SONIC CORP
Form 10-Q/A
July 31, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

T **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended May 31, 2001

OR

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

For the transition period from _______________ to _________________
Commission File Number 0-18859

SONIC CORP.

(Exact name of registrant as specified in its charter)

Delaware	**73-1371046**
(State of Incorporation)	(I.R.S. Employer Identification No.)

101 Park Avenue **Oklahoma City, Oklahoma**	**73102**
(Address of Principal Executive Offices)	Zip Code

Registrant s telephone number, including area code: (405) 280-7654

Indicate by check mark whether the Registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for the shorter period that the Registrant has had to file the reports), and (2) has been subject to the filing requirement for the past 90 days.
Yes T. No £.

As of May 31, 2001, the Registrant had 26,735,461 shares of common stock issued and outstanding (excluding 4,969,345 shares of common stock held as treasury stock).

SONIC CORP.

NOTE: The Registrant hereby amends and restates Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations contained in its Quarterly Report on Form 10-Q for the period ended May 31, 2001 to correct certain amounts reported for system-wide sales and the related percentage increase in the table Percentage Results of Operations. No other changes have been made to the Company s Quarterly Report on Form 10-Q for the period ended May 31, 2001.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Form 10-Q contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements represent the Company's expectations or belief concerning future events, including the following: any statements regarding future sales or expenses, any statements regarding the continuation of historical trends, and any statements regarding the sufficiency of the Company's working capital and cash generated from operating and financing activities for the Company's future liquidity and capital resources needs. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," and similar expressions are intended to identify forward-looking statements. The Company cautions that those statements are further qualified by important economic and competitive factors that could cause actual results to differ materially from those in the forward-looking statements, including, without limitation, risks of the restaurant industry, including a highly competitive industry and the impact of changes in consumer spending patterns, consumer tastes, local, regional and national economic conditions, weather, demographic trends, traffic patterns, employee availability and cost increases. In addition, the opening and success of new restaurants will depend on various factors, including the availability of suitable sites for new restaurants, the negotiation of acceptable lease or purchase terms for new locations, permitting and regulatory compliance, the ability of the Company to manage the anticipated expansion and hire and train personnel, the financial viability of the Company's franchisees, particularly multi-unit operators, and general economic and business conditions. Accordingly, such forward-looking statements do not purport to be predictions of future events or circumstances and may not be realized.

Results of Operations

The Company derives its revenues primarily from Company-owned restaurant sales and royalty fees from franchisees. The Company also receives revenues from initial franchise fees, area development fees, and the selling and leasing of signs and real estate. Costs of Company-owned restaurant sales and minority interest in earnings of restaurants relate directly to Company-owned restaurant sales. Other expenses, such as depreciation, amortization, and general and administrative expenses, relate to both Company-owned restaurant operations, as well as the Company s franchising operations. The Company s revenues and expenses are directly affected by the number and sales volumes of Company-owned restaurants. The Company s revenues and, to a lesser extent, expenses also are affected by the number and sales volumes of franchised restaurants. Initial franchise fees and franchise royalties are directly affected by the number of franchised restaurant openings.

The following table sets forth the percentage relationship to total revenues, unless otherwise indicated, of certain items included in the Company s statements of income. The table also sets forth certain restaurant data for the periods indicated.

PERCENTAGE RESULTS OF OPERATIONS

	Three months ended		Nine months ended	
	May 31, 2001	**May 31, 2000**	**May 31, 2001**	**May 31, 2000**
INCOME STATEMENT DATA:				
Revenues:				
Company-owned restaurant sales	**82.2%**	81.3%	**80.3%**	80.7%
Franchised restaurants:				
Franchise royalties	**15.3**	16.4	**16.9**	16.8

Franchise fees	**1.1**	1.0	**1.3**	1.2
Other	**1.4**	1.3	**1.5**	1.3
	100.0%	100.0%	**100.0%**	100.0%
Costs and expenses:				
Company-owned restaurants (1):				
Food and packaging	**25.6%**	26.1%	**26.2%**	26.2%
Payroll and other employee benefits	**27.6**	27.2	**28.5**	28.0
Other operating expenses	**17.1**	17.7	**19.0**	19.0
	70.3%	71.0%	**73.7%**	73.2%
Selling, general and administrative	**8.8**	9.5	**9.7**	10.2
Depreciation and amortization	**6.8**	6.9	**7.6**	7.6
Minority interest in earnings of restaurants (1)	**5.6**	5.3	**4.3**	4.3
Provision for impairment of long-lived assets	**0.4**		**0.2**	0.3
Income from operations	**21.6**	21.5	**19.8**	19.4
Net interest expense	**1.7**	2.0	**1.8**	1.9
Net income	**12.5%**	12.3%	**11.3%**	11.0%
RESTAURANT OPERATING DATA:				
RESTAURANT COUNT (2):				
Company-owned restaurants:				
Core-markets	**295**	228	**295**	228
Developing markets	**85**	78	**85**	78
All markets	**380**	306	**380**	306
Franchise restaurants	**1,913**	1,807	**1,913**	1,807
System-wide restaurants	**2,293**	2,113	**2,293**	2,113
SALES DATA ($ in thousands):				
System-wide sales	**$ 543,264**	$ 477,632	**$ 1,389,365**	$ 1,269,248
Percentage increase (3)	**13.7%**	11.1%	**9.5%**	12.8%
Average sales per restaurant:				
Company-owned	**$ 209**	$ 199	**$ 544**	$ 538
Franchise	**247**	234	**642**	633
System-wide	**240**	229	**624**	617
Change in comparable restaurant sales (4):				
Company-owned restaurants:				
Core markets	**5.9%**	1.0%	**1.1%**	2.6%
Developing markets	**1.0**	(0.3)	**(2.0)**	(0.7)
All markets	**4.9**	0.7	**0.5**	1.9
Franchise	**4.7**	2.3	**0.7**	3.4
System-wide	**4.8**	2.0	**0.7**	3.2

(1) As a percentage of Company-owned restaurant sales.

(2) Number of restaurants open at end of period.
(3) Represents percentage increase from the comparable period in the prior year.
(4) Represents percentage increase (decrease) for restaurants open in both the current and prior year.

Comparison of the Third Fiscal Quarter of 2001 to the Third Fiscal Quarter of 2000.

Total revenues increased 23.3% to $91.6 million in the third fiscal quarter of 2001 from $74.3 million in the third fiscal quarter of 2000. Company-owned restaurant sales increased 24.6% to $75.3 million in the third fiscal quarter of 2001 from $60.4 million in the third fiscal quarter of 2000. Of the $14.9 million increase in Company-owned restaurant sales, $12.3 million was due to the net addition of 84 Company-owned restaurants since the beginning of fiscal year 2000, including 35 stores in the Tulsa, Oklahoma market acquired as of April 1, 2001. Average sales increases of approximately 4.9% by stores open the full reporting periods of fiscal year 2001 and 2000 accounted for $2.6 million of the increase. The Company s targeted rate of increase for same-store sales is 2% to 4% for the balance of the fiscal year and for fiscal year 2002. Franchise fees increased 35.6% as 36 franchise drive-ins opened in the third fiscal quarter of 2001 compared to 33 in the same period of fiscal year 2000. While the number of franchised drive-in openings increased modestly, most are now opening under the newest form of license agreement, which requires a higher franchise fee. Franchise royalties increased 15.5% to $14.0 million in the third fiscal quarter of 2001, compared to $12.2 million in the third fiscal quarter of 2000. Of the $1.9 million increase, approximately $1.0 million was attributable to additional franchise restaurants in operation. The balance of the increase resulted from franchise same-store sales growth of 4.7% over the third fiscal quarter of 2000, an increase in the average royalty rate due to the ascending nature of the Company s license agreements as volume increases, and an increasing number of stores operating under the newest license agreement, which requires a higher royalty rate. Other income increased 30.8% to $1.3 million in the third fiscal quarter of 2001 from $1.0 million in the third fiscal quarter of 2000 as a result of a gain on the sale of a non-strategically located Company-owned restaurant to the minority operating partner.

Restaurant cost of operations, as a percentage of Company-owned restaurant sales, was 70.3% in the third fiscal quarter of 2001, compared to 71.0% in the third fiscal quarter of 2000. Food and packaging costs, as a percentage of Company-owned restaurant sales, decreased 50 basis points as a result of a significantly lower rate of discounting from standard menu pricing, a reduction in unit costs in several items, and favorable beef and dairy arrangements which helped shield the Company from sharp increases in these items during March and April. Management expects increases in beef and dairy costs which may result in higher year-over-year food and packaging costs in the future. Payroll and employee benefits, as a percentage of Company-owned restaurant sales, increased 40 basis points as a result of an increase in the average wage rate, higher training costs and double-digit year-over-year increases in health insurance costs. The Company expects continued pressure on labor costs during the fourth quarter of fiscal 2001 and into fiscal 2002. Other operating expenses decreased 60 basis points primarily due to the leverage of higher sales volumes which combined with a lower rate of discounting to more than offset higher utility costs. Minority interest in earnings of restaurants increased, as a percentage of Company-owned restaurant sales, to 5.6% in the third fiscal quarter of 2001, compared to 5.3% in the third fiscal quarter of 2000 as a result of an improvement in store level profitability and the restructuring of partnership arrangements so that store level managers receive a greater proportion of their total compensation from the partnership program.

Selling, general and administrative expenses decreased, as a percentage of total revenues, to 8.8% in the third fiscal quarter of 2001, compared with 9.5% in the third fiscal quarter of 2000. Depreciation and amortization expense increased 20.9% or $1.1 million in the third fiscal quarter of 2001 over the comparable quarter in 2000. The increase in depreciation resulted primarily from new drive-in development and store acquisitions. Management expects depreciation and amortization to grow at a higher rate over the next several quarters primarily as a result of amortization related to the acquisition of franchise stores during the second and third quarters of fiscal year 2001.

During the third fiscal quarter of 2001, one drive-in in a developing market became impaired under the guidelines of FAS 121 Accounting for the Impairment of Long-Lived Assets. As a result, a provision for impairment of long-lived assets of $0.3 million was recorded for the drive-in s carrying cost in excess of the present value of estimated future cash flows.

Income from operations increased 24.1% to $19.8 million in the third fiscal quarter of 2001 from $16.0 million in the third fiscal quarter of 2000 due primarily to the growth in revenues and other matters discussed above.

Net interest expense increased by 5.9% in the third fiscal quarter of 2001 as compared to the third fiscal quarter of 2000. This increase was the result of additional borrowings to fund the Tulsa acquisition as well as other capital expenditures. The Company expects interest expense to continue to increase in future quarters as a result of incremental borrowings made to fund the acquisition of franchise stores during fiscal year 2001.

Provision for income taxes reflects an effective federal and state tax rate of 37.25% for the third fiscal quarter of 2001, consistent with the same period in fiscal year 2000.

Net income increased 25.9% over the comparable period in 2000. Diluted earnings per share increased to $.41 per share in the third fiscal quarter of 2001, compared to $.33 per share in the third fiscal quarter of 2000, for an increase of 24.2%.

Comparison of the First Three Fiscal Quarters of 2001 to the First Three Fiscal Quarters of 2000.

Total revenues increased 13.7% to $225.9 million in the first three fiscal quarters of 2001 from $198.6 million in the first three fiscal quarters of 2000. Company-owned restaurant sales increased 13.3% to $181.5 million in the first three fiscal quarters of 2001 from $160.2 million in the first three fiscal quarters of 2000. Of the $21.3 million increase, $20.8 million was due to the net addition of 84 Company-owned restaurants since the beginning of fiscal year 2000. Average sales increases of approximately 0.5% by stores open the full reporting periods of fiscal year 2001 and 2000 accounted for $0.5 million of the increase. Sales during the months of November and December 2000 were negatively impacted by record or near-record cold and wet weather. Franchise fees increased 20.6% as 101 franchise drive-ins opened in the first three fiscal quarters of 2001 as compared to 95 in the first three fiscal quarters of 2000, in addition to more stores opening under the newest license agreement which requires a higher franchise fee. Franchise royalties increased 14.1% to $38.1 million in the first three fiscal quarters of 2001, compared to $33.4 million in the first three fiscal quarters of 2000. Of the $4.7 million increase, approximately $2.6 million was attributable to additional franchise restaurants in operation. The balance of the increase was primarily attributable to an increase in the average royalty rate due to the ascending nature of all of the Company s license agreements as volume increases, conversion of some of the older license agreements to newer agreements and an increase in the number of stores operating under the newest license agreement, which requires a higher royalty rate.

Restaurant cost of operations, as a percentage of Company-owned restaurant sales, was 73.7% in the first three fiscal quarters of 2001, compared to 73.2% in the first three fiscal quarters of 2000. Food and packaging costs, as a percentage of Company-owned restaurant sales, remained flat at 26.2% in the first three fiscal quarters of 2001, compared to the same period in fiscal 2000. Decreases in unit costs for several items in the Company s wide menu helped offset the year-over-year increases in beef and dairy prices. Payroll and employee benefits, as a percentage of Company-owned restaurant sales, increased 50 basis points as a result of an increase in average wage rates, continued pressure on health care costs, and increased investment in labor reflecting the Company s continuing commitment to provide a superior level of customer service through investment in store-level labor and quality initiatives. Other operating expenses, as a percentage of Company-owned restaurant sales, remained flat at 19.0% as increases in utilities, marketing, and rent expense were offset by the leveraging impact of volume increases. Minority interest in earnings of restaurants remained flat, as a percentage of Company-owned restaurant sales, at 4.3% through the first three fiscal quarters of 2001, compared to the same period in fiscal 2000. Many of the managers and supervisors of Company-owned restaurants own a minority interest in the restaurants, and a substantial portion of their compensation flows through the minority interest in earnings of restaurants.

Selling, general and administrative expenses decreased, as a percentage of total revenues, to 9.7% in the first three fiscal quarters of 2001, compared with 10.2% in the first three fiscal quarters of 2000. Depreciation and amortization expense increased 14.6% or $2.2 million in the first three fiscal quarters of 2001 over the comparable quarters in 2000. The increase in depreciation resulted primarily from new drive-in development and the net acquisition of 48 franchise restaurants during the first three fiscal quarters of 2001. Management expects depreciation and amortization to grow by 18% to 20% in fiscal year 2002, excluding any effect of accounting Statement No. 142, Goodwill and Other Intangible Assets which was recently approved by the Financial Accounting Standards Board. See Note 5 of Notes to Condensed Consolidated Financial Statements for a discussion of the new accounting Statement.

During the first three fiscal quarters of 2001, one drive-in in a developing market became impaired under the guidelines of FAS 121. As a result, a provision for impairment of long-lived assets of $0.3 million was recorded for the drive-in s carrying cost in excess of the present value of estimated future cash flows. One drive-in also became impaired under the guidelines of FAS 121 during the first three fiscal quarters of 2000, resulting in a provision for impairment of $0.5 million. The Company continues to perform quarterly analyses of certain underperforming restaurants. It is reasonably possible that the estimate of future cash flows associated with these restaurants may change in the near future resulting in the need to write-down assets associated with one or more of these restaurants to fair value.

Income from operations increased 15.9% to $44.7 million in the first three fiscal quarters of 2001 from $38.6 million in the first three fiscal quarters of 2000 due primarily to the growth in revenues and other matters discussed above.

Net interest expense in the first three fiscal quarters of 2001 increased $0.2 million over the first three fiscal quarters of 2000. This increase was the result of additional borrowings to fund, in part, acquisitions, capital additions and share repurchases made during fiscal year

2000 and the first nine months of fiscal year 2001. The Company expects interest expense to continue to increase in fiscal year 2002. The amount of the increase will depend on the level of future share repurchases as well as the number of newly-constructed and acquired restaurants.

Provision for income taxes reflects an effective federal and state tax rate of 37.25% for the first three fiscal quarters of 2001, consistent with the same period in fiscal year 2000.

Net income increased 17.0% over the comparable period in 2000. Diluted earnings per share increased to $.92 per share in the first three fiscal quarters of 2001, compared to $.77 per share in the first three fiscal quarters of 2000, for an increase of 19.5%.

Liquidity and Sources of Capital

Net cash provided by operating activities increased by $6.3 million or 18.8% during the first three fiscal quarters of 2001 as compared to the same period in fiscal 2000, primarily as the result of the increase in operating profit before depreciation.

During the first three fiscal quarters of 2001, the Company opened 22 newly-constructed restaurants and acquired a net of 46 existing restaurants from franchisees. The Company funded the total capital additions for the first three fiscal quarters of 2001 of $69.6 million (which included the cost of newly-opened restaurants, restaurants under construction, acquired restaurants, new equipment for existing restaurants, and other general expenditures) from cash generated by operating activities and long-term borrowings. During the nine months ended May 31, 2001, the Company purchased the real estate on 18 of the 70 newly-constructed and acquired restaurants. The Company expects to own the land and building for most of its future newly-constructed restaurants.

In fiscal year 2000, the Company s board of directors expanded the stock repurchase program, increasing the funds authorized for the repurchase of the Company s common stock to $72.8 million. As of May 31, 2001, the Company had approximately $20 million available under the repurchase program.

As of May 31, 2001, the Company s total cash balance of $2.8 million reflected the impact of the cash generated from operating activities, borrowing activity, and expenditures mentioned above. The Company has an agreement with a group of banks which provides the Company with an $80.0 million line of credit expiring in July of 2004. The Company will use the line of credit to finance the opening of newly-constructed restaurants, acquisitions, purchases of the Company s common stock and for other general corporate purposes. As of May 31, 2001, the Company s outstanding borrowings under the line of credit were $57.0 million, as well as $0.2 million in outstanding letters of credit. The available line of credit as of May 31, 2001, was $22.8 million.

The Company plans total capital expenditures of $80.0 million to $90.0 million in fiscal year 2001. These capital expenditures primarily relate to the development of additional Company-owned restaurants, the acquisition of franchised restaurants, stall additions, relocations of older restaurants, store equipment upgrades, and enhancements to existing financial and operating information systems. The Company expects to fund these capital expenditures through borrowings under its existing unsecured revolving credit facility and cash flow from operations. The Company believes that existing cash and funds generated from internal operations, as well as borrowings under the line of credit, will meet the Company s needs for the foreseeable future.

Impact of Inflation

Though increases in labor, food or other operating costs could adversely affect the Company s operations, management does not believe that inflation has had a material effect on income during the past several years.

Seasonality

The Company s results during its second fiscal quarter (the months of December, January and February) generally are lower than other quarters because of the climate of the locations of a number of Company-owned and franchised restaurants.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the Company has caused the undersigned, duly authorized, to sign this amended report on behalf of the Company.

SONIC CORP.

By: /s/ W. Scott McLain

W. Scott McLain, Senior Vice President
and Chief Financial Officer

Date: July 30, 2001