IHOP CORP
Form 10-K
March 01, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

o 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 001-15283

IHOP CORP.

(Exact name of registrant as specified in its charter)

Delaware	**95-3038279**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
450 North Brand Boulevard, Glendale, California	**91203-2306**
(Address of principal executive offices)	(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 Par Value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 o

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

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 and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of July 2, 2006: $856 million.

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

Class	**Outstanding as of February 16, 2007**
Common Stock, $.01 par value	17,880,448

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on Tuesday, May 8, 2007 (the 2007 Proxy Statement) are incorporated by reference into Part III.

IHOP CORP. AND SUBSIDIARIES
Annual Report on Form 10-K
For the Fiscal Year Ended December 31, 2006
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PART I

Item 1. Business.

a. General Information

IHOP Corp. (referred to herein as the Company) was incorporated under the laws of the State of Delaware in 1976. In July 1991, the Company completed an initial public offering of common stock. There were no significant changes to our corporate structure in the past five years.

IHOP Corp. s principal executive offices are located at 450 North Brand Boulevard, Glendale, California 91203-2306 and our telephone number is (818) 240-6055. Our website is located at www.ihop.com. We make all of our filings with the Securities and Exchange Commission (referred to herein as the SEC) available free of charge on our website as soon as reasonably practicable after such reports have been filed with or furnished to the SEC. The information contained on our website is not incorporated into this Annual Report on Form 10-K.

This Annual Report on Form 10-K should be read in conjunction with the cautionary statements on page 21 under Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. Forward Looking Statements.

b. Financial Information about Industry Segments

We identify our segments based on the organizational units used by management to monitor performance and make operating decisions. Our segments are recorded in four categories: franchise operations, rental operations, company restaurant operations and financing operations. The franchise operations segment consists of restaurants operated by our franchisees and area licensees in the United States and Canada. Franchise operations revenue consists primarily of royalty revenues, sales of proprietary products, advertising fees and the portion of the franchise fees allocated to the Company s intellectual property. Franchise operations expenses consist primarily of support for the national advertising fund, the cost of proprietary products and pre-opening expenses. Rental operations revenue consists of revenue from operating leases and interest income from direct financing leases. Rental operations expenses are costs of operating leases and interest expense on capital leases on franchisee-operated restaurants. The company restaurant operations segment consists of company-operated restaurants in the United States. Company restaurant sales are retail sales at company-operated restaurants. Company restaurant expenses are operating expenses at company-operated restaurants and include food, labor, benefits, utilities, rent and other real estate related costs. Financing operations revenue consists of the portion of franchise fees not allocated to the Company s intellectual property and sales of equipment as well as interest income from the financing of franchise fees and equipment leases. Financing operations expenses are primarily the cost of restaurant equipment and interest expense not associated with capital leases.

c. Narrative Description of Business

General

IHOP Corp. and its subsidiaries develop, franchise and operate International House of Pancakes, or IHOP, restaurants, one of America s best-known, national, family restaurant chains. At December 31, 2006, there were 1,302 IHOP restaurants. Franchisees operated 1,132 of these restaurants, area licensees operated 160 restaurants, and the Company operated ten restaurants. Franchisees and area licensees are independent third parties who are licensed by us to operate their restaurants using our trademarks, operating systems and methods. IHOP restaurants are located in 49 states and Canada.

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

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

Restaurant Development

Prior to 2004, we financed and developed the large majority of new IHOP restaurants prior to franchising them (the Old Business Model). Under the Old Business Model, when the restaurant was ultimately franchised, we typically became the franchisee s landlord and equipment lessor. Our new business model (the New Business Model) relies on franchisees to find sources of financing and develop IHOP restaurants. Under the New Business Model, we approve the franchisees proposed sites but do not contribute capital or become the franchisee s landlord.

Under the New Business Model, substantially all new IHOP restaurants are financed and developed by franchisees or area licensees. In 2006, our franchisees and area licensees financed and developed 65 additional new restaurants and we developed four restaurants in our company operations market in Cincinnati, Ohio.

Regardless of the business model, new IHOP restaurants are only developed after a stringent site selection process supervised by our senior management. We expect to add restaurants to the IHOP system in major markets where we already have a core guest base. We believe that concentrating growth in existing markets allows us to achieve economies of scale in our supervisory and advertising functions. We also look to strategically add restaurants in geographic areas in which we have no presence or our presence is limited.

Future Restaurant Development

In 2006, we entered into 30 franchise development agreements. As of December 31, 2006, we had signed commitments from our franchisees to build 365 restaurants over the next several years plus options for an additional 82 restaurants. This number includes 12 Single-Store Development Agreements, 80 Multi-Store Development Agreements and three International Development Agreements.

In 2007, we expect to open a total of 61 to 66 new restaurants, as follows: Our franchisees are expected to open approximately 55 to 60 new restaurants, our area licensee in Florida will open approximately three restaurants and we expect franchisees to open a total of three new restaurants in Canada, Mexico, and the U.S. Virgin Islands in 2007. We expect the majority of openings to occur in the second and third quarters of 2007.

The following table represents our restaurant development commitments including options as of December 31, 2006.

		Scheduled Opening of Restaurants by				
	Number of Signed Agreements at 12/31/06	**2007**	**2008**	**2009**	**2010 and thereafter**	**Total**
Single-store development agreements	12	8	4			12
Multi-store development agreements	80	59	73	62	215	409
International development agreements	3	4	2	3	17	26
	95	71	79	65	232	447

The Company believes in 2007 there are approximately 500 to 600 additional IHOP restaurant opportunities existing in the United States, and is actively recruiting existing and new franchisees to develop these opportunities.

Franchising

Our franchising activities for the years ended December 31, 2006 and 2005 included both company financed and franchisee financed development. For clarity of presentation, the discussion below is separated between those activities specific to the Old Business Model and those which apply to the New Business Model.

Old Business Model

Under the Old Business Model, when we developed a restaurant, we identified the site for the new restaurant, purchased the site or leased it from a third party, and built the restaurant and equipped it with all required equipment. We selected and trained the franchisee and supervisory personnel who would operate the restaurant. In addition, we financed approximately 80% of the franchise fee and leased the restaurant and equipment to the franchisee. In accordance with U.S. generally accepted accounting principles (herein referred to as GAAP), the equipment lease between the Company and the franchisee was treated as a sale in our financial statements.

Our involvement in the development and financing of new restaurants allowed the Company to charge a core franchise fee and development and financing fees totaling $50,000 to $575,000. The franchisee typically paid approximately 20% of the initial franchise fee in cash, and we financed the remaining amount over five to eight years. The financing of the initial franchise fee allowed the Company to derive interest income from the financing of the core franchise fee and development and financing fees, and the leasing of property and equipment to franchisees. We also continue to receive revenues from the franchisee as follows: (1) a royalty equal to 4.5% of the restaurant s sales; (2) income from the leasing of the restaurant property and related equipment; (3) revenue from the sale of certain proprietary products, primarily pancake mixes; (4) a local advertising fee equal to about 2% of the restaurant s sales, which is usually collected by us and then paid to a local advertising cooperative to cover the cost of media purchases and other advertising expenses; and (5) a national advertising fee equal to 1% of the restaurant s sales. In some cases, we have agreed to accept reduced royalties for a period of time from franchisees in order to assist them in establishing their businesses, where business conditions justify it.

New Business Model

Under the New Business Model, our approach to franchising is similar to that of most franchising systems in the foodservice industry. Franchisees can undertake individual store development or multi-store development. Under the single-store development program, the franchisee is required to pay a non-refundable location fee of $15,000. If the proposed site is approved for development, the location fee of $15,000 is credited against an initial franchise fee of $50,000. The franchisee then uses his or her own capital and financial resources along with third party financial sources to acquire a site, build and equip the business and fund working capital needs.

In addition to offering franchises for individual restaurants, the Company offers multi-store development agreements. These multi-store development agreements provide franchisees with an exclusive right to develop new IHOP restaurants in designated geographic territories for specified periods of time. Multi-store developers are required to develop and operate a specified number of restaurants according to an agreed upon development schedule. Multi-store developers are required to pay a development fee of $20,000 for each restaurant to be developed under a multi-store development agreement. Additionally, for each store which is actually developed, the franchise developer must pay an initial franchise fee of $40,000 against which the development fee of $20,000 is credited. The number of stores and the schedule of stores to be developed under multi-store development agreements are negotiated on an agreement by agreement basis. The average franchise period under the New Business Model is 20 years. With respect to restaurants developed under the New Business Model, the Company receives continuing revenues from the franchisee as follows: (1) a royalty equal to 4.5% of the restaurant s sales; (2) revenue from the sale of certain proprietary products, primarily pancake mixes; (3) a local advertising fee equal to about 2% of the restaurant s sales, which is usually paid to a local advertising cooperative; and (4) a national advertising fee equal to 1% of the restaurant s sales.

In 2005, we began to charge a franchise renewal fee of approximately $50,000 per franchise agreement. This fee was charged to existing franchisees who refranchise their restaurants upon the expiration of the original franchise agreement.

Area License Agreements

We have long-term area licensing agreements covering the state of Florida and the southern-most counties of Georgia and the province of British Columbia, Canada. As of December 31, 2006, the area licensee for the state of Florida and certain counties in Georgia operated or sub-franchised a total of 148 IHOP restaurants and the area licensee for the province of British Columbia, Canada operated or sub-franchised a total of 12 IHOP restaurants. The area license agreements provide for royalties ranging from 0.5% to 2% of sales, and advertising fees of 0.25% of sales and give the area licensees the right to develop new IHOP restaurants in their territories. We also derive revenue from the sale of proprietary products to these area licensees and their sub-franchisees. We treat the revenues from our area licensees as franchise operations revenues for financial reporting purposes.

Company-Operated Restaurants

Company-operated restaurants are comprised of our dedicated company-operations market in Cincinnati, Ohio. In addition, from time to time, restaurants developed by the Company under the Old Business Model are returned by franchisees to the Company and operated by the Company. The type and number of company-operated restaurants varies from time to time as we develop new restaurants, reacquire franchised restaurants and franchise reacquired restaurants.

At the end of 2006, the Company operated a total of ten IHOP restaurants, all of which are located in our dedicated Company market of Cincinnati. The Company will operate these restaurants in order to highlight best practices in operations and training, and perform various marketing, development and operations tests that can be instructive in the development of new business ideas. Restaurants that we reacquire from franchisees usually require investment in remodeling and rehabilitation before being refranchised. As a consequence, a number of reacquired company-operated restaurants are likely to incur operating losses during the period of their rehabilitation.

Refranchising Program

From time to time, we reacquire restaurants from franchisees for various reasons including franchisees not meeting their financial obligations to the Company. Our strategy is to refranchise these restaurants without operating the restaurant whenever possible. However, when it is necessary to operate the restaurant, our goal is to refranchise the restaurant as quickly as possible. We never operated five of the nine total restaurants refranchised in 2006. In 2006, the average time from the takeback to refranchising restaurants was approximately 19 days.

Remodel Program

We require all of our franchisees to periodically remodel their restaurants. In most instances, we require that the restaurants be remodeled at least every five years. In 2004, we finalized our new ICON remodel package. We believe that the new ICON remodel design will continue to revitalize the IHOP brand and create an environment that our guests can enjoy throughout the day. In 2006, there were 182 remodels completed, bringing the total number of restaurants remodeled under the new ICON remodel package to 351. We believe that our franchisees will complete approximately 220 remodels in 2007.

Composition of Franchise System

The table below sets forth information regarding the distribution of single-store and multi-store franchisees in the IHOP system as of December 31, 2006. It does not include information concerning our area licensees or their sub-franchisees.

Number of Restaurants Held by Franchisee	Franchisees	Percent of Total	Restaurants	Percent of Total
One	175	47.8 %	175	15.5 %
Two to Five	143	39.1 %	386	34.1 %
Six to Ten	31	8.5 %	229	20.2 %
Eleven to Fifteen	7	1.9 %	88	7.8 %
Sixteen and over	10	2.7 %	254	22.4 %
Total	366	100.0 %	1,132	100.0 %

Restaurant Operations and Support

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

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

The Company has established a rating system whereby all IHOP franchisees are evaluated and graded on important operational standards. The evaluation consists of many factors including consultation, mystery shop and health department scores. The franchisee grades are on an A through F scale. Our Operations Department works closely with all of our operators in order to improve their scores and grades. However, in the cases of D and F operators, immediate improvement is expected or proactive efforts are undertaken to remove these operators from our system.

Each franchise restaurant is assigned a Franchise Business Consultant and an Operational Assessment Specialist. The Franchise Business Consultant regularly visits an assigned group of restaurants and is responsible for consultation with franchisees regarding financial, operational, marketing, and human resource objectives, including certification of trainers, and development of strategies and tactics for each franchise restaurant. In addition, the Franchise Business Consultant assists the franchisee in the achievement of sales objectives. The Operational Assessment Specialist visits an assigned group of restaurants at least twice a year, and is responsible for conducting operational audits, providing consultation reports, and assessing product quality, quality assurance, equipment, facilities, and management techniques. The Company expects to outsource the Operational Assessment Specialist functions in 2007.

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

The Company offers additional training courses periodically throughout the year on subjects such as operations improvement, guest service, leadership, technology in the restaurants, and new menu items. In 2007, the Company is rolling out its new IHOP Restaurant Training Program (IRTP) which is a comprehensive program aimed at training all non-management, restaurant-level employees. This program is a paper/video based program, designed to be flexible to the learner and adaptable to different franchisee systems. It covers full training for Servers, Cook positions, Host/Hostess/Cashiers, Dish Machine Operators, and Bussers. The program was created and tested in 2006 and is being rolled out in the first quarter of 2007.

The IHOP menu offers a large selection of high-quality, moderately priced products designed to appeal to a broad guest base. These include a wide variety of pancakes, waffles, omelets and breakfast specialties, chicken, steak, sandwiches, salads and lunch and dinner specialties. Most IHOP restaurants offer special items for children and seniors at reduced prices. In recognition of local tastes, IHOP restaurants typically offer regional specialties that complement the IHOP core menu. Our Product Research and Development Department works together with franchisees and our Operations and Marketing Departments to continually develop new menu and promotion ideas. These new items are thoroughly evaluated in our test kitchen and in limited regional tests, which include both operational tests and media supported tests, before being introduced throughout the system through core menu updates at least once annually. The purpose of adding new items is to enhance the menu through improving existing items and adding new items which will appeal to our customers. All our efforts are based on consumer research and feedback,which help us identify opportunities for improvement to existing items as well as for developing new items.

Mystery Shop Program

The Company utilizes an independent firm to conduct unannounced and anonymous visits to each IHOP restaurant several times each quarter. These mystery shoppers provide the Company and our franchisees direct independent feedback at the restaurant on food quality, cleanliness, service and other aspects of the guest experience at IHOP restaurants. This on-going independent Mystery Shop Program is designed to give us a better understanding of how our restaurant teams operate and how we measure against our competitors. As a result, we are able to apply the individual feedback from each mystery shop visit at the restaurant level and work closely with our franchisees to develop a specific action plan to improve each restaurant s performance. This program is incorporated into the Company s rating system which evaluates and grades all IHOP franchisees. The Company believes improved operations of each individual restaurant through this rating system will provide a basis for continued increases in same-store sales performance over time.

Marketing and Advertising

All IHOP franchisees and company-operated restaurants contribute 2% of sales to local advertising cooperatives. The advertising co-ops use these funds to purchase television advertising time, radio advertising time and place advertisements in printed media or direct mail locally. In addition to these forms of advertising, we encourage other local marketing by our franchisees. These marketing programs often include discount coupons and specials aimed at increasing guest traffic and encouraging repeat business.

In addition, IHOP franchisees and company-operated restaurants contribute 1% of sales to a national advertising fund. We pursue national television advertising, in recognition of the national scope of the chain and the economies of scale available to national advertisers. Continuing our use of national advertising and our new successful advertising campaign, we implemented four promotions in 2006 supported with national advertising and two others supported with local media. The combined impact of the media spending, the creative campaign and the execution at the store level helped us achieve a system-wide same-store sales increase of 2.5% for the year, on top of the 2.9% increase in 2005. In 2007, with the strong support of our franchisees, a portion of our local cooperative advertising will be reallocated to our national advertising fund allowing us to reach our target audience more frequently and in a more effective way through increased national spending.

In 2007, we plan to launch six promotions, five of which will be advertised on national television. We plan to continue to use our very successful Come hungry. Leave happy. advertising campaign and our strategy of building on our breakfast strength while growing sales at lunch, dinner and other day parts. With the appeal of limited time offerings unique to IHOP, the power of national advertising and the positive momentum in the field, we expect to continue to drive increased same-store sales throughout our system.

Purchasing

We have entered into supply contracts for pancake mixes and pricing agreements for most major products carried in IHOP restaurants to ensure the availability of quality products at competitive prices. We also have negotiated agreements with food distribution companies to limit markups charged on food and restaurant supplies purchased by individual IHOP restaurants. In some instances, we are required to enter into commitments to purchase food and other items on behalf of the IHOP system as a whole for the purpose of supplying limited-time promotions. At December 31, 2006, our outstanding purchase commitments for upcoming limited-time offers advertised on television were $0.7 million. We have developed processes to facilitate the liquidation of these commitments to minimize financial exposure. In addition, to take advantage of economies associated with system-wide volume purchasing, the Company and our franchisees have developed procurement processes to secure favorable pricing agreements based on system-wide ordering and ensure availability for most major products carried in IHOP restaurants.

Competition and Markets

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

The acquisition of sites is also highly competitive. Our franchisees often compete with other restaurant chains and retail businesses for suitable sites for the development of new restaurants.

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

Information published in 2006 by *The Nations Restaurant News* ranked IHOP 25 out of the top 100 foodservice chains based on estimated fiscal 2005 system-wide sales in the United States. The same publication included nine family restaurant chains in its top 100 chains, and IHOP ranked second in this segment based on system-wide sales.

The Company also competes against other franchising organizations both within and outside the restaurant industry for new franchise developers.

Trademarks and Service Marks

We have registered our trademarks and service marks with the United States Patent and Trademark Office. These include International House of Pancakes, IHOP and variations of each, as well as The Never Empty Coffee Pot, Rooty Tooty Fresh N Fruity, and Harvest Grain N Nut. W register new trademarks and service marks from time to time. We have also registered our trademarks and service marks and variations thereof in Canada for use by our current licensees. Where feasible and appropriate, we register our trademarks and service marks in other nations for future use.

In 2006, we became aware of certain technical issues relating to registrations and applications filed with the United States Patent and Trademark Office prior to July 5, 1999 (the Pre-1999 Registrations), which include registrations for various IHOP and International House of Pancakes marks. These issues affected the continued validity of the Pre-1999 Registrations and made inaccurate certain statements in the Uniform Franchise Offering Circular (UFOC) we used during certain periods after July 5, 1999.

The invalidity of the Pre-1999 Registrations affects our ability to take advantage of certain trademark enforcement features available under the Lanham Act (15 U.S.C. §1051 et seq.) with respect to the trademarks covered by the Pre-1999 Registrations. We have taken and will continue to take corrective actions including canceling the Pre-1999 Registrations and obtaining new registrations for any affected trademarks that are still in use. We anticipate these steps will be fully effective within the next 18-24 months. Our intellectual property rights include the common law rights in the marks that are subject to the Pre-1999 Registrations, as well as post-July 5, 1999 registrations for logos which contain IHOP and International House of Pancakes and rights in other more recent registered marks, such as Come Hungry. Leave Happy.

We may rely upon the extensive common law rights in the trademarks subject to Pre-1999 Registrations derived from established usage of the IHOP and International House of Pancakes marks and IHOP s presence in 49 states to address trademark infringement under federal and state law. Federal registration is not required to bring a trademark infringement claim under Section 43(a) of the Lanham Act or to bring unfair competition claims under state law. We do not need to rely on its U.S. federal registrations as bases to obtain or maintain foreign trademark registrations. Accordingly, we should continue to have the ability to enforce our existing rights in the affected marks.

In addition, we have taken the corrective actions we believe necessary with respect to any misstatements in the UFOCs derived from the invalid trademark registrations, including the filing of amendments to those UFOCs in those States where amended filings are required.

We believe that any issues regarding the invalidity of the federal registrations of the affected marks and the related UFOC misstatements have not had and will not have any material impact on the IHOP Franchisees or our business.

We are not aware of any infringing uses that could materially affect our business, or any prior claim to any rights in these marks that would prevent us from using or licensing the use of those marks for IHOP Restaurants in any area of the United States. In addition, we believe that the inadvertent misstatements in the UFOCs derived from the invalid trademark registrations have had no adverse consequences to us or to our Franchisees and that adverse regulatory action based on the inadvertent misstatements in the UFOCs is not reasonably likely to occur.

Seasonal Operations

The Company does not consider its operations to be seasonal to any material degree.

Government Regulation

We are subject to various federal, state and local laws affecting our business as well as a variety of regulatory provisions relating to zoning of restaurant sites, sanitation, health and safety. As a franchisor, we are subject to state and federal laws regulating various aspects of franchise operations and sales. These laws impose registration and disclosure requirements on franchisors in the offer and sale of franchises. In certain cases, they also apply substantive standards to the relationship between franchisor and franchisee, including primarily defaults, termination, non-renewal of franchises, and the potential impact of new IHOP restaurants on sales levels at existing IHOP restaurants. Environmental requirements have not had a material effect on the operations of our company-operated restaurants or the restaurants of our franchisees.

Various federal and state labor laws govern our relationships with our employees. These include such matters as minimum wage requirements, overtime and other working conditions. Significant additional government-imposed increases in minimum wages, paid leaves of absence, mandated health benefits or increased tax reporting and tax payment requirements with respect to employees who receive gratuities could, however, be detrimental to the economic viability of franchisee-operated and company-operated IHOP restaurants.

Employees

At December 31, 2006, we employed 972 persons, of whom 267 were full-time, non-restaurant, corporate personnel.

Item 1A. Risk Factors.

Risks Related to the Food Service Industry. Food service businesses may be affected by changes in consumer tastes, national, regional and local economic and political conditions, demographic trends, and the impact on consumer eating habits of new information regarding diet, nutrition and health. The performance of individual restaurants may be adversely affected by factors such as traffic patterns, demographics and the type, number and location of competing restaurants.

Multi-unit food service businesses such as ours can also be materially and adversely affected by widespread negative publicity of any type, but particularly regarding food quality, illness, obesity, injury or other health concerns with respect to certain foods. All restaurants are operated in accordance with uniform operating standards and specifications relating to the quality and preparation of menu items, maintenance, repair and cleanliness of premises. Nevertheless, the risk of food-borne illness cannot be completely eliminated. Any outbreak of such illness attributed to our restaurants or within the food service industry or any widespread negative publicity regarding our brands or the restaurant industry in general could have a material adverse effect on our financial condition or results of operations.

Dependence on frequent deliveries of fresh produce and groceries subjects food service businesses, such as ours, to the risk that shortages or interruptions in supply, caused by adverse weather or other conditions, could adversely affect the availability, quality and cost of ingredients. In addition, unfavorable trends or developments concerning factors such as inflation, increased cost of food, labor, construction, fuel, utilities, technology, insurance and employee benefits (including increases in hourly wage, and workers compensation and other insurance premiums), increases in the number and locations of competing restaurants, regional weather conditions and the availability of experienced management and hourly employees, may also adversely affect the food service industry in general. Changes in economic conditions affecting our customers could reduce traffic in some or all of our restaurants or impose practical limits on pricing, either of which could have a material adverse effect on our financial condition and results of operations. Our continued success will depend in part on our ability to anticipate, identify and respond to changing conditions.

Risks Associated with the Company s Development Plan. The Company relies on franchisees to develop IHOP restaurants. Development involves substantial risks, including the risk of (a) the availability of suitable locations and terms of the sites designated for development, (b) the ability of franchise developers to fulfill their commitments to build new IHOP restaurants in the numbers and time frames covered by their development agreements, (c) the availability of financing to franchisees at acceptable rates and terms, (d) delays in completion of construction, (e) developed properties not achieving desired revenue or cash flow levels once opened, (f) competition for suitable development sites, (g) changes in governmental rules, regulations, and interpretations (including interpretations of the requirements of the American with Disabilities Act (ADA), and (h) general economic and business conditions.

Although we intend to manage our future restaurant development to reduce such risks, we cannot be sure that present or future development will perform in accordance with our expectations. We cannot be sure that the development and construction of the facilities will be completed, or that any such development will be completed in a timely manner. Our inability to expand in accordance with our plans or manage our growth could have a material adverse effect on our results of operations and financial condition.

Risks Related to Entering New Domestic Markets. We cannot be sure that we will be able to successfully expand or acquire critical market presence for our brands in new geographic markets, as we may encounter well-established competitors with substantially greater financial resources. Our franchisees may be unable to find attractive locations, acquire name recognition, successfully market our products and attract new customers. Competitive circumstances and consumer characteristics in new market segments and new geographic markets may differ substantially from those in the market segments and geographic markets in which we have substantial experience. We cannot assure that our franchisees will be able to profitably operate new franchised restaurants in new geographic markets. Management decisions to curtail or cease investment in certain locations or markets may result in impairment charges.

Risks Related to Entering New International Markets. We cannot be sure that we will be successful in our international markets or in achieving expected growth. Certain inherent risks are associated with international markets such as foreign currency exchange rate fluctuations, interpretation and application of laws and regulations, restrictive actions of foreign or United States governmental authorities affecting trade and foreign investment, including protective measures such as export and customs duties and tariffs and restrictions on the level of foreign ownership, import or other business licensing requirements, the enforceability of intellectual property and contract rights, and lower levels of consumer spending on a per capita basis than in the United States.

Risks Related to Competition. The restaurant industry is highly competitive with respect to price, service, location, personnel and the type and quality of food. Each of our restaurants competes directly and indirectly with a large number of national and regional restaurant chains, as well as with locally-owned quick service restaurants, fast-casual restaurants, sandwich shops and similar types of businesses. The trend toward convergence in grocery, deli, and restaurant services may increase the number of our competitors. Such increased competition could have a material adverse effect on our financial condition and results of operations. Certain of our competitors have introduced a variety of new products and engaged in substantial price discounting in recent years and may continue to do so in the future. We plan to continue our product promotion schedule supported by national and local advertising, as well as strengthen our core menu. However, there can be no assurance of the success of our new products, initiatives or our overall strategies or that competitive product offerings, pricing and promotions will not have an adverse effect upon our results of operations and financial condition.

Risks Related to Advertising. We plan to continue our advertising campaign Come hungry. Leave happy. which we believe resonates positively with our customers, as well as continue to shift advertising expenditures from local market spending to coordinated national spending with the support of our franchisees. Should our competitors increase spending on advertising and promotion, should the cost of television or radio advertising increase, or our advertising funds decrease for any reason, including implementation of reduced spending strategies, or should our advertising and promotion be less effective than that of our competitors, there could be a material adverse effect on our results of operations and financial condition.

Risks Related to Income Taxes. Our income tax provision is based on estimates of federal and state income tax liabilities and includes effective state and local income tax rates, allowable tax credits for items such as FICA taxes paid on reported tip income and estimates related to depreciation expenses allowable for tax purposes. Thus, our income tax provision may vary quarter-to-quarter and year-to-year based on these estimates. We usually file our income tax returns a number of months after our fiscal year-end. All tax returns are subject to audit by federal and state governments, usually years after the returns are filed, and could be subject to differing interpretation of the tax laws. The ultimate outcome of these audits could have an adverse effect upon our results of operations and financial condition.

In addition, our tax contingency reserves result from estimates of potential liabilities resulting from differences between actual and audited results. Changes in the tax contingency reserve result from resolution of audits of prior year filings, the expiration of the statute of limitations, changes in tax laws and current year estimates for asserted and unasserted items. Inherent uncertainties exist in estimates of tax contingencies due to changes in tax law, both legislated and concluded through the various jurisdictions tax court systems. Significant changes in our estimates could adversely affect our reported results.

Risks Related to Franchise Operations. The opening and success of franchised restaurants depends on various factors, including the demand for our franchises and the selection of appropriate franchisee candidates, the availability of suitable sites, the negotiation of acceptable lease or purchase terms for new locations, permitting and regulatory compliance, the ability to meet construction schedules, the availability of financing and other capabilities of our franchisees and developers. We cannot be sure that developers planning the opening of franchised restaurants will have the business abilities or sufficient access to financial resources necessary to open the restaurants required by their agreements. We cannot be sure that franchisees will successfully participate in our strategic initiatives or operate their restaurants in a manner consistent with our concept and standards. In addition, certain federal and state laws govern our relationships with our franchisees. See Risks Related to Government Regulations below.

Risks Related to Government Regulations. The restaurant industry is subject to extensive federal, state and local governmental regulations, including those relating to the preparation and sale of food and those relating to building and zoning requirements. We and our franchisees are also subject to licensing and regulation by state and local departments relating to health, sanitation and safety standards, and to laws governing our relationships with employees, including minimum wage requirements, overtime, working conditions and citizenship requirements. The ability to obtain or maintain such licenses or publicity

resulting from actual or alleged violations of such laws could have an adverse effect on our results of operations. We are also subject to federal regulation and certain state laws which govern the offer and sale of franchises. Many state franchise laws impose substantive requirements on franchise agreements, including limitations on non-competition provisions and on provisions concerning the termination or non-renewal of a franchise. Some states require that certain materials be registered before franchises can be offered or sold in that state. The failure to obtain or retain licenses or approvals to sell franchises could adversely affect us and our franchisees. Changes in, and the cost of compliance with, government regulations could have a material adverse effect on our operations.

Risks Related to Trademarks and Service Marks. We are dependent on continued rights to use, exploit and protect our trademarks and service marks, many of which have been in use for many years. In 2006, we became aware of certain technical issues relating to registrations and applications filed with the United States Patent and Trademark Office prior to July 5, 1999 (the Pre 1999 Registrations), which include registrations for various IHOP and International House of Pancakes marks. These issues affected the continued validity of the Pre-1999 Registrations and made inaccurate certain statements in the Uniform Franchise Offering Circular (UFOC) we used during certain periods after July 5, 1999.

The invalidity of the Pre-1999 Registrations affects our ability to take advantage of certain trademark enforcement features available under the Lanham Act with respect to the trademarks covered by the Pre-1999 Registrations. We have taken and will continue to take corrective actions including canceling the Pre-1999 Registrations and obtaining new registrations for any affected trademarks that are still in use. We anticipate these steps will be fully effective within the next 18-24 months.

Our intellectual property rights include the common law rights in the marks that are subject to the Pre-1999 Registrations, as well as post-July 5, 1999 registrations for logos which contain IHOP and International House of Pancakes and rights in other more recent registered marks, such as Come Hungry. Leave Happy. We may rely upon the extensive common law rights in the trademarks subject to Pre-1999 Registrations derived from established usage of the IHOP and International House of Pancakes marks and IHOP s presence in 49 states to address trademark infringement under federal and state law. Federal registration is not required to bring a trademark infringement claim under Section 43(a) of the Lanham Act or to bring unfair competition claims under state law. We do not need to rely on its U.S. federal registrations as bases to obtain or maintain foreign trademark registrations. Accordingly, we should continue to have the ability to enforce our existing rights in the affected marks.

Under the Lanham Act, there are a number of benefits afforded to marks registered on the Principal Register of the United States Patent and Trademark Office. These benefits include, among other things: (1) constructive notice that the registrant of the mark has the right to use the mark throughout the United States; (2) prima facie evidence that the mark is valid; (3) prima facie evidence that the mark has been in continuous use since filing of the application; (4) the fact that the mark cannot be attacked on the basis of prior use or descriptiveness, after five years of continuous use; and (5) the existence of certain rights under international conventions that assist in foreign registration of the mark. The invalidity of the Pre-1999 Registrations means that we will not be able to rely on these provisions of the Lanham Act until the new registrations are effective.

In addition, we have taken the corrective actions we believe necessary with respect to any misstatements in the UFOCs derived from the invalid trademark registrations, including the filing of amendments to those UFOCs in those States where amended filings are required.

We believe that any issues regarding the invalidity of the federal registrations of the affected marks and the related UFOC misstatements have not had and will not have any material impact on the IHOP Franchisees or our business.

We are not aware of any infringing uses that could materially affect our business, or any prior claim to any rights in these marks that would prevent us from using or licensing the use of those marks in any area of the United States. In addition, we believe that the inadvertent misstatements in the UFOCs derived from the invalid trademark registrations have had no adverse consequences to us or to our Franchisees and that adverse regulatory action based on the inadvertent misstatements in the UFOCs is not reasonably likely to occur.

Risks Related to the Failure of Internal Controls. The Company maintains a documented system of internal controls which is reviewed and monitored by the Audit Committee and tested by the Company s full time Internal Audit Department to meet the Sarbanes-Oxley Act of 2002 standards. The Internal Audit Department reports to the Audit Committee of the Board of Directors. The Company believes it has a well-designed system to maintain adequate internal controls on the business. However, there can be no assurance that there will not be any control deficiencies in the future. Should we become aware of any significant control deficiencies, the Audit Committee will require prompt remediation. We have devoted significant resources to document, test, monitor and improve our internal controls and will continue to do so; however, we cannot be certain that these measures will ensure that our controls are adequate in the future or that adequate controls will be effective in preventing fraud. If we fail to maintain an effective system of internal controls, we might not be able to accurately report our financial results or prevent fraud. Any failures in the effectiveness of our internal controls could have a material adverse effect on our operating results or cause us to fail to meet reporting obligations.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The table below shows the location and status of the 1,302 IHOP restaurants as of December 31, 2006:

Location	Franchise	Company-Operated	Area License	Total
United States				
Alabama	17	0	0	17
Alaska	2	0	0	2
Arizona	32	0	0	32
Arkansas	12	0	0	12
California	221	0	0	221
Colorado	28	0	0	28
Connecticut	5	0	0	5
Delaware	3	0	0	3
Florida	0	0	145	145
Georgia	56	0	3	59
Hawaii	2	0	0	2
Idaho	8	0	0	8