

CHECKERS DRIVE IN RESTAURANTS INC /DE

Form 10-Q

July 26, 2004

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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 June 14, 2004

OR

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

For the transition period from _____ to _____

Commission file number 0-19649

Checkers Drive-In Restaurants, Inc.

(Exact name of Registrant as specified in its charter)

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Delaware (State or other jurisdiction of incorporation or organization)	58-1654960 (I.R.S. employer identification no.)
4300 West Cypress Street Suite 600	
Tampa, FL (Address of principal executive offices)	33607 (Zip code)

Registrant's telephone number, including area code: (813) 283-7000

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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b - 2). Yes No

The Registrant had 11,758,205 shares of Common Stock, par value \$.001 per share, outstanding as of June 14, 2004 (excludes 944,000 shares held in treasury).

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	June 14, 2004	December 29, 2003
	<u> </u>	<u> </u>
Current Assets:		
Cash and cash equivalents	\$ 13,097	\$ 13,566
Accounts, notes and leases receivable, net	2,962	3,182
Inventory	1,033	1,112
Prepaid rent	318	1,522
Deferred income tax assets	3,910	3,585
Property and equipment held for sale	1,027	1,313
Other current assets	433	498
	<u> </u>	<u> </u>
Total current assets	22,780	24,778
Restricted cash	4,429	4,141
Property and equipment, net	52,007	47,270
Notes receivable, net - less current portion	4,909	4,325
Leases receivable, net - less current portion	4,786	5,371
Intangible assets, net	17,286	20,940
Deferred income tax assets	21,607	21,104
Other assets	1,405	1,506
	<u> </u>	<u> </u>
	\$ 129,209	\$ 129,435
	<u> </u>	<u> </u>
Current Liabilities:		
Current maturities of long-term debt and obligations under capital leases	\$ 2,574	\$ 3,071
Accounts payable	4,590	5,110
Reserves for restaurant relocations and abandoned sites	1,168	999
Accrued wages and benefits	2,452	2,166
Accrued self insurance	1,517	1,327
Accrued liabilities	5,941	4,832
	<u> </u>	<u> </u>
Total current liabilities	18,242	17,505
Long-term debt, less current maturities	18,080	19,974
Obligations under capital leases, less current maturities	4,486	4,982
Long-term reserves for restaurant relocations and abandoned sites	4,729	4,602
Deferred revenue	3,403	4,249
Accrued self insurance	3,243	3,366
Other long-term liabilities	1,371	1,290

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Total liabilities	53,554	55,968
Stockholders Equity:		
Preferred stock, \$.001 par value, authorized 2,000,000 shares, none issued at June 14, 2004 and December 29, 2003		
Common stock, \$.001 par value, authorized 175,000,000 shares, issued 12,702,205 at June 14, 2004 and 12,541,588 at December 29, 2003	13	12
Additional paid-in capital	148,899	147,733
Accumulated deficit	(64,915)	(70,583)
	83,997	77,162
Less: Treasury stock, 944,000 shares at June 14, 2004 500,000 shares at December 29, 2003, at cost	(8,342)	(3,695)
Total stockholders equity	75,655	73,467
	\$ 129,209	\$ 129,435

See accompanying notes to the consolidated financial statements

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CHECKERS DRIVE-IN RESTAURANTS, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(Dollars in thousands except per share amounts)
(UNAUDITED)

	<u>Quarter Ended</u>		<u>Two Quarters Ended</u>	
	<u>June 14, 2004</u>	<u>June 16, 2003</u>	<u>June 14, 2004</u>	<u>June 16, 2003</u>
REVENUES:				
Restaurant sales	\$ 41,330	\$ 42,160	\$ 80,556	\$ 81,879
Franchise royalty revenue	4,025	3,715	7,764	7,023
Franchise fees and other income	273	130	319	184
Total revenues	45,628	46,005	88,639	89,086
COSTS AND EXPENSES:				
Restaurant food and paper costs	13,285	13,271	25,433	25,712
Restaurant labor costs	12,123	12,500	24,304	24,548
Restaurant occupancy expenses	2,702	2,851	5,447	5,837
Restaurant depreciation and amortization	1,293	1,303	2,662	2,591
Other restaurant operating expenses	5,100	5,097	9,628	9,797
General and administrative expenses	3,554	3,655	6,832	6,844
Advertising	2,505	2,500	4,808	5,001
Bad debt expense	59	53	113	216
Non-cash compensation		23		46
Other depreciation and amortization	268	194	534	376
Impairment of long lived assets		65		65
Restaurant retirement costs, net	(281)	18	(308)	32
Gain on sale of assets, net	(134)	(87)	(255)	(263)
Total costs and expenses	40,474	41,443	79,198	80,802
Operating income	5,154	4,562	9,441	8,284
OTHER INCOME (EXPENSE):				
Interest income	221	274	465	535
Interest expense	(510)	(644)	(1,061)	(1,339)
Income before minority interest, income tax expense and cumulative effect of a change in accounting principle	4,865	4,192	8,845	7,480
Minority interests in operations of joint ventures		(19)		(37)
	4,865	4,173	8,845	7,443

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Income before income tax expense and cumulative effect of a change in accounting principle				
Income tax expense	1,676	66	3,177	66
Income before cumulative effect of a change in accounting principle	3,189	4,107	5,668	7,377
Cumulative effect of a change in accounting principle - net of income tax effect				(51)
Net income	\$ 3,189	\$ 4,107	\$ 5,668	\$ 7,326
Comprehensive income	\$ 3,189	\$ 4,107	\$ 5,668	\$ 7,326
Basic net earnings per share	\$ 0.26	\$ 0.34	\$ 0.47	\$ 0.60
Diluted net earnings per share	\$ 0.25	\$ 0.32	\$ 0.44	\$ 0.57
Weighted average number of common shares outstanding:				
Basic	12,065	12,000	12,068	12,136
Diluted	12,855	12,790	12,867	12,895

See accompanying notes to consolidated financial statements.

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CHECKERS DRIVE-IN RESTAURANTS, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(UNAUDITED)

	Two Quarters Ended	
	June 14, 2004	June 16, 2003
Cash flows from operating activities:		
Net income	\$ 5,668	\$ 7,326
Adjustments to reconcile net earnings to cash provided by operating activities:		
Cumulative effect of a change in accounting principle		51
Deferred tax expense	2,711	
Income tax effect of exercise of options	283	
Depreciation and amortization	3,196	2,967
Amortization of deferred loan costs	60	102
Impairment of long-lived assets		65
Bad debt expense	113	216
Non-cash compensation		46
Gain on sale of assets	(255)	(263)
Minority interest in operations of joint ventures		37
Change in assets and liabilities:		
(Increase), decrease in receivables	(227)	445
Decrease, (increase) in inventory	94	(158)
Decrease in prepaid expenses and other current assets	1,161	723
Decrease, (increase) in other assets	41	(28)
Decrease in accounts payable	(524)	(2,269)
Decrease in accrued liabilities	223	(1,573)
Net cash provided by operating activities	<u>12,544</u>	<u>7,687</u>
Cash flows from investing activities:		
Capital expenditures	(8,347)	(5,045)
Acquisitions of restaurants and equity interests	(815)	
Proceeds from sale of property and equipment	3,088	503
Net cash used in investing activities	<u>(6,074)</u>	<u>(4,542)</u>
Cash flows from financing activities:		
Principal payments on long-term debt and capital lease obligations	(2,887)	(1,527)
Increase in restricted cash	(288)	(354)
Proceeds from exercise of stock options and warrants	883	55
Purchase of treasury stock	(4,647)	(3,921)
Repayment of note receivable - officer		67
Distributions to minority interests		(17)

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Net cash used in financing activities	(6,939)	(5,697)
Net decrease in cash	(469)	(2,552)
Cash at beginning of period	13,566	14,323
Cash at end of period	\$ 13,097	\$ 11,771
Supplemental disclosures of cash flow information		
Interest paid	\$ 1,180	\$ 1,411
Issuance of capital lease obligation for equipment	\$	\$ 203
Issuance of treasury stock	\$	\$ 115
Income tax paid	\$ 234	\$

See accompanying notes to the consolidated financial statements.

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CHECKERS DRIVE-IN RESTAURANTS, INC.

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1: Summary of Significant Accounting Policies

(a) Basis of Presentation - The accompanying unaudited consolidated financial statements include the accounts of Checkers Drive-In Restaurants, Inc., its wholly-owned subsidiaries collectively referred to as the Company. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the information set forth therein have been included, and all adjustments were of a normal and recurring nature.

The Company reports on a fiscal year which will end on the Monday closest to December 31st. Each quarter consists of three 4-week periods, with the exception of the fourth quarter which typically consists of four 4-week periods. The fourth quarter of 2004 will consist of three four week periods and one five week period ending January 3, 2005.

The operating results for the first two quarters ended June 14, 2004, are not necessarily an indication of the results that may be expected for the fiscal year ending January 3, 2005. Except as disclosed herein, there has been no material change in the information disclosed in the notes to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 29, 2003. Therefore, the accompanying consolidated financial statements should be read in conjunction with the Company's December 29, 2003 consolidated financial statements.

(b) Purpose and Organization Our principal business is the operation and franchising of Checkers® and Rally's® Hamburger® (Rally's) restaurants. At June 14, 2004, there were 380 Rally's restaurants operating in 17 different states and there were 407 Checkers restaurants operating in 20 different states, the District of Columbia, Mexico and the West Bank. Ten states have both Checkers and Rally's restaurants. Of the 787 total restaurants, 221 are owned by the Company and 566 are owned by franchisees.

Our restaurants offer high quality food, serving primarily the drive-thru and take-out segments of the quick-service restaurant industry. Checkers commenced operations in April 1986 and began offering franchises in January 1987. Rally's opened its first restaurant in January 1985 and began offering franchises in November 1986.

(c) Pro forma Diluted Earnings per Share Basic earnings per common share are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding. Diluted computations are based on the treasury stock method and include assumed conversions of stock options, net of shares assumed to be repurchased from the proceeds, when outstanding and dilutive. Options to purchase 704,762 and 650,894 shares of common stock were not included in the computation of diluted earnings per common share for the second quarter of 2004 and 2003, respectively. These options were excluded from the calculation because the exercise price of these

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options was greater than the average market price in the quarter, and therefore, they are antidilutive.

If the compensation cost for all option grants to employees and directors had been determined consistent with SFAS No. 123, as amended by SFAS No. 148, the Company's net income and earnings per share would have been adjusted to the following pro forma amounts:

(Dollars in thousands, except per share amounts)

	Quarter Ended		Two Quarters Ended	
	June 14, 2004	June 16, 2003	June 14, 2004	June 16, 2003
Net income, as reported	\$ 3,189	\$ 4,107	\$ 5,668	\$ 7,326
Deduct: Additional stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(632)	555	(1,370)	65
Pro forma net income	\$ 2,557	\$ 4,662	\$ 4,298	\$ 7,391
Earnings per share:				
Basic- as reported	0.26	0.34	0.47	0.60
Basic - pro forma	0.21	0.39	0.36	0.61
Diluted - as reported	0.25	0.32	0.44	0.57
Diluted - pro forma	0.20	0.36	0.33	0.57

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For purposes of the proforma disclosures, assuming the use of the fair value method of accounting, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Assumptions	June 14, 2004	June 16, 2003
Risk-free interest rates	1.00%	1.73%
Volatility	59%	94%
Expected lives (months)	48	48

The Company accrues compensation costs as if all instruments granted are expected to vest. The effect of actual forfeitures is recognized as they occur. An expected dividend yield of zero percent was used for all periods based on the Company's history without any dividend payments.

The Company granted 8,335 stock options on December 30, 2003 at an exercise price of \$10.47 and 150,000 on February 25, 2004 at an exercise price of \$11.70 to members of the Board of Directors under the 1994 Directors Plan for Non-Employee Directors. On May 25, 2004, the Company granted 580,000 stock options to certain employees at an exercise price of \$10.14 under the 2001 Stock Option Plan. On May 25, 2004, the Company also granted 125,000 stock options to members of the Board of Directors at an exercise price of \$10.14 under the 1994 Directors Plan for Non-Employee Directors.

(d) Advertising Costs - The Company expenses advertising costs as incurred. To the extent we participate in independent advertising cooperatives, we expense our contributions as incurred.

(e) Use of Estimates - The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(f) Reclassifications - Certain amounts in the 2003 financial statements have been reclassified to conform to the current quarter 2004 presentation.

Note 2: Liquidity and Capital Resources

The restaurant industry, in general, operates with a working capital deficit because most investments are in long-term restaurant operating assets. We do not normally require large amounts of working capital to maintain operations since sales are for cash, purchases are on open accounts and meat and produce inventories are limited to a three-to-five day supply to assure freshness. We do not have significant levels of accounts receivable or inventory, and we receive credit from our trade suppliers. Funds available from cash sales not needed immediately to pay our trade suppliers are used for non-current capital expenditures.

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We had working capital of \$4.5 million on June 14, 2004 compared to \$7.3 million on December 29, 2003. The factors having the greatest impact on liquidity are cash provided by operating activities of \$12.5 million, capital additions of \$9.2 million, proceeds from sale of property and equipment of \$3.1 million, principal payments on debt and capital leases of \$2.9 million and the purchase of treasury shares of \$4.6 million.

The Company is subject to certain restrictive financial and non-financial covenants under certain of its debt agreements, including EBITDA and a Fixed Charge Coverage ratio, each as defined in the agreements. We were in compliance with all of the covenants as of June 14, 2004.

Note 3: Leases Receivable

As a result of the sale of Company-owned restaurants in 1999 and 2000, we have recorded capital leases receivable for those restaurants sold which are subject to capital lease and mortgage obligations. The amount of capital leases receivable as of June 14, 2004 was approximately \$5.2 million. As of June 14, 2004, we have deferred gains of \$3.3 million from these sales since we continue to be responsible for the payment of these obligations to the original lessors and mortgagors. The gains are being recognized over the life of the related capital leases. The deferred gains relating to these sales are included in the consolidated balance sheet on June 14, 2004, under the captions accrued liabilities and deferred revenue for \$0.4 million and \$2.9 million, respectively.

We have subleased the property associated with the sale of Company-owned restaurants under operating leases. The revenue from these subleases is offset against rent expense, as we continue to be responsible for the rent payments to the original lessors. Sublease rental income totaled \$4.2 million and \$3.5 million for the two quarters ended June 14, 2004 and June 16, 2003, respectively.

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We assess the impairment of intangible assets with an indefinite life on an annual basis (tradename and goodwill), or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

significant underperformance relative to expected historical or projected future operating results;

significant negative industry or economic trends;

significant decline in our stock price for a sustained period; and

our market capitalization relative to net book value.

In accordance with SFAS No. 142 Goodwill and Other Intangible Assets we ceased to amortize approximately \$24 million of goodwill and \$17.5 million for the intangible value of our tradename in fiscal 2002. During fiscal year 2003, the Company reversed \$29.7 million of the valuation allowance against deferred tax assets. As a result, \$23.5 million was recorded as a reduction of goodwill. During the quarter ended June 14, 2004, the Company recognized a previously unrecognized deferred tax asset of approximately \$3.5 million which resulted in the reduction of goodwill by \$0.7 million and tradename by \$2.8 million.

In lieu of amortization, we performed an initial impairment review of our goodwill and tradename as of January 1, 2002. Subsequently, we performed annual impairment reviews on December 30, 2002 and December 29, 2003. Based upon these reviews, no adjustment was required, and we do not believe circumstances have changed since the 2003 review date which would make it necessary to reassess their values subsequent to the balance sheet date. We will continue our annual evaluation, unless circumstances call for us to perform an evaluation prior to then.

Intangible assets consist of the following:

	(Dollars in thousands)	
	June 14, 2004	Dec. 29, 2003
Goodwill	\$	\$ 744
Tradename	14,767	17,548
Amortizable intangible assets	2,519	2,648
Intangible assets, net	\$ 17,286	\$ 20,940

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Amortizable intangible assets:

	June 14, 2004			December 29, 2003			Estimated Lives
	Gross Amount	Accum Amort	Net	Gross Amount	Accum Amort	Net	
Reacquired franchise rights	\$ 1,237	\$ (608)	\$ 629	\$ 1,237	\$ (570)	\$ 667	8 years
Other intangibles	4,191	(2,301)	1,890	4,191	(2,210)	1,981	7-15 years
	<u>\$ 5,428</u>	<u>\$ (2,909)</u>	<u>\$ 2,519</u>	<u>\$ 5,428</u>	<u>\$ (2,780)</u>	<u>\$ 2,648</u>	

Amortization for amortizable intangible assets, for each of the next five fiscal years is as follows:

	Total
2004	\$ 262
2005	251
2006	251
2007	251
2008	251

Note 5: Line of Credit

The Company obtained a credit facility with U.S. Bancorp Equipment Finance, Inc. in 2003 that allows it to borrow up to \$3 million, which is available through December 31, 2004. The agreement allows the Company to borrow at the 7-year interest rate swap published in the Federal Reserve Statistical Release plus 2.2%. There were no borrowings under this facility as of June 14, 2004.

Table of Contents**Note 6: Long-term debt and Obligations under Capital Leases**

Long-term debt and obligations under capital leases consist of the following:

(Dollars in thousands)	<u>June 14, 2004</u>	<u>December 29, 2003</u>
Note payable (Loan A) to GE Capital Franchise Finance Corporation payable in 120 monthly installments, maturing July 1, 2010, including interest at LIBOR plus 3.7% (4.8% at June 14, 2004) secured by property and equipment.	\$ 7,313	\$ 8,791
Mortgages payable to GE Capital Franchise Finance Corporation secured by thirty-two Company-owned restaurants, payable in 240 aggregate monthly installments of \$133, maturing January 1, 2019, including interest at 9.5%.	12,243	12,754
Obligations under capital leases, maturing at various dates through December 1, 2019, secured by property and equipment, bearing interest ranging from 7.0% to 10%. The leases are payable in monthly principal and interest installments averaging \$73.	2,617	2,923
Obligations under capital leases, maturing at various dates through January 1, 2016, secured by property and equipment, bearing interest ranging from 10.4% to 16.4%. The leases are payable in monthly principal and interest installments averaging \$102.	2,947	3,358
Notes payable to a former Rally's franchise owner for acquisition of markets, secured by the related assets acquired, with maturities through May 1, 2004, bearing interest at 7.8%.		75
Other notes payable, maturing at various dates through September 17, 2004, secured by property and equipment, bearing interest at 7.70%. The notes are payable in monthly principal and interest installments of \$18.	20	126
Total long-term debt and obligations under capital leases	<u>25,140</u>	<u>28,027</u>
Less current installments	<u>(2,574)</u>	<u>(3,071)</u>
Long-term debt, less current maturities	<u>\$ 22,566</u>	<u>\$ 24,956</u>

Although we continue to be obligated, approximately \$5.2 million of the mortgage and capital lease obligations noted above pass directly through to franchisees (See Note 3).

Note 7: Acquisitions

On April 8, 2004, the Company acquired seven restaurants located in the Jacksonville, Florida market from a franchisee. The purchase price for the restaurants totaled \$2.1 million, including \$0.8 million in cash, \$1.0 million relating to the assumption of liabilities and \$0.3 million relating to the forgiveness of amounts owed by the franchisee to the Company.

Note 8: Accounting Charges and Loss Provisions

As of the quarter ended June 14, 2004, we had reserves of \$5.9 million relating to restaurant relocations and abandoned sites. These reserves represent management's estimate of the Company's ultimate obligations under the related operating leases, and are reviewed and adjusted periodically, as more information becomes available related to our ability to sublease or assign the lease and other negotiations with the landlord. During the two quarters ended June 14, 2004, the Company made lease and other payments of \$0.5 million against this reserve. The Company terminated leases for surplus sites which were negotiated for less than the contractual obligation, further reducing the reserve by approximately \$148,000. The Company also increased the reserve by approximately \$950,000 for closed restaurants located in Jacksonville, Florida which were acquired with seven operating restaurants. See Note 7.

We measure impairment of long-lived assets under Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. The Company regularly prepares an evaluation of long-lived

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assets during the year. The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The events we considered during our impairment review included, individual restaurant performance relative to historical and projected future operating results and the negative economic trends that have taken place for these locations. Based on our review, there were no locations that required additional impairment charges as of June 14, 2004.

Note 9: Equity

On May 25, 2004, the shareholders approved the 2004 Stock Award Plan for Non-Employee Directors. The purpose of the 2004 Plan is to attract and retain the best available individuals to serve as independent directors to the Company. Under the terms of the 2004 Plan, the Company is authorized to grant (i) automatic, non-discretionary stock awards and (ii) stock options or shares of restricted stock that may be awarded in such amounts and with such terms and conditions as determined under the 2004 Plan. All options granted under the 2004 Plan will be non-qualified stock options that do not qualify as incentive stock options, as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the Code).

Each Non-Employee director who is currently serving on the Company's Board of Directors will be automatically granted a stock award annually, on the effective date of the 2004 Plan, of 10,000 shares of common stock; subject, however, to such restrictions as to vesting, forfeiture, resale or other terms and conditions as may be imposed by the Committee at the time of the award. Each non-employee director that is elected to the Board after May 25, 2004 will be awarded annually, on the effective date of the 2004 Plan, 7,000 shares of common stock; subject, however, to such restrictions as to vesting, forfeiture, resale or other terms and conditions as may be imposed by the Committee at the time of such award.

On May 25, 2004, the Company's Board of Directors approved a 500,000 share increase to the 1,300,000 share Stock Repurchase Program announced on March 19, 2003, bringing the total of shares available for repurchase to 1,800,000.

Note 10: Income Taxes

The Company accounts for income taxes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires the Company to recognize income tax assets and liabilities based on the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes. Deferred tax assets must be evaluated for realizability and if necessary reduced by a valuation allowance. Realization of the deferred tax assets is dependant upon the Company's ability to generate sufficient taxable income in future years. The deferred tax assets are reviewed periodically for recoverability, and valuation allowances are adjusted as necessary.

Income tax expense for the first two quarters ended June 14, 2004 was \$3.2 million. Through the quarter ended June 16, 2003, the Company recognized minimal income tax expense of \$66,000. Although management is recording tax expense at an estimated effective tax rate of 36%, we expect tax payments for 2004 to be limited to the federal alternative minimum tax and certain state income taxes.

During the quarter ended June 14, 2004, the Company recorded a deferred tax asset of approximately \$3.5 million. This deferred tax asset is related to intangible assets arising from acquisitions prior to the merger on August 9, 1999 whose tax deductibility was deemed uncertain at the time of the acquisitions. The recognition of this tax asset correspondingly reduced the goodwill and other long-term intangible assets

(Tradename) recorded at the merger date.

Note 11: Subsequent events

Subsequent to June 14, 2004, the Company repurchased 330,300 shares of its outstanding common stock for approximately \$3.8 million.

On June 17, 2004, each of the five current Non-employee directors received 10,000 shares of common stock vesting immediately under the 2004 Stock Award Plan for Non-Employee Directors. Consequently, the Company will recognize non-cash compensation expense of approximately \$0.5 million for the quarter ending September 6, 2004. See Note 9.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Checkers Drive-In Restaurants, Inc. (Checkers), a Delaware corporation and its wholly-owned subsidiaries (collectively, the Company) is the largest chain of double drive-thru restaurants in the United States. Our Company is a combination of two separate quick-service restaurant chains, Checkers® and Rally's Hamburgers® (Rally's). At June 14, 2004, there were 380 Rally's restaurants operating in 17 different states and 407 Checkers restaurants operating in 20 different states, the District of Columbia,

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Mexico and the West Bank. Of the 787 total restaurants, 221 are owned by the Company and 566 are owned by franchisees. Ten states have both Checkers and Rally's restaurants. Our restaurants offer high quality food, serving primarily the drive-thru and take-out segments of the quick-service restaurant industry. Checkers commenced operations in April 1986 and began offering franchises in January 1987. Rally's opened its first restaurant in January 1985 and began offering franchises in November 1986.

We receive revenues from restaurant sales, franchise fees and royalties. Restaurant food and paper costs, labor costs, occupancy expense, other operating expenses, restaurant depreciation and amortization, and advertising relate directly to Company-owned restaurants. Expenses such as other depreciation and amortization, and general and administrative expenses relate to Company-owned restaurant operations and the Company's franchise sales and support functions. Our revenues and expenses are affected by the number and timing of additional restaurant openings, closings and the sales volume of both existing and new restaurants.

Special Note Regarding Forward-Looking Statements

Certain statements in this Form 10-Q under Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Part II, Item 1. Legal Proceedings and elsewhere in this Form 10-Q constitute forward-looking statements which we believe are within the meaning of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended. Also, when we use words such as believes, expects, anticipates or similar expressions, we are making forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Some of the risks that should be considered include:

(i) The fact that we compete with numerous well established competitors who have substantially greater financial resources and longer operating histories than us, which enables them to engage in heavy and sustained discounting as well as substantial advertising and promotion. While this competition is already intense, if it increases, it could have an even greater adverse impact on revenues and profitability of company and franchise restaurants.

(ii) The fact that we anticipate the need to continue the improvement in same restaurant sales if we are to achieve improved profitability. Sales increases will depend, among other things, on the success of our advertising and promotion efforts and the success of other operating and training initiatives, all of which are speculative.

We may also be negatively impacted by other factors common to the restaurant industry such as changes in consumer tastes away from red meat and fried foods; consumer acceptance of new products; consumer frequency; increases in the costs of food, paper, labor, health care, workers compensation or energy; an inadequate number of available hourly paid employees; decreases in the availability of affordable capital resources; and/or development and operating costs. Other factors which may negatively impact the Company include, among others, adverse publicity; general economic and business conditions; availability, locations, and terms of sites for restaurant development; changes in business strategy or development plans; quality of management; availability, terms and deployment of capital; the results of financing efforts; business abilities and judgment of personnel; availability of qualified personnel; changes in, or failure to comply with, government regulations; continued NASDAQ listing; weather conditions; construction schedules; uninterrupted product supply; results of existing and future litigation and other risk factors referenced in this Form 10-Q and in our annual report on Form 10-K for the year ended December 29, 2003.

**Restaurants Operating in the System
For the Quarters Ended**

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	<u>Sept. 9,</u> <u>2002</u>	<u>Dec. 30,</u> <u>2002</u>	<u>March 24,</u> <u>2003</u>	<u>June 16,</u> <u>2003</u>	<u>Sept. 8,</u> <u>2003</u>	<u>Dec. 29,</u> <u>2003</u>	<u>March 22,</u> <u>2004</u>	<u>June 14,</u> <u>2004</u>
Company-operated:								
Beginning of quarter	253	248	248	242	242	242	222	222
Openings/transfers in					1	5		7
Closings/transfers out	(5)		(6)		(1)	(25)		(8)
End of quarter	<u>248</u>	<u>248</u>	<u>242</u>	<u>242</u>	<u>242</u>	<u>222</u>	<u>222</u>	<u>221</u>
Franchise:								
Beginning of quarter	541	541	536	536	539	540	562	565
Openings/transfers in	7	3	2	4	2	31	3	10
Closings/transfers out	(7)	(8)	(2)	(1)	(1)	(9)		(9)
End of quarter	<u>541</u>	<u>536</u>	<u>536</u>	<u>539</u>	<u>540</u>	<u>562</u>	<u>565</u>	<u>566</u>
	<u>789</u>	<u>784</u>	<u>778</u>	<u>781</u>	<u>782</u>	<u>784</u>	<u>787</u>	<u>787</u>

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The table below sets forth the percentage relationship to total revenues, unless otherwise indicated, of items included in the Company's consolidated statements of income for the periods indicated:

	Two Quarters			
	Quarter Ended		Ended	
	June 14, 2004	June 16, 2003	June 14, 2004	June 16, 2003
REVENUES:				
Restaurant sales	90.6%	91.6%	90.9%	91.9%
Franchise royalty revenue	8.8%	8.1%	8.8%	7.9%
Franchise fees and other income	0.6%	0.3%	0.3%	0.2%
Total revenues	100.0%	100.0%	100.0%	100.0%
COSTS AND EXPENSES:				
Restaurant food and paper costs (1)	32.1%	31.5%	31.6%	31.4%
Restaurant labor costs (1)	29.3%	29.6%	30.2%	30.0%
Restaurant occupancy expenses (1)	6.5%	6.8%	6.8%	7.1%
Restaurant depreciation and amortization (1)	3.1%	3.1%	3.3%	3.2%
Other restaurant operating expenses (1)	12.3%	12.1%	12.0%	11.9%
General and administrative expenses	7.8%	7.9%	7.7%	7.7%
Advertising (1)	6.1%	5.9%	6.0%	6.1%
Bad debt expense	0.1%	0.1%	0.1%	0.2%
Non-cash compensation	0.0%	0.1%	0.0%	0.1%
Other depreciation and amortization	0.6%	0.4%	0.6%	0.4%
Impairment of long-lived assets	0.0%	0.0%	0.0%	0.1%
Restaurant retirement costs, net	(0.6)%	0.0%	(0.3)%	0.0%
Gain on sale of assets	(0.3)%	(0.2)%	(0.3)%	(0.3)%
Total costs & expenses	88.7%	90.1%	89.3%	90.7%
Operating income	11.3%	9.9%	10.7%	9.3%
OTHER INCOME (EXPENSE):				
Interest income	0.5%	0.6%	0.5%	0.6%
Interest expense	(1.1)%	(1.4)%	(1.2)%	(1.5)%
Income before minority interest, income tax expense and cumulative effect of a change in accounting principle	10.7%	9.1%	10.0%	8.4%
Minority interests in operations of joint ventures	0.0%	0.0%	0.0%	0.0%
Income before income tax expense and cumulative effect of a change in accounting principle	10.7%	9.1%	10.0%	8.4%
Income tax expense	3.7%	(0.2)%	3.6%	0.1%
Income before cumulative effect of a change in accounting principle	7.0%	8.9%	6.4%	8.3%

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Cumulative effect of change in accounting principle - net of income tax effect	0.0%	0.0%	0.0%	(0.1)%
Net income	7.0%	8.9%	6.4%	8.2%

(1) As a percentage of restaurant sales

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Comparison of Historical Results - Quarter Ended June 14, 2004 and Quarter Ended June 16, 2003

Total Revenues

Total revenues, which consist of restaurant sales and franchise royalty and fee income, were \$45.6 million for the quarter ended June 14, 2004, compared to \$46.0 million for the quarter ended June 16, 2003.

Restaurant Sales

Company-owned restaurant sales decreased by \$0.9 million for the quarter ended June 14, 2004 to \$41.3 million compared to \$42.2 million for the same quarter last year. This decrease was primarily due to a net reduction of 21 restaurants since the second quarter of last year, partially offset by same-store sales growth of 8.3% for the second quarter ended June 14, 2004.

Franchise Royalty Revenue

Franchise royalties increased by \$0.3 million in the second quarter of 2004, to \$4.0 million, primarily due to an increase of 27 franchise restaurants comprised mainly of the sale of company-owned restaurants to franchisees. In addition, royalties for the quarter increased due to a same-store sales improvement of 4.9% at franchise restaurants.

Restaurant Food and Paper Costs

Restaurant food and paper costs were \$13.3 million or 32.1% of restaurant sales for the quarter ended June 14, 2004 compared with 31.5% of restaurant sales in the same quarter of 2003. The increase in these costs, as a percentage of restaurant sales, was primarily due to increased prices of beef and cheese relative to the same quarter a year ago.

Restaurant Labor Costs

Restaurant labor costs, which include restaurant employees' salaries, wages, benefits, workers' compensation costs, bonuses and related taxes, totaled \$12.1 million or 29.3% of restaurant sales for the quarter ended June 14, 2004 compared with \$12.5 million or 29.6% for the quarter ended June 16, 2003. The decrease in restaurant labor costs was primarily due to the net reduction of 21 restaurants since the same quarter last year, while the decrease in costs as a percentage of restaurant sales, was due primarily due to an increase in same store sales for the quarter.

Restaurant Occupancy Expense

Restaurant occupancy expense, which includes rent, property taxes, licenses and insurance, was \$2.7 million or 6.5% of restaurant sales in the second quarter of 2004 compared with \$2.9 million or 6.8% of restaurant sales for the quarter ended June 16, 2003. The decrease in restaurant occupancy expense as a percentage of restaurant sales is due primarily to the increase in comparable restaurant sales as well as the sale of company-owned restaurants to franchisees during the fourth quarter of 2003 for which rent exceeded the company average.

Restaurant Depreciation and Amortization

Restaurant depreciation and amortization totaled \$1.3 million or 3.1% of restaurant sales for the second quarter of both 2004 and 2003. The net decrease of company-owned restaurants' assets was offset by depreciation on \$18.5 million of capital additions and restaurant assets acquired since June 16, 2003.

Other Restaurant Operating Expenses

Other restaurant operating expense includes all other restaurant level operating expenses, and specifically includes utilities, repairs and maintenance and other costs. These expenses totaled \$5.1 million, or 12.3% of restaurant sales for the quarter ended June 14, 2004 compared with \$5.1 million or 12.1% of restaurant sales for the quarter ended June 16, 2003. Repairs and maintenance decreased to 3.1% as a percentage of restaurant sales for 2004 compared to 3.4% for the same quarter of 2003. Utilities remained constant at 4.7% as a percentage of restaurant sales. Other costs in this category increased to 4.5% as a percentage of restaurant sales for the quarter ended June 14, 2004 relative to 4.0% for the same quarter one year ago.

General and Administrative Expenses

General and administrative expenses were \$3.6 million, or 7.8% of total revenues for the quarter ended June 14, 2004 compared to \$3.7 million, or 7.9% of total revenues for the first quarter of 2003. These expenses decreased due primarily to a decrease in consulting costs relative to the second quarter of 2003.

Advertising

Advertising expense was \$2.5 million or 6.1% of restaurant sales for the quarter ended June 14, 2004 compared to \$2.5 million, or 5.9% of restaurant sales for the quarter ended June 16, 2003. The increase in expense as a percentage of restaurant sales was attributable to motor sports initiatives, local sport affiliations and other promotional campaigns which contributed to same store sales increases for the quarter.

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Restaurant Retirement Costs

During the second quarter of 2004, the Company recognized gains of \$0.3 million for the termination of two leases which were negotiated for less than the contractual obligation.

Gain on Sale of Assets

During the second quarter of 2004 and 2003, the Company recognized gains of \$0.1 million from the sale of assets. These gains were primarily due to the recognition of deferred gains on restaurant market sales recorded in 1999 and 2000, the divestiture of eight Atlanta restaurants recognized during the second quarter of 2004 and the gain on the sale of one modular building sold in the second quarter of 2003.

Income Tax

Income tax expense of \$1.7 million for the quarter ended June 14, 2004 is \$1.7 million. Although management is recording tax expense at an estimated effective tax rate of 36%, we expect tax payments for 2004 to be limited to the federal alternative minimum tax and certain state income taxes.

Comparison of Historical Results Two Quarters Ended June 14, 2004 and Two Quarters Ended June 16, 2003

Total Revenues

Total revenues, which consist of restaurant sales and franchise royalty and fee income, were \$88.6 million for the two quarters ended June 14, 2004, compared to \$89.1 million for the two quarters ended June 16, 2003.

Restaurant Sales

Restaurant sales decreased by \$1.3 million for the two quarters ended June 14, 2004 to \$80.6 million compared to \$81.9 million for the same two quarters last year. This decrease was primarily due to a net reduction of 21 company-owned restaurants since June 16, 2003, partially offset by same-store sales growth of 8.2% for the first two quarters ended June 14, 2004.

Franchise Royalty Revenue

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Franchise royalties increased by \$0.8 million in the first half of 2004, to \$7.8 million, primarily due to an increase of 27 franchise restaurant locations comprised mainly of the sale of company-owned restaurants to franchisees. In addition, royalties for the first two quarters increased due to a same-store sales improvement of 5.2% at franchise restaurants.

Restaurant Food and Paper Costs

Restaurant food and paper costs were \$25.4 million or 31.6% of restaurant sales for the two quarters ended June 14, 2004 compared with \$25.7 million or 31.4% for the first half of 2003. The slight increase in these costs, as a percentage of restaurant sales, was primarily due to increased beef and cheese prices.

Restaurant Labor Costs

Restaurant labor costs, which include restaurant employees' salaries, wages, benefits, workers' compensation costs, bonuses and related taxes, totaled \$24.3 million or 30.2% of restaurant sales for the two quarters ended June 14, 2004 compared with \$24.5 million or 30.0% of restaurant sales for the two quarters ended June 16, 2003. The slight increase in restaurant labor costs, as a percentage of restaurant sales, was due to an increase in workers compensation expense and the costs associated with new incentive programs which we believe were instrumental in driving sales volume during 2004.

Restaurant Occupancy Expense

Restaurant occupancy expense, which includes rent, property taxes, licenses and insurance, was \$5.4 million or 6.8% of restaurant sales in the first two quarters of 2004 compared with \$5.8 million or 7.1% of restaurant sales for the two quarters ended June 16, 2003. The decrease in restaurant occupancy expense as a percentage of restaurant sales is due primarily to the increase in comparable restaurant sales as well as the sale of company-owned restaurants to franchisees during the fourth quarter of 2003 whose rent exceeded the company average.

Restaurant Depreciation and Amortization

Restaurant depreciation and amortization totaled \$2.7 million or 3.3% of restaurant sales for the first two quarters of 2004 compared to \$2.6 million or 3.2% of restaurant sales for the first two quarters of 2003. The net increase was primarily due to depreciation on \$18.5 million of capital additions and restaurant assets acquired since June 16, 2003, partially offset by the sale of company owned restaurants assets.

Other Restaurant Operating Expenses

Other restaurant operating expense includes all other restaurant level operating expenses, and specifically includes utilities, repairs and maintenance and other costs. These expenses totaled \$9.6 million, or 12.0% of restaurant sales for the two quarters ended June 14, 2004 compared with \$9.8 million, or 11.9% of restaurant sales for the two quarters ended June 16, 2003. Repairs and

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maintenance decreased to 3.0% as a percentage of restaurant sales for 2004 compared to 3.4% for the same quarters of 2003. Utilities increased slightly to 4.8% as a percentage of restaurant sales compared to 4.6%. Other costs in this category increased to 4.2% as a percentage of restaurant sales for the first two quarters ended June 14, 2004 relative to 3.9% for the same quarters one year ago.

Advertising

Advertising expense was \$4.8 million or 6.0% of restaurant sales for the two quarters ended June 14, 2004 compared to \$5.0 million, or 6.1% of restaurant sales for the quarters ended June 16, 2003. The decrease was due primarily to increased same store sales leverage, as well as a net reduction of 21 Company-owned restaurants since June 16, 2003.

Restaurant Retirement Costs

During the first two quarters of 2004, the Company recognized gains of \$0.3 million for the termination of two leases which were negotiated for less than the contractual obligation.

Gain on Sale of Assets

During the first two quarters of both 2004 and 2003, the Company recognized gains of \$0.3 million from the sale of assets. These gains were primarily due to the recognition of deferred gains on restaurant market sales recorded in 1999 and 2000, gain on the divestiture of eight Atlanta restaurants recognized during the second quarter of 2004 and the gain on the sale of one modular building sold in the second quarter of 2003.

Income Tax

Income tax expense of \$3.2 million for the first half of 2004 is based on the estimated effective federal and state tax rate of 36%. Although management is recording tax expense at an estimated effective tax rate of 36%, we expect tax payments for 2004 to be limited to the federal alternative minimum tax and certain state income taxes.

Liquidity and Capital Resources

We had working capital of \$4.5 million on June 14, 2004 compared to \$7.3 million on December 29, 2003. Cash and cash equivalents decreased \$0.5 million to \$13.1 million since the fiscal year ended December 29, 2003. Cash flow provided by operating activities was \$12.5 million compared to \$7.7 million for the same two quarters last year. Current year cash flows are attributable to current profits and a decrease in prepaid expenses, partially offset by a decrease in accounts payable and accrued liabilities and an increase in receivables.

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Cash flow used for investing activities was \$6.1 million relating primarily to capital expenditures of \$8.3 million for restaurant level renovations and technology enhancements company-wide as well as \$0.8 million for the acquisition of seven restaurants in Jacksonville, Florida. These expenditures were partially offset by proceeds of \$3.0 million from the sale of restaurants and other capital assets.

Cash used for financing activities was \$6.9 million. The most significant activities were principal payments of \$2.9 million on our debt and capital lease obligations, purchase of treasury shares of \$4.6 million and an increase in restricted cash of \$0.3 million. These outlays were partially offset from the receipt of \$0.9 million for the issuance of common stock from the exercise of stock options through June 14, 2004.

Capital expenditures for fiscal 2004 are expected to total \$20 million. These expenditures include the development of new restaurants, the remodeling of existing restaurants as well as other capital equipment and improvements on operating restaurants. Although there can be no assurance, we believe that our existing cash as of June 14, 2004, the expected cash provided from operations, and the available \$3 million credit facility with U.S. Bancorp Equipment Finance, Inc. will be sufficient to meet our working capital and capital expenditure requirements for the remainder of fiscal 2004.

The Company is subject to financial and non-financial covenants under certain of its debt agreements, including EBITDA and a Fixed Charge Coverage ratio, each as defined in the agreements. We were in compliance with all of the covenants as of June 14, 2004.

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Critical Accounting Policies:

Our critical accounting policies are as follows:

Revenue Recognition - Franchise fees and area development franchise fees are generated from the sale of rights to develop, own and operate restaurants. Such fees are based on the number of potential restaurants in a specific area which the franchisee agrees to develop pursuant to the terms of the franchise agreement between the Company and the franchisee and are recognized as income on a pro rata basis when substantially all of the Company's obligations per location are satisfied (generally at the opening of the restaurant). Franchise fees are nonrefundable. Franchise fees and area development franchise fees received prior to substantial completion of the Company's obligations are deferred. The Company receives royalty fees from franchisees based on a percentage of each restaurant's gross revenues. Royalty fees are recognized as earned.

Gains associated with the sale of certain Company-owned restaurants to franchisees with associated mortgages and capital leases are recognized over the life of the related capital leases. During fiscal years 1999 and 2000, several Company-owned restaurants were sold to franchisees with associated mortgages and capital leases. As a result of the sales, we have recorded lease receivables for those restaurants sold which are subject to capital lease and mortgage obligations. The amount of capital lease receivables as of June 14, 2004 was approximately \$5.2 million. We have remaining deferred gains of \$3.3 million from these sales since we continue to be responsible for the payment of the obligations to the original lessors and mortgagors. The deferred gains are included in the June 14, 2004 balance sheet under the captions accrued liabilities and deferred revenues for \$0.4 million and \$2.9 million, respectively and will be recognized over the next 16 years. Additionally, the Company has remaining deferred gains of approximately \$0.5 million, as of June 14, 2004, where notes receivable were accepted as consideration for sales of certain Company-owned restaurants. These notes as well as the associated deferred gains are scheduled to be collected and recognized over the term of the notes, which are due over the next 6 years.

Valuation of Long-Lived Assets We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

offers from current or potential franchisees for restaurants below carrying value;

significant underperformance relative to expected historical or projected future operating results; and

significant negative industry or economic trends.

Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. In applying SFAS No. 144, we reviewed historical and projected cash flows of all restaurants and performed a discounted cash flow analysis where indicated for each restaurant based upon such results projected over a ten year period. This period of time was selected based upon the lease term and the age of the related buildings. Impairments are recorded to adjust the asset values to the amount recoverable under the discounted cash flow analysis, in accordance with SFAS No. 144. The Company regularly completes an evaluation of long-lived assets during the year. Based on our review, there were no locations that required additional impairment charges as of June 14, 2004.

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Valuation of Intangible Assets and Goodwill - We assess the impairment of intangible assets with an indefinite life on an annual basis (tradenname and goodwill), or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

significant underperformance relative to expected historical or projected future operating results;

significant negative industry or economic trends;

significant decline in our stock price for a sustained period; and

our market capitalization relative to net book value.

In accordance with SFAS No. 142 Goodwill and Other Intangible Assets we ceased to amortize approximately \$24.2 million of goodwill and \$17.5 million for the intangible value of our tradenname in fiscal 2002. The Company recorded an adjustment to goodwill in fiscal 2003 of \$23.5 million, reducing goodwill to \$0.7 million in conjunction with the reduction to the valuation allowance on net deferred tax assets. During the quarter ended June 14, 2004, the Company recognized a previously unrecognized deferred tax asset of approximately \$3.5 million which resulted in the reduction of goodwill by the remaining \$0.7 million and a reduction of tradenname by \$2.8 million.

In lieu of amortization, we performed an initial impairment review of our goodwill and tradenname as of January 1, 2002. Subsequently, we performed annual impairment reviews on December 30, 2002 and December 29, 2003. Based upon these reviews, no adjustment was required, and we do not believe circumstances have changed since the 2003 review date which would make it necessary to reassess their values subsequent to the balance sheet date. We will continue our annual evaluation, unless circumstances call for us to perform an evaluation prior to then.

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Allowance for doubtful receivables - Management must make estimates of the collectability of our accounts receivable. Management specifically analyzes accounts and notes receivable and related historical bad debts, franchise concentrations, franchise credit-worthiness, and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. The current portion of accounts, notes and leases receivable totaled \$3.0 million, or \$7.6 million net of bad debt allowances of \$4.6 million, as of June 14, 2004.

Contingencies - Management's current estimated range of liability related to some of the pending litigation is based on claims for which we can estimate the amount and range of loss. We have recorded the minimum estimated liability related to those claims, where there is a range of loss. Because of the uncertainties related to both the amount and range of loss on the remaining pending litigation, management is unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise our estimates accordingly. Such revisions in our estimates of the potential liability could materially impact our results of operation and financial position.

Restaurant retirement costs - Reserves for restaurant relocations and abandoned sites consist of our estimates for the ongoing costs of each location which has been closed or was never developed. Those costs include rent, property taxes, and in some cases, the cost to relocate the modular restaurant to a storage facility. The cash outlays for these costs have been estimated for the remaining terms of the lease obligations, ranging from less than 1 year to 12 years. Although the Company has negotiated out of several of these sites, the current economic outlook and lack of alternative investment opportunities have hindered the Company's ability to successfully negotiate out of the remaining sites. As a result, management believes that cash outlays for these sites will continue through lease maturity, and the reserve reflects this.

Accounting for income taxes - The Company accounts for income taxes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires the Company to recognize income tax benefits and liabilities for loss carryforwards and other income tax assets and liabilities. The tax benefits must be reduced by a valuation allowance in certain circumstances. Realization of the deferred tax benefits is dependant on generating sufficient taxable income prior to expiration of any net operating loss carryforwards (NOL's). The deferred tax assets are reviewed periodically for recoverability, and valuation allowances are provided for as necessary. During 2003, the Company reversed \$29.7 million of the valuation allowance. As of June 14, 2004 the Company has approximately \$57.9 million of the net deferred tax assets available to reduce future income taxes partially offset by a valuation allowance of \$32.4 million.

Self Insurance - The Company is partially self-insured for workers' compensation claims up to \$250,000 per occurrence on the first two claims and \$150,000 per occurrence thereafter. We utilize third party actuarial experts' estimates of expected losses based on statistical analyses of historical industry data as well as our own estimates based on our actual historical data. These assumptions are adjusted when warranted by changing circumstances. Should a greater number of claims occur compared to what was estimated or the cost of those claims is higher than anticipated, reserves might not be sufficient and additional expense may be recorded. Should the actual experience be more favorable than estimated, a resulting expense reduction may be recorded. The Company is partially self-insured for general liability up to \$100,000 per claim and automotive liability losses subject to per occurrence and aggregate annual liability limitations as well. The Company maintains \$3.8 million in restricted cash as collateral securing self-insured workers' compensation claims until they are settled. The Company is also self-insured, subject to umbrella policies, for health care claims for eligible participating employees subject to certain deductibles and limitations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate and foreign exchange rate fluctuations:

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Our exposure to financial market risks is the impact that interest rate changes and availability could have on our debt. Borrowings under our primary debt facilities and capital lease obligations bear interest ranging from 4.8% to 16.4%. An increase in short-term and long-term interest rates would result in a reduction of pre-tax earnings. Substantially all of our business is transacted in U.S. dollars. Accordingly, foreign exchange rate fluctuations have not had a significant impact on the Company and are not expected to in the foreseeable future.

Commodity Price Risk:

We purchase certain products which are affected by commodity prices and are, therefore, subject to price volatility caused by weather, market conditions and other factors which are not considered predictable or within our control. Although many of the products purchased are subject to changes in commodity prices, certain purchasing contracts or pricing arrangements contain risk management techniques designed to minimize price volatility. Typically, we use these types of purchasing techniques to control

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costs as an alternative to directly managing financial instruments to hedge commodity prices. In many cases, we believe we will be able to address commodity cost increases, which are significant and appear to be long-term in nature, by adjusting our menu pricing or changing our product delivery strategy. However, increases in commodity prices could result in lower restaurant-level operating margins.

ITEM 4. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the fiscal period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting information required to be disclosed by the Company in the reports it files or submits under the Exchange Act within the time periods specified in the Commission's rules and forms.

(b) Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Jonathan Mittman et al. v. Rally's Hamburgers, Inc., et al. In January and February 1994, two putative class action lawsuits were filed, purportedly on behalf of the stockholders of Rally's, in the United States District Court for the Western District of Kentucky, Louisville division, against Rally's, Burt Sugarman and GIANT GROUP, LTD. and certain of Rally's former officers and directors and its auditors. The cases were subsequently consolidated under the case name Jonathan Mittman et. al. vs. Rally's Hamburgers, Inc., et. al. The complaints allege that the defendants violated the Securities Exchange Act of 1934, among other claims, by issuing inaccurate public statements about Rally's in order to arbitrarily inflate the price of its common stock. The plaintiffs seek compensatory and other damages, and costs and expenses associated with the litigation. On April 15, 1994, Rally's filed a motion to dismiss and a motion to strike. On April 5, 1995, the Court struck certain provisions of the complaint but otherwise denied Rally's motion to dismiss. In addition, the Court denied plaintiffs' motion for class certification; the plaintiffs renewed this motion, and despite opposition by the defendants, the Court granted such motion for class certification on April 16, 1996, certifying a class from July 20, 1992 to September 29, 1993. On August 22, 2003, the court ruled for the Company on all counts, and subsequently the plaintiffs filed an appeal.

Greenfelder et al. v. White, Jr., et al. On August 10, 1995, a state court complaint was filed in the Circuit Court of the Sixth Judicial Circuit in and for Pinellas County, Florida, Civil Division, entitled Gail P. Greenfelder and Powers Burgers, Inc. v. James F. White, Jr., Checkers Drive-In Restaurants, Inc., Herbert G. Brown, James E. Mattei, Jared D. Brown, Robert G. Brown and George W. Cook, Case No. 95-4644-CI-20. A companion complaint was also filed in the same Court on May 21, 1997, entitled Gail P. Greenfelder, Powers Burgers of Avon Park, Inc., and Power Burgers of Sebring, Inc. v. James F. White, Jr., Checkers Drive-In Restaurants, Inc., Herbert G. Brown, James E. Mattei, Jared D. Brown, Robert G. Brown and George W. Cook.

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The original complaint alleged, generally, that certain officers of the Company intentionally inflicted severe emotional distress upon Ms. Greenfelder, who is the sole stockholder, president and director of Powers Burgers, Inc., a Checkers franchisee. The present versions of the amended complaints in the two actions assert a number of claims for relief, including claims for breach of contract, fraudulent inducement to contract, post-contract fraud, breaches of implied duties of good faith and fair dealings in connection with various franchise agreements and an area development agreement, battery, defamation, negligent retention of employees, and violation of Florida's Franchise Act.

The Company believes that this lawsuit is without merit, and intends to continue to defend it vigorously. No estimate of possible loss or range of loss resulting from the lawsuit can be made at this time.

Checkers Drive-In Restaurants, Inc. v. Tampa Checkmate Food Services, Inc., et al. On August 10, 1995, a state court counterclaim and third party complaint was filed in the Circuit Court of the Thirteenth Judicial Circuit in and for Hillsborough County, Florida, Civil Division, entitled Tampa Checkmate Food Services, Inc., Checkmate Food Services, Inc. and Robert H. Gagne v. Checkers Drive-In Restaurants, Inc., Herbert G. Brown, James E. Mattei, James F. White, Jr., Jared D. Brown, Robert G. Brown and George W. Cook.

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A complaint was originally filed by the Company in July of 1995 against Mr. Gagne (Gagne) and Tampa Checkmate Food Services, Inc. (Tampa Checkmate), a company controlled by Mr. Gagne, to collect on a promissory note in the original principal amount of \$1,007,295 (the promissory note) and foreclose on a mortgage securing the promissory note issued by Tampa Checkmate, enforce the terms of a personal guaranty executed by Mr. Gagne, and obtain declaratory relief regarding the rights of the respective parties under Tampa Checkmate's franchise agreement with the Company. The counterclaim and third party complaint, as amended, generally alleged that Mr. Gagne, Tampa Checkmate and Checkmate Food Services, Inc. (Checkmate) were induced into entering into various franchise agreements with personal guarantees to the Company based upon misrepresentations by the Company and the named individuals and alleged violations of Florida's Franchise Act, Florida's Deceptive and Unfair Trade Practices Act, and breaches of implied duties of good faith and fair dealings in connection with a settlement agreement and franchise agreement between various of the parties.

The action was tried before a jury in August of 1999. The Company's action against Tampa Checkmate to collect the promissory note was stayed by virtue of Tampa Checkmate's bankruptcy filing (see discussion below). The Court entered a directed verdict and an involuntary dismissal as to all claims alleged against Jared D. Brown, Robert G. Brown, and George W. Cook and also entered a directed verdict and an involuntary dismissal as to certain other claims asserted against the Company and the remaining individual counterclaim defendants, Herbert G. Brown (H. Brown), James E. Mattei (Mattei), James F. White, Jr. (White). The jury rendered a verdict in favor of the Company, H. Brown, Mattei, and White as to all claims asserted by Checkmate and in favor of Mattei as to all claims asserted by Tampa Checkmate and Gagne. In response to certain jury interrogatories, however, the jury made the following determinations: (i) That Gagne was fraudulently induced to execute a certain Unconditional Guaranty and that the Company was therefore not entitled to enforce its terms; (ii) That Tampa Checkmate was fraudulently induced to execute a certain franchise agreement by the actions of the Company, H. Brown, and White, jointly and severally, and that Tampa Checkmate was damaged as a result thereof in the amount of \$151,330; (iii) That the Company, H. Brown, and J. White, jointly and severally, violated § 817.416(2)(a)(1) of the Florida Franchise Act relating to the franchise agreement and that Tampa Checkmate was damaged as a result thereof in the amount of \$151,330 and that Gagne was damaged as a result thereof in the amount of \$151,330; and (iv) That the Company, H. Brown, and J. White did not violate Florida's Deceptive and Unfair Trade Practices Act relating to the Ehrlich Road franchise agreement.

The foregoing judgments were appealed to the Second District Court of Appeal and on November 14, 2001, the Appeals Court (i) affirmed the \$151,330 judgment, plus statutory interest from August of 1999, entered in favor of Tampa Checkmate and against the Company and White for fraudulent inducement, but reversed as to Brown and that portion of the judgment awarding Tampa Checkmate statutory interest prior to the jury's verdict in August of 1999; (ii) affirmed the \$151,330 judgment, plus statutory interest from August of 1999, entered in favor of Tampa Checkmate and against the Company and White for violation of § 817.416(2)(a)(1) of the Florida Franchise Act, but reversed as to Brown; and (iii) reversed, *in toto*, the judgment entered in favor of Gagne.

On February 4, 2002, the state trial court granted a motion filed by Tampa Checkmate and entered summary judgment as to the Company's affirmative defenses of setoff and recoupment. In lieu of filing a *supercedes bond*, the Company satisfied the foregoing two judgments and appealed the summary judgment to the Second District Court of Appeal. That appeal was decided adversely to the Company.

Reciprocal motions for attorney fees also remain pending in the state court. On December 17, 2003, the trial court entered an order awarding Tampa Checkmate attorney fees in the amount of \$153,285. Tampa Checkmate has moved for reconsideration of the December 17, 2003 order. Tampa Checkmate's motion for reconsideration and the Company's motion for attorney fees against Gagne remain pending.

On or about July 15, 1997, Tampa Checkmate filed a Chapter 11 petition in the United States Bankruptcy Court for the Middle District of Florida, Tampa Division entitled *In re: Tampa Checkmate Food Services, Inc.*, as noted above, the bankruptcy filing stayed the Company's claim against Tampa Checkmate to collect the promissory note. Subject to the execution of a written agreement and the approval of the Bankruptcy Court supervising Tampa Checkmate Food Services, Inc. bankruptcy proceedings, the Company has reached a settlement of all remaining issues arising from the litigation between the Company and Tampa Checkmate Food Services, Inc., Robert Gagne, and Checkmate Food Services, Inc.. All claims against the Company will be released in return for the payment to the bankruptcy estate of Tampa Checkmate Food Services, Inc. of \$213,244 payable in installments of \$150,000 upon execution of the settlement agreement and \$63,244 on or before September 7, 2004. While the Company believes the parties will agree to the terms of a written settlement agreement and that the settlement will be approved by the

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Bankruptcy Court, no definitive assurances can be given.

Suncheck X, Inc. and Executive Restaurant Management, Inc. v. Checkers Drive-In Restaurants, Inc., Suncheck Corporation and Checkers of Puerto Rico, Inc. The case was filed October 25, 2001, and is before the American Arbitration Association, Tampa, Florida. The Claimants seek undisclosed damages under contract and tort theories. This arbitration is subject to the outcome of a lawsuit filed by Checkers Drive-In Restaurants, Inc. in the Circuit Court for the Thirteenth Judicial Circuit, Hillsborough County, Florida now on appeal to disqualify Claimants counsel based on conflict of interest. Checkers Drive-In Restaurants, Inc. is defending the proceedings and vigorously denies the allegations set forth in the complaint.

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Checkers Drive-In Restaurants, Inc. and Checkers of Puerto Rico, Inc. v. Suncheck I, Inc., Suncheck III, Inc., Suncheck IV, Inc., Suncheck X, Inc., Swaincheck, Inc., Starcheck Corporation, A&E Burgers, Inc., Suncheck Ponce II, Inc., Mooncheck of Puerto Rico, Inc., Villanueva, Inc., Executive Restaurant Management, Inc., Cerex Investments, Inc., Ratito, Inc., Antunez & Sons Produce, Inc., Mark Antunez, Mario Rivera, Raul Ramirez, a/k/a Raul Ramirez Fernandez, a/k/a Raul Jose Ramirez Fernandez, Ronald Rivas, Carlos Del Pozo, a/k/a Carlos Del Pozo Carafa, Robert E. Swain, Benedetto A. Cerilli Family Trust, Raul Cal, Jorge Tirado, Jose Toro, Jerry Algarin, Jimmie Algarin, Liliana Agarin, Angel Sanchez, Rene Mercado, Marisol Mercado, Ingacio Arias, Carmen Martinez, Juan Carrion, Luis Cortez, Sr., Luis Cortez, Jr., Alfredo Ramirez, Miquel Perez Comas, a/k/a Miquel Perez, James Dooley, Ruben Lugo, Edgar Ortiz, Benigno Contreras, Jr., and Sebastian Estarellas.

In November 2000, Checkers initiated this arbitration proceeding to recover unpaid royalties and advertising fees from former franchisees in Puerto Rico and the respective personal guarantors. Some of the respondents filed a counterclaim seeking undisclosed damages under contract and tort theories. On February 20, 2004, the arbitration tribunal entered an Order on Checkers' Amended Motion to Dismiss Amended Counterclaim (the Order). In the Order, the tribunal: (1) dismissed two of the seven counts asserted against Checkers in the Counterclaim; and (2) granted Checkers' Motion to Dismiss with respect to portions of each of the remaining counts in the Counterclaim. The tribunal also ruled that there is no basis for imposing liability on Checkers for the acts or omissions of Suncheck of Puerto Rico, Inc. The counterclaimants voluntarily dismissed a third count, and filed a motion seeking to amend the Counterclaim to replead the count, which was denied.

This case was consolidated with Suncheck X, Inc. and Executive Restaurant Management, Inc., Claimants v. Checkers Drive-In Restaurants, Inc., Suncheck Corporation and Checkers of Puerto Rico, Inc. Checkers denies the allegations of the counterclaims and is vigorously defending the proceedings.

We are involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations or liquidity.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER REPURCHASES OF EQUITY SECURITIES

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</u>
Period 5 (4/20/04 - 5/17/04)	101,600	\$ 10.03	804,967	995,033
Period 6 (5/18/04 - 6/14/04)	342,400	\$ 10.60	1,147,367	652,633

All purchases noted above were made under the 1,300,000 share Stock Repurchase Program disclosed March 19, 2003 and subsequently increased to 1,800,000 shares by the Board of Directors on May 25, 2004.

Subsequent to June 14, 2004, the Company repurchased 330,300 shares of its outstanding common stock for approximately \$3.8 million.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our annual meeting of shareholders for fiscal 2004 on May 25, 2004. The following matters were voted upon at the meeting: the election of Terry N. Christensen and Willie D. Davis as directors to serve until the annual shareholders meeting in 2007, appointment of KPMG LLP as our independent auditors for fiscal 2004 and ratification of the Company's 2004 Stock Award Plan for Non-Employee Directors. All matters were voted on and approved by shareholders.

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The following are the total number of votes cast for, against, withheld, abstentions, and non-votes as to the matters set forth above:

	<u>For</u>	<u>Against/ Withheld</u>	<u>Abstentions</u>	<u>Broker Non-votes</u>
The election of Terry N. Christensen	7,395,025	1,887,438		
The election of Willie D. Davis	7,475,832	1,806,631		
The ratification and approval of the appointment of KPMG LLP as our independent registered public accounting firm.	7,395,025	794,261	13,125	1,080,052
The ratification and approval of the 2004 Stock Award Plan for Non-Employee Directors	2,700,362	2,209,606	182,269	4,190,226

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

- ** 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated July 23, 2004.
- ** 31.2 Certification of Chief Financial (Accounting) Officer pursuant to Rule 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated July 23, 2004.
- ** 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated July 23, 2004.
- ** 32.2 Certification of Chief Financial (Accounting) Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated July 23, 2004.

** Filed electronically herewith

(b) Reports on 8-K:

The following reports on Form 8-K were filed during the quarter covered by this report:

On April 15, 2004, the Company issued a news release entitled Checkers Drive-In Restaurants, Inc. to announce 2004 Fiscal First Quarter Earnings .

On April 16, 2004, the Company issued a news release entitled Checkers Drive-In Restaurants, Inc. Teams up with Cure Autism Now Foundation Checkers/Rally s sponsors Team CAN and offers collectible cup

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On April 22, 2004, Checkers Drive-In Restaurants, Inc. Reports First Quarter 2004 Earnings.

On May 13, 2004, the Company issued a news release entitled Checkers® / Rally ® Honored at the 2004 Business Awards (SM) Company received Stevie Award for Best Human Resources Executive; also named finalist in four categories

On May 17, 2004, the Company issued a news release entitled Checkers® / Rally ® Award-winning You Gotta Eat (SM) Advertising Adds Fresh Twist .

On May 27, 2004, the Company issued a news release entitled Checker® / Rally ® Raises Awareness at Indianapolis 500 ® Double Drive-Thru Chain Expands its Official Burger Activities Presents \$100,000 to Cure Autism Now Foundation .

On May 27, 2004, the Company issued a news release entitled Checkers Announces Increase To Stock Repurchase .

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SIGNATURE

Pursuant to the requirements 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.

Checkers Drive-In Restaurants, Inc.
(Registrant)

Date: July 23, 2004

By: /s/ S. Patric Plumley

Treasurer and Chief Financial Officer