being compared will be different from period to period. Comparable average sales do not include data on restaurants located in Florida and Japan.
- (d) The Company's area licensee in Japan negotiated an early termination of the area license agreement as of April 30, 2001. Excluding the units in Japan, system-wide sales increased 10.1%, 10.9% and 9.3% for 2001, 2000 and 1999, respectively; total effective restaurants grew by 8.0%, 7.6% and 7.7% for 2001, 2000 and 1999, respectively; and average system-wide sales per effective restaurant increased 2.0%, 3.0% and 1.5% for 2001, 2000 and 1999, respectively.

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The following table summarizes IHOP's restaurant development and franchising activity:

|  | Year Ended December 31, |            |            |            |            |
|--|-------------------------|------------|------------|------------|------------|
|  | 2001                    | 2000       | 1999       | 1998       | 1997       |
| <b>Restaurant Development Activity</b> |                         |            |            |            |            |
| IHOP beginning of year                 | 968                     | 903        | 835        | 787        | 729        |
| New openings                           |                         |            |            |            |            |
| IHOP-developed                         | 76                      | 70         | 65         | 56         | 45         |
| Investor and conversion programs       | 12                      | 10         | 7          | 13         | 13         |
| Area license                           | 5                       | 4          | 4          | 4          | 9          |
| <b>Total new openings</b>              | <b>93</b>               | <b>84</b>  | <b>76</b>  | <b>73</b>  | <b>67</b>  |
| Closings                               |                         |            |            |            |            |
| Company and franchise                  | (11)                    | (16)       | (8)        | (21)       | (9)        |
| Area license                           | (33)                    | (3)        |            | (4)        |            |
| <b>IHOP end of year</b>                | <b>1,017</b>            | <b>968</b> | <b>903</b> | <b>835</b> | <b>787</b> |
| Summary end of year                    |                         |            |            |            |            |

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Year Ended December 31,

|  | Year Ended December 31, |            |            |            |            |
|--|-------------------------|------------|------------|------------|------------|
| <b>IHOP</b>                            |                         |            |            |            |            |
| Franchise                              | 823                     | 747        | 678        | 624        | 571        |
| Company                                | 72                      | 71         | 76         | 66         | 71         |
| Area license                           | 122                     | 150        | 149        | 145        | 145        |
| <b>Total IHOP</b>                      | <b>1,017</b>            | <b>968</b> | <b>903</b> | <b>835</b> | <b>787</b> |
| <b>Restaurant Franchising Activity</b> |                         |            |            |            |            |
| IHOP-developed                         | 74                      | 70         | 61         | 60         | 45         |
| Investor and conversion programs       | 12                      | 10         | 7          | 13         | 13         |
| Rehabilitated and refranchised         | 9                       | 15         | 6          | 10         | 6          |
| <b>Total restaurants franchised</b>    | <b>95</b>               | <b>95</b>  | <b>74</b>  | <b>83</b>  | <b>64</b>  |
| Reacquired by IHOP                     | (12)                    | (19)       | (14)       | (17)       | (23)       |
| Closed                                 | (7)                     | (7)        | (6)        | (13)       | (5)        |
| <b>Net addition</b>                    | <b>76</b>               | <b>69</b>  | <b>54</b>  | <b>53</b>  | <b>36</b>  |

**Comparison of Year Ended December 31, 2001 to Year Ended December 31, 2000**

The fiscal years ended December 31, 2001 and 2000 were comprised of 52 weeks (364 days).

**System-Wide Retail Sales**

System-wide retail sales include the sales of all IHOP restaurants as reported to IHOP by its franchisees, area licensees and company-operated restaurants. System-wide retail sales grew by \$99,580,000 or 8.0% in 2001. Growth in the number of effective restaurants and increases in average sales per effective restaurant caused the growth in system-wide sales. "Effective restaurants" are the number of restaurants in operation in a given fiscal period, adjusted to account for restaurants in operation for only a portion of the fiscal period. Effective restaurants grew by 5.2% in 2001 due to new restaurant development. Average sales per effective restaurant increased by 2.6% in 2001 over the prior year period. Newly developed restaurants generally have seating capacity and sales greater than the system-wide averages. System-wide comparable average sales per restaurant (exclusive of area license restaurants in Florida and Japan) grew 0.8% in 2001. Management continues to pursue growth in sales through new restaurant development, advertising and marketing efforts, new products, improvements in customer service and operations, and remodeling of existing restaurants.

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During the second quarter of 2001, the Company's area licensee in Japan negotiated an early termination of its area license agreement. IHOP received a fee of approximately \$250,000 for this early termination and the area licensee discontinued operations of its 32 IHOP restaurants. Excluding these units in Japan, system-wide sales increased 10.1% for the year ended December 31, 2001; effective restaurants grew by 8.0% for the year ended December 31, 2001; and average sales per effective restaurants increased 2.0% for the year ended December 31, 2001 over the same period in 2000.

**Franchise Operations**

Franchise operations revenues are the revenues received by IHOP from its franchisees and include rent, royalties, sales of proprietary products, advertising fees and interest. Franchise operations revenues grew by 13.8% in 2001. Franchise operations revenues grew primarily due to an increase in retail sales in franchise restaurants of 11.6% in 2001. Retail sales in franchised restaurants grew primarily due to a 10.2% increase in effective franchise restaurants and a 1.3% increase in average sales per effective franchise restaurant in 2001 over 2000.

Franchise operations costs and expenses include facility rent, advertising, the cost of proprietary products, and other direct costs associated with franchise operations. Franchise operations costs and expenses increased by 19.0% in 2001. Increases in franchise operations costs and expenses were greater than the growth in franchise operations revenue primarily due to higher rent expense.

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Rent expense has been primarily affected by our new unit development program. New unit development will initially have a negative effect on rent margin percentages. The timing of lease transactions also has an impact on rent expense. Actual profit margin on rent transactions increased \$4.5 million to \$27.9 million in 2001, a 19.1% improvement over the \$23.4 million rent margin in 2000.

Franchise operations margin as a percent of revenues was 58.7% in 2001 compared with 60.5% in 2000. The decrease in the margin percentage was primarily due to the rent expense mentioned above.

### **Sales of Franchises and Equipment**

Sales of franchises and equipment decreased by 0.1% in 2001. IHOP franchised 95 restaurants in both 2001 and 2000, however, the units franchised in 2001 had a lower average franchise sales price than those in 2000.

Cost of sales of franchises and equipment increased 0.5% in 2001. The increase was primarily due to preopening costs and site related costs that are not directly linked to the number of units franchised.

Margin on sales of franchises and equipment was 33.9% in 2001 compared with 34.3% in 2000. The decrease in margins primarily resulted from the mix of units franchised and an increase in preopening and site related costs.

### **Company Operations**

Company operations revenues are sales to customers at restaurants operated by IHOP. Company operation revenues decreased 5.5% in 2001. A decrease in the number of effective IHOP-operated restaurants coupled with a decrease in the average sales per IHOP-operated restaurant caused the revenue decrease. Effective IHOP-operated restaurants decreased by 5.3% in 2001. Average sales per effective IHOP-operated restaurant decreased by 0.2% in 2001.

Company operations costs and expenses include food, labor and benefits, utilities and occupancy costs. Company operations costs decreased 5.4% in 2001. Company operations costs were primarily affected by decreases in the number of effective restaurants.

Company operations gross profit margin as a percent of Company operations revenues was 3.6% and 3.8% of company operations revenues in 2001 and 2000, respectively.

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### **Other Costs and Expenses**

Field, corporate and administrative costs and expenses increased by 11.3% in 2001. The rise in expenses was primarily due to higher compensation and rent expenses. The primary cause of the increases in rent expense was the initiation of a new 10-year lease for the Company's corporate headquarters in late 2000 and the opening of a new regional office in the Rocky Mountain area in early 2001. Field, corporate and administrative expenses were 3.0% of system-wide sales in 2001, compared to 2.9% in 2000.

Depreciation and amortization expense in 2001 increased 9.3%. The increases were caused primarily by the addition of new restaurants to the IHOP chain from our restaurant development program.

Interest expense decreased by 3.0% in 2001. Long term debt increased by approximately \$14 million since December 31, 2000. However, the Company has benefited from lower interest rates in 2001 compared to the prior year.

### **Income Tax Provision**

The Company's effective tax rate was 37.5% for 2001 and 38.5% for 2000. The decrease in the effective tax rate for 2001 was due to the positive results of the Company's tax planning efforts.

### **Balance Sheet Accounts**

The balance of property and equipment, net at December 31, 2001, increased 22.9% primarily due to new restaurant development.

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The balance of long-term receivables at December 31, 2001, increased 7.1% from the prior year primarily due to IHOP's financing activities associated with sales of franchises and equipment.

The balance of long-term debt increased by 38.1% in 2001 primarily due to the \$11,649,000 leasehold mortgage term loan the company entered into in 2001 and an increase in the balance of our revolving line of credit. These additions were partially offset by a \$8,460,000 repayment of our senior notes.

### **Comparison of Year Ended December 31, 2000 to Year Ended December 31, 1999**

The fiscal years ended December 31, 2000 and 1999 were comprised of 52 weeks (364 days).

### **System-Wide Retail Sales**

System-wide retail sales include the sales of all IHOP restaurants as reported to IHOP by its franchisees, area licensees and company-operated restaurants. System-wide retail sales grew 10.6% in 2000. Growth in the number of effective restaurants and increases in average per unit sales caused the growth in system-wide sales. "Effective restaurants" are the number of restaurants in operation in a given fiscal period, adjusted to account for restaurants in operation for only a portion of the fiscal period. Effective restaurants grew 7.3% in 2000 due to new restaurant development. Newly developed restaurants generally have seating and sales above the system-wide averages. System-wide comparable average sales per restaurant (exclusive of area license restaurants in Florida and Japan) grew 0.8% in 2000. Management continues to pursue growth in sales through new restaurant development, advertising and marketing efforts, improvements in customer service and operations, and remodeling of existing restaurants.

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### **Franchise Operations**

Franchise operations revenues are the revenues received by IHOP from its franchisees and include rent, royalties, sales of proprietary products, advertising fees and interest. Franchise operations revenues grew 12.2% in 2000. Retail sales in franchise restaurants increased 11.5%. Effective franchise restaurants grew by 9.1% in 2000. Average sales per effective franchise restaurant grew 2.1% in 2000. The percentage increase in franchise operations revenue exceeded the percentage increase in retail sales due to a 14.3% increase in rental income, partially offset by a decline in per unit merchandise sales. In 2000, the Company stopped supplying franchise restaurants with certain replacement fixtures and equipment. This decision is part of an effort to reduce inventory, and eliminate certain general and administrative costs.

Franchise operations costs and expenses include facility rent, advertising, the cost of proprietary products, and other direct costs associated with franchise operations. Franchise operations costs and expenses increased 12.8% in 2000. Increases in franchise operations costs and expenses were generally in line with the growth in franchise operations revenue. However, the percentage increase exceeded that of revenues because of increases in rent expense and certain non-recurring costs associated with discontinuing certain merchandise sales. Increases in rent expense are impacted by the pricing, timing, and mix of lease transactions.

Franchise operations margin was 60.5% in 2000 compared with 60.7% in 1999.

### **Sales of Franchises and Equipment**

Sales of franchises and equipment increased 19.0% in 2000. An increase in the number of restaurants franchised was the primary cause of the increase in sales of franchises and equipment. IHOP franchised 95 restaurants in 2000 compared to 74 in 1999. However, IHOP rehabilitated and refranchised 15 units in 2000 compared to 6 in 1999. Refranchised units generally have lower average franchise sales prices and lower average equipment values. In 2000, the Company increased its efforts to reduce or eliminate some underproducing property and equipment.

Cost of sales of franchises and equipment increased 29.2% in 2000. The increase was generally in line with the increase in the number of restaurants franchised, although the mix of restaurants franchised also impacted the cost of sales.

Margin on sales of franchises and equipment was 34.3% in 2000 compared with 39.4% in 1999. The margin was negatively impacted by the franchising of more rehabilitated restaurants in 2000 compared with the prior year.

### **Company Operations**

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Company operations revenues are sales to customers at restaurants operated by IHOP. Company operations revenues increased 3.7% in 2000. Increases in the number of effective IHOP-operated restaurants coupled with an increase in the average sales per IHOP-operated restaurant caused the revenue increase. Effective IHOP-operated restaurants increased by 2.7% in 2000. Average sales per effective IHOP-operated restaurant increased by 0.9% in 2000.

Company operations costs and expenses include food, labor and benefits, utilities and occupancy costs. Company operations costs increased 6.2% in 2000. Company operations costs were affected by increases in the number of effective restaurants and increases in certain costs, primarily labor, rent and utilities.

Company operations gross profit margin was 3.8% and 6.0% of company operations revenues in 2000 and 1999, respectively. The decline in margin for 2000 was primarily the result of higher salaries and wages as a percent of sales in 2000 as compared to 1999.

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### **Other Costs and Expenses**

Field, corporate and administrative costs and expenses in 2000 increased 5.6%. The rise in expenses was primarily due to higher compensation expenses offset by lower professional service expenses. Field, corporate and administrative expenses were 2.9% and 3.1% of system-wide sales in 2000 and 1999, respectively.

Depreciation and amortization expense in 2000 increased 10.2%. The increases were caused primarily by the addition of new restaurants to the IHOP chain from our ongoing restaurant development program.

Interest expense increased 12.2% in 2000. The increases were due to interest associated with new capital leases that were partially offset by reductions in interest on our senior notes as the principal balances are paid down.

### **Balance Sheet Accounts**

The balance of property and equipment, net at December 31, 2000, increased 8.9% primarily due to new restaurant development.

The balance of long-term receivables at December 31, 2000, increased 8.0% primarily due to IHOP's financing activities associated with sales of franchises and equipment.

### **Liquidity and Capital Resources**

The Company invests in its business primarily through the development of additional restaurants and, to a lesser extent, through the remodeling of older company-operated restaurants. Also, the Company began repurchasing shares of its common stock in 2000. As of December 31, 2001, the Company has cumulatively repurchased 389,168 shares of its common stock, of which 182,086 were contributed to the Employee Stock Ownership Plan.

In 2001, IHOP and its franchisees and area licensees developed and opened 93 IHOP restaurants. Of these, we developed and opened 76 restaurants, and franchisees and area licensees developed and opened 17 restaurants. Capital expenditures in 2001, which included our portion of the above development program, were \$119.8 million. Funds for investment primarily came from cash generated from operations (\$55.7 million), and proceeds from sale and leaseback arrangements of restaurant land and buildings (\$45.7 million). We also incurred leasehold mortgages of \$12.0 million.

In 2002, IHOP and its franchisees and area licensees plan to develop and open approximately 90 to 105 restaurants. Included in that number is the development of 80 to 90 new restaurants by us and the development of 10 to 15 restaurants by our franchisees and area licensees. Capital expenditure projections for 2002, which include our portion of the above development program, are estimated to be approximately \$130 to \$140 million. In November 2002, the seventh and final annual installment of \$4.6 million in principal is due on our 7.79% senior notes due 2002 and the third installment of \$3.9 million in principal is due on our senior notes due 2008. We expect that funds from operations, leasehold mortgage term debt, proceeds from sale and leaseback arrangements (estimated to be about \$55 to \$65 million) and our \$25 million revolving line of credit will be sufficient to cover our operating requirements, our budgeted capital expenditures and our principal repayments on our senior notes in 2002. At December 31, 2001, \$10 million was available to be borrowed under our noncollateralized bank revolving credit agreement.



### **Critical Accounting Policies**

The consolidated financial statements include accounts of the Company and all subsidiaries. The preparation of financial statements in conformity with accounting principles generally accepted in the

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United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company does not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

#### ***Leasing***

IHOP leases equipment consisting of restaurant equipment, furniture and fixtures to our franchisees and retains title to the leased equipment. These equipment contracts are accounted for as sales-type leases upon acceptance of the equipment by the franchisee. Leases of restaurant facilities that meet the criteria are recorded as direct financing leases or are treated as operating leases.

#### ***Accounting for Long-lived Assets***

The Company reviews long-lived assets whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable. In evaluating whether an asset has been impaired, the Company compares the anticipated undiscounted future cash flows to be generated by the asset to the asset's carrying value. If the sum of the undiscounted future cash flows is less than the carrying amount of the asset, an impairment loss is recognized.

#### ***Reacquired Franchises and Equipment Held for Sale***

Restaurants that we reacquire are often underperforming as a result of having been poorly operated and sometimes physically neglected. When we reacquire a restaurant and assume operations, we begin a multi-step rehabilitation program for that restaurant. First these restaurants are physically rehabilitated, then we hire and train the restaurant staff. After these first steps are completed, we implement new marketing and operations programs designed to regain the business of former guests and attract new patrons. After a restaurant has been rehabilitated and its sales volume reaches acceptable levels, the restaurant is refranchised to a qualified franchisee.

Reacquired franchises and equipment held for sale are accounted for on the specific identification basis. At the date of reacquisition, the franchise and equipment are recorded at the lower of (1) the sum of the franchise receivables and costs of reacquisition, or (2) the estimated net realizable value. Pending the sale of such franchise, the carrying value is amortized ratably over the remaining life of the asset or lease and the estimated net realizable value is reassessed each year.

#### ***Income Taxes***

Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities. They are measured using the enacted marginal tax rates and laws that will be in effect when the differences are expected to reverse.

### **New Accounting Pronouncements**

In June 2001, Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets," were issued and are effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives. The Company will apply the new rules for accounting for goodwill and other intangible assets beginning in the first quarter of

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fiscal year 2002. The Company is currently evaluating its impact on the Company's financial position or results of operations.

In June 2001, SFAS No. 143, "Accounting for Asset Retirement Obligations" was issued and is effective for fiscal years beginning after June 15, 2002. This Statement addresses the financial accounting and reporting for obligations associated with the retirement of a tangible long-lived asset and the associated asset retirement costs. It applies to the legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and, or the normal operation of a long-lived asset. The Company believes that adopting this Statement will not have a material impact on the Company's financial position or results of operations.

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" was issued and is effective for fiscal years beginning after December 15, 2001. This Statement supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of" and APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effect of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". SFAS No. 144 established a single accounting model for long-lived assets to be disposed of by sale. This Statement provides guidance on differentiating between assets held and used, held for sale and held for disposal other than by sale (e.g., abandonment, exchanged, distributed). The Company believes that adopting this Statement will not have a material impact on the Company's financial position or results of operations.

### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

IHOP is exposed to market risk from changes in interest rates on debt and changes in commodity prices.

IHOP's exposure to interest rate risk relates to its \$25 million revolving credit agreement and its \$12 million mortgage term loan with its banks. Borrowings under the revolving credit agreement bear interest at the bank's reference rate (prime) or, at IHOP's option, at the bank's quoted rate or at a Eurodollar rate. There was \$15 million outstanding under this agreement at December 31, 2001, and the largest amount outstanding under the agreement during 2001 was \$19.6 million. Borrowings under the mortgage term loan agreement bear interest at the London interbank offered rate ("LIBOR") plus the applicable margin. The applicable margin will be a function of the funded debt to EBITDA ratio as defined under the loan agreement. The impact on our results of operations due to a hypothetical 1% interest rate change would be immaterial.

Many of the food products purchased by IHOP and its franchisees and area licensees are affected by commodity pricing and are, therefore, subject to unpredictable price volatility. We attempt to mitigate price fluctuations by entering into forward purchase agreements on all our major products purchased such as coffee, pancake mixes, pork products, soft drinks and orange juice. None of these food product contracts or agreements are derivative instruments. Extreme changes in commodity prices and/or long-term changes could affect IHOP's franchisees, area licensees and company-operated restaurants adversely. However, any changes in commodity prices would also generally affect IHOP's competitors at about the same time as IHOP. We expect that in most cases the IHOP system would be able to pass increased commodity prices through to its consumers via increases in menu prices. From time to time, competitive circumstances could limit short-term menu price flexibility, and in those cases margins would be negatively impacted by increased commodity prices. This would be mitigated by the fact that the majority of IHOP restaurants are franchised and IHOP's revenue stream from franchisees is based on the gross sales of the restaurants. We believe that any changes in commodity pricing that cannot be adjusted for by changes in menu pricing or other strategies would not be material to IHOP's results of operations.

### **Item 8. Financial Statements and Supplementary Data.**

#### **Index to Consolidated Financial Statements**

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| Consolidated Balance Sheets as of December 31, 2001 and 2000  | 22                        |
| Consolidated Statements of Operations for each of the three years in the period ended December 31, 2001           | 23                        |
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**IHOP Corp. and Subsidiaries**  
**Consolidated Balance Sheets**  
**(In thousands, except share amounts)**

|  | <b>December 31,</b> |                   |
|--|---------------------|-------------------|
|  | <b>2001</b>         | <b>2000</b>       |
| <b>Assets</b>  |                     |                   |
| Current assets   |                     |                   |
| Cash and cash equivalents                              | \$ 6,252            | \$ 7,208          |
| Receivables, net                                       | 47,451              | 39,600            |
| Reacquired franchises and equipment held for sale, net | 3,234               | 3,172             |
| Inventories  | 837                 | 691               |
| Prepaid expenses                                       | 1,386               | 431               |
|  | <b>59,160</b>       | <b>51,102</b>     |
| Total current assets                                   |                     |                   |
| Long-term receivables                                  | 307,859             | 287,346           |
| Property and equipment, net                            | 238,026             | 193,624           |
| Reacquired franchises and equipment held for sale, net | 18,327              | 17,973            |
| Excess of costs over net assets acquired, net          | 10,767              | 11,196            |
| Other assets   | 7,290               | 971               |
|  | <b>\$ 641,429</b>   | <b>\$ 562,212</b> |
| Total assets   |                     |                   |
| <b>Liabilities and Stockholders' Equity</b>            |                     |                   |
| Current liabilities                                    |                     |                   |
| Current maturities of long-term debt                   | \$ 9,711            | \$ 8,939          |
| Accounts payable                                       | 16,666              | 20,588            |
| Accrued employee compensation and benefits             | 7,621               | 6,776             |
| Other accrued expenses                                 | 7,238               | 7,835             |
| Deferred income taxes                                  | 1,129               | 3,957             |
| Capital lease obligations                              | 2,164               | 1,878             |
|  | <b>44,529</b>       | <b>49,973</b>     |
| Total current liabilities                              |                     |                   |
| Long-term debt   | 50,209              | 36,363            |
| Deferred income taxes                                  | 59,084              | 46,585            |

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|   | December 31,      |                   |
|---|-------------------|-------------------|
|   | 2001              | 2000              |
| Capital lease obligations and other   | 175,177           | 169,296           |
| Commitments and contingencies   |                   |                   |
| Stockholders' equity  |                   |                   |
| Preferred stock, \$1 par value, 10,000,000 shares authorized; shares issued and outstanding: 2001 and 2000, none  |                   |                   |
| Common stock, \$.01 par value, 40,000,000 shares authorized: 2001; 20,918,283 shares issued and 20,711,201 shares outstanding; 2000; 20,299,091 shares issued and 20,011,341 shares outstanding | 209               | 203               |
| Additional paid in capital  | 79,837            | 69,655            |
| Retained earnings   | 233,920           | 193,632           |
| Treasury stock, at cost (2001; 207,082 shares; 2000; 287,750 shares)  | (3,386)           | (5,170)           |
| Contribution to ESOP  | 1,850             | 1,675             |
| <b>Total stockholders' equity</b>   | <b>312,430</b>    | <b>259,995</b>    |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 641,429</b> | <b>\$ 562,212</b> |

See the accompanying notes to the consolidated financial statements.

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**IHOP Corp. and Subsidiaries**

**Consolidated Statements of Operations**

(In thousands, except per share amounts)

|                                   | Year Ended December 31, |                |                |
|-----------------------------------|-------------------------|----------------|----------------|
|                                   | 2001                    | 2000           | 1999           |
| <b>Revenues</b>                   |                         |                |                |
| Franchise operations              |                         |                |                |
| Rent                              | \$ 65,780               | \$ 51,135      | \$ 44,722      |
| Service fees and other            | 142,850                 | 132,226        | 118,764        |
|                                   | 208,630                 | 183,361        | 163,486        |
| Sales of franchises and equipment | 46,996                  | 47,065         | 39,545         |
| Company operations                | 68,810                  | 72,818         | 70,204         |
| <b>Total revenues</b>             | <b>324,436</b>          | <b>303,244</b> | <b>273,235</b> |
| <b>Costs and Expenses</b>         |                         |                |                |
| Franchise operations              |                         |                |                |
| Rent                              | 37,867                  | 27,695         | 23,233         |
| Other direct costs                | 48,269                  | 44,699         | 40,956         |
|                                   | 86,136                  | 72,394         | 64,189         |

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|  | Year Ended December 31, |                  |                  |
|--|-------------------------|------------------|------------------|
| Cost of sales of franchises and equipment  | 31,086                  | 30,944           | 23,958           |
| Company operations                         | 66,330                  | 70,085           | 66,016           |
| Field, corporate and administrative        | 40,621                  | 36,481           | 34,531           |
| Depreciation and amortization              | 14,818                  | 13,562           | 12,310           |
| Interest                                   | 21,107                  | 21,751           | 19,391           |
| Other (income) expense, net                | (123)                   | 567              | 604              |
| <b>Total costs and expenses</b>            | <b>259,975</b>          | <b>245,784</b>   | <b>220,999</b>   |
| Income before income taxes                 | 64,461                  | 57,460           | 52,236           |
| Provision for income taxes                 | 24,173                  | 22,122           | 20,111           |
| <b>Net income</b>                          | <b>\$ 40,288</b>        | <b>\$ 35,338</b> | <b>\$ 32,125</b> |
| <b>Net Income Per Share</b>                |                         |                  |                  |
| Basic                                      | \$ 1.98                 | \$ 1.77          | \$ 1.61          |
| Diluted                                    | \$ 1.94                 | \$ 1.74          | \$ 1.58          |
| <b>Weighted Average Shares Outstanding</b> |                         |                  |                  |
| Basic                                      | 20,398                  | 20,017           | 19,983           |
| Diluted                                    | 20,762                  | 20,263           | 20,358           |

See the accompanying notes to the consolidated financial statements.

IHOP Corp. and Subsidiaries

Consolidated Statements of Shareholders' Equity

(In thousands, except share amounts)

|  | Common Stock |        | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Contribution<br>to ESOP | Total      |
|--|--------------|--------|----------------------------------|----------------------|-------------------|-------------------------|------------|
|  | Shares       | Amount |                                  |                      |                   |                         |            |
| <b>Balance, December 31, 1998</b>          | 9,881,580    | \$ 99  | \$ 60,100                        | \$ 126,269           | \$                | \$ 1,400                | \$ 187,868 |
| Issuance of shares to ESOP                 | 28,714       |        | 1,206                            |                      |                   | (1,206)                 |            |
| Reissuance of treasury shares to ESOP      | 4,620        |        | 348                              |                      |                   | (194)                   | 154        |
| Issuance of shares pursuant to stock plans | 219,952      | 2      | 3,560                            |                      |                   |                         | 3,562      |
| Tax benefit from stock options exercised   |              |        | 1,190                            |                      |                   |                         | 1,190      |
| Unearned compensation restricted stock.    |              |        | 81                               |                      |                   |                         | 81         |
| Contribution to ESOP                       |              |        |                                  |                      |                   | 1,500                   | 1,500      |

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| <b>Common Stock</b>  |                   |               |                  |                   |                   |                 |                   |
|--|-------------------|---------------|------------------|-------------------|-------------------|-----------------|-------------------|
| 2-for-1 stock split effective May 27, 1999, in the form of a 100% stock dividend |                   |               |                  |                   |                   |                 |                   |
|  |                   | 100           |                  | (100)             |                   |                 |                   |
| Net income   | 9,982,448         |               |                  | 32,125            |                   |                 | 32,125            |
| <b>Balance, December 31, 1999</b>  | <b>20,117,314</b> | <b>201</b>    | <b>66,485</b>    | <b>158,294</b>    |                   | <b>1,500</b>    | <b>226,480</b>    |
| Repurchase of treasury shares  |                   |               |                  |                   | (6,631)           |                 | (6,631)           |
| Reissuance of treasury shares to ESOP  |                   |               | 39               |                   | 1,461             | (1,500)         |                   |
| Issuance of shares pursuant to stock plans                                       | 181,777           | 2             | 2,576            |                   |                   |                 | 2,578             |
| Tax benefit from stock options exercised   |                   |               | 536              |                   |                   |                 | 536               |
| Unearned compensation restricted stock   |                   |               | 19               |                   |                   |                 | 19                |
| Contribution to ESOP   |                   |               |                  |                   |                   | 1,675           | 1,675             |
| Net income   |                   |               |                  | 35,338            |                   |                 | 35,338            |
| <b>Balance, December 31, 2000</b>  | <b>20,299,091</b> | <b>203</b>    | <b>69,655</b>    | <b>193,632</b>    | <b>(5,170)</b>    | <b>1,675</b>    | <b>259,995</b>    |
| Repurchase of treasury shares  |                   |               |                  |                   | (23)              |                 | (23)              |
| Reissuance of treasury shares to ESOP  |                   |               | (132)            |                   | 1,807             | (1,675)         |                   |
| Issuance of shares pursuant to stock plans                                       | 619,192           | 6             | 7,123            |                   |                   |                 | 7,129             |
| Tax benefit from stock options exercised   |                   |               | 3,191            |                   |                   |                 | 3,191             |
| Contribution to ESOP   |                   |               |                  |                   |                   | 1,850           | 1,850             |
| Net income   |                   |               |                  | 40,288            |                   |                 | 40,288            |
| <b>Balance, December 31, 2001</b>  | <b>20,918,283</b> | <b>\$ 209</b> | <b>\$ 79,837</b> | <b>\$ 233,920</b> | <b>\$ (3,386)</b> | <b>\$ 1,850</b> | <b>\$ 312,430</b> |

See the accompanying notes to the consolidated financial statements.

**IHOP Corp. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(In thousands)

|  | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2001                    | 2000      | 1999      |
| <b>Cash flows from operating activities</b>                                  |                         |           |           |
| Net income   | \$ 40,288               | \$ 35,338 | \$ 32,125 |
| Adjustments to reconcile net income to cash provided by operating activities |                         |           |           |
| Depreciation and amortization  | 14,818                  | 13,562    | 12,310    |
| Deferred income taxes  | 9,671                   | 6,941     | 6,333     |
| Contribution to ESOP   | 1,850                   | 1,675     | 1,500     |
| Tax benefit from stock options exercised                                     | 3,191                   | 536       | 1,190     |

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|  | Year Ended December 31, |                  |                 |
|--|-------------------------|------------------|-----------------|
| <b>Change in current assets and liabilities</b>                  |                         |                  |                 |
| Accounts receivable  | (7,852)                 | (2,200)          | (4,814)         |
| Inventories  | (146)                   | 532              | (1)             |
| Prepaid expenses   | (955)                   | 3,878            | (619)           |
| Accounts payable   | (3,922)                 | 2,572            | (1,706)         |
| Accrued employee compensation and benefits                       | 845                     | (1,028)          | 1,787           |
| Other accrued expenses   | (597)                   | 1,939            | 587             |
| Other, net   | (1,488)                 | 4,310            | 2,700           |
|  | <b>55,703</b>           | <b>68,055</b>    | <b>51,392</b>   |
| <b>Cash flows from investing activities</b>                      |                         |                  |                 |
| Additions to property and equipment                              | (119,797)               | (99,378)         | (72,290)        |
| Additions to notes   | (14,993)                | (13,916)         | (14,209)        |
| Principal receipts from notes and equipment contracts receivable | 14,668                  | 12,594           | 10,963          |
| Additions to reacquired franchises held for sale                 | (2,320)                 | (2,570)          | (1,567)         |
|  | <b>(122,442)</b>        | <b>(103,270)</b> | <b>(77,103)</b> |
| <b>Cash flows from financing activities</b>                      |                         |                  |                 |
| Proceeds from issuance of long-term debt                         | 26,532                  | 12,703           | 3,372           |
| Proceeds from sale and leaseback arrangements                    | 45,652                  | 48,274           | 30,159          |
| Repayment of long-term debt                                      | (11,915)                | (17,575)         | (8,349)         |
| Principal payments on capital lease obligations                  | (1,592)                 | (1,121)          | (1,386)         |
| Treasury stock transactions                                      | (23)                    | (6,631)          |                 |
| Proceeds from stock options exercised                            | 7,129                   | 2,597            | 3,797           |
|  | <b>65,783</b>           | <b>38,247</b>    | <b>27,593</b>   |
| Net change in cash and cash equivalents                          | (956)                   | 3,032            | 1,882           |
| Cash and cash equivalents at beginning of period                 | 7,208                   | 4,176            | 2,294           |
|  | <b>\$ 6,252</b>         | <b>\$ 7,208</b>  | <b>\$ 4,176</b> |
| <b>Supplemental disclosures</b>                                  |                         |                  |                 |
| Interest paid, net of capitalized amounts                        | \$ 21,238               | \$ 21,752        | \$ 19,162       |
| Income taxes paid  | 15,257                  | 15,974           | 12,411          |
| Capital lease obligations incurred                               | 2,388                   | 4,153            | 32,169          |

See the accompanying notes to the consolidated financial statements.

IHOP Corp. and Subsidiaries

Notes to the Consolidated Financial Statements

1. Summary of Significant Accounting Policies

**Operations**

IHOP Corp. and its subsidiaries ("IHOP" or the "Company") engage exclusively in the food-service industry, primarily in the United States, wherein we franchise and operate restaurants. IHOP grants credit to our franchisees and licensees, all of whom are in the restaurant business. In the majority of our franchised operations, we have developed restaurants on sites that we either own or control through leases. We then lease or sublease the restaurants to our franchisees. Additionally, we finance approximately 80% of the initial franchise fee, lease restaurant equipment and fixtures to our franchisees, and sell proprietary products to our franchisees and licensees and provide marketing and promotional services to our franchisees and area licensees.

**Basis of Presentation**

The consolidated financial statements include the accounts of IHOP Corp. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

**Fiscal Periods**

IHOP's fiscal year ends on the Sunday nearest to December 31 of each year. For convenience, we report all fiscal years as ending on December 31 and fiscal quarters as ending on March 31, June 30 and September 30.

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires IHOP management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. They also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

IHOP at times purchases highly liquid, investment-grade securities with an original maturity of three months or less. These cash equivalents are stated at cost which approximates market value. We do not believe that we are exposed to any significant credit risk on cash and cash equivalents. At times, cash and cash equivalent balances may be in excess of FDIC insurance limits.

**Inventories**

Inventories consisting of merchandise and supplies are stated at the lower of cost (on a first-in, first-out basis) or market.

**Property and Equipment**

Property and equipment are stated at cost and depreciated on the straight-line method over the estimated useful lives as follows:

| Category                       | Depreciable Life                  |
|--------------------------------|-----------------------------------|
| Buildings and improvements     | Shorter of lease term or 40 years |
| Leaseholds and improvements    | 3 25 years                        |
| Equipment and fixtures         | 3 10 years                        |
| Properties under capital lease | Primary lease term                |

Leaseholds and improvements are amortized over a period not exceeding the primary term of the lease.

Effective January 1, 2000, IHOP changed the estimated useful life for new buildings from 25 years to 40 years to better reflect their proven economic lives. This change is applied to new buildings completed in 2000 and later, and does not change the estimated useful lives of previously constructed restaurants. Because most buildings are leased or located on leased land, the effective depreciation period is limited to the term of the underlying lease. Therefore, the effect of this change in estimated useful lives was insignificant to either depreciation expense, net income, or earnings per share for the years ended December 31, 2001 and 2000.



***Excess of Costs Over Net Assets Acquired***

The excess of costs over net assets acquired is amortized utilizing the straight-line method over forty years. Accumulated amortization at December 31, 2001 and 2000 was \$6,320,000 and \$5,891,000, respectively.

***Leasing***

IHOP leases equipment consisting of restaurant equipment, furniture and fixtures to our franchisees and retains title to the leased equipment. These equipment contracts are accounted for as sales-type leases upon acceptance of the equipment by the franchisee. Leases of restaurant facilities that meet the criteria are recorded as direct financing leases or are treated as operating leases.

***Accounting for Long-lived Assets***

The Company reviews long-lived assets whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable. In evaluating whether an asset has been impaired, the Company compares the anticipated undiscounted future cash flows to be generated by the asset to the asset's carrying value. If the sum of the undiscounted future cash flows is less than the carrying amount of the asset, an impairment loss is recognized.

***Franchise Revenues***

Revenues from the sales of franchises are recognized as income when IHOP has substantially performed all of its material obligations under the franchise agreement, and the franchisee has

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commenced operations. Continuing service fees, which are a percentage of the net sales of franchised operations, are accrued as income when earned.

***Preopening Expenses***

Expenditures related to the opening of new restaurants, other than those for capital assets, are charged to expense when incurred.

***Advertising***

Advertising costs are expensed as incurred. Advertising expenses for the years ended December 31, 2001, 2000 and 1999 were \$36,617,000, \$32,678,000 and \$29,163,000, respectively.

***Income Taxes***

Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities. They are measured using the enacted marginal tax rates and laws that will be in effect when the differences are expected to reverse.

***Net Income Per Share***

Basic net income per share is computed by dividing the net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income attributable to common stockholders by the weighted average number of common and common equivalent shares outstanding during the period. Common share equivalents included in the diluted computation represent shares issuable upon assumed exercises of outstanding stock options using the treasury stock method.

***Comprehensive Income***

Comprehensive income includes net income and other comprehensive income components which, under GAAP, bypass the income statement and are reported in the balance sheet as a separate component of stockholders' equity. For the three years ended December 31, 2001, IHOP had no other comprehensive income components, as defined by GAAP. As a result, net income is the same as comprehensive income for

the years ended December 31, 2001, 2000 and 1999.

### *Stock Split*

On April 29, 1999, IHOP's Board of Directors approved a 2 for 1 stock split of its common stock effective May 27, 1999, in the form of a 100% stock dividend for stockholders of record at the close of business on May 13, 1999. All share and per-share amounts in the accompanying consolidated financial statements, except for the statement of stockholders' equity, have been restated to reflect the stock split.

### *Reclassification*

Certain reclassifications have been made to prior year information to conform to the current year presentation.

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### *New Accounting Pronouncements*

In June 2001, Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets," were issued and are effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives. The Company will apply the new rules for accounting for goodwill and other intangible assets beginning in the first quarter of fiscal year 2002. The Company is currently evaluating its impact on the Company's financial position or results of operations.

In June 2001, SFAS No. 143, "Accounting for Asset Retirement Obligations" was issued and is effective for fiscal years beginning after June 15, 2002. This Statement addresses the financial accounting and reporting for obligations associated with the retirement of a tangible long-lived asset and the associated asset retirement costs. It applies to the legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and, or the normal operation of a long-lived asset. The Company believes that adopting this Statement will not have a material impact on the Company's financial position or results of operations.

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" was issued and is effective for fiscal years beginning after December 15, 2001. This Statement supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of" and APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effect of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". SFAS No. 144 established a single accounting model for long-lived assets to be disposed of by sale. This Statement provides guidance on differentiating between assets held and used, held for sale and held for disposal other than by sale (e.g., abandonment, exchanged, distributed). The Company believes that adopting this Statement will not have a material impact on the Company's financial position or results of operations.

## **2. Receivables**

|                                      | 2001              | 2000              |
|--------------------------------------|-------------------|-------------------|
|                                      | (In thousands)    |                   |
| Accounts receivable                  | \$ 34,005         | \$ 25,964         |
| Notes receivable                     | 52,901            | 48,445            |
| Equipment contracts receivable       | 134,851           | 114,969           |
| Direct financing leases receivable   | 135,085           | 138,911           |
|                                      | <u>356,842</u>    | <u>328,289</u>    |
| Less allowance for doubtful accounts | 1,532             | 1,343             |
|                                      | <u>355,310</u>    | <u>326,946</u>    |
| Less current portion                 | 47,451            | 39,600            |
| Long-term receivables                | <u>\$ 307,859</u> | <u>\$ 287,346</u> |

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| 2001              | 2000              |
|-------------------|-------------------|
| <u>          </u> | <u>          </u> |
| <u>          </u> | <u>          </u> |

Notes receivable include franchise fee notes due in five to eight years in the amount of \$50,158,000 and \$45,230,000 at December 31, 2001 and 2000, respectively. Franchise fee notes are due in equal

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weekly installments, primarily bear interest at 12.0%, and are collateralized by the franchise. The term of an equipment contract coincides with the term of the corresponding restaurant building lease. Equipment contracts are due in equal weekly installments, primarily bear interest at 11.0%, and are collateralized by the equipment. Where applicable, franchise fee notes, equipment contracts and building leases contain cross-default provisions wherein a default under one constitutes a default under all. There is not a disproportionate concentration of credit risk in any geographic area.

**3. Property and Equipment, at Cost**

|  | 2001              | 2000              |
|--|-------------------|-------------------|
|  | <u>          </u> | <u>          </u> |
|  | <u>          </u> | <u>          </u> |
|  | (In thousands)    |                   |
| Land   | \$ 25,283         | \$ 18,424         |
| Buildings and improvements                     | 42,760            | 32,610            |
| Leaseholds and improvements                    | 159,536           | 137,604           |
| Equipment and fixtures                         | 14,668            | 15,034            |
| Construction in progress                       | 14,693            | 12,372            |
| Properties under capital lease                 | 37,516            | 31,609            |
|  | <u>          </u> | <u>          </u> |
|  | 294,456           | 247,653           |
| Less accumulated depreciation and amortization | 56,430            | 54,029            |
|  | <u>          </u> | <u>          </u> |
| Property and equipment, net                    | \$ 238,026        | \$ 193,624        |
|  | <u>          </u> | <u>          </u> |

Accumulated depreciation and amortization includes accumulated amortization for properties under capital lease in the amount of \$5,982,000 and \$4,502,000 at December 31, 2001 and 2000, respectively.

**4. Reacquired Franchises and Equipment Held for Sale**

Reacquired franchises and equipment held for sale are accounted for on the specific identification basis. At the date of reacquisition, the franchise and equipment are recorded at the lower of (1) the sum of the franchise receivables and costs of reacquisition, or (2) the estimated net realizable value. Pending the sale of such franchise, the carrying value is amortized ratably over the remaining life of the asset or lease and the estimated net realizable value is reassessed each year.

|                      | 2001              | 2000              |
|----------------------|-------------------|-------------------|
|                      | <u>          </u> | <u>          </u> |
|                      | (In thousands)    |                   |
| Franchises           | \$ 12,960         | \$ 11,780         |
| Equipment            | 15,485            | 14,505            |
|                      | <u>          </u> | <u>          </u> |
|                      | 28,445            | 26,285            |
| Less amortization    | 6,884             | 5,140             |
|                      | <u>          </u> | <u>          </u> |
|                      | 21,561            | 21,145            |
| Less current portion | 3,234             | 3,172             |

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|  | 2001              | 2000              |
|--|-------------------|-------------------|
|  | <u>          </u> | <u>          </u> |
|  | <u>          </u> | <u>          </u> |
| Long-term reacquired franchises and equipment held for sale, net | \$ 18,327         | \$ 17,973         |

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**5. Debt**

Debt consists of the following:

|  | 2001              | 2000              |
|--|-------------------|-------------------|
|  | <u>          </u> | <u>          </u> |
|  | <u>          </u> | <u>          </u> |
|  | (In thousands)    |                   |
| Senior notes due November 2008, payable in equal annual installments commencing November 2000, fixed interest at 7.42% | \$ 27,222         | \$ 31,111         |
| Senior notes due November 2002, payable in equal annual installments commencing November 1996, fixed interest at 7.79% | 4,571             | 9,142             |
| Leasehold mortgage term loan   | 11,609            |                   |
| Revolving line of credit   | 15,000            | 4,000             |
| Other  | 1,518             | 1,049             |
|  | <u>          </u> | <u>          </u> |
| Total debt   | 59,920            | 45,302            |
| Less current maturities  | 9,711             | 8,939             |
|  | <u>          </u> | <u>          </u> |
| Long-term debt   | \$ 50,209         | \$ 36,363         |

The senior notes due November 2002 and 2008 are noncollateralized.

The leasehold mortgage term loan due May 2013 is collateralized by certain IHOP restaurants. Borrowings under this loan agreement bear interest at the London interbank offered rate ("LIBOR") plus the applicable margin. The applicable margin will be a function of the funded debt to EBITDA ratio as defined under the loan agreement.

IHOP has a noncollateralized revolving credit agreement with a bank in the amount of \$25,000,000 with a maturity date of May 31, 2004. Borrowings under the agreement bear interest at the bank's reference rate (prime) or, at our option, at the bank's quoted rate or at a Eurodollar rate. A commitment fee of 0.375% per annum is payable on unborrowed funds available under the agreement. There was \$15 million and \$4 million outstanding under this agreement at December 31, 2001 and 2000, respectively. The largest amount outstanding under the agreement during 2001 was \$19,600,000.

The senior note agreements, the leasehold mortgage term loan and the bank revolving credit agreement contain certain restrictions and conditions, the most restrictive of which limit dividends and investments. At December 31, 2001, approximately \$105 million of retained earnings were free of restriction as to distribution as dividends.

The prime rate was 4.75% at December 31, 2001 and 9.50% at December 31, 2000.

IHOP's long-term debt maturities are as follows: 2002 \$9,711,000; 2003 \$4,977,000; 2004 \$19,972,000; 2005 \$4,800,000; 2006 \$4,744,000 and thereafter \$15,716,000.

**6. Leases**

The Company leases the majority of its restaurants with the exception of those where a franchisee enters into a lease directly with a landlord and those associated with area license agreements. The restaurants are subleased to franchisees or operated by IHOP. These noncancelable leases and subleases consist primarily of land and buildings and improvements.

Net investment in direct financing leases receivable is as follows:

|  | <u>2001</u>    | <u>2000</u>    |
|--|----------------|----------------|
|  | (In thousands) |                |
| Total minimum rents receivable                       | \$ 395,492     | \$ 426,375     |
| Less unearned income                                 | 260,407        | 287,464        |
|  | <u>135,085</u> | <u>138,911</u> |
| Net investment in direct financing leases receivable | 135,085        | 138,911        |
| Less current portion                                 | 985            | 874            |
|  | <u>134,100</u> | <u>138,037</u> |
| Long-term direct financing leases receivable         | \$ 134,100     | \$ 138,037     |

Contingent rental income for the years ended December 31, 2001, 2000 and 1999 was \$21,899,000, \$21,238,000, and \$19,828,000 respectively.

Minimum future lease payments on noncancelable leases at December 31, 2001, are as follows:

|                                     | <u>Capital<br/>Leases</u> | <u>Operating<br/>Leases</u> |
|-------------------------------------|---------------------------|-----------------------------|
|                                     | (In thousands)            |                             |
| 2002                                | \$ 20,621                 | \$ 44,597                   |
| 2003                                | 20,880                    | 43,798                      |
| 2004                                | 21,173                    | 43,028                      |
| 2005                                | 21,522                    | 42,567                      |
| 2006                                | 21,551                    | 42,046                      |
| Thereafter                          | 307,587                   | 656,722                     |
|                                     | <u>413,334</u>            | <u>\$ 872,758</u>           |
| Total minimum lease payments        | 413,334                   | \$ 872,758                  |
| Less interest                       | 243,065                   |                             |
|                                     | <u>170,269</u>            |                             |
| Capital lease obligations           | 170,269                   |                             |
| Less current portion                | 2,164                     |                             |
|                                     | <u>168,105</u>            |                             |
| Long-term capital lease obligations | \$ 168,105                |                             |

The minimum future lease payments shown above have not been reduced by the future minimum rents to be received on noncancelable subleases and leases of owned property at December 31, 2001, as follows:

|  | <u>Direct<br/>Financing<br/>Leases</u> | <u>Operating Leases</u> |
|--|--|-------------------------|
|--|--|-------------------------|

|                                       | <b>Direct<br/>Financing<br/>Leases</b> | <b>Operating Leases</b> |
|---------------------------------------|--|-------------------------|
| (In thousands)                        |  |                         |
| 2002                                  | \$ 18,441                              | \$ 55,857               |
| 2003                                  | 18,820                                 | 55,808                  |
| 2004                                  | 19,027                                 | 56,164                  |
| 2005                                  | 19,254                                 | 56,823                  |
| 2006                                  | 19,331                                 | 57,413                  |
| Thereafter                            | 300,619                                | 1,072,811               |
| <b>Total minimum rents receivable</b> | <b>\$ 395,492</b>                      | <b>\$ 1,354,876</b>     |

IHOP has noncancelable leases, expiring at various dates through 2031, that require payment of contingent rents based upon a percentage of sales of the related restaurant as well as property taxes, insurance and other charges. Subleases to franchisees of properties under such leases are generally for the full term of our lease obligation at rents that include our obligations for property taxes, insurance, contingent rents and other charges. Generally, the noncancelable leases include renewal options. Contingent rent expense for all noncancelable leases for the years ended December 31, 2001, 2000 and 1999 was \$2,902,000, \$3,317,000 and \$3,416,000, respectively. Minimum rent expense for all noncancelable operating leases for the years ended December 31, 2001, 2000 and 1999 was \$40,312,000, \$30,084,000 and \$25,130,000, respectively.

## 7. Stockholders' Equity

The Stock Incentive Plan (the "Plan") was adopted in 1991 and amended and restated in 1998 to authorize the issuance of up to 3,760,000 shares of common stock pursuant to options, restricted stock, and other long-term stock-based incentives to officers and key employees of IHOP. The 2001 Stock Incentive Plan was adopted in 2001 to authorize the issuance of up to 1,200,000 shares of common stock. Except for substitute stock options which were issued in 1991 pursuant to the cancellation of a stock appreciation rights plan, no option can be granted at an option price of less than the fair market value at the date of grant as defined by the plan. Exercisability of options is determined at, or after, the date of grant by the administrator of the Plan. Substitute stock options issued in 1991 were immediately exercisable. All other options granted under the Plan through December 31, 2001, become exercisable  $\frac{1}{3}$  after one year,  $\frac{2}{3}$  after two years and 100% after three years or immediately upon a change in control of IHOP, as defined by the Plan.

The Stock Option Plan for Non-Employee Directors (the "Directors Plan") was adopted in 1994 and amended and restated in 1999 to authorize the issuance of up to 400,000 shares of common stock pursuant to options to non-employee members of IHOP's Board of Directors. Options are to be granted at an option price equal to 100% of the fair market value of the stock on the date of grant. Options granted pursuant to the Directors Plan vest and become exercisable  $\frac{1}{3}$  after one year,  $\frac{2}{3}$  after two years and 100% after three years. Options for the purchase of shares are granted to each non-employee Director under the Directors Plan as follows: (1) 15,000 on February 23, 1995, or on the

Director's election to the Board of Directors if he or she was not a Director on such date, and (2) 5,000 annually in conjunction with IHOP's Annual Meeting of Stockholders for that year.

In 2000, IHOP initiated a plan to repurchase up to 1,000,000 shares of its common stock. This plan will reduce the dilutive effect of employee stock option exercises and contributions to IHOP's Employee Stock Ownership Plan; however, the repurchase program does not obligate IHOP to acquire any specific number of shares and it may be suspended at any time. As of December 31, 2001, 389,168 shares were repurchased by IHOP under this plan, of which 182,086 shares were contributed to the Employee Stock Ownership Plan.

Information regarding activity for stock options outstanding under IHOP's stock option plans is as follows:

| <b>Shares Under Option</b>       | <b>Shares</b> | <b>Weighted Average<br/>Exercise Price</b> |
|----------------------------------|---------------|--|
| Outstanding at December 31, 1998 | 1,879,156     | \$ 13.35                                   |
| Granted                          | 307,000       | 20.69                                      |

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| Shares Under Option              | Shares    | Weighted Average<br>Exercise Price |
|----------------------------------|-----------|------------------------------------|
| Exercised                        | (287,486) | 12.71                              |
| Terminated                       | (37,331)  | 18.34                              |
| <hr/>                            |           |                                    |
| Outstanding at December 31, 1999 | 1,861,339 | 14.56                              |
| Granted                          | 261,000   | 15.10                              |
| Exercised                        | (181,777) | 14.18                              |
| Terminated                       | (33,999)  | 18.80                              |
| <hr/>                            |           |                                    |
| Outstanding at December 31, 2000 | 1,906,563 | 14.59                              |
| Granted                          | 323,000   | 23.64                              |
| Exercised                        | (619,192) | 11.53                              |
| Terminated                       | (22,001)  | 17.37                              |
| <hr/>                            |           |                                    |
| Outstanding at December 31, 2001 | 1,588,370 | \$ 17.58                           |
| <hr/>                            |           |                                    |
| Exercisable at December 31, 2001 | 1,023,026 | \$ 15.81                           |
| <hr/>                            |           |                                    |

Information regarding options outstanding and exercisable at December 31, 2001 is as follows:

| Range of Exercise Prices | Number<br>Outstanding<br>as of<br>12/31/2001 | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable as<br>of 12/31/2001 | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------|--|---|--|---|--|
| \$ 8.25 - \$13.88        | 452,200                                      | 3.41  | \$ 13.59                                 | 452,200                                   | \$ 13.59                                 |
| \$13.94 - \$17.81        | 523,165                                      | 6.13  | \$ 15.52                                 | 361,169                                   | \$ 15.70                                 |
| \$19.22 - \$21.06        | 398,005                                      | 7.87  | \$ 20.29                                 | 176,319                                   | \$ 20.41                                 |
| \$21.69 - \$27.33        | 215,000                                      | 9.29  | \$ 25.99                                 | 33,338                                    | \$ 22.67                                 |
| <hr/>                    |  |   |  |   |  |
| \$ 8.25 - \$27.33        | 1,588,370                                    | 6.22  | \$ 17.58                                 | 1,023,026                                 | \$ 15.81                                 |
| <hr/>                    |  |   |  |   |  |

IHOP has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." We will continue to use the intrinsic value based method of accounting prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation cost

has been recognized for the stock option plans. Had compensation cost for IHOP's stock option plans been determined based on the fair value at the grant date for awards in the three year period ended December 31, 2001, consistent with the provisions of SFAS No. 123, IHOP's net income and diluted net income per share would have been reduced to the pro forma amounts indicated below:

|  | 2001  | 2000      | 1999      |
|--|---|-----------|-----------|
|  | (In thousands, except<br>per share amounts) |           |           |
| Net income, as reported                        | \$ 40,288                                   | \$ 35,338 | \$ 32,125 |
| Net income, pro forma                          | 39,328                                      | 34,342    | 31,029    |
| Net income per share diluted, as reported      | 1.94  | 1.74      | 1.58      |
| Net income per share diluted, pro forma        | 1.89  | 1.69      | 1.52      |
| Weighted average fair value of options granted | 24.18                                       | 15.22     | 21.42     |

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The fair value of each option grant issued in the three year period ended December 31, 2001, is estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                                | 2001    | 2000    | 1999    |
|--------------------------------|---------|---------|---------|
| Risk free interest rate        | 5.75%   | 5.875%  | 5.25%   |
| Expected volatility            | 37.0%   | 37.0%   | 37.0%   |
| Dividend yield                 |         |         |         |
| Weighted average expected life | 5 years | 3 years | 3 years |

### 8. Income Taxes

The provision for income taxes is as follows:

|                             | 2001           | 2000      | 1999      |
|-----------------------------|----------------|-----------|-----------|
|                             | (In thousands) |           |           |
| Provision for income taxes: |                |           |           |
| Current                     |                |           |           |
| Federal                     | \$ 13,008      | \$ 13,160 | \$ 12,051 |
| State and foreign           | 1,494          | 2,021     | 1,766     |
|                             | 14,502         | 15,181    | 13,817    |
| Deferred                    |                |           |           |
| Federal                     | 8,224          | 5,623     | 5,455     |
| State                       | 1,447          | 1,318     | 839       |
|                             | 9,671          | 6,941     | 6,294     |
| Provision for income taxes  | \$ 24,173      | \$ 22,122 | \$ 20,111 |

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The provision for income taxes differs from the expected federal income tax rates as follows:

|   | 2001  | 2000  | 1999  |
|---|-------|-------|-------|
| Statutory federal income tax rate                 | 35.0% | 35.0% | 35.0% |
| State and other taxes, net of federal tax benefit | 2.5   | 3.5   | 3.5   |
| Effective tax rate                                | 37.5% | 38.5% | 38.5% |

Deferred tax liabilities (assets) consist of the following:

|   | 2001           | 2000      |
|---|----------------|-----------|
|   | (In thousands) |           |
| Franchise and equipment sales, including differences in capitalization and revenue recognition    | \$ 72,615      | \$ 62,328 |
| Property and equipment, including differences in capitalization and depreciation and amortization | 10,129         | 10,828    |



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|   | 2001             | 2000             |
|---|------------------|------------------|
| Reacquired franchises and equipment held for resale, including differences in capitalization and depreciation and amortization                    | (9,298)          | (10,050)         |
| Direct financing leases and capital lease obligations, including differences in capitalization and application of cash receipts and disbursements | (13,922)         | (12,093)         |
| Federal tax benefit of net deferred state tax liability   | (2,497)          | (2,551)          |
| Other net liabilities   | 3,186            | 2,080            |
| <b>Deferred tax liabilities, net</b>  | <b>\$ 60,213</b> | <b>\$ 50,542</b> |

**9. Employee Benefit Plans**

In 1987, IHOP adopted a noncontributory Employee Stock Ownership Plan ("ESOP"). The ESOP is a stock bonus plan under Section 401(a) of the Internal Revenue Code. The plan covers IHOP employees who meet the minimum credited service requirements of the plan. Employees whose terms of service are covered by a collective bargaining agreement are not eligible for the ESOP unless the terms of such agreement specifically provide for participation in the ESOP.

The cost of the ESOP is borne by IHOP through contributions determined by the Board of Directors in accordance with the ESOP provisions and Internal Revenue Service regulations. The contributions to the plan for the years ended December 31, 2001, 2000 and 1999 were \$1,850,000, \$1,675,000 and \$1,500,000, respectively. The contribution for the year ended December 31, 2001, will be made in shares of IHOP Corp. common stock.

Shares of stock acquired by the ESOP are allocated to each eligible employee and held by the ESOP. Upon the employee's termination after vesting, or in certain other limited circumstances, the employee's shares are distributed to the employee according to his or her direction.

In 2001, IHOP adopted a defined contribution plan authorized under Section 401(k) of the Internal Revenue Code. The plan covers IHOP employees who meet the minimum credited service requirements of the plan. Employees whose terms of service are covered by a collective bargaining

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agreement are not eligible. Employees may contribute up to 15 percent of their pre-tax covered compensation subject to limitations of the tax codes. IHOP Corp. Common Stock is currently not an investment option for employees in the Plan. The administrative cost of the 401(k) plan is borne by IHOP. The Company does not contribute towards the plan.

**10. Commitments and Contingencies**

IHOP is subject to various claims and legal actions that have arisen in the ordinary course of business. We believe such claims and legal actions, individually or in the aggregate, will not have a material adverse effect on the business or financial condition of our company.

**11. Derivative and Financial Instruments**

On January 1, 2001, IHOP adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), which established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in the other contracts. During 2001, IHOP purchased 25% of estimated requirements through December 2002 of natural gas contracts to limit exposure to market increases in natural gas prices for IHOP-operated restaurants. The derivative instruments do not qualify under SFAS No. 133 as either a fair value or cash flow hedge. They are valued at fair value with the resultant gain or loss recognized in current earnings. The adoption of SFAS No. 133 had no material impact on either IHOP's results of operations, financial position or cash flows.

IHOP does not hold or issue financial instruments for trading purposes. The estimated fair values of all cash and cash equivalents, notes receivable and equipment contracts receivable as of December 31, 2001 and 2000, approximated their carrying amounts in the Consolidated Balance Sheets as of those dates. The estimated fair values of notes receivable and equipment contracts receivable are based on current interest rates offered for similar loans in our present lending activities.

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The estimated fair values of long-term debt are based on current rates available to IHOP for similar debt of the same remaining maturities. The carrying values of long-term debt at December 31, 2001 and 2000 were \$50,209,000 and \$36,363,000, respectively, and the fair values at those dates were \$52,957,000 and \$34,268,000, respectively.

### 12. Segment Reporting

IHOP identifies its operating segments based on the organizational units used by management to monitor performance and make operating decisions. The Franchise Operations segment includes restaurants operated by franchisees and area licensees in the United States, Canada and Japan. The Company Operations segment includes company-operated restaurants in the United States. We measure segment profit as operating income, which is defined as income before field, corporate and

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administrative expense, interest expense, and income taxes. Information on segments and a reconciliation to income before income taxes are as follows:

|  | Franchise<br>Operations | Company<br>Operations | Sales of<br>Franchises and<br>Equipment | Consolidating<br>And Other<br>Adjustments | Consolidated<br>Total |
|--|-------------------------|-----------------------|---|---|-----------------------|
| (In thousands)                                 |                         |                       |   |   |                       |
| <b>Year Ended December 31, 2001</b>            |                         |                       |   |   |                       |
| Revenues from external customers               | \$ 204,970              | \$ 68,810             | \$ 46,996                               | \$ 3,660                                  | \$ 324,436            |
| Intercompany real estate charges<br>(revenues) | 6,083                   | 901                   |   | (6,984)                                   |                       |
| Depreciation & amortization                    | 5,703                   | 4,157                 |   | 4,958                                     | 14,818                |
| Operating income (loss)                        | 91,555                  | (4,447)               | 15,910                                  | 23,171                                    | 126,189               |
| Field, corporate and administrative            |                         |                       |   |   | 40,621                |
| Interest expense                               |                         |                       |   |   | 21,107                |
| Income before income taxes                     |                         |                       |   |   | 64,461                |
| Additions to long lived assets                 | 62,382                  | 8,188                 | 2,320                                   | 49,227                                    | 122,117               |
| Total assets                                   | 484,438                 | 52,143                | 21,561                                  | 83,287                                    | 641,429               |
| <b>Year Ended December 31, 2000</b>            |                         |                       |   |   |                       |
| Revenues from external customers               | \$ 183,361              | \$ 72,818             | \$ 47,065                               | \$  | \$ 303,244            |
| Intercompany real estate charges<br>(revenues) | 6,376                   | 726                   |   | (7,102)                                   |                       |
| Depreciation & amortization                    | 4,228                   | 4,221                 |   | 5,113                                     | 13,562                |
| Operating income (loss)                        | 82,953                  | (4,450)               | 16,121                                  | 21,068                                    | 115,692               |
| Field, corporate and administrative            |                         |                       |   |   | 36,481                |
| Interest expense                               |                         |                       |   |   | 21,751                |
| Income before income taxes                     |                         |                       |   |   | 57,460                |
| Additions to long lived assets                 | 54,520                  | 12,626                | 2,570                                   | 32,232                                    | 101,948               |
| Total assets                                   | 423,877                 | 49,437                | 21,145                                  | 67,753                                    | 562,212               |
| <b>Year Ended December 31, 1999</b>            |                         |                       |   |   |                       |
| Revenues from external customers               | \$ 163,449              | \$ 70,204             | \$ 39,545                               | \$ 37                                     | \$ 273,235            |
| Intercompany real estate charges<br>(revenues) | 5,768                   | 578                   |   | (6,346)                                   |                       |
| Depreciation & amortization                    | 3,681                   | 3,973                 |   | 4,656                                     | 12,310                |
| Operating income (loss)                        | 75,067                  | (2,379)               | 15,587                                  | 17,883                                    | 106,158               |
| Field, corporate and administrative            |                         |                       |   |   | 34,531                |
| Interest expense                               |                         |                       |   |   | 19,391                |
| Income before income taxes                     |                         |                       |   |   | 52,236                |
| Additions to long lived assets                 | 41,350                  | 5,568                 | 1,567                                   | 25,372                                    | 73,857                |
| Total assets                                   | 380,680                 | 47,848                | 18,944                                  | 72,930                                    | 520,402               |

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Franchise Operations, Company Operations and Sales of Franchises and Equipment are reported on the same basis as used by IHOP's management. Franchise Operations revenues from external customers includes interest income from the financing of sales of franchises and equipment in the amounts of \$18,165,000, \$15,573,000 and \$13,465,000 for the years ended December 31, 2001, 2000 and

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1999 respectively. For management reporting purposes, we treat all restaurant lease revenues and expenses as operating lease revenues and expenses, although most of these leases are direct financing leases (revenues) or capital leases (expenses). The accounting adjustments required to bring lease revenues and expenses into conformance with GAAP are included in the Consolidated Adjustments and Other segment. These adjustments include interest income from direct financing leases of restaurant buildings in the amounts of \$18,257,000, \$18,779,000 and \$15,918,000 for the three years ended December 31, 2001, 2000 and 1999 respectively. All of IHOP's owned land and restaurant buildings are included in the total assets of the Consolidating and Other Adjustments segment and are leased to the Franchise Operations and Company Operations segments.

### 13. Selected Quarterly Financial Data (Unaudited)

|  | Revenues  | Operating<br>Income | Net Income | Net Income<br>Per Share<br>Basic(a) | Net Income<br>Per Share<br>Diluted(a) |
|--|-----------|---------------------|------------|-------------------------------------|---------------------------------------|
| (In thousands, except per share amounts) |           |                     |            |                                     |                                       |
| <b>2001</b>                              |           |                     |            |                                     |                                       |
| 1st Quarter                              | \$ 70,106 | \$ 27,043           | \$ 7,474   | \$ .37                              | \$ .37                                |
| 2nd Quarter                              | 82,825    | 32,251              | 10,168     | .50                                 | .49                                   |
| 3rd Quarter                              | 81,096    | 32,421              | 11,076     | .54                                 | .53                                   |
| 4th Quarter                              | 90,409    | 34,474              | 11,570     | .56                                 | .55                                   |
| <b>2000</b>                              |           |                     |            |                                     |                                       |
| 1st Quarter                              | \$ 68,406 | \$ 25,618           | \$ 7,229   | \$ .36                              | \$ .36                                |
| 2nd Quarter                              | 70,304    | 28,253              | 8,294      | .41                                 | .41                                   |
| 3rd Quarter                              | 78,667    | 30,609              | 10,079     | .50                                 | .50                                   |
| 4th Quarter                              | 85,867    | 31,212              | 9,736      | .49                                 | .48                                   |

(a) The quarterly amounts may not add to the full year amount due to rounding.

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### Report of Independent Accountants

The Stockholders and Board of Directors  
IHOP Corp.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of IHOP Corp. and its subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of IHOP Corp.'s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable

basis for our opinion.

PricewaterhouseCoopers LLP

Los Angeles, California

February 15, 2002

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**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant.**

Information appearing under the captions "Information Concerning Nominees and Members of the Board of Directors," "Executive Officers of the Company" and "Compliance with Section 16(a) of the Securities Exchange Act" contained in the 2002 Proxy Statement is incorporated herein by reference.

**Item 11. Executive Compensation.**

Information appearing under the captions "Executive Compensation Summary of Compensation," "Executive Compensation Stock Options and Stock Appreciation Rights" and "Executive Officers of the Company Employment Agreements" contained in the 2002 Proxy Statement is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management.**

Information appearing under the caption "Security Ownership of Certain Beneficial Owners and Management" contained in the 2002 Proxy Statement is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions.**

Information appearing under the caption "Certain Relationships and Related Transactions" contained in the 2002 Proxy Statement is incorporated herein by reference.

**PART IV**

**Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

**(a)(1) Consolidated Financial Statements**

The following documents are contained in Part II, Item 8 of this Annual Report on Form 10-K:

Consolidated Balance Sheets as of December 31, 2001 and 2000.

Consolidated Statements of Operations for each of the three years in the period ended December 31, 2001.

Consolidated Statements of Stockholders' Equity for each of the three years in the period ended December 31, 2001.

Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2001.

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Notes to the Consolidated Financial Statements.

Report of Independent Accountants.

### (a)(2) Financial Statement Schedules

All schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

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### (a)(3) Exhibits

Exhibits not incorporated by reference are filed herewith. The remainder of the exhibits have heretofore been filed with the Securities and Exchange Commission and are incorporated herein by reference. Management contracts or compensatory plans or arrangements are marked with an asterisk.

3.1 Restated Certificate of Incorporation of IHOP Corp. Exhibit 3.1 to IHOP Corp.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1997 (the "1997 Form 10-K"), is hereby incorporated by reference.

3.2 Bylaws of IHOP Corp. Exhibit 3.2 to the 1997 Form 10-K is hereby incorporated by reference.

4.1 Senior Note Purchase Agreement, dated as of November 19, 1992, among IHOP Corp., International House of Pancakes, Inc. ("IHOP, Inc.") and Mutual Life Insurance Company of New York and other purchasers. Exhibit 4.1 to the 1997 Form 10-K is hereby incorporated by reference.

4.2 Senior Note Purchase Agreement, dated as of November 1, 1996, among IHOP, Inc., IHOP Corp. and Jackson National Life Insurance Company and other purchasers. Exhibit 4.8 to IHOP Corp.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1996 (the "1996 Form 10-K"), is hereby incorporated by reference.

4.3 First Amendment to Senior Note Purchase Agreement, dated as of November 1, 1996, among IHOP Corp., IHOP Inc., and Mutual Life Insurance Company of New York and other purchasers. Exhibit 4.2 to IHOP Corp.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1996 (the "1996 Form 10-K"), is hereby incorporated by reference.

4.4 Revolving line of credit note among International House of Pancakes, Inc., a Delaware Corporation and Wells Fargo Bank, N.A. dated as of June 28, 2001 is filed herewith.

4.5 Loan Agreement dated as of April 27, 2001, among IHOP Properties, Inc., International House of Pancakes, Inc., IHOP Corp., and Bank of America, N.A., is filed herewith.

\*10.1 Employment Agreement between IHOP Corp. and Rand Michael Ferris. Exhibit 10.6 to the 1996 Form 10-K is hereby incorporated by reference.

\*10.2 Employment Agreement between IHOP Corp. and Susan Henderson-Hernandez. Exhibit 10.7 to the 1996 Form 10-K is hereby incorporated by reference.

\*10.3 Employment Agreement between IHOP Corp. and Richard K. Herzer. Exhibit 10.8 to the 1996 Form 10-K is hereby incorporated by reference.

\*10.4 Employment Agreement between IHOP Corp. and Anna G. Ulvan. Exhibit 10.12 to the 1996 Form 10-K is hereby incorporated by reference.

\*10.5 Employment Agreement between IHOP Corp. and Mark D. Weisberger. Exhibit 10.13 to the 1996 Form 10-K is hereby incorporated by reference.

- \*10.6 Employment Agreement between IHOP Corp. and Richard C. Celio. Exhibit 10 to IHOP Corp.'s Form 10-Q for the quarterly period ended March 31, 1997, is hereby incorporated by reference.
- \*10.7 Employment Agreement between IHOP Corp. and John Jordan. Exhibit 10.13 to the 1997 Form 10-K is hereby incorporated by reference.

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- \*10.8 Employment Agreement between IHOP Corp. and Alan S. Unger. Exhibit 10.21 to IHOP Corp.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1999, is hereby incorporated by reference.
- \*10.9 Employment Agreement between IHOP Corp. and Robin S. Elledge. Exhibit 10.1 to IHOP Corp.'s Form 10-Q for the quarterly period ended June 30, 2000, is hereby incorporated by reference.
- \*10.10 Employment Agreement between IHOP Corp. and Julia A. Stewart is filed herewith.
- \*10.11 Area Franchise Agreement, effective as of May 5, 1988, by and between IHOP, Inc. and FMS Management Systems, Inc. Exhibit 10.14 to the 1997 Form 10-K is hereby incorporated by reference.
- \*10.12 International House of Pancakes Employee Stock Ownership Plan as Amended and Restated as of January 1, 2001 ("the ESOP") is filed herewith.
- \*10.13 IHOP Corp. 1994 Stock Option Plan for Non-Employee Directors as Amended and Restated February 23, 1999. Annex "A" to the IHOP Corp. Proxy Statement for Annual Meeting of Stockholders held on Tuesday, May 11, 1999, is hereby incorporated by reference.
- \*10.14 IHOP Corp. 2001 Stock Incentive Plan (the "2001 Plan") as Amended and Restated on March 1, 2001. Appendix "B" to the IHOP Corp. Proxy Statement for the Annual Meeting of Stockholders held on May 15, 2001, is hereby incorporated by reference.
- \*10.15 International House of Pancakes 401(k) Plan is filed herewith.
- \*10.16 IHOP Corp. Executive Incentive Plan effective January 1, 2001 and supersedes all previously implemented plans is filed herewith.

11.0 Statement Regarding Computation of Per Share Earnings.

21.0 Subsidiaries of IHOP Corp. Exhibit 21.0 to the 1997 Form 10-K is hereby incorporated by reference.

23.0 Consent of PricewaterhouseCoopers LLP.

(b)

**Reports on Form 8-K:**

On October 30, 2001, IHOP Corp. filed a current report on Form 8-K, dated October 30, 2001, disclosing a press release announcing its results for the quarter ended September 30, 2001.

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**SIGNATURES**



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| Name                | Title    |
|---------------------|----------|
| /s/ PATRICK W. ROSE | Director |
| Patrick W. Rose     |          |

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PART II

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PART IV

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