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APPLEBEES INTERNATIONAL INC

Form 10-Q

October 26, 2006

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 24, 2006

OR

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

For the transition period from _____ to _____

Commission File Number: 000-17962

Applebee's International, Inc.

(Exact name of registrant as specified in its charter)

Delaware

43-1461763

(State or other jurisdiction of incorporation or organization)

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

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

(Address of principal executive offices and zip code)

(913) 967-4000

(Registrant's telephone number, including area code)

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

Yes X

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" in Rule 12b-2 of the Exchange Act. (check one):

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Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

The number of shares of the registrant's common stock outstanding as of October 23, 2006 was 74,239,024.

1.

APPLEBEE'S INTERNATIONAL, INC.
FORM 10-Q
FISCAL QUARTER ENDED SEPTEMBER 24, 2006
INDEX

PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements:

Consolidated Balance Sheets as of September 24, 2006 and December 25, 2005
Consolidated Statements of Earnings for the 13 Weeks and 39 Weeks Ended September 24, 2006 and September 25, 2005
Consolidated Statement of Stockholders' Equity for the 39 Weeks Ended September 24, 2006
Consolidated Statements of Cash Flows for the 39 Weeks Ended September 24, 2006 and September 25, 2005
Notes to Condensed Consolidated Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.....

Item 5. Other Information.....

Item 6. Exhibits.....

Signatures

Exhibit Index.....

2.

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

APPLEBEE'S INTERNATIONAL, INC. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 (in thousands, except share amounts)

September 24,
 2006

ASSETS

Current assets:	
Cash and cash equivalents.....	\$ 9,776
Short-term investments, at market value.....	291
Receivables (less allowance of \$325 in 2006 and \$340 in 2005).....	36,958
Receivables related to captive insurance subsidiary.....	463
Inventories.....	10,400
Prepaid income taxes.....	55
Prepaid and other current assets.....	12,086
Assets held for sale.....	7,498

Total current assets.....	77,527
Property and equipment, net.....	620,983
Goodwill.....	139,111
Restricted assets related to captive insurance subsidiary.....	15,011
Other intangible assets, net.....	6,561
Other assets, net.....	34,827

	\$ 894,020
	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Current portion of long-term debt.....	\$ 274
Notes payable.....	10,000
Accounts payable.....	38,016
Accrued expenses and other current liabilities.....	84,426
Loss reserve related to captive insurance subsidiary.....	6,025
Accrued dividends.....	--

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Accrued income taxes.....	4,007
Total current liabilities.....	142,748
Non-current liabilities:	
Long-term debt, less current portion.....	184,006
Deferred income taxes.....	27,757
Other non-current liabilities.....	60,372
Total non-current liabilities.....	272,135
Total liabilities.....	414,883
Commitments and contingencies (Note 3)	
Stockholders' equity:	
Preferred stock- par value \$0.01 per share:authorized - 1,000,000 shares; no shares issued.....	--
Common stock - par value \$0.01 per share:authorized - 125,000,000 shares; issued - 108,503,243 shares.....	1,085
Additional paid-in capital.....	255,029
Unearned compensation.....	--
Retained earnings.....	772,673
	1,028,787
Treasury stock - 34,563,782 shares in 2006 and 34,304,693 shares in 2005 at cost.....	(549,650)
Total stockholders' equity.....	479,137
	\$ 894,020

See notes to condensed consolidated financial statements.

3.

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

	13 Weeks Ended	
	September 24, 2006	September 25, 2005
Operating revenues:		
Company restaurant sales.....	\$ 286,938	\$ 272,673
Franchise royalties and fees.....	33,340	31,589
Other franchise income.....	371	1,064
Total operating revenues.....	320,649	305,326
Cost of company restaurant sales:		
Food and beverage.....	76,616	71,555

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Labor.....	99,105	90,231
Direct and occupancy.....	80,047	74,706
Pre-opening expense.....	1,115	1,089
	-----	-----
Total cost of company restaurant sales.....	256,883	237,581
	-----	-----
Cost of other franchise income.....	694	790
General and administrative expenses.....	35,601	26,329
Amortization of intangible assets.....	154	204
Impairment and other restaurant closure costs.....	1,900	3,900
Loss on disposition of property and equipment.....	685	480
	-----	-----
Operating earnings.....	24,732	36,042
	-----	-----
Other income (expense):		
Investment income.....	885	568
Interest expense.....	(2,970)	(1,232)
Other income.....	301	593
	-----	-----
Total other income (expense).....	(1,784)	(71)
	-----	-----
Earnings before income taxes.....	22,948	35,971
Income taxes.....	8,107	13,836
	-----	-----
Net earnings.....	\$ 14,841	\$ 22,135
	=====	=====
Basic net earnings per common share.....	\$ 0.20	\$ 0.28
	=====	=====
Diluted net earnings per common share.....	\$ 0.20	\$ 0.28
	=====	=====
Basic weighted average shares outstanding.....	73,902	78,485
	=====	=====
Diluted weighted average shares outstanding.....	74,673	79,691
	=====	=====

See notes to condensed consolidated financial statements.

4.

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

	Common Stock		Additional	Unearned	R
	Shares	Amount	Paid-In	Compensation	E
	-----	-----	-----	-----	-----
Balance, December 25, 2005	108,503	\$ 1,085	\$234,988	\$ (2,614)	\$
Net earnings.....	--	--	--	--	

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Purchases of treasury stock.....	--	--	--	--
Reclassification of unearned compensation related to the adoption of Statement of Financial Accounting Standards No. 123(R) (Note 2).....	--	--	(2,614)	2,614
Stock options exercised and related tax benefit.....	--	--	5,112	--
Shares issued under employee benefit plans..	--	--	1,616	--
Nonvested shares awarded under equity incentive plans.....	--	--	(657)	--
Stock-based compensation expense related to employee-based awards.....	--	--	16,584	--
Balance, September 24, 2006.....	108,503	\$ 1,085	\$255,029	\$ --

See notes to condensed consolidated financial statements.

5.

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

	39 Weeks En
	----- September 24, 2006 -----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings.....	\$ 62,396
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization.....	48,092
Amortization of intangible assets.....	562
Stock-based compensation.....	16,584
Other amortization.....	233
Deferred income tax benefit.....	(8,615)
Impairment and other restaurant closure costs.....	6,500
Loss on disposition of property and equipment.....	1,692
Income tax benefit from stock-based compensation.....	1,233
Changes in assets and liabilities, exclusive of effect of acquisitions:	
Receivables.....	1,540
Receivables related to captive insurance subsidiary.....	1,249
Inventories.....	10,031
Prepaid and other current assets.....	115
Accounts payable.....	(24,502)
Accrued expenses and other current liabilities.....	(16,750)
Loss reserve and unearned premiums related to captive insurance subsidiary.....	(4,210)
Income taxes.....	7,440

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Other non-current liabilities.....	7,770
Other.....	(1,922)

NET CASH PROVIDED BY OPERATING ACTIVITIES.....	109,438

CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment.....	(86,635)
Change in restricted assets related to captive insurance subsidiary.....	4,318
Acquisition of restaurants.....	(8,053)
Proceeds from sale of property and equipment.....	281

NET CASH USED BY INVESTING ACTIVITIES.....	(90,089)

CASH FLOWS FROM FINANCING ACTIVITIES:	
Purchases of treasury stock.....	(27,528)
Dividends paid.....	(14,840)
Issuance of common stock upon exercise of stock options.....	8,814
Shares issued under employee benefit plans.....	3,345
Excess tax benefits from stock-based compensation.....	1,683
Net debt proceeds	5,913

NET CASH USED BY FINANCING ACTIVITIES.....	(22,613)

NET DECREASE IN CASH AND CASH EQUIVALENTS.....	(3,264)
CASH AND CASH EQUIVALENTS, beginning of period.....	13,040

CASH AND CASH EQUIVALENTS, end of period.....	\$ 9,776
	=====

See notes to condensed consolidated financial statements.

6.

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

	39 Week

	September 24,
	2006

SUPPLEMENTAL DISCLOSURES OF CASH	
FLOW INFORMATION:	
Cash paid during the 39 week period for:	
Income taxes.....	\$ 27,699
	=====
Interest.....	\$ 8,938
	=====

SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

We issued nonvested shares (previously referred to as restricted stock prior to

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fiscal 2006) with grant date fair values of \$3,598,000 for the 39 weeks ended September 24, 2006 and nonvested shares, net of forfeitures, of \$2,916,000 for the 39 weeks ended September 25, 2005.

In 2002, we entered into a rabbi trust agreement to protect the assets of the nonqualified deferred compensation plan for certain of our associates. The plan investments are included in other assets and the offsetting obligation is included in other non-current liabilities in our consolidated balance sheets. We had non-cash increases in these balances of \$1,522,000 and \$3,049,000 for the 39 weeks ended September 24, 2006 and September 25, 2005, respectively.

We had property and equipment purchases accrued in accounts payable of approximately \$13,500,000 and \$11,200,000 as of September 24, 2006 and September 25, 2005, respectively.

See notes to condensed consolidated financial statements.

7.

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

1. Basis of Presentation

Our condensed consolidated financial statements included in this Form 10-Q have been prepared without audit in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Although certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, we believe that the disclosures are adequate to make the information presented not misleading. The accompanying condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 25, 2005.

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

2. Stock-Based Compensation

Our Board of Directors has approved the Amended and Restated 1995 Equity Incentive Plan ("1995 Plan") and the 1999 Employee Incentive Plan ("1999 Plan") which allow for the granting of stock options, stock appreciation rights ("SARs"), nonvested shares, performance units and performance shares to eligible participants. Grants of stock options may be either incentive or nonqualified. There are 19,900,000 and 2,473,875 shares authorized under the 1995 Plan and the 1999 Plan, respectively. As of September 24, 2006, we had 3,487,420 shares available for grant under the 1995 Plan. We will not make additional grants under the 1999 Plan. We issue shares out of our treasury for stock option exercises, SAR exercises and nonvested share issuances.

Prior to fiscal 2006, we accounted for these stock-based compensation equity awards under the intrinsic method of Accounting Principles Board ("APB") Opinion No. 25. Opinion No. 25 required compensation cost to be recognized based on the excess, if any, between the quoted market price of the stock at the date of

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grant and the amount an employee must pay to acquire the stock. All options awarded under both of our plans were granted with an exercise price equal to the fair market value on the date of the grant and, accordingly, no compensation expense was recognized for stock option awards. In addition, we adopted the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." The statement required prominent disclosures in financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

Under APB Opinion No. 25, pro forma expense for stock-based compensation was calculated using a graded vesting schedule over the explicit vesting period. The following table presents the effect on our net earnings and earnings per share had we adopted the fair value method of accounting for stock-based compensation under SFAS No. 123, "Accounting for Stock-Based Compensation" for the 13 weeks and 39 weeks ended September 25, 2005 (in thousands, except for per share amounts).

8.

	13 Weeks Ended September 25, 2005	39 Se
	-----	-----
Net earnings, as reported.....	\$ 22,135	\$
Add: Stock-based compensation expense included in net earnings, net of related taxes.....	385	
Less: Total stock-based employee compensation expense determined under fair value-based methods for all equity awards, net of related taxes (1).....	2,049	
Pro forma net earnings.....	\$ 20,471	\$
	=====	=====
Basic net earnings per common share, as reported.....	\$ 0.28	\$
	=====	=====
Basic net earnings per common share, as adjusted.....	\$ 0.26	\$
	=====	=====
Diluted net earnings per common share, as reported.....	\$ 0.28	\$
	=====	=====
Diluted net earnings per common share, as adjusted.....	\$ 0.26	\$
	=====	=====

We adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment" ("SFAS 123(R)") at the beginning of fiscal year 2006. SFAS 123(R) requires all stock-based compensation, including grants of employee stock options, to be recognized in the statement of earnings based on fair value. With limited exceptions, the amount of compensation cost will be measured based on the fair value on the grant date of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service for that award. We adopted this accounting treatment using the modified prospective transition method; therefore, results for prior periods have not been restated.

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Beginning in fiscal 2006, we changed our method of determining the fair value of stock-based equity awards from the Black-Scholes model to a binomial model. The binomial model considers a range of assumptions relative to volatility, risk-free interest rates and employee exercise behavior, which models actual employee behaviors. We believe the binomial model provides a fair value that is more representative of actual and future experience as compared to the Black-Scholes model.

Compensation costs for the 13 weeks ended September 24, 2006 ("2006 quarter") and the 39 weeks ended September 24, 2006 ("2006 year-to-date period") have been recognized for all new equity awards granted in fiscal 2006 and those equity awards granted prior to fiscal 2006 that have yet to reach the end of their

9.

service period. As required by SFAS 123(R), we began recognizing expense for employee stock-based compensation over the shorter of the vesting period or the period from the date of the grant until the date the employee becomes eligible for retirement. We recognize expense for stock-based compensation over the graded vesting period. We recognized stock-based compensation in the condensed consolidated financial statements as follows:

	2006 Quarter	2005 Quarter	2006 Year-to-D Period
Labor.....	\$ 216	\$ --	\$ 703
General and administrative expenses.....	4,956	598	15,881
Income taxes.....	(1,827)	(213)	(5,760)
Stock-based compensation expense included in net earnings, net of related tax.....	\$ 3,345	\$ 385	\$10,824

As of September 24, 2006, we had unrecognized compensation expense for stock options and SARs of \$18,400,000 to be recognized over a weighted average period of 2.0 years.

As required by SFAS 123(R), unearned compensation of \$2,614,000, which was previously reflected as a reduction to stockholders' equity as of December 25, 2005, was reclassified as a reduction to additional paid-in capital upon our adoption of this statement.

Stock Options

Prior to fiscal 2005, we granted substantially all of our equity awards through stock options once per year. These stock options generally vest over three years and expire ten years from the date of the grant.

In fiscal 2005, we granted substantially all of our equity awards through quarterly stock option grants. Grants issued in the first quarter of each year vest three years from the date of the grant. Grants issued in subsequent quarters vest on the same date as the first quarterly stock option grant of that year. In fiscal 2005 and the 2006 year-to-date period, we also granted to certain employees stock options with 25% of the grant vesting four years from

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the grant date and the remaining 75% of the grant vesting five years from the grant date. The fiscal 2005 option grants expire six to seven years from the date of the grant. In the first quarter of fiscal 2006, we issued grants to certain employees and members of the board of directors which vest either one or three years from the date of the grant. As part of their compensation package, the outside members of the board of directors receive a grant of options in the first quarter of every year which expire 10 years from the grant date.

10.

Transactions for stock options relative to both plans for the 2006 year-to-date period were as follows:

1995 Plan				
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag Intri
(in				
Options outstanding at				
December 25, 2005.....	7,365,933	\$ 21.33	6.5 years	
Granted.....	410,921	\$ 22.14		
Exercised.....	(559,100)	\$ 11.98		\$
Expired.....	(120)	\$ 8.30		
Forfeited.....	(476,398)	\$ 25.63		

Options outstanding at				
September 24, 2006.....	6,741,236	\$ 21.85	6.0 years	\$
=====				
Options exercisable at				
September 24, 2006.....	2,308,902	\$ 15.34	5.5 years	\$
=====				

1999 Plan				
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag Intri
(in				
Options outstanding at				
December 25, 2005.....	664,656	\$ 13.73	6.0 years	
Granted.....	--	--		
Exercised.....	(155,853)	\$ 14.21		\$
Expired.....	--	--		
Forfeited.....	(505)	\$ 13.22		

Options outstanding at				

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September 24, 2006.....	508,298	\$ 13.58	5.2 years	\$
	=====			
Options exercisable at September 24, 2006.....	503,798	\$ 13.56	5.2 years	\$
	=====			

The aggregate intrinsic value was calculated using the difference between the current market price and the grant price for only those equity awards that have a grant price that is less than the current market price.

11.

We derived the following weighted-average assumptions using the binomial model in the 2006 quarter and the 2006 year-to-date period and the Black-Scholes model for the 2005 quarter and the 2005 year-to-date period for stock options:

	2006 Quarter	2005 Quarter	2006 Year-to-Date Period
	(Binomial)	(Black-Scholes)	(Binomial)
Expected term in years.....	5.2	5.6	4.8
Expected stock price volatility.....	32.1%	32.0%	31.4%
Expected dividend yield.....	1.0%	0.9%	0.9%
Risk-free interest rate.....	4.7%	3.7%	4.6%
Fair value of options granted.....	\$ 6.90	\$ 8.56	\$ 6.89

Stock Appreciation Rights

Beginning in the first quarter of fiscal 2006, we began granting substantially all of our equity awards through quarterly nonvested share and SAR grants which are exercisable in shares of our common stock. Grants issued for the first quarter of each year vest three years from the date of the grant. Grants issued in subsequent quarters vest on the same date as the first quarterly grant of that year. The SARs granted in the 2006 year-to-date period expire six to seven years from the date of the grant. Transactions for SARs for the 2006 year-to-date period were as follows:

	1995 Plan			
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag Intri
SARs outstanding at December 25, 2005.....	--	--		(in

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Granted(1).....	960,414	\$	21.67	
Exercised.....	--		--	
Expired.....	--		--	
Forfeited.....	(46,725)	\$	22.32	

SARs outstanding at September 24, 2006.....	913,689	\$	21.63	6.4 years
	=====			
SARs exercisable at September 24, 2006.....	--			
	=====			

12.

We derived the following weighted-average assumptions for SARs using the binomial model:

	2006 Quarter	2006 Year-to-Date Period
	-----	-----
Expected term in years	4.2	4.2
Expected stock price volatility	32.1%	31.7%
Expected dividend yield	1.0%	0.9%
Risk-free interest rate	4.7%	4.8%
Fair value of SARs granted	\$ 6.09	\$ 6.24

Assumptions

We determined our assumptions for stock options and SAR grants based on the following methodology:

Expected term: We have determined the expected term based upon the assumption that all outstanding options and SARs will be exercised at the midpoint of the current holding period and the full contractual term.

Expected volatility: We have determined the expected volatility based on a weighted average of Applebee's volatility over the expected term, historical volatility of certain peer group restaurant volatilities and Applebee's implied volatility.

Expected dividend yield: We have determined the expected dividend yield based upon our expected dividends as a percentage of our current stock price.

Risk-free interest rate: We have determined the risk-free interest rate using the U.S. Treasury yield curve in effect at the time of the grant for the expected term of the equity award.

Nonvested Shares

We grant nonvested shares under our 1995 Plan. Nonvested shares vest either one, two or three years after the date of the grant. The fair value of nonvested shares granted is equal to the market price of the stock at the date of grant.

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The weighted average fair value of nonvested shares granted was \$20.84 and \$25.77 in the 2006 quarter and the 2005 quarter, respectively, and \$21.67 and \$27.81 in the 2006 year-to-date period and the 2005 year-to-date period, respectively. Transactions during the 2006 year-to-date period were as follows:

	Number of Awards	W Fa
	-----	-----
Nonvested share awards outstanding as of December 25, 2005.....	257,813	\$
Granted.....	166,050	
Vested.....	(98,618)	
Forfeited.....	(35,157)	
	-----	-----
Nonvested share awards outstanding as of September 24, 2006.....	290,088	\$
	=====	=====

13.

As of September 24, 2006, we had unrecognized compensation expense related to nonvested share awards of approximately \$2,500,000 which will be recognized over a weighted average period of 1.3 years.

Employee stock purchase plan

Our Board of Directors has authorized an employee stock purchase plan that allows associates to purchase shares of our common stock at a 15% discount through a payroll deduction. We record compensation for this plan using the Black-Scholes valuation model in the quarter that the purchase occurs. As of September 24, 2006, 190,590 shares of the 1,850,000 shares which were authorized under this plan were available for purchase.

3. Commitments and Contingencies

Litigation, claims and disputes: We are subject from time to time to lawsuits, claims and governmental inspections or audits arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. In the opinion of management, these matters are adequately covered by insurance, or if not so covered, are without merit or are of such a nature or involve amounts that would not have a material adverse impact on our business or consolidated financial position.

Lease guarantees and contingencies: In connection with the sale of restaurants to franchisees and other parties, we have, in certain cases, remained contingently liable for the remaining lease payments. As of September 24, 2006, we have outstanding lease guarantees of approximately \$15,800,000. In addition, we or our subsidiaries are contingently liable for various leases that we have assigned in connection with the sale of restaurants to franchisees and other parties, in the potential amount of \$12,800,000. These leases expire at various times with the final lease agreement expiring in 2018. We did not record a liability related to these contingent lease liabilities as of September 24, 2006 or December 25, 2005.

In 2004, we arranged for a third-party financing company to provide up to \$250,000,000 to qualified franchisees for loans to fund development of new

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restaurants through October 2007, subject to our approval. We will provide a limited guarantee of 10% of certain loans advanced under this program. We will be released from our guarantee if certain operating results are met after the restaurant has been open for at least two years. As of September 24, 2006, there were loans outstanding to six franchisees for approximately \$69,200,000 under this program. The fair value of our guarantees under this financing program is approximately \$140,000 and is recorded in non-current liabilities in our consolidated balance sheet as of September 24, 2006.

Severance agreements: We have severance and employment agreements with certain officers providing for severance payments to be made in the event the associate resigns or is terminated not related to a change in control, some of which require payments to be made only if we enforce certain terms in the agreements. If the severance payments had been due as of September 24, 2006, we would have been required to make payments totaling approximately \$12,100,000. In addition, we have severance and employment agreements with certain officers which contain severance provisions related to a change in control. The agreements define the circumstances which will constitute a change in control. Those provisions would have required additional aggregate payments of approximately \$5,300,000 if such officers had been terminated as of September 24, 2006.

14.

4. Net Earnings Per Share

We compute basic net earnings per common share by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted net earnings per common share reflects the potential dilution that could occur if holders of options or other contracts to issue common stock exercised or converted their holdings into common stock. Outstanding stock options and equity-based compensation represent the only dilutive effects on weighted average shares. The chart below presents a reconciliation between basic and diluted weighted average shares outstanding and the related net earnings per share. All amounts in the chart, except per share amounts, are expressed in thousands.

	2006 Quarter	2005 Quarter	2006 Year-to-D Period
Net earnings.....	\$ 14,841	\$ 22,135	\$ 62,39
Basic weighted average shares outstanding.....	73,902	78,485	74,04
Dilutive effect of stock options and equity-based compensation.....	771	1,206	96
Diluted weighted average shares outstanding.....	74,673	79,691	75,00
Basic net earnings per common share.....	\$ 0.20	\$ 0.28	\$ 0.8
Diluted net earnings per common share.....	\$ 0.20	\$ 0.28	\$ 0.8

We excluded stock options and SARs with exercise prices greater than the average market price of our common stock for the applicable periods from the computation

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of diluted weighted average shares outstanding as the effect would be anti-dilutive. We excluded approximately 5,700,000 and 3,400,000 of these options and SARs from our diluted weighted average share computation for the 2006 quarter and the 2005 quarter, respectively, and approximately 5,300,000 and 900,000 of these options and SARs for the 2006 year-to-date period and the 2005 year-to-date period, respectively.

5. Acquisitions

All of our acquisitions discussed below have been accounted for using the purchase method of accounting and, accordingly, our condensed consolidated financial statements reflect the results of operations for each acquisition subsequent to the date of acquisition. The assets acquired and liabilities assumed are recorded at estimates of fair value as determined by management based upon information available. We finalize the allocation of purchase price to the fair value of assets acquired and liabilities assumed when we obtain information sufficient to complete the allocation, but in each case, no longer than one year after the acquisition date.

In January 2006, we completed the acquisition of four Applebee's restaurants in the Houston market for approximately \$8,200,000. The purchase price was allocated to the fair value of property and equipment of \$7,400,000, goodwill of approximately \$600,000, reacquired franchise rights of approximately \$100,000, and other net assets of approximately \$100,000. In connection with this acquisition, we paid approximately \$8,100,000 in the 2006 year-to-date period.

15.

In May 2005, we completed the acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas, which included one restaurant under construction, for approximately \$39,500,000 in cash. The purchase price was allocated to the fair value of property and equipment of \$17,500,000, goodwill of \$21,500,000, reacquired franchise rights of approximately \$300,000, and other net assets of approximately \$200,000.

The following table is comprised of actual company restaurant sales for the two restaurant acquisitions above, which are included in our condensed consolidated financial statements for each period presented, and pro forma company restaurant sales. The pro forma company restaurant sales for the 2006 quarter and the 2006 year-to-date period include sales related to the January 2006 acquisition discussed above as if the acquisition had occurred as of the beginning of each respective period. The pro forma company restaurant sales for the 2005 quarter and the 2005 year-to-date period include sales for the two acquisitions discussed above as if the acquisitions had occurred as of the beginning of each respective period.

	2006 Quarter	2005 Quarter	2006 Year-to-Date Period
	-----	-----	-----
Actual company restaurant sales for acquired restaurants.....	\$ 1,500	\$ 7,500	\$ 4,800
	=====	=====	=====
Pro forma company restaurant sales for acquired restaurants.....	\$ 1,500	\$ 8,200	\$ 5,500
	=====	=====	=====

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In April 2005, we completed the acquisition of eight Applebee's restaurants in the Memphis market, which were closed in 2004 by a former franchisee, for approximately \$8,800,000 payable in cash. In connection with this acquisition, we paid approximately \$800,000 in 2004 and \$8,000,000 in 2005. The purchase price of \$8,800,000 was allocated to the fair value of property and equipment of approximately \$8,200,000 and goodwill of approximately \$600,000. We have remodeled and opened seven restaurants and the remaining restaurant was sold to a third party.

6. Goodwill and Other Intangible Assets

Changes in goodwill are summarized below (in thousands):

	September 24, 2006	December 2005
	-----	-----
Carrying amount, beginning of the year.....	\$ 138,443	\$ 116,3
Goodwill acquired during the period.....	668	22,0
	-----	-----
Goodwill amount, end of the period.....	\$ 139,111	\$ 138,4
	=====	=====

16.

Intangible assets subject to amortization pursuant to SFAS No. 142, "Goodwill and Other Intangible Assets," are summarized below (in thousands):

	September 24, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net V
	-----	-----	-----
Amortized intangible assets:			
Franchise interest and rights.....	\$ 6,371	\$ 6,103	\$
Lease acquisition costs (1).....	3,430	590	
Noncompete agreement.....	350	175	
	-----	-----	-----
Total.....	\$ 10,151	\$ 6,868	\$
	=====	=====	=====

	December 25, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net V
	-----	-----	-----

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Amortized intangible assets:

Franchise interest and rights.....	\$	6,371	\$	5,896	\$
Lease acquisition costs (1).....		4,939		743	
Noncompete agreement.....		350		109	
		-----		-----	
Total.....	\$	11,660	\$	6,748	\$
		=====		=====	

We expect annual amortization expense for amortizable other assets for the next five fiscal years to range from approximately \$200,000 to \$700,000.

Intangible assets not subject to amortization are summarized below (in thousands):

	September 24, 2006	Decem
	-----	-----
Carrying amount, beginning of the year.....	\$ 3,138	\$
Nonamortizable intangible assets acquired during the period.....	140	
	-----	-----
Nonamortizable intangible assets amount, end of the period.....	\$ 3,278	\$
	=====	=====

In connection with our acquisition of four Applebee's restaurants in Houston from a franchisee in January 2006, we recorded approximately \$100,000 of reacquired franchise rights (Note 5).

In connection with our acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas from a franchisee in May 2005, we recorded approximately \$300,000 of reacquired franchise rights (Note 5).

The amount allocated to reacquired franchise rights is based upon the initial franchise fees received from these franchisees. This intangible asset has an indefinite life and, accordingly, will not be amortized but tested for impairment at least annually.

17.

7. Assets Held for Sale

We classify assets as held for sale when there is a plan for disposal of assets and those assets meet the held for sale criteria as defined in SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." During the 2006 quarter, we began to actively market our existing corporate headquarters under a plan approved by management. Consequently, we have classified the building and land as held for sale as of September 24, 2006. In addition, we began to actively market a corporate aircraft. As a result, we recorded an impairment charge of approximately \$900,000 to reduce the carrying amount to its fair value, which was based on an independent third-party estimate.

8. Captive Insurance Subsidiary

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In 2002, we formed Neighborhood Insurance, Inc., a Vermont corporation and a wholly-owned captive insurance subsidiary to provide Applebee's International, Inc. and qualified franchisees with workers' compensation and general liability insurance. In 2005, we reduced the types of insurance coverage plans offered which resulted in fewer franchisee participants in our captive insurance program. Through 2005, Applebee's International, Inc. and covered franchisees made premium payments to the captive insurance company which pays administrative fees and insurance claims, subject to individual and aggregate maximum claim limits under the captive insurance company's reinsurance policies. Franchisee premium amounts billed by the captive insurance company were established based upon third-party actuarial estimates of settlement costs for incurred and anticipated claims and administrative fees. Franchisee premiums were included in other franchise income ratably over the policy year and the related offsetting expenses were included in cost of other franchise income. In 2006, we discontinued writing any new insurance coverage. Franchise premium adjustments will be included in other franchise income and cost of other franchise income when audited. Cost of other franchise income includes costs related to the resolution of claims arising from franchisee participation in our captive insurance program. We do not expect franchisee participation in the captive insurance company to have a material impact on our net earnings. Our consolidated balance sheets include the following balances related to the captive insurance subsidiary:

- o Franchise premium receivables of approximately \$500,000 and \$1,700,000 as of September 24, 2006 and December 25, 2005, respectively, included in receivables related to captive insurance subsidiary.
- o Cash equivalent and other long-term investments restricted for the payment of claims of approximately \$14,300,000 and \$18,600,000 as of September 24, 2006 and December 25, 2005, respectively, included in restricted assets related to captive insurance subsidiary.
- o Loss reserve related to captive insurance subsidiary of approximately \$16,000,000 and \$20,700,000 as of September 24, 2006 and December 25, 2005, respectively. Approximately \$8,000,000 and \$10,500,000 for September 24, 2006 and December 25, 2005, respectively, is included in other non-current liabilities.

9. Impairment and Other Restaurant Closure Costs

During the 2006 year-to-date period, we had impairment and other restaurant closure costs as follows:

- o In connection with the review of long-lived assets during our preparation of the 2006 quarter condensed consolidated financial statements, we recorded an asset impairment charge of \$1,900,000. The impairment charge consisted of approximately \$1,000,000 write-down of the carrying value of two restaurants whose carrying amounts were deemed not recoverable and approximately \$900,000 write-down of a corporate aircraft.

18.

- o We previously recorded impairment and other restaurant closure costs of \$3,000,000 in the second quarter of fiscal 2006 and \$1,600,000 in the first quarter of fiscal 2006.

In assessing restaurants for impairment, we use current and historical operating results to estimate future cash flows on a restaurant by restaurant basis. The asset impairment charges for the 2006 year-to-date period were calculated by comparing the carrying value of the restaurants' assets to the estimated future cash flow projections.

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10. Treasury Shares

As of September 24, 2006, we had approximately 34,564,000 shares held in treasury. A reconciliation of our treasury shares for the 2006 year-to-date period is provided below (shares in thousands):

	Treasury Shares

Balance as of December 25, 2005.....	34,305
Purchases of treasury stock.....	1,286
Stock options exercised.....	(711)
Shares issued under employee benefit plans.....	(185)
Nonvested shares awarded under equity incentive plans.....	(131)

Balance as of September 24, 2006.....	34,564
	=====

11. New Accounting Pronouncements

In March 2006, the Emerging Issues Task Force ("EITF") issued EITF Issue 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)." A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes. The guidance is effective for periods beginning after December 15, 2006. We present company sales net of sales taxes. This issue will not impact the method for recording these sales taxes in our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 is effective for fiscal years beginning after December 15, 2006. We are evaluating the impact the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are evaluating the impact the adoption of SFAS No. 157 will have on our consolidated financial statements.

19.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." This statement requires companies to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income to report the funded status of defined benefit pension and other postretirement benefit plans. The statement requires prospective application, and the recognition and disclosure requirements are effective for companies with fiscal years ending after December 15, 2006.

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Additionally, SFAS No. 158 requires companies to measure plan assets and obligations at their year-end balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. We are evaluating the impact the adoption of SFAS No. 158 will have on our consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which provides interpretive guidance regarding the consideration given to prior year misstatements when determining materiality in current year financial statements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We are evaluating the impact of SAB No. 108 on our consolidated financial statements.

20.

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

Forward-Looking Statements

The statements contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations section regarding restaurant development, comparable sales, revenue growth, restaurant margins, commodity costs, general and administrative expenses, capital expenditures, return on equity and financial commitments are forward-looking and based on current expectations. There are several risks and uncertainties that could cause actual results to differ materially from those described. These risks include, but are not limited to, our ability and the ability of our franchisees to open and operate additional restaurants profitably, the ability of our franchisees to obtain financing, the continued growth of our franchisees, our ability to attract and retain qualified franchisees, the impact of intense competition in the casual dining segment of the restaurant industry, the impact of economic factors on consumer spending and our ability to control restaurant operating costs which are impacted by market changes, minimum wage and other employment laws, food costs and inflation. For a more detailed discussion of the principal factors that could cause actual results to be materially different, you should read our risk factors in Item 1A of our 2005 Annual Report on Form 10-K. We disclaim any obligation to update forward-looking statements.

General

We operate on a 52 or 53 week fiscal year ending on the last Sunday in December. Our fiscal years and fiscal periods are as follows:

Fiscal Year	Fiscal Year End	Number of Weeks
-----	-----	-----
2005	December 25, 2005	52
2006	December 31, 2006	53
2007	December 30, 2007	52
Fiscal Period	Fiscal Period End	Number of Weeks
-----	-----	-----
2005 Quarter	September 25, 2005	13
2006 Quarter	September 24, 2006	13
2005 Year-to-date period	September 25, 2005	39

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2006 Year-to-date period

September 24, 2006

39

Our revenues are generated from three primary sources:

- o Company restaurant sales (food and beverage sales)
- o Franchise royalties and fees
- o Other franchise income

Beverage sales consist of sales of alcoholic beverages, while non-alcoholic beverages are included in food sales. Franchise royalties are generally 4% of each franchise restaurant's monthly gross sales. Franchise fees typically range from \$30,000 to \$35,000 for each restaurant opened. Other franchise income includes revenue from information technology products and services provided to

21.

certain franchisees. In fiscal 2005, other franchise income also included insurance premiums for the current year and premium audit adjustments for prior years from franchisee participation in our captive insurance program. In fiscal 2006, we discontinued writing any new insurance coverage. Franchise premium adjustments will be included in other franchise income when audited.

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

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

Cost of other franchise income includes costs related to information technology products and services provided to certain franchisees. In fiscal 2005, cost of other franchise income included the costs related to franchisee participation in our captive insurance program. In fiscal 2006, we discontinued writing any new insurance coverage. Cost of other franchise income includes costs related to the resolution of claims arising from franchisee participation in our captive insurance program.

Other expenses, such as general and administrative and amortization expenses, relate to both company operated restaurants and franchise operations.

Overview

Applebee's International, Inc. and our subsidiaries develop, franchise and operate casual dining restaurants under the name "Applebee's Neighborhood Grill & Bar," which is the largest casual dining concept in the world with nearly 1,900 system-wide restaurants open as of September 24, 2006. The casual dining segment of the restaurant industry is highly competitive and there are many factors that affect our profitability. Our industry is susceptible to changes in economic conditions, trends in lifestyles, fluctuating costs, government regulation, availability of resources, and consumer perceptions. When evaluating and assessing our financial performance, we believe there are five key factors:

- o Development - the number of new company and franchise restaurants opened during the period. As the largest casual dining concept in the world, Applebee's has a unique opportunity to leverage our brand, system size and scale to optimize our future growth. Our expansion strategy has been to cluster restaurants in targeted markets, thereby increasing consumer awareness and convenience, and enabling us to take advantage of operational, distribution and advertising efficiencies. We currently expect that the Applebee's system will encompass at least 3,000 restaurants in the United

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States, as well as the potential for at least 1,000 restaurants internationally. In the 2006 quarter and the 2006 year-to-date period, we and our franchisees opened 28 and 92 restaurants, respectively. Together, we have opened at least 100 restaurants system-wide each year for the past 13 fiscal years. In 2006, we currently expect to open approximately 125 restaurants system-wide, comprised of approximately 35 company and at least 90 franchise restaurants. Development costs, which include construction costs, fixtures and equipment and land costs, continue to increase as a result of increased demand for material, labor and commercial real estate. We continually evaluate our development strategy. As a result of rising development costs, slower industry sales trends and the underperformance of several of our newer restaurants, we currently expect to open approximately 10 to 15 company restaurants in fiscal 2007.

22.

- o Comparable restaurant sales - a year-over-year comparison of sales for restaurants open at least 18 months. Changes in comparable restaurant sales are driven by changes in the average guest check and/or changes in guest traffic. Average guest check changes result from menu price changes and/or changes in menu mix. During the 2006 quarter and the 2006 year-to-date period, the impact of menu price increases on company restaurants was 2.5%. In the fourth quarter, we will roll over a 1% price increase taken in November of 2005. We do not expect to take further company restaurant price increases for the remainder of fiscal 2006. Although we may have changes in our average guest check from period to period, our main focus has been increasing guest traffic as we view this component to be more indicative of the long-term health of the Applebee's brand. We are constantly seeking to increase guest traffic by focusing on operations and improving our menu with new food and beverage offerings. In 2006, we began implementation of a plan to substantially improve the quality and flavor profile of our food and beverage offerings as a result of comprehensive consumer research we completed in 2005. In the 2006 quarter, company comparable sales decreased 1.7% while domestic franchise and domestic system-wide comparable sales decreased 2.5% and 2.3%, respectively. In the 2006 year-to-date period, company comparable sales decreased 0.8%, while domestic franchise and domestic system-wide comparable sales decreased 0.4% and 0.5%, respectively. We believe our sales and traffic have been negatively impacted by multiple factors. Lower income households, which represent a significant portion of our guests, have been impacted by higher energy costs and interest rates. The bar and grill category of the restaurant industry has been negatively impacted by increased trade-down to quick-service restaurants. In addition, the supply growth of chains in the category in 2006 and 2005 has outpaced demand contributing to weaker sales trends. As a result of these factors, we currently expect system-wide comparable sales for the remainder of the year to be in a range from down 1.0% to down 3.0%.
- o Company restaurant margins - company restaurant sales, less food and beverage, labor, direct and occupancy restaurant costs and pre-opening expenses, expressed as a percentage of company restaurant sales. Company restaurant margins were 10.5% and 12.9% in the 2006 quarter and the 2005 quarter, respectively, and 12.4% and 14.1% in the 2006 year-to-date period and the 2005 year-to-date period, respectively. We currently expect fiscal 2006 company restaurant margins, which will be dependent on comparable sales performance at company restaurants, to be lower than margins in fiscal 2005. Company restaurant margins are susceptible to fluctuations in commodity costs, labor costs and other operating costs such as utilities. We attempt to negotiate contracts for the majority of our food products in order to mitigate the impact of rising commodity costs. We currently expect fiscal 2006 net commodity costs to be flat, including the negative impact of fuel surcharges. In addition, our improved menu offerings are expected to

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increase food costs, as a percentage of sales, when compared to other menu offerings. We expect labor costs to continue to be negatively impacted by hourly wage rate increases (including the potential impact of various state and federal minimum wage rate initiatives), incremental hourly training labor to support our new food campaigns, management wage rate increases to remain competitive and modifications to our bonus plan designed to retain our best restaurant managers. In addition, higher energy costs, including utilities and the cost of materials used in the production of packaging, will have a negative impact on company restaurant margins, but will be partially offset by the favorable impact of a change in accounting convention for smallwares that was implemented in the second quarter of fiscal 2006 and the impact of the 53rd week in fiscal 2006.

- o General and administrative expenses - general and administrative expenses expressed as a percentage of total operating revenues. General and administrative expenses were 11.1% and 8.6% in the 2006 quarter and the 2005 quarter, respectively, and 10.4% and 8.9% in the 2006 year-to-date period and the 2005 year-to-date period, respectively. Stock-based compensation included in general and administrative expenses was 1.5% and 0.2% in the 2006 quarter and the 2005 quarter, respectively, and 1.6% and 0.2% in the 2006 year-to-date period and the 2005 year-to-date period, respectively.

23.

General and administrative expenses, as a percentage of operating revenues, for fiscal 2006 are expected to be in the low-to-mid 10 percent range, including the impact of stock-based compensation.

- o Return on equity - net earnings expressed as a percent of average stockholders' equity. We believe this is an important indicator as it allows us to evaluate our ability to create value for our shareholders. In fiscal 2006, our return on equity has declined due primarily to the impact of stock-based compensation and lower than expected sales and company restaurant margins. We now expect our return on equity in fiscal 2006 to be lower than our stated goal of at least 20%.

Application of Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our condensed consolidated financial statements, which were prepared in accordance with accounting principles generally accepted in the United States of America. These principles require us to make estimates and assumptions that affect the reported amounts in the condensed consolidated financial statements and notes thereto. Actual results may differ from these estimates, and such differences may be material to our condensed consolidated financial statements. We believe that the following accounting policies involve a significant degree of judgment or complexity.

Inventory valuation: We state inventories at the lower of cost, using the first-in, first-out method, or market. Market is determined based upon our estimates of the net realizable value.

We may periodically purchase and maintain inventories of certain specialty products to ensure sufficient supplies to the system, to ensure continuity of supply, or to control food costs. We review and make quality control inspections of our inventories to determine obsolescence on an ongoing basis. These reviews require management to make certain estimates and judgments regarding projected usage which may change in the future and may require us to record an inventory impairment.

Property and equipment: We report property and equipment at historical cost less

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accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the related asset. The useful lives of the assets are based upon management's expectations. We periodically review the assets for changes in circumstances which may impact their useful lives. If there are changes in circumstances that revise an asset's useful life, we will adjust the depreciation expense accordingly for that asset in future periods.

Stock-based compensation: Beginning in fiscal 2006, we account for stock-based compensation in accordance with SFAS No. 123(R). As required by SFAS No. 123(R), stock-based compensation is estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using a binomial model. The binomial model requires various highly judgmental assumptions including the expected life, stock price volatility and the forfeiture rate. If any of the assumptions used in the model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

Impairment of long-lived assets: We periodically review restaurant property and equipment for impairment on a restaurant-by-restaurant basis using certain market and restaurant operating indicators including historical cash flows as well as current estimates of future cash flows and/or appraisals. We review other long-lived assets at least annually and when events or circumstances indicate that the carrying value of the asset may not be recoverable. The recoverability is assessed in most instances by comparing the carrying value to

24.

its undiscounted cash flows. This assessment process requires the use of estimates and assumptions regarding future cash flows and estimated useful lives, which are subject to a significant degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

Income taxes: We record valuation allowances against our deferred tax assets, when necessary, in accordance with SFAS No. 109, "Accounting for Income Taxes." Realization of deferred tax assets is dependent on future taxable earnings and is therefore uncertain. We assess the likelihood that our deferred tax assets in each of the jurisdictions in which we operate will be recovered from future taxable income. Deferred tax assets do not include future tax benefits that we deem likely not to be realized.

We are periodically audited by foreign and domestic tax authorities for both income and sales and use taxes. We record accruals when we determine it is probable that we have an exposure in a matter relating to an audit. The accruals may change in the future due to new developments in each matter.

Legal and insurance reserves: We are periodically involved in various legal actions. We are required to assess the probability of any adverse judgments as well as the potential range of loss. We determine the required accruals after a review of the facts of each legal action.

We use estimates in the determination of the appropriate liabilities for general liability, workers' compensation and health insurance. The estimated liability is established based upon historical claims data and third-party actuarial estimates of settlement costs for incurred claims. Unanticipated changes in these factors may require us to revise our estimates.

We periodically reassess our assumptions and judgments and make adjustments when significant facts and circumstances dictate. A change in any of the above

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estimates could impact our consolidated statements of earnings and the related asset or liability recorded in our consolidated balance sheets would be adjusted accordingly. Historically, actual results have not been materially different than the estimates that are described above.

Acquisitions

All of our acquisitions discussed below have been accounted for using the purchase method of accounting and, accordingly, our condensed consolidated financial statements reflect the results of operations for each acquisition subsequent to the date of acquisition. The assets acquired and liabilities assumed are recorded at estimates of fair value as determined by management based upon information available. We finalize the allocation of purchase price to the fair value of assets acquired and liabilities assumed when we obtain information sufficient to complete the allocation, but in each case, no longer than one year after the acquisition date.

In January 2006, we completed the acquisition of four Applebee's restaurants in the Houston market for approximately \$8,200,000. The purchase price was allocated to the fair value of property and equipment of \$7,400,000, goodwill of approximately \$600,000, reacquired franchise rights of approximately \$100,000, and other net assets of approximately \$100,000. In connection with this acquisition, we paid approximately \$8,100,000 in the 2006 year-to-date period.

In May 2005, we completed the acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas, which included one restaurant under construction, for approximately \$39,500,000 in cash. The purchase price was allocated to the fair value of property and equipment of \$17,500,000, goodwill of \$21,500,000, reacquired franchise rights of approximately \$300,000, and other net assets of approximately \$200,000.

25.

The following table is comprised of actual company restaurant sales for the two restaurant acquisitions above, which are included in our condensed consolidated financial statements for each period presented, and pro forma company restaurant sales. The pro forma company restaurant sales for the 2006 quarter and the 2006 year-to-date period include sales related to the January 2006 acquisition discussed above as if the acquisition had occurred as of the beginning of each respective period. The pro forma company restaurant sales for the 2005 quarter and the 2005 year-to-date period include sales for the two acquisitions discussed above as if the acquisitions had occurred as of the beginning of each respective period.

	2006 Quarter	2005 Quarter	2006 Year-to-Date Period
	-----	-----	-----
Actual company restaurant sales for acquired restaurants.....	\$ 1,500	\$ 7,500	\$ 4,800
	=====	=====	=====
Pro forma company restaurant sales for acquired restaurants.....	\$ 1,500	\$ 8,200	\$ 5,500
	=====	=====	=====

In April 2005, we completed the acquisition of eight Applebee's restaurants in

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the Memphis market, which were closed in 2004 by a former franchisee, for approximately \$8,800,000 payable in cash. In connection with this acquisition, we paid approximately \$800,000 in 2004 and \$8,000,000 in 2005. The purchase price of \$8,800,000 was allocated to the fair value of property and equipment of approximately \$8,200,000 and goodwill of approximately \$600,000. We have remodeled and opened seven restaurants and the remaining restaurant was sold to a third party.

Captive Insurance Subsidiary

In 2002, we formed Neighborhood Insurance, Inc., a Vermont corporation and a wholly-owned captive insurance subsidiary to provide Applebee's International, Inc. and qualified franchisees with workers' compensation and general liability insurance. In 2005, we reduced the types of insurance coverage plans offered which resulted in fewer franchisee participants in our captive insurance program. Through 2005, Applebee's International, Inc. and covered franchisees made premium payments to the captive insurance company which pays administrative fees and insurance claims, subject to individual and aggregate maximum claim limits under the captive insurance company's reinsurance policies. Franchisee premium amounts billed by the captive insurance company were established based upon third-party actuarial estimates of settlement costs for incurred and anticipated claims and administrative fees. Franchisee premiums were included in other franchise income ratably over the policy year and the related offsetting expenses were included in cost of other franchise income. In 2006, we discontinued writing any new insurance coverage. Franchise premium adjustments will be included in other franchise income and cost of other franchise income when audited. Cost of other franchise income includes costs related to the resolution of claims arising from franchisee participation in our captive insurance program. We do not expect franchisee participation in the captive insurance company to have a material impact on our net earnings. Our consolidated balance sheets include the following balances related to the captive insurance subsidiary:

26.

- o Franchise premium receivables of approximately \$500,000 and \$1,700,000 as of September 24, 2006 and December 25, 2005, respectively, included in receivables related to captive insurance subsidiary.
- o Cash equivalent and other long-term investments restricted for the payment of claims of approximately \$14,300,000 and \$18,600,000 as of September 24, 2006 and December 25, 2005, respectively, included in restricted assets related to captive insurance subsidiary.
- o Loss reserve related to captive insurance subsidiary of approximately \$16,000,000 and \$20,700,000 as of September 24, 2006 and December 25, 2005, respectively. Approximately \$8,000,000 and \$10,500,000 for September 24, 2006 and December 25, 2005, respectively, is included in other non-current liabilities.

Results of Operations

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

	2006	2005	2006
	Quarter	Quarter	Year-t
			Date
			Perio

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Operating revenues:			
Company restaurant sales.....	89.5%	89.3 %	89.5
Franchise royalties and fees.....	10.4	10.3	10.4
Other franchise income.....	0.1	0.3	0.1
	-----	-----	-----
Total operating revenues.....	100.0%	100.0%	100.0
	=====	=====	=====
Cost of sales (as a percentage of company restaurant sales):			
Food and beverage.....	26.7%	26.2%	26.6
Labor.....	34.5	33.1	33.7
Direct and occupancy.....	27.9	27.4	26.9
Pre-opening expense.....	0.4	0.4	0.3
	-----	-----	-----
Total cost of sales.....	89.5%	87.1%	87.6
	=====	=====	=====
Cost of other franchise income (as a percentage of other franchise income).....			
General and administrative expenses.....	187.1%	74.2%	128.5
Amortization of intangible assets.....	11.1	8.6	10.4
Impairment and other restaurant closure costs.....	--	0.1	0.1
Loss on disposition of property and equipment.....	0.6	1.3	0.7
	-----	-----	-----
Operating earnings.....	0.2	0.2	0.2
	-----	-----	-----
Operating earnings.....	7.7	11.8	10.2
	-----	-----	-----
Other income (expense):			
Investment income.....	0.3	0.2	0.1
Interest expense.....	(0.9)	(0.4)	(0.9)
Other income	0.1	0.2	0.1
	-----	-----	-----
Total other income (expense).....	(0.6)	--	(0.7)
	-----	-----	-----
Earnings before income taxes.....	7.2	11.8	9.6
Income taxes.....	2.5	4.5	3.3
	-----	-----	-----
Net earnings.....	4.6%	7.2%	6.3
	=====	=====	=====

27.

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

	13 Weeks Ended		
	-----	-----	-----
	September 24,	September 25,	Septem
	2006	2005	2
	-----	-----	-----
Number of restaurants:			
Company:			
Beginning of period.....	507	462	
Restaurant openings.....	6	12	
Restaurant closings.....	(1)	(1)	

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Restaurants acquired from franchisees.....	--	--	
End of period.....	512	473	
Franchise:			
Beginning of period.....	1,353	1,260	1
Restaurant openings.....	22	23	
Restaurant closings.....	(3)	(1)	
Restaurants acquired from franchisees.....	--	--	
End of period.....	1,372	1,282	1
Total:			
Beginning of period.....	1,860	1,722	1
Restaurant openings.....	28	35	
Restaurant closings.....	(4)	(2)	
End of period.....	1,884	1,755	1
Weighted average weekly sales per restaurant:			
Company.....	\$ 43,331	\$ 44,825	\$ 45
Domestic franchise.....	\$ 47,516	\$ 48,677	\$ 50
Domestic total.....	\$ 46,327	\$ 47,598	\$ 49
Change in comparable restaurant sales:(1)			
Company.....	(1.7)%	(1.6)%	(0)
Domestic franchise.....	(2.5)%	1.6%	(0)
Domestic total.....	(2.3)%	0.8%	(0)
Total operating revenues (in thousands):			
Company restaurant sales.....	\$ 286,938	\$ 272,673	\$ 890
Franchise royalties and fees(2).....	33,340	31,589	103
Other franchise income(3).....	371	1,064	1
Total.....	\$ 320,649	\$ 305,326	\$ 995

28.

2006 Quarter Compared With 2005 Quarter and 2006 Year-to-Date Period Compared With 2005 Year-to-Date Period

Company Restaurant Sales. Total company restaurant sales increased \$14,265,000 (5%) from \$272,673,000 in the 2005 quarter to \$286,938,000 in the 2006 quarter and increased \$75,131,000 (9%) from \$815,834,000 in the 2005 year-to-date period to \$890,965,000 in the 2006 year-to-date period. The percentage increase in total company restaurant sales was due to an increase in the number of restaurant weeks open of approximately 9% in the 2006 quarter and 12% in the 2006 year-to-date period, which was partially offset by a decline in weighted average weekly sales in the 2006 quarter and the 2006 year-to-date period.

Comparable restaurant sales at company restaurants decreased by 1.7% and 0.8% in the 2006 quarter and the 2006 year-to-date period, respectively. Weighted average weekly sales at company restaurants decreased 3.3% from \$44,825 in the 2005 quarter to \$43,331 in the 2006 quarter and decreased 2.2% from \$46,561 in the 2005 year-to-date period to \$45,527 in the 2006 year-to-date period. The

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decrease in average weekly sales was due to a decline in guest traffic in 2006 as compared to 2005 as well as the underperformance of restaurants open less than 18 months. In both periods, we experienced more significant guest count declines in New England and Virginia, where approximately 25% of our company restaurants are located. These decreases were partially offset by an increase in the average guest check resulting from menu price increases of approximately 2.5% in the 2006 quarter and the 2006 year-to-date period.

Franchise Royalties and Fees. Franchise royalties and fees increased \$1,751,000 (6%) from \$31,589,000 in the 2005 quarter to \$33,340,000 in the 2006 quarter and increased \$6,491,000 (7%) from \$97,090,000 in the 2005 year-to-date period to \$103,581,000 in the 2006 year-to-date period due primarily to the increased number of franchise restaurants operating during both periods as compared to the prior year. Domestic franchise weighted average weekly sales and comparable restaurant sales decreased 2.4% and 2.5%, respectively, in the 2006 quarter and decreased 0.3% and 0.4%, respectively, in the 2006 year-to-date period.

Other Franchise Income. Other franchise income decreased \$693,000 (65%) from \$1,064,000 in the 2005 quarter to \$371,000 in the 2006 quarter and decreased \$2,198,000 (62%) from \$3,553,000 in the 2005 year-to-date period to \$1,355,000 in the 2006 year-to-date period due primarily to the decision to discontinue writing new coverage in our captive insurance program. In 2005, franchisee premiums were included in other franchise income ratably over the policy year.

Cost of Company Restaurant Sales. Food and beverage costs increased from 26.2% in the 2005 quarter to 26.7% in the 2006 quarter and increased from 26.4% in the 2005 year-to-date period to 26.6% in the 2006 year-to-date period. Food and beverage costs in both periods were negatively impacted by an increase in food spoilage and waste associated with a reduction in the number of menu items offered, our enhanced bar menu and a new fall menu. In addition, we experienced an unfavorable shift in menu mix and higher alcoholic beverage costs, as a percentage of sales, partially related to our late-night value strategy. These increases were partially offset by menu price increases of 2.5% in the 2006 quarter and the 2006 year-to-date period.

Labor costs increased from 33.1% in the 2005 quarter to 34.5% in the 2006 quarter and increased from 33.0% in the 2005 year-to-date period to 33.7% in the 2006 year-to-date period. Both periods were unfavorably impacted by hourly state minimum wage rate increases, higher management wage rates, training related to

29.

the rollout of a new promotion, payroll taxes and the impact of lower sales volumes, as a percentage of sales, which were partially offset by lower workers' compensation expense. In addition, the 2006 quarter was favorably impacted by lower health insurance expense and was unfavorably impacted by higher incentive compensation as a result of modifications to our bonus plan designed to retain our best restaurant managers.

Direct and occupancy costs increased from 27.4% in the 2005 quarter to 27.9% in the 2006 quarter and increased from 26.0% in the 2005 year-to-date period to 26.9% in the 2006 year-to-date period due primarily to higher utilities and unfavorable year-over-year comparisons for depreciation and rent expense, as a percentage of sales, due to their relatively fixed nature, which were partially offset by the favorable impact of a change in accounting convention for smallwares that was implemented in the second quarter of fiscal 2006. The 2006 quarter was favorably impacted by lower advertising expense due to the timing of our food promotions.

Cost of Other Franchise Income. Cost of other franchise income decreased \$96,000 (12%) from \$790,000 in the 2005 quarter to \$694,000 in the 2006 quarter and

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decreased \$1,097,000 (39%) from \$2,838,000 in the 2005 year-to-date period to \$1,741,000 in the 2006 year-to-date period due to the decision to discontinue writing new coverage in our captive insurance program, which was partially offset by \$425,000 in the 2006 quarter and \$925,000 in the 2006 year-to-date period recorded for estimated insurance losses from franchise participants.

General and Administrative Expenses. General and administrative expenses increased from 8.6% in the 2005 quarter to 11.1% in the 2006 quarter and increased from 8.9% in the 2005 year-to-date period to 10.4% in the 2006 year-to-date period due primarily to the recognition of stock-based compensation related to adoption of SFAS 123(R), higher compensation expense due to staffing levels and an accrued legal expense of \$1,500,000 related to the pending settlement and related costs of a California wage and hour lawsuit. The impact of the pending legal settlement is 0.5% and 0.2% in the 2006 quarter and the 2006 year-to-date period, respectively. Stock-based compensation included in general and administrative expenses was 1.5% and 0.2% in the 2006 quarter and the 2005 quarter, respectively, and 1.6% and 0.2% in the 2006 year-to-date period and the 2005 year-to-date period, respectively. In addition, expenses incurred related to the development of international markets increased our general and administrative expenses by 0.4% in both 2006 periods.

Impairment and Other Restaurant Closure Costs. Impairment and other restaurant closure costs decreased \$2,000,000 from \$3,900,000 in the 2005 quarter to \$1,900,000 in the 2006 quarter and increased from \$3,900,000 in the 2005 year-to-date period to \$6,500,000 in the 2006 year-to-date period. During the 2006 year-to-date period, we had impairment and other restaurant closure costs as follows:

- o In connection with the review of long-lived assets during our preparation of the 2006 quarter condensed consolidated financial statements, we recorded an asset impairment charge of \$1,900,000. The impairment charge consisted of approximately \$1,000,000 write-down of the carrying value of two restaurants whose carrying amounts were deemed not recoverable and approximately \$900,000 write-down of a corporate aircraft.
- o We previously recorded impairment and other restaurant closure costs of \$3,000,000 in the second quarter of fiscal 2006 and \$1,600,000 in the first quarter of fiscal 2006.

Interest Expense. Interest expense increased from \$1,232,000 in the 2005 quarter to \$2,970,000 in the 2006 quarter and from \$2,203,000 in the 2005 year-to-date period to \$8,509,000 in the 2006 year-to-date period due primarily to higher interest rates and increased borrowings used for capital expenditure funding, repurchases of our common stock and acquisitions.

30.

Income Taxes. The effective income tax rate, as a percentage of earnings before income taxes, decreased from 38.5% in the 2005 quarter to 35.3% in the 2006 quarter and decreased from 35.7% in the 2005 year-to-date period to 34.4% in the 2006 year-to-date period. Both periods were impacted by favorable employment tax credits. The year-to-date period was also favorably impacted by the resolution of state tax matters. In addition, the income tax rates in the 2005 quarter and the 2005 year-to-date period were impacted by higher state tax rates discovered following the completion of the 2004 tax returns.

Liquidity and Capital Resources

Our primary sources of liquidity are cash provided by operations and borrowings under our credit facility. Our need for capital resources historically has resulted from the construction and acquisition of restaurants, the repurchase of our common stock, and investment in information technology systems. In the past,

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we have obtained capital through our ongoing operations and debt financing.

Cash flows from our operating activities primarily include the net cash generated from company and franchise operations and management of credit from trade suppliers. Cash flows from investing activities include capital expenditures for restaurant construction, refurbishment, information technology, acquisitions of franchisee restaurants and asset sales. Cash flows from financing activities include borrowings and repayments of debt, repurchases of our common stock, dividends to shareholders and the cash received from the exercise of employee stock options. The following table presents a summary of our cash flows for the 2006 year-to-date period and the 2005 year-to-date period (in thousands):

	2006 Year-to-Date Period	2005 Year-to-Date Period
Net cash provided by operating activities.....	\$ 109,438	\$ 158,676
Net cash used by investing activities.....	(90,089)	(149,245)
Net cash used by financing activities.....	(22,613)	(9,933)
Net decrease in cash and cash equivalents.....	\$ (3,264)	\$ (502)

Capital expenditures were \$100,802,000 in the 2005 year-to-date period and \$86,635,000 in the 2006 year-to-date period. In 2006, we currently expect to open approximately 35 company restaurants, and capital expenditures, excluding franchise acquisitions, are expected to be between \$115,000,000 and \$125,000,000. The decrease in the expected capital expenditures of \$20,000,000 from the amount reported in the second quarter of fiscal 2006 is due to a reduction in 2007 restaurant openings and a delay in the timing of capital expenditures related to the new corporate headquarters.

Future capital expenditures will primarily be for the development of new restaurants, refurbishment and capital replacement for existing restaurants, and the enhancement of information systems. Because we expect to continue to purchase a portion of our restaurant sites, the amount of actual capital expenditures will be dependent upon, among other things, the proportion of leased versus owned properties. If we construct more or fewer restaurants than we currently anticipate, or acquire additional restaurants, our capital requirements will increase or decrease accordingly.

In fiscal 2006, we expect to incur approximately \$12,500,000 in costs associated with the construction of our new corporate headquarters including \$4,500,000 for land, which we paid in January 2006. We will incur additional construction costs in fiscal 2007, the amount of which has yet to be determined. We intend to enter into a sale leaseback arrangement of the new headquarters upon its completion or thereafter, depending upon market conditions.

In January 2006, we completed the acquisition of four Applebee's restaurants in the Houston area for approximately \$8,200,000. In connection with this

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acquisition, we paid approximately \$8,100,000 in the 2006 year-to-date period.

In May 2005, we completed the acquisition of 12 Applebee's restaurants in Missouri, Kansas and Arkansas, which included one restaurant under construction, for approximately \$39,500,000 in cash.

In April 2005, we completed the acquisition of eight Applebee's restaurants in the Memphis market, which were closed in 2004 by a former franchisee, for approximately \$8,800,000 in cash. In connection with this acquisition, we paid approximately \$800,000 in 2004 and \$8,000,000 in 2005.

In December 2004, we completed the refinancing of our \$150,000,000 unsecured revolving credit facility. The new bank credit agreement provided for a \$150,000,000 five-year unsecured revolving credit facility, of which \$40,000,000 may be used for the issuance of letters of credit. The facility is subject to various covenants and restrictions which, among other things, require the maintenance of stipulated fixed charge, leverage and indebtedness to capitalization ratios, as defined. There is no limit on cash dividends provided that the declaration and payment of such dividend does not cause a default of any other covenant contained in the agreement. The facility is subject to other standard terms, conditions, covenants and fees. In September 2005, we entered into an amendment to our credit facility which increased the revolving credit commitment available from \$150,000,000 to \$200,000,000. In October 2005, we entered into a second amendment to our credit facility which increased the revolving credit commitment available from \$200,000,000 to \$250,000,000 and provided for an additional \$75,000,000 of revolving credit upon satisfaction of the conditions set forth in the credit facility. As of September 24, 2006, we were in compliance with the covenants contained in our credit agreement. As of September 24, 2006, we had borrowings of \$189,000,000, standby letters of credit of \$16,400,000 outstanding and approximately \$44,600,000 available under our revolving credit facility.

In October 2005, our Board of Directors approved a \$175,000,000 authorization to repurchase our common stock, subject to market conditions. During the 2006 year-to-date period, we repurchased 1,285,900 shares of our common stock at an average price of \$21.41 for an aggregate cost of \$27,528,000. As of September 24, 2006, we had \$101,439,000 remaining under our repurchase authorization.

In October 2005, the Board of Directors declared an annual dividend of \$0.20 per share payable to shareholders of record on December 23, 2005. We paid approximately \$14,800,000 in January 2006 related to this dividend.

As of September 24, 2006, our liquid assets totaled \$10,067,000. These assets consisted of cash and cash equivalents in the amount of \$9,776,000 and short-term investments in the amount of \$291,000. The working capital deficit decreased from \$107,400,000 as of December 25, 2005 to \$65,221,000 as of September 24, 2006. This decrease was due primarily to the higher redemption of gift cards as compared to sales of gift cards in the 2006 year-to-date period, a reclass of property and equipment to assets held for sale and decreases in accounts payable and dividends accrued in fiscal 2005.

We believe that our liquid assets and cash generated from operations, combined with available borrowings, will provide sufficient funds for capital expenditures, repurchases of our common stock, the payment of dividends and

32.

operating activities for at least the next 12 months and thereafter for the foreseeable future.

The following table shows our debt amortization schedule, future capital lease

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commitments (including principal and interest payments), future operating lease commitments and future purchase obligations as of September 24, 2006 (in thousands):

Certain Contractual Obligations	Payments due by period		
	Total	Less than 1 year	1-3 years
Long-term Debt (excluding capital lease obligations) (1).....	\$ 190,324	\$ 12,099	\$ 88
Capital Lease Obligations.....	7,739	815	1,716
Operating Leases (2).....	395,875	28,876	57,571
Purchase Obligations - Company(3).....	183,907	163,574	12,074
Purchase Obligations - Franchise(4).....	424,250	369,765	32,355

Other Contractual Obligations

In connection with the sale of restaurants to franchisees and other parties, we have, in certain cases, remained contingently liable for the remaining lease payments. As of September 24, 2006, we have outstanding lease guarantees of approximately \$15,800,000. In addition, we or our subsidiaries are contingently liable for various leases that we have assigned in connection with the sale of restaurants to franchisees and other parties, in the potential amount of \$12,800,000. These leases expire at various times with the final lease agreement expiring in 2018. We did not record a liability related to these contingent lease liabilities as of September 24, 2006 or December 25, 2005.

In 2004, we arranged for a third-party financing company to provide up to \$250,000,000 to qualified franchisees for loans to fund development of new restaurants through October 2007, subject to our approval. We will provide a limited guarantee of 10% of certain loans advanced under this program. We will be released from our guarantee if certain operating results are met after the restaurant has been open for at least two years. As of September 24, 2006, there were loans outstanding to six franchisees for approximately \$69,200,000 under this program. The fair value of our guarantees under this financing program is approximately \$140,000 and is recorded in non-current liabilities in our consolidated balance sheet as of September 24, 2006.

We have severance and employment agreements with certain officers providing for severance payments to be made in the event the associate resigns or is terminated not related to a change in control, some of which require payments to be made only if we enforce certain terms in the agreements. If the severance payments had been due as of September 24, 2006, we would have been required to

33.

make payments totaling approximately \$12,100,000. In addition, we have severance and employment agreements with certain officers which contain severance provisions related to a change in control. The agreements define the circumstances which will constitute a change in control. Those provisions would have required additional aggregate payments of approximately \$5,300,000 if such officers had been terminated as of September 24, 2006.

New Accounting Pronouncements

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In March 2006, the Emerging Issues Task Force ("EITF") issued EITF Issue 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)." A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes. The guidance is effective for periods beginning after December 15, 2006. We present company sales net of sales taxes. This issue will not impact the method for recording these sales taxes in our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 is effective for fiscal years beginning after December 15, 2006. We are evaluating the impact the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are evaluating the impact the adoption of SFAS No. 157 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." This statement requires companies to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income to report the funded status of defined benefit pension and other postretirement benefit plans. The statement requires prospective application, and the recognition and disclosure requirements are effective for companies with fiscal years ending after December 15, 2006. Additionally, SFAS No. 158 requires companies to measure plan assets and obligations at their year-end balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. We are evaluating the impact the adoption of SFAS No. 158 will have on our consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which provides interpretive guidance regarding the consideration given to prior year misstatements when determining materiality in current year financial statements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We are evaluating the impact of SAB No. 108 on our consolidated financial statements.

34.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from fluctuations in interest rates and changes in commodity prices. Our revolving credit facility bears interest at either the bank's prime rate or LIBOR plus 0.75%, at our option. As of September 24, 2006, the total amount of debt subject to interest rate fluctuations was \$189,000,000, which was outstanding on our revolving credit facility. A 1% change in interest rates would result in an increase or decrease in interest expense of approximately \$1,900,000 per year. We may from time to time enter into interest rate swap agreements to manage the impact of interest rate changes on our

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earnings. A substantial portion of the food products and utilities we purchase are subject to price volatility due to factors that are outside of our control such as weather, seasonality and fuel costs. As part of our strategy to moderate this volatility, we have entered into fixed price purchase commitments.

Item 4. Controls and Procedures

As of September 24, 2006, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, under the supervision and with the participation of the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Based on this evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures are effective.

During the 2006 quarter, there have been no changes in our internal control over financial reporting that occurred that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

35.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are subject from time to time to lawsuits, claims and governmental inspections or audits arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. In the opinion of management, these matters are adequately covered by insurance, or if not so covered, are without merit or are of such a nature or involve amounts that would not have a material adverse impact on our business or consolidated financial position.

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our 2005 Annual Report on Form 10-K.

36.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Purchases of Equity Securities.

Purchases of Equity Securities(1)				Maximum Dollar Shares that Purchased Plans or
(a)	(b)	(c)		
Total Number of Shares	Average Price Paid Per	Total Number of Shares Purchased as Part of Publicly Announced		

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Period	Purchased	Share	Plans or Programs	(in tho
June 26, 2006 through July 23, 2006	--	--	--	\$112,
July 24, 2006 through August 20, 2006	388,800	\$18.61	388,800	\$105,
August 21, 2006 through September 24, 2006	209,900	\$19.81	209,900	\$101,
Total	598,700		598,700	

Item 5. Other Information

(a) None

(b) As disclosed in our Current Report on Form 8-K filed with the SEC on August 30, 2006, the Board of Directors has adopted Amended and Restated Bylaws of the Company (the "Bylaws"). These Bylaws change the procedures by which holders of our common stock may nominate persons for election to our Board of Directors at a meeting of stockholders and adopt a new advance notice procedure for stockholders who wish to submit matters to a meeting of our stockholders. The previous bylaw for submitting nominations of directors has been deleted and the new provision governs all submissions by stockholders of proposals to our stockholder meetings.

Under Article II, Section 7 of the Bylaws, any stockholder proposal, including, without limitation, a notice of intention to nominate an individual for election to the Board, must be delivered to the our corporate secretary not less than 120 days nor more than 165 days prior to the date on which we first mailed our proxy materials for the prior year's annual meeting of stockholders; provided, however, that in the event the date of the annual meeting is advanced by more than 30 days or delayed (other than as a result of adjournment) by more than 30 days from the anniversary of the previous year's annual meeting, notice by the stockholder to be timely must be delivered not later than the close of business on the later of the 60th day prior to such annual meeting or the tenth day following the date on which public announcement of the date of such meeting is first made. The notice must contain the information specified in the Bylaws.

37.

As previously stated in our 2006 definitive Proxy Statement, if a stockholder wants us to include a proposal in our proxy statement and form of proxy for presentation at the 2007 meeting, it must be submitted no later than December 12, 2006, and must comply with the rules of the Securities and Exchange Commission.

Under the Bylaws, if a stockholder (i) wants to submit a proposal for the 2007 annual meeting but does not ask us to include it in the proxy statement, or (ii) intends to nominate a person as a candidate for election to the Board directly, rather than through the Corporate Governance/Nominating Committee, the stockholder still must submit the

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proposal or nomination under the timeframes set forth above. For our 2007 annual meeting, we must receive proposals and nominations no earlier than October 28, 2006 and no later than December 12, 2006. If the date of the 2007 annual meeting is advanced by more than 30 days or delayed (other than as a result of adjournment) by more than 30 days from the anniversary of the 2006 annual meeting, the stockholder must submit any such proposal or nomination no later than the close of business on the later of the 60th day prior to the 2007 annual meeting or the tenth day following the day on which public announcement of the date of such meeting is first made. If we do not receive notice of a proposal by the dates set forth above, or if we meet certain other requirements of the SEC rules, the persons named as proxies in the proxy materials relating to that meeting will use their discretion in voting the proxies when these matters are raised at the meeting.

The revised Bylaws also change some procedural aspects of how stockholders may recommend nominees for the board of directors. Stockholders may still submit recommendations for nominees to the Board of Directors to the Corporate Governance/Nominating Committee but must now deliver to the corporate secretary the same information within the same time periods as required by the revised Bylaws for a direct nomination at a meeting. The committee will consider these candidates the same way it evaluates all other candidates.

Item 6. Exhibits

The Exhibits listed on the accompanying Exhibit Index are filed as part of this report.

38.

SIGNATURES

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

APPLEBEE'S INTERNATIONAL, INC.
(Registrant)

Date: October 25, 2006

By: /s/ David L. Goebel

David L. Goebel
Director, President and
Chief Executive Officer
(principal executive officer)

Date: October 25, 2006

By: /s/ Steven K. Lumpkin

Steven K. Lumpkin
Director, Executive Vice President,
Chief Financial Officer and Treasurer

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(principal financial officer)

Date: October 25, 2006

By: /s/ Beverly O. Elving

Beverly O. Elving
Vice President and Controller
(principal accounting officer)

39.

APPLEBEE'S INTERNATIONAL, INC.
EXHIBIT INDEX

Exhibit Number	Description of Exhibit
-----	-----
10.1	Amended and Restated Bylaws of Applebee's International Inc. (incorporated by reference to the Registrant's Form 8-K filed on August 30, 2006).
10.2	Personal Use of Corporate Aircraft by Non-Executive Chairman (incorporated by reference to the Registrant's Form 8-K filed on August 30, 2006).
10.3	Severance Plan for Officers (incorporated by reference to the Registrant's Form 8-K filed on August 30, 2006).
10.4	Amended and Restated Nonqualified Deferred Compensation Plan.
10.5	Form of Officer Restricted Stock Award Agreement for shares subject to the Company's ownership guidelines.
10.6	Form of Officer Restricted Stock Award Agreement for Participants in the Retirement Plan.
10.7	Amended Executive Stock Ownership Guidelines.
31.1	Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a).
31.2	Certification of Chief Financial Officer Pursuant to SEC Rule 13a-14(a).
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

40.