# Authentic. Simple. Agile.


2002 Annual Report

**Sonic,** founded in Shawnee, Oklahoma, in 1953, franchises and operates the largest chain of drive-in restaurants in the United States. The drive-in restaurant setting, together with Sonic's unique menu and personalized carhop service, position the company as one of the most highly differentiated concepts in the restaurant industry's quick-service sector.

## Financial Highlights

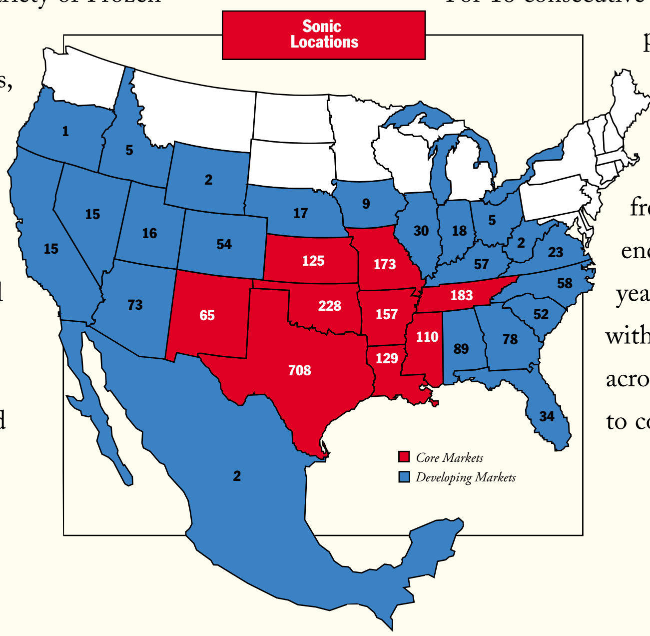
*($ in thousands, except per share data)*

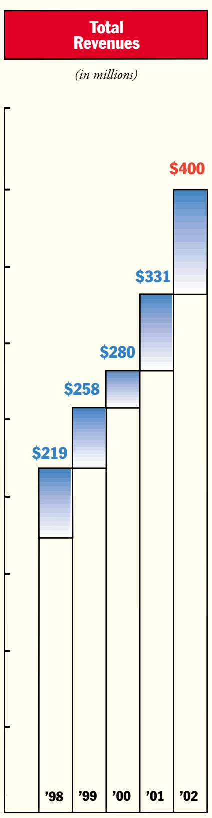
| | 2002 | 2001 | % Change |
|---|---|---|---|
| **Operations** (for the year) | | | |
| Total revenues | **$ 400,162** | $ 330,638 | 21% |
| Income from operations | **$ 82,322** | $ 67,607 | 22% |
| Net income | **$ 47,692** | $ 38,956 | 22% |
| Net income per diluted share* | **$ 1.13** | $ 0.93 | 22% |
| Return on average stockholders' equity | **22.1%** | 21.9% | |
| **Financial Position** (at year end) | | | |
| Total assets | **$ 405,356** | $ 358,000 | 13% |
| Stockholders' equity | **$ 230,670** | $ 200,719 | 15% |
| **System-wide Information** | | | |
| Total sales (for the year) | **$ 2,205,269** | $ 1,971,477 | 12% |
| Average unit sales (for the year) | **$ 906** | $ 874 | 4% |
| Company-owned restaurants (at year end) | **452** | 393 | 15% |
| Franchised restaurants (at year end) | **2,081** | 1,966 | 6% |
| Total restaurants (at year end) | **2,533** | 2,359 | 7% |

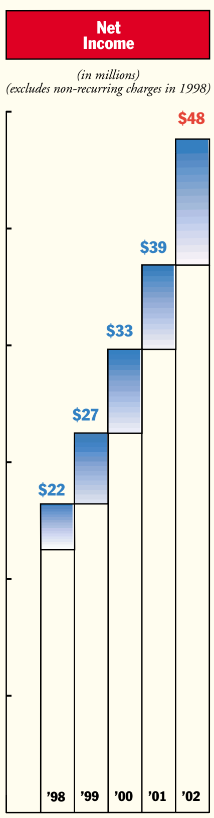
** Adjusted for 2002 stock split.*

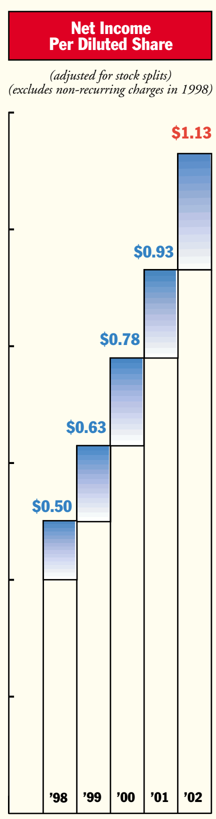
Sonic Drive-Ins offer food made after you order and feature signature items such as Toaster® Sandwiches, Extra-Long Cheese Coneys, hand-battered Onion Rings, Tater Tots, and a variety of Frozen Favorites® desserts and Fountain Favorites® drinks, including Cherry Limeades, Slushes, Cream Pie Shakes, and a complete soft-serve dessert menu. At a typical Sonic Drive-In, customers drive into one of 24 to 36 covered parking spaces and place orders through an intercom speaker system. A carhop delivers the customer's order curbside, usually within four minutes.

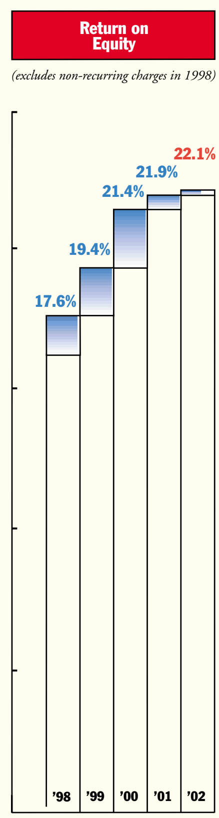
For 16 consecutive years, Sonic has posted positive same-store sales growth. It also enjoys industry-leading customer loyalty, as measured by frequency of visits. Sonic ended its most recent fiscal year on August 31, 2002, with more than 2,500 drive-ins across 30 states from coast to coast.



## To Our Stockholders

# Sonic continued to set the pace in fiscal 2002!

## Quite literally, the past 12 months were record-setting in many ways.

**For Sonic, it was a year to move forward with multi-layered strategies and extend strong growth trends. In response to these proven efforts, revenues and earnings both hit record amounts in fiscal 2002, with our top line increasing 21% to $400 million and our bottom line advancing 22% to $1.13 per diluted share. System-wide sales grew 12% to $2.2 billion – the first full fiscal year that we have surpassed the $2 billion mark! Same-store sales also increased a healthy 3.0%, marking the 16th consecutive year of same-store sales growth. And, with 182 new Sonic Drive-Ins opening last year, we continued to expand the reach of our brand, growing to more than 2,500 locations across 30 states.**

For investors, this progress translated into a 22% return on equity for the year, our third consecutive year above 20% and the highest return in our history as a public company. That growth generated free cash flow of about $23 million, before acquisitions and share repurchases, helping us maintain a strong balance sheet. This positive cash flow also provided support for our drive-in development efforts and our stock repurchase program, under which we purchased approximately $26 million of our shares during fiscal 2002. As we begin fiscal 2003, we have remaining authorization under this program totaling almost $50 million. Lastly, the continued financial success of the company also enabled Sonic to declare another three-for-two stock split during the year – our fourth stock split since 1995.

When we talk about the factors that have helped produce Sonic's consistent growth, we normally think in terms of key drivers, such as media expenditures, unit growth, new product news, and our day-part initiatives, to name a few. Sonic's ongoing success, however, also reveals certain fundamental underpinnings that make the company a distinctive and different quick-service choice for our guests – and an attractive, straightforward investment opportunity for our stockholders.

With curbside carhop service and fast, fresh food made after you order, today's Sonic remains authentic, holding firmly to ideals pioneered almost 50 years ago – ideals others now try increasingly to emulate. Sonic also is simple and easy to understand. Our business is all about surprising and delighting customers by exceeding their expectations for our brand, thousands of times a day. And, even with the scale of our business today, Sonic remains nimble, able to capitalize on menu and operational opportunities quickly and successfully. The recent rollout of our breakfast menu across half the chain, which resulted in few changes to drive-in operations and minimal capital expenditures per unit, attests to this agility.

So, just as Sonic continues to differentiate its brand along the lines of service, quality and menu, the company also continues to earn distinction as an investment choice that is authentic, simple and agile.

While these figures provide a customary measure of our overall progress in fiscal 2002, there are other notable statistics that provide texture to the Sonic message. Media expenditures, which increased to $90 million during fiscal 2002 from $80 million last year, together with a steady program of new product news, have continued to push average unit sales past the $900,000 mark per store. With our unique ascending royalty rates, these volume gains in turn have generated handsome growth in our franchise income – a revenue stream that provides a solid and stable foundation for the company's future growth objectives.

New day-part initiatives, which have proven effective in building our business in the afternoon and evening segments, also continue to play a key role in our success. Certainly, the most significant of these last year was the expansion of our breakfast menu, which we rolled out to almost 800 drive-ins during the spring and which is now available at about 1,200 locations, or almost 50% of our system. Customer feedback on our breakfast menu continues to be very positive and its availability all day long, just like the rest of our menu, clearly is a factor in the growth of our average unit sales. Moreover, breakfast is helping us win new customers to the brand; in fact, our early, limited research found that almost one in five breakfast customers were new to Sonic.

All of the foregoing factors that combined to produce a year of record results for Sonic worked in a similar fashion to strengthen our relationship with the franchisees who operate approximately 80% of our chain. With steadily rising average unit profits, which increased $10,000 per drive-in during fiscal 2002, their opportunities and incentives with Sonic have never been better.

Going forward, these same factors are expected to provide continued brand momentum in the coming year, even though current economic uncertainty has many consumers on the sidelines. Our media expenditures are planned to top $100 million in fiscal 2003, and we'll continue to focus more resources on national cable advertising and highly productive sponsorships like CBS College Football. With a strong franchisee development pipeline, we also expect that new drive-in development will accelerate next year, and we have targeted 190 to 200 openings system-wide for fiscal 2003. The expansion of our brand, together with our outlook for continued low single-digit same-store sales growth, driven by new product news and day-part initiatives, should provide an ongoing lift for sales and franchise income. Add the prospects of greater operating leverage as we expand our business and you can see why we are excited about the outlook for continued brand growth next year and beyond.

Sincerely,

Clifford Hudson
*Chairman and Chief Executive Officer*

Pattye Moore
*President*

# You want something different? Carhop service? Food made after you order?

# Get Real!

**Authentic.**

Few quick-service concepts today can say that they are loyal to their founding principles. Few deliver the quality and service they promise. At times they are unreliable or erratic in meeting their own standards, hurting their brand and costing them sales and customer loyalty.

Not so at Sonic. Different from the beginning, inside and out, Sonic remains *authentic.*

With drive-in, order-from-your-car convenience at your own ordering station, and two-way intercom connections – the basis for Sonic's name selection almost 50 years ago – Sonic offers the most differentiated dining experience in quick service today. It's an experience that the customer controls, starting with the push of a little red button and ending with smiles and satisfaction. Quality food made after you order, menu variety and fast carhop service are just a few of the stops along this journey.

Whether it's a classic American burger and fries, a grilled chicken wrap, a fresh Cherry Limeade, a snack, or an amazing ice cream treat, food at Sonic is made *after* the customer orders, not before. It's always been that way; it's not a marketing fad, a superficial claim to hide mediocrity, or the latest attempt to reinvent a concept or revive sales. It's the real deal.

Sonic's menu is different too, with unique, hall-of-fame items so delicious that return visits are virtually assured. Where else can you find Tater Tots, hand-battered Onion Rings, Extra-Long Cheese Coneys, and a line of Toaster® sandwiches, where classic tastes meet toast with a Texas attitude? Where else can you top off your meal with a plethora of drink and dessert choices, like a Cherry Limeade or a Premi-YUM!™ Cream Pie Shake? Could any quick-service concept be more authentic?

Perhaps the most visible difference at Sonic, though, is its signature carhop service. Usually just minutes after an order is placed, Sonic's carhops are curbside, sometimes on skates, to deliver fresh food made after you order. What's more, they usually check back later in the meal to offer mints, napkins, or additional condiments, making sure every aspect of the customer's Sonic experience is pleasant and as expected.

Now approaching its 50th birthday, Sonic continues to deliver a distinctive, highly differentiated dining experience unlike any other in quick-service. It's a place where the ordinary becomes the extraordinary, where fun and menu variety rule. It's authentic, and that's helped build the highest customer loyalty in the industry.


SONIC
America's Drive-In

# With so many menu choices, it's hard to think of us as just Plain Vanilla.

**Simple.**

From its earliest days, Sonic has operated with a simple, cash-oriented business model. And while Sonic has become larger through the years, stretching out with more than 2,500 drive-ins across 30 states and into northeastern Mexico, it remains homegrown and uncomplicated.

This simplicity in operations can be traced to its origin and tradition as a franchisor. Perhaps nothing typifies its simple approach to operations better than one of Sonic's first decisions: to figure royalties at the rate of one penny for each paper sack ordered by franchisees. Similarly, the company has collaborated since then in a strong, two-way relationship with its franchisees to build the Sonic brand, not create complex transactions. For example, all franchisees control their own real estate, and Sonic sells neither food nor equipment to its franchisees.

Sonic's franchising orientation has provided it with a straightforward, capital-efficient way to expand its brand, manage growth and reduce development risk. In fact, franchisees have developed more than 80% of the drive-ins in the chain, which has expanded by almost one-third over the past five years. During this same time frame, Sonic's earnings have increased steadily, as has the company's return on equity.

Today, royalties are no longer a penny a bag. In fact, they are uniquely ascending, which increases Sonic's earnings as drive-ins build volume. Even so, Sonic's royalties remain among the lowest in the industry, which in turn allows its franchisees to enjoy more financial success with the brand and see more incentive to grow. As a result of its ascending royalty rates and with steady growth in its base of franchised drive-ins, franchising income has become a predictable, stable element in the company's financial results. In more recent years, with the continued development of its company-owned drive-ins and the contributions to growth that they offer, together with the company's other multi-layered growth strategies, Sonic's business model has become even more balanced.

Today, Sonic is strongly positioned to deliver consistent sales and earnings growth and continues to build one of the most-loved restaurant brands in the country.


# Flexibility

## may be one of the most important ingredients in QSR.

**Agile.**

An entrepreneurial spirit has always been alive and well at Sonic, creating an environment for success and driving a determination to stand out from the competition in every way possible. While other quick-service companies shun change and seem to sacrifice quality and service to compete on price alone, Sonic thrives on diversity in its menu and operations, and prizes the flexibility to pursue innovations that meet and exceed the changing taste and quality expectations of quick-service customers.

The latest signs of Sonic's innovations can be found as easily as looking on the menu, now strengthened with new initiatives for all day parts. Perhaps the most important of these is the arrival of breakfast at Sonic. Just like the rest of Sonic's menu, it's different – from Breakfast Burritos to Pancake on a Stick – and available all day long. No reason to get up early to beat the clock. This addition translates into new customers for the brand and even more reasons for already-loyal customers to return to Sonic.

But the best part of breakfast at Sonic is the way it fits strategically with the company's growth objectives. With other quick-service concepts deriving about 11% of their sales from the morning day part versus Sonic's current mix of 6%, the opportunity for Sonic is significant. Moreover, operators have embraced the program as they have witnessed its success firsthand. They are still experiencing volume gains in the second and third years since the original test, and along with these increased sales, breakfast also creates higher drive-in profits since it requires little capital investment to extend operations into the morning hours.

Clearly, Sonic's roots as a franchising organization help account for the company's spirit of innovation, and its solid relationship with franchisees puts muscle behind the brand promise. The company's franchisees have traditionally led the company's menu development program, originating many of the hit products that continue to please customers – great ideas like Sonic's Toaster® sandwiches and new chicken wraps, for instance. As an active partner in building the Sonic brand, these franchisees have played an integral role in developing operational and service programs that, adopted system-wide, help ensure that the best Sonic experience is never a one-time phenomenon.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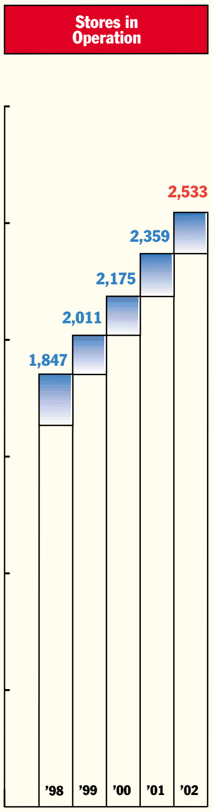
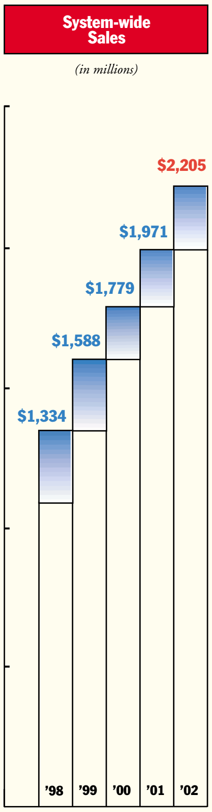
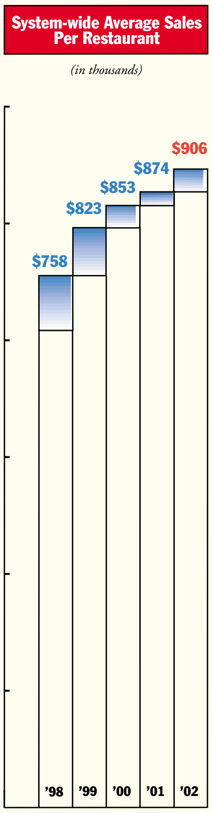
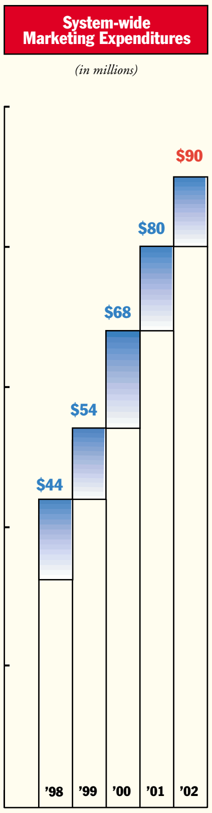
# System Highlights



## Financial Section Table of Contents

## Selected Financial Data

| | Year ended August 31, | | | | |
|---|---|---|---|---|---|
| | **2002** | 2001 | 2000 | 1999 | 1998 |
| | (In thousands, except per share data) | | | | |
| **Income Statement Data:** | | | | | |
| Company-owned restaurant sales | **$ 330,707** | $ 267,463 | $ 224,880 | $ 210,419 | $ 182,011 |
| Franchised restaurants: | | | | | |
| Franchise royalties | **61,392** | 54,220 | 47,595 | 40,859 | 32,391 |
| Franchise fees | **4,020** | 4,408 | 3,717 | 3,468 | 2,564 |
| Other | **4,043** | 4,547 | 3,864 | 2,861 | 2,141 |
| Total revenues | **400,162** | 330,638 | 280,056 | 257,607 | 219,107 |
| Cost of restaurant sales | **242,193** | 195,338 | 163,570 | 155,521 | 135,806 |
| Selling, general and administrative | **33,444** | 30,602 | 27,894 | 25,543 | 22,250 |
| Depreciation and amortization | **26,078** | 23,855 | 20,287 | 18,464 | 14,790 |
| Minority interest in earnings of restaurants | **14,864** | 12,444 | 10,173 | 8,623 | 7,904 |
| Provision for impairment of long-lived assets | **1,261** | 792 | 951 | 1,519 | 285 |
| Special provision for litigation settlement | **–** | – | – | – | 2,700 |
| Total expenses | **317,840** | 263,031 | 222,875 | 209,670 | 183,735 |
| Income from operations | **82,322** | 67,607 | 57,181 | 47,937 | 35,372 |
| Net interest expense | **6,319** | 5,525 | 5,186 | 4,278 | 2,750 |
| Income before income taxes and cumulative effect of change in accounting | **$ 76,003** | $ 62,082 | $ 51,995 | $ 43,659 | $ 32,622 |
| Income before cumulative effect of change in accounting | **$ 47,692** | $ 38,956 | $ 32,627 | $ 27,396 | $ 20,470 |
| Cumulative effect of change in accounting, net of taxes and minority interest | **–** | – | – | – | 681 |
| Net income | **$ 47,692** | $ 38,956 | $ 32,627 | $ 27,396 | $ 19,789 |
| Income per share before cumulative effect of change in accounting (1) | | | | | |
| Basic | **$ 1.19** | $ 0.98 | $ 0.81 | $ 0.65 | $ 0.47 |
| Diluted | **$ 1.13** | $ 0.93 | $ 0.78 | $ 0.63 | $ 0.46 |
| **Balance Sheet Data:** | | | | | |
| Working capital (deficit) | **$ (12,942)** | $ (3,335) | $ (6,371) | $ (7,743) | $ (7,292) |
| Property, equipment and capital leases, net | **305,286** | 273,198 | 222,318 | 207,890 | 188,065 |
| Total assets | **405,356** | 358,000 | 278,371 | 256,677 | 233,180 |
| Obligations under capital leases (including current portion) | **12,938** | 13,688 | 7,299 | 8,048 | 8,379 |
| Long-term debt (including current portion) | **109,375** | 109,168 | 83,881 | 72,400 | 61,518 |
| Stockholders' equity | **230,670** | 200,719 | 155,263 | 149,755 | 132,011 |

(1) Adjusted for a 3-for-2 stock split in 2002, 2000 and 1998

# Management's Discussion and Analysis

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

## Results of Operations

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

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

# Management's Discussion and Analysis

| | Year ended August 31, | | |
|---|---|---|---|
| | **2002** | 2001 | 2000 |
| | | *($ in thousands)* | |
| **Income Statement Data:** | | | |
| Revenues: | | | |
| Company-owned restaurant sales | **82.7%** | 80.9% | 80.3% |
| Franchised restaurants: | | | |
| Franchise royalties | **15.3** | 16.4 | 17.0 |
| Franchise fees | **1.0** | 1.3 | 1.3 |
| Other | **1.0** | 1.4 | 1.4 |
| | **100.0%** | 100.0% | 100.0% |
| Costs and expenses: | | | |
| Company-owned restaurants (1) | **73.2%** | 73.0% | 72.7% |
| Selling, general and administrative | **8.4** | 9.3 | 10.0 |
| Depreciation and amortization | **6.5** | 7.2 | 7.2 |
| Minority interest in earnings of restaurants (1) | **4.5** | 4.7 | 4.5 |
| Provision for impairment of long-lived assets | **0.3** | 0.2 | 0.3 |
| Income from operations | **20.6** | 20.4 | 20.4 |
| Net interest expense | **1.6** | 1.7 | 1.9 |
| Net income | **11.9** | 11.8 | 11.7 |
| | | | |
| **Restaurant Operating Data:** | | | |
| Company-owned restaurants (2): | | | |
| Core markets | **350** | 300 | 234 |
| Developing markets | **102** | 93 | 78 |
| All markets | **452** | 393 | 312 |
| Franchised restaurants (2) | **2,081** | 1,966 | 1,863 |
| Total | **2,533** | 2,359 | 2,175 |
| | | | |
| System-wide sales | **$ 2,205,269** | $ 1,971,477 | $ 1,778,828 |
| Percentage increase (3) | **11.9%** | 10.8% | 12.0% |
| | | | |
| Average sales per restaurant: | | | |
| Company-owned | **$ 791** | $ 772 | $ 747 |
| Franchise | **935** | 899 | 872 |
| System-wide | **906** | 874 | 853 |
| | | | |
| Change in comparable restaurant sales (4): | | | |
| Company-owned restaurants: | | | |
| Core markets (5) | **2.6%** | 2.4% | 2.9% |
| Developing markets (5) | **-2.1** | -0.5 | 0.6 |
| All markets | **1.7** | 1.8 | 2.4 |
| Franchise | **3.2** | 1.8 | 3.2 |
| System-wide | **3.0** | 1.8 | 3.0 |

(1) As a percentage of company-owned restaurant sales.
(2) Number of restaurants open at end of year.
(3) Represents percentage increase from the comparable period in the prior year.
(4) Represents percentage change for restaurants open in both the reported and prior years.
(5) The calculation of the percentage change of company-owned restaurants by core and developing markets is based on a television market determination rather than a state determination.

## Management's Discussion and Analysis

*Comparison of Fiscal Year 2002 to Fiscal Year 2001.* Total revenues increased 21.0% to $400.2 million during fiscal year 2002 from $330.6 million in fiscal year 2001. Company-owned restaurant sales increased 23.6% to $330.7 million during fiscal year 2002 from $267.5 million in fiscal year 2001. Of the $63.2 million increase, $58.9 million was due to the net addition of 140 company-owned restaurants since the beginning of fiscal year 2001 ($61.4 million from the addition of 74 newly constructed restaurants and 75 acquired restaurants since the beginning of fiscal year 2001 less $2.5 million from nine stores sold or closed during the same period). Average sales increases of approximately 1.7% by stores open the full reporting periods of fiscal year 2002 and 2001 accounted for $4.3 million of the increase.

Franchise royalties increased 13.2% to $61.4 million during fiscal year 2002, compared to $54.2 million in fiscal year 2001. Of the $7.2 million increase, approximately $3.9 million was attributable to franchise same-store sales growth of 3.2% combined with an increase in the effective royalty rate from 3.18% in fiscal year 2001 to 3.27% in fiscal year 2002. Each of the company's license agreements contains an ascending royalty rate feature whereby the royalty rate increases as sales volumes increase. The balance of the increase resulted from an increase in the number of franchise restaurants operating in fiscal year 2002 compared to fiscal year 2001. Franchise fees decreased 8.8% as 142 franchise drive-ins opened during fiscal year 2002 as compared to 157 in fiscal year 2001. However, the average franchise fee increased as a greater percentage of stores opened under the newest form of license agreement, which has a higher franchise fee and royalty rate.

The company expects total revenue growth during fiscal year 2003 of approximately 15% based on targeted same-store sales growth of 1% to 3% as well as the addition of approximately 190 to 200 new drive-ins (35 to 40 company-owned and 150 to 160 franchise). The company anticipates that the continued benefit of the ascending royalty rate and new franchise store openings will result in $7.0 million to $8.0 million in incremental franchise royalties and an increase of approximately seven to ten basis points in the average royalty rate.

Restaurant cost of operations, as a percentage of company-owned restaurant sales, was 73.2% during fiscal year 2002 compared to 73.0% in fiscal year 2001. Food and packaging costs, as a percentage of company-owned restaurant sales, remained flat as lower than expected beef costs and a moderation in dairy costs were offset by slightly increased discounting from standard menu prices. Payroll and employee benefits, as a percentage of company-owned restaurant sales, increased 40 basis points as a result of an increase in average wage rates, increased investment in store-level labor as a part of the company's commitment to outstanding customer service, and an increase in training and store-level management for the rollout of the breakfast program. Other operating expenses, as a percentage of company-owned restaurant sales, decreased 13 basis points primarily as a result of the leverage of higher sales volumes and improvements in utility costs. Minority interest in earnings of restaurants decreased, as a percentage of company-owned restaurant sales, to 4.5% during fiscal year 2002, compared to 4.7% in fiscal year 2001 as a result of the decline in overall restaurant-level margins. Most of the managers and supervisors of company-owned restaurants own a minority interest in the restaurants, and a substantial portion of their compensation flows through the minority interest in earnings of restaurants.

Looking forward, the company expects restaurant cost of operations to remain flat or increase slightly, as a percentage of company-owned restaurant sales, during fiscal year 2003 as the leverage of operating at higher volumes and a favorable food cost environment is anticipated to mostly offset the continued investment in store-level labor and rising workers' compensation insurance rates. The company continues to look for ways to strengthen its partnership program so that a larger percentage of managers' and supervisors' compensation is derived from the partnership program. However, since the company expects store-level margins to remain flat or deteriorate slightly, minority interest in earnings of restaurants is expected to remain flat or decline slightly as a percentage of company-owned restaurant sales.

Selling, general and administrative expenses decreased, as a percentage of total revenues, to 8.4% during fiscal year 2002, compared with 9.3% in fiscal year 2001 as a result of the leverage of operating at higher sales volumes. The company expects selling, general and administrative expenses to grow by 8% to 10% in fiscal year 2003 while continuing to decline as a percentage of total revenues. A significant portion of the company's future revenue growth will be attributable to company-owned restaurants. Company-owned restaurants require a lower level of selling, general and administrative expenses, as a percentage of revenues, than the company's franchising operations since most expenses of company-owned restaurant operations are reflected in restaurant cost of operations and minority interest in restaurant operations.

## Management's Discussion and Analysis

Depreciation and amortization expense increased 9.3% to $26.1 million during fiscal year 2002 compared to 17.6% in fiscal year 2001 while declining as a percentage of revenue to 6.5% as compared to 7.2% the prior year. The increase in depreciation resulted primarily from new drive-in development and store acquisitions in the third fiscal quarter of 2002. The company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," effective September 1, 2001 which resulted in a reduction in amortization expense of $2.2 million during fiscal year 2002 as compared to fiscal year 2001, excluding any related tax effects. See Note 1 of Notes to Consolidated Financial Statements for a discussion of the new Accounting Statement. Management expects depreciation and amortization to grow by approximately 12% to 14% during fiscal year 2003 and to continue to decline as a percentage of total revenues.

During fiscal year 2002, two drive-ins in developing markets became impaired under the guidelines of FAS 121 – "Accounting for the Impairment of Long-Lived Assets," and estimates were revised on three stores which were previously impaired under FAS 121. As a result, a provision for impairment of long-lived assets of $1.3 million was recorded for the drive-in's carrying cost in excess of its estimated fair value. During fiscal year 2001, two drive-ins became impaired under FAS 121 resulting in an impairment of $0.8 million. The company continues to perform quarterly analyses of certain underperforming restaurants. It is reasonably possible that the estimate of future cash flows associated with these restaurants may change in the near future resulting in the need to write-down assets associated with one or more of these restaurants to fair value.

Income from operations increased 21.8% to $82.3 million during fiscal year 2002 from $67.6 million in fiscal year 2001 due primarily to the growth in revenues and other matters discussed above.

Net interest expense during fiscal year 2002 increased 14.4% to $6.3 million from $5.5 million in fiscal year 2001. This increase was the result of additional borrowings to fund share repurchases of $26.0 million and capital expenditures of $71.1 million, including $20.5 million for acquisitions. The company expects interest expense to increase slightly in fiscal year 2003, excluding the impact of potential acquisitions and share repurchases.

Provision for income taxes reflects an effective federal and state tax rate of 37.25% for fiscal year 2002 and 2001. Net income increased 22.4% to $47.7 million in fiscal year 2002 compared to $39.0 million in fiscal year 2001. Diluted earnings per share increased to $1.13 per share during fiscal year 2002, compared to $0.93 per share in fiscal year 2001, for an increase of 21.5%. The company expects diluted earnings per share to grow by 18% to 20% during fiscal year 2003.

*Comparison of Fiscal Year 2001 to Fiscal Year 2000.* Total revenues increased 18.1% to $330.6 million during fiscal year 2001 from $280.1 million in fiscal year 2000. Company-owned restaurant sales increased 18.9% to $267.5 million in fiscal year 2001 from $224.9 million in fiscal year 2000. Of the $42.6 million increase in company-owned restaurant sales, $39.3 million was due to the net addition of 97 company-owned restaurants since the beginning of fiscal 2000 ($42.1 million from the addition of 58 newly constructed restaurants and 52 acquired restaurants since the beginning of fiscal year 2000 less $2.8 million from 13 stores sold or closed during the same period). Average sales increases of approximately 1.8% by stores open throughout the full reporting periods of fiscal year 2001 and 2000 accounted for $3.3 million of the increase.

Franchise royalties increased 13.9% to $54.2 million in fiscal year 2001, compared to $47.6 million in fiscal year 2000. Of the $6.6 million increase, approximately $3.4 million was attributable to additional franchise restaurants in operation and an increase in royalty rates caused by the conversion of some of the company's older license agreements to newer agreements, and the automatic royalty rate step-up feature contained in many of the company's older license agreements. The balance of the increase resulted from franchise same-store sales growth of 1.8% in fiscal year 2001. Each of the company's license agreements contains an ascending royalty rate feature whereby the royalty rate increases as sales volumes increase As a result of this feature and the majority of new stores opening under the most current form of license agreement, which contains higher rates, as well as the conversion and automatic step-up features described above, the company's average royalty rate grew to 3.18% during fiscal 2001 from 3.06% during fiscal 2000. One hundred fifty-seven franchise drive-ins opened in fiscal year 2001 compared to 150 in fiscal year 2000, resulting in an 18.6% increase in franchise fee revenues.

Restaurant cost of operations, as a percentage of company-owned restaurant sales, was 73.0% in fiscal year 2001, compared to 72.7% in fiscal year 2000. Food and packaging costs decreased 10 basis points, as a percentage of company-owned restaurant sales, primarily as a result of a lower rate of discounting from standard menu pricing, which combined

## Management's Discussion and Analysis

with lower unit costs for potatoes and pork to more than offset higher beef, dairy and packaging costs. Payroll and employee benefits, as a percentage of company-owned restaurant sales, increased 50 basis points from fiscal year 2000 as a result of several factors including an increase in the average wage rate, additional labor related to the company's effort to expand its business in under-penetrated day parts, including an expanded breakfast program, as well as incremental training hours associated with an ongoing Quality Assurance initiative. Other operating expenses decreased 10 basis points due to the leveraging of fixed costs over higher volumes and a lower rate of discounting. Minority interest in earnings of restaurants increased 22.3% to $12.4 million in fiscal year 2001, compared to $10.2 million in fiscal year 2000.

Selling, general and administrative expenses, as a percentage of total revenues, decreased to 9.3% in fiscal year 2001, compared with 10.0% in fiscal year 2000. Depreciation and amortization expense increased 17.6% to $23.9 million in fiscal year 2001 resulting primarily from store acquisitions and new drive-in development as well as store equipment and technology upgrades.

During fiscal year 2001, two drive-ins became impaired under the guidelines of FAS 121, "Accounting for the Impairment of Long-Lived Assets." As a result, a provision for impairment of $0.8 million was recorded for the drive-ins' carrying cost in excess of the present value of estimated future cash flows. Two drive-ins also became impaired under the guidelines of FAS 121 in fiscal year 2000, resulting in an impairment of $1.0 million.

Income from operations increased 18.2% to $67.6 million in fiscal year 2001 from $57.2 million in fiscal year 2000.

Net interest expense in fiscal year 2001 increased 6.5% to $5.5 million from $5.2 million in fiscal year 2000. This increase was the result of additional borrowings to fund share repurchases of $2.1 million and capital expenditures of $90.1 million including $29.1 million for acquisitions.

Provision for income taxes reflects an effective federal and state tax rate of 37.25% for fiscal year 2001 and 2000. Net income increased 19.4% to $39.0 million in fiscal year 2001 compared to $32.6 million in fiscal year 2000. Diluted earnings per share increased to $0.93 per share in fiscal year 2001, compared to $0.78 per share in fiscal year 2000, for an increase of 19.7%.

### Liquidity and Sources of Capital

Net cash provided by operating activities increased $17.8 million or 27.1% in fiscal year 2002 as compared to the same period in fiscal year 2001, primarily as the result of the increase in operating profit before depreciation and amortization and the provision for deferred income taxes.

The company opened 40 newly-constructed restaurants and acquired a net of 20 existing restaurants from franchisees in fiscal year 2002. The company funded total capital additions for fiscal year 2002 of $71.1 million, which included the cost of newly-opened restaurants, new equipment for existing restaurants, retrofits of existing restaurants, restaurants under construction, acquired restaurants, and other capital expenditures, from cash generated by operating activities and through borrowings under the company's line of credit. During fiscal year 2002, the company purchased the real estate for 46 of the 65 newly-constructed and acquired restaurants. The company expects to own the land and building for most of its future newly-constructed restaurants.

The company's board of directors expanded the stock repurchase program during fiscal year 2002, increasing the funds authorized for the repurchase of the company's common stock from $74.6 million to $130.3 million and extended the term of the program to December 31, 2003. The company repurchased approximately 1.2 million shares of common stock at an aggregate cost of $26.0 million during the year, leaving approximately $49.3 million available under the share repurchase program as of the end of the fiscal year. As of August 31, 2002, the company's total cash balance of $9.0 million reflected the impact of the cash generated from operating activities, borrowing activity, and capital expenditures mentioned above.

The company has an agreement with a group of banks which provides the company with an $80.0 million line of credit expiring in July of 2004. The company plans to use the line of credit to finance the opening of newly-constructed restaurants, acquisitions of existing restaurants, purchases of the company's common stock, retirement of senior notes and for other general corporate purposes. As of August 31, 2002, the company's outstanding borrowings under the line of credit were $29.0 million, at an effective borrowing rate of 3.9%, as well as $0.2 million in outstanding letters of credit. The amount available under the line of credit as of August 31, 2002, was $50.8 million. See Note 9 of the Notes to Consolidated Financial Statements for additional information regarding the company's long-term debt.

# Management's Discussion and Analysis

The company plans capital expenditures of $60 to $70 million in fiscal year 2003, excluding potential acquisitions and share repurchases. These capital expenditures primarily relate to the development of additional company-owned restaurants, stall additions, relocations of older restaurants, store equipment upgrades, and enhancements to existing financial and operating information systems, including refinement of a point-of-sale system. The company expects to fund these capital expenditures through borrowings under its existing line of credit and cash flow from operations. The company expects to generate free cash flow, after capital expenditures of $20 million to $25 million during fiscal 2003. The company has long-term debt maturing in fiscal years 2003, 2004 and 2005 of $20.1 million, $30.1 million and $34.6 million respectively. The company expects to refinance amounts maturing in 2003 under the senior unsecured notes with its line of credit and plans to extend the line of credit under existing renewal options and to increase the amount available as needed. The company believes that existing cash and funds generated from operations, as well as borrowings under the line of credit, will meet the company's needs for the foreseeable future.

## Impact of Inflation

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

## Seasonality

The company does not expect seasonality to affect its operations in a materially adverse manner. The company's results during its second fiscal quarter (the months of December, January and February) generally are lower than other quarters because of the climate of the locations of a number of company-owned and franchised restaurants.

## Critical Accounting Policies and Estimates

The Consolidated Financial Statements and Notes to Consolidated Financial Statements contain information that is pertinent to management's discussion and analysis. The preparation of financial statements in conformity with generally accepted accounting principles requires management to use its judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. These assumptions and estimates could have a material affect on the company's Financial Statements. The company evaluates its assumptions and estimates on an ongoing basis using historical experience and various other factors that are believed to be relevant under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The company annually reviews its financial reporting and disclosure practices and accounting policies to ensure that its financial reporting and disclosures provide accurate and transparent information relative to the current economic and business environment. The company believes that of its significant accounting policies (see Note 1 of Notes to Consolidated Financial Statements), the following policies involve a higher degree of risk, judgment and/or complexity.

*Impairment of Long-Lived Assets.* The company reviews each restaurant for impairment when events or circumstances indicate it might be impaired. The company tests for impairment using historical cash flows and other relevant facts and circumstances as the primary basis for its estimates of future cash flows. This process requires the use of estimates and assumptions, which are subject to a high degree of judgment. In addition, at least annually the company assesses the recoverability of goodwill and other intangible assets related to its brand and its restaurants. These impairment tests require the company to estimate fair values of its brand and its restaurants by making assumptions regarding future cash flows and other factors. If these assumptions change in the future, the company may be required to record impairment charges for these assets.

*Ownership Program/Allowance for Uncollectible Notes and Accounts Receivable.* The company's restaurant philosophy stresses an ownership relationship with supervisors and drive-in managers. Most supervisors and managers of company-owned restaurants own an equity interest in the restaurant, which is financed by the company. These notes are typically financed for a term of five years, bear interest at market rates, and are secured by the partner's equity interest. The company evaluates whether the partner notes are collectible and makes estimates of bad debts based on the restaurants'

## Management's Discussion and Analysis

financial performance and collection history with individual partners. If an individual restaurant's performance declines, the probability of default by the partners is increased.

The investments made by managers and supervisors in each partnership or limited liability company are accounted for as minority interests in the financial statements. The ownership agreements contain provisions for buying-out partners upon termination. The amount of the investment made by a partner and the amount of the buy-out are based on a number of factors, primarily upon the restaurant's financial performance for the preceding 12 months. In no case, does the buy-out amount exceed fair market value. Such payments are accounted for under the purchase method of accounting.

The company collects royalties from franchisees and provides for estimated losses for receivables that are not likely to be collected. General allowances for uncollectible receivables are estimated based on historical trends. Although the company has a good relationship with its franchisees and collection rates are currently high, if average sales or the financial health of franchisees were to deteriorate, the company may have to increase reserves against collection of franchise revenues.

*Contingency Reserves.* From time to time, the company is involved in various legal proceedings and has certain unresolved claims pending involving taxing authorities, franchisees, suppliers, employees and competitors. The company is required to assess the likelihood of any adverse judgments or outcomes to these matters as well as estimate potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is made after careful analysis of each issue. In addition, the company's estimate of probable losses may change in the future due to new developments or changes in approach such as a change in settlement strategy in dealing with these matters. The company believes that all claims currently pending are either adequately covered by insurance or would not have a material adverse effect on the company's business or financial condition.

*Advertising.* Under the company's license agreements, each drive-in, either company-owned or franchise, must contribute a minimum percentage of revenues to a national media production fund (Sonic Advertising Fund) and spend an additional minimum percentage of gross revenues on local advertising, either directly or through company-required participation in advertising cooperatives. A portion of the local advertising contributions is redistributed to a System Marketing Fund, which purchases advertising on national cable and broadcast networks and other national media and sponsorship opportunities.

As stated in the terms of existing license agreements, these funds do not constitute assets of the company and the company acts with limited agency in the administration of these funds. Accordingly, neither the revenues and expenses nor the assets and liabilities of the advertising cooperatives, the Sonic Advertising Fund, or the System Marketing Fund are included in the company's consolidated financial statements. However, all advertising contributions by company-owned restaurants are recorded as an expense in the company's financial statements.

*Revenue Recognition Related to Franchise Fees and Royalties.* Initial franchise fees are nonrefundable and are recognized in income when all material services or conditions relating to the sale of the franchise have been substantially performed or satisfied by the company. Area development fees are nonrefundable and are recognized in income on a pro-rata basis when the conditions for revenue recognition under the individual development agreements are met. Both initial franchise fees and area development fees are generally recognized upon the opening of a franchise drive-in or upon termination of the agreement between the company and the franchisee.

The company's franchisees are required under the provisions of the license agreements to pay the company royalties each month based on a percentage of actual net royalty sales. However, the royalty payments and supporting financial statements are not due until the 20th of the following month. As a result, the company accrues royalty revenue in the month earned based on estimates of franchise store sales. These estimates are based on actual sales at company-owned stores and projections of average unit volume growth at franchise stores.

*Income Taxes.* The company provides for income taxes based on its estimate of federal and state tax liability. In making this estimate, the company considers the impact of legislative and judicial developments. As these developments evolve, the company will update its estimate which could result in an adjustment to the tax rate.

# Management's Discussion and Analysis

## Quantitative and Qualitative Disclosures About Market Risk

The company is exposed to market risk from changes in interest rates on debt and notes receivable, as well as changes in commodity prices.

The company's exposure to interest rate risk currently consists of its Senior Notes, outstanding line of credit, and notes receivable. The Senior Notes bear interest at fixed rates which average 6.8%. The aggregate balance outstanding under the Senior Notes as of August 31, 2002 was $80.0 million. Should interest rates increase or decrease, the estimated fair value of these notes would decrease or increase, respectively. As of August 31, 2002, the estimated fair value of the Senior Notes exceeded the carrying amount by approximately $4.2 million. The line of credit bears interest at a rate benchmarked to U.S. and European short-term interest rates. The balance outstanding under the line of credit was $29.0 million as of August 31, 2002. The company has made certain loans to its store operating partners and franchisees totaling $11.3 million as of August 31, 2002. The interest rates on these notes are generally between 10% and 11%. The company believes the fair market value of these notes approximates their carrying amount. The impact on the company's results of operations of a one-point interest rate change on the outstanding balances under the line of credit as of the end of fiscal year 2002 would be approximately $0.3 million.

The company and its franchisees purchase certain commodities such as beef, potatoes, chicken and dairy products. These commodities are generally purchased based upon market prices established with vendors. These purchase arrangements may contain contractual features that limit the price paid by establishing price floors or caps; however, the company has not made any long-term commitments to purchase any minimum quantities under these arrangements. The company does not use financial instruments to hedge commodity prices because these purchase agreements help control the ultimate cost and any commodity price aberrations are generally short term in nature.

This market risk discussion contains forward-looking statements. Actual results may differ materially from this discussion based upon general market conditions and changes in financial markets.

# Consolidated Balance Sheets

| | August 31, 2002 | August 31, 2001 |
|---|---|---|
| | ($ in thousands) | |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 8,951** | $ 6,971 |
| Accounts and notes receivable, net | **13,755** | 12,142 |
| Net investment in direct financing leases | **802** | 683 |
| Inventories | **2,274** | 2,030 |
| Deferred income taxes | **481** | 388 |
| Prepaid expenses | **3,710** | 1,315 |
| Total current assets | **29,973** | 23,529 |
| Notes receivable, net | **8,529** | 7,375 |
| Net investment in direct financing leases | **7,137** | 7,148 |
| Property, equipment and capital leases, net | **305,286** | 273,198 |
| Goodwill, net | **46,826** | 38,850 |
| Trademarks, trade names and other intangibles, net | **6,755** | 6,980 |
| Other assets, net | **850** | 920 |
| Total assets | **$ 405,356** | $ 358,000 |
| **Liabilities and stockholders' equity** | | |
| Current liabilities: | | |
| Accounts payable | **$ 6,799** | $ 8,052 |
| Deposits from franchisees | **1,015** | 1,020 |
| Accrued liabilities | **34,029** | 18,380 |
| Long-term debt and obligations under capital leases due within one year | **1,072** | 1,083 |
| Total current liabilities | **42,915** | 28,535 |
| Obligations under capital leases due after one year | **11,991** | 12,801 |
| Long-term debt due after one year | **109,250** | 108,972 |
| Other noncurrent liabilities | **5,807** | 5,238 |
| Deferred income taxes | **4,723** | 1,735 |
| Commitments and contingencies (Notes 6, 7, 14, and 15) | | |
| Stockholders' equity: | | |
| Preferred stock, par value $.01; 1,000,000 shares authorized; none outstanding | **–** | – |
| Common stock, par value $.01; 100,000,000 shares authorized; shares issued 48,477,652 in 2002 and 31,913,898 in 2001 | **485** | 319 |
| Paid-in capital | **86,563** | 78,427 |
| Retained earnings | **236,126** | 188,434 |
| | **323,174** | 267,180 |
| Treasury stock, at cost; 8,736,701 shares in 2002 and 5,029,345 shares in 2001 | **(92,504)** | (66,461) |
| Total stockholders' equity | **230,670** | 200,719 |
| Total liabilities and stockholders' equity | **$ 405,356** | $ 358,000 |

*See accompanying notes.*

## Consolidated Statements of Income

| | Year ended August 31, | | |
|---|---|---|---|
| | **2002** | 2001 | 2000 |
| | *(In thousands, except per share data)* | | |
| **Revenues:** | | | |
| Company-owned restaurant sales | **$ 330,707** | $ 267,463 | $ 224,880 |
| Franchised restaurants: | | | |
| Franchise royalties | **61,392** | 54,220 | 47,595 |
| Franchise fees | **4,020** | 4,408 | 3,717 |
| Other | **4,043** | 4,547 | 3,864 |
| | **400,162** | 330,638 | 280,056 |
| **Costs and expenses:** | | | |
| Company-owned restaurants: | | | |
| Food and packaging | **85,838** | 69,609 | 58,778 |
| Payroll and other employee benefits | **95,085** | 75,822 | 62,576 |
| Other operating expenses | **61,270** | 49,907 | 42,216 |
| | **242,193** | 195,338 | 163,570 |
| Selling, general and administrative | **33,444** | 30,602 | 27,894 |
| Depreciation and amortization | **26,078** | 23,855 | 20,287 |
| Minority interest in earnings of restaurants | **14,864** | 12,444 | 10,173 |
| Provision for impairment of long-lived assets and other | **1,261** | 792 | 951 |
| | **317,840** | 263,031 | 222,875 |
| **Income from operations** | **82,322** | 67,607 | 57,181 |
| Interest expense | **7,406** | 6,628 | 6,234 |
| Interest income | **(1,087)** | (1,103) | (1,048) |
| Net interest expense | **6,319** | 5,525 | 5,186 |
| Income before income taxes | **76,003** | 62,082 | 51,995 |
| Provision for income taxes | **28,311** | 23,126 | 19,368 |
| **Net income** | **$ 47,692** | $ 38,956 | $ 32,627 |
| **Basic income per share** | **$ 1.19** | $ .98 | $ .81 |
| **Diluted income per share** | **$ 1.13** | $ .93 | $ .78 |

*See accompanying notes.*

# Consolidated Statements of Stockholders' Equity

| | Common Stock | | Paid-in | Retained | Treasury Stock | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Earnings | Shares | Amount |
| | | | *(In thousands)* | | | |
| Balance at August 31, 1999 | 20,746 | $ 207 | $ 67,212 | $ 116,851 | 2,164 | $ (34,515) |
| Exercise of common stock options | 137 | 2 | 1,911 | – | – | – |
| Tax benefit related to exercise of employee stock options | – | – | 767 | – | – | – |
| Purchase of treasury stock | – | – | – | – | 1,138 | (29,799) |
| Three-for-two stock split | 10,442 | 104 | (104) | – | 1,651 | – |
| Net income | – | – | – | 32,627 | – | – |
| Balance at August 31, 2000 | 31,325 | 313 | 69,786 | 149,478 | 4,953 | (64,314) |
| Exercise of common stock options | 589 | 6 | 5,827 | – | – | – |
| Tax benefit related to exercise of employee stock options | – | – | 2,814 | – | – | – |
| Purchase of treasury stock | – | – | – | – | 76 | (2,147) |
| Net income | – | – | – | 38,956 | – | – |
| Balance at August 31, 2001 | 31,914 | 319 | 78,427 | 188,434 | 5,029 | (66,461) |
| Exercise of common stock options | **512** | **5** | **4,823** | **–** | **–** | **–** |
| Tax benefit related to exercise of employee stock options | **–** | **–** | **3,474** | **–** | **–** | **–** |
| Purchase of treasury stock | **–** | **–** | **–** | **–** | **1,033** | **(26,043)** |
| Three-for-two stock split | **16,052** | **161** | **(161)** | **–** | **2,675** | **–** |
| Net income | **–** | **–** | **–** | **47,692** | **–** | **–** |
| Balance at August 31, 2002 | **48,478** | **$ 485** | **$ 86,563** | **$ 236,126** | **8,737** | **$ (92,504)** |

*See accompanying notes.*

# Consolidated Statements of Cash Flows

| | Year ended August 31, 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (In thousands) | |
| **Cash flows from operating activities** | | | |
| Net income | **$ 47,692** | $ 38,956 | $ 32,627 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | **25,531** | 21,186 | 18,369 |
| Amortization | **547** | 2,669 | 1,918 |
| (Gains) losses on dispositions of assets | **(179)** | (936) | 63 |
| Amortization of franchise and development fees | **(4,020)** | (4,408) | (3,705) |
| Franchise and development fees collected | **4,116** | 4,702 | 3,930 |
| Provision (benefit) for deferred income taxes | **2,895** | (1,471) | 881 |
| Provision for impairment of long-lived assets | **1,261** | 792 | 951 |
| Tax benefit related to exercises of employee stock options | **3,474** | 2,814 | 767 |
| Other | **380** | 212 | (19) |
| (Increase) decrease in operating assets: | | | |
| Accounts and notes receivable | **(1,152)** | (1,228) | (2,245) |
| Inventories and prepaid expenses | **(2,530)** | (308) | (690) |
| Increase (decrease) in operating liabilities: | | | |
| Accounts payable | **(1,235)** | 590 | 2,342 |
| Accrued and other liabilities | **6,703** | 2,129 | 1,420 |
| Total adjustments | **35,791** | 26,743 | 23,982 |
| Net cash provided by operating activities | **83,483** | 65,699 | 56,609 |
| **Cash flows from investing activities** | | | |
| Purchases of property and equipment | **(50,572)** | (61,499) | (35,151) |
| Acquisition of businesses, net of cash received | **(20,505)** | (29,120) | – |
| Investments in direct financing leases | **(893)** | (862) | (2,713) |
| Collections on direct financing leases | **810** | 850 | 1,353 |
| Proceeds from dispositions of assets | **4,072** | 2,911 | 933 |
| Increase in intangibles and other assets | **(1,234)** | (2,183) | (2,036) |
| Net cash used in investing activities | **(68,322)** | (89,903) | (37,614) |
| **Cash flows from financing activities** | | | |
| Proceeds from long-term borrowings | **115,275** | 238,685 | 124,155 |
| Payments on long-term debt | **(115,083)** | (213,929) | (112,674) |
| Purchases of treasury stock | **(17,137)** | (1,843) | (29,799) |
| Payments on capital lease obligations | **(887)** | (744) | (725) |
| Exercises of stock options | **4,651** | 5,529 | 1,913 |
| Net cash provided by (used in) financing activities | **(13,181)** | 27,698 | (17,130) |
| Net increase in cash and cash equivalents | **1,980** | 3,494 | 1,865 |
| Cash and cash equivalents at beginning of the year | **6,971** | 3,477 | 1,612 |
| Cash and cash equivalents at end of the year | **$ 8,951** | $ 6,971 | $ 3,477 |
| **Supplemental cash flow information** | | | |
| Cash paid during the year for: | | | |
| Interest (net of amounts capitalized of $433, $732 and $316, respectively) | **$ 7,641** | $ 6,339 | $ 6,147 |
| Income taxes (net of refunds) | **19,190** | 22,203 | 18,649 |
| Additions to capital lease obligations | **137** | 7,346 | 294 |
| Accounts and notes receivable and decrease in capital lease obligations from property and equipment sales | **1,650** | 945 | 1,742 |
| Obligation to acquire treasury stock | **8,729** | – | – |
| Stock options exercised by stock swap | **177** | 304 | – |

*See accompanying notes.*

# Notes to Consolidated Financial Statements

August 31, 2002, 2001 and 2000 (In thousands, except share data)

## 1. Summary of Significant Accounting Policies

*Operations*

Sonic Corp. (the "company") operates and franchises a chain of quick-service drive-in restaurants in the United States. It derives its revenues primarily from company-owned restaurant sales and royalty fees from franchisees. The company also leases signs and real estate, and owns a minority interest in several franchised restaurants. The company grants credit to its operating partners and its franchisees, all of whom are in the restaurant business. Substantially all of the notes receivable and direct financing leases are collateralized by real estate or equipment.

On April 1, 2001, the company acquired 35 existing franchise restaurants located in the Tulsa, Oklahoma market from a franchisee and other minority investors. The acquisitions were accounted for under the purchase method of accounting, with the results of operations of these restaurants included with that of the company's commencing April 1, 2001. The company's cash acquisition cost, prior to post-closing adjustments, of approximately $21.9 million consisted of the drive-ins' operating assets ($0.2 million), equipment ($4.4 million) and goodwill ($17.3 million, which is expected to be fully deductible for tax purposes). The company also entered into long-term real estate leases on each of these drive-in restaurants, which have future minimum rental payments aggregating $1.8 million annually over the next 15 years ($5.1 million of which was recorded as capital leases related to the buildings). The company funded this acquisition through operating cash flows and borrowings under its existing $80.0 million bank line of credit.

On April 1, 2002, the company acquired 23 existing franchise restaurants located in the Wichita, Kansas market from a franchisee and other minority investors. The acquisitions were accounted for under the purchase method of accounting, with the results of operations of these restaurants included with that of the company's commencing April 1, 2002. The company's cash acquisition cost, prior to post-closing adjustments, of approximately $19.4 million consisted of real estate ($10.7 million), equipment ($1.7 million) and goodwill ($7.0 million, which is expected to be fully deductible for tax purposes). The company funded this acquisition through operating cash flows and borrowings under its existing $80.0 million bank line of credit.

*Principles of Consolidation*

The accompanying financial statements include the accounts of the company, its wholly-owned subsidiaries and its majority-owned, company-operated restaurants, organized as general partnerships and limited liability companies. All significant intercompany accounts and transactions have been eliminated.

Certain amounts have been reclassified in the consolidated balance sheets to conform to the fiscal year 2002 presentation.

*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported and contingent assets and liabilities disclosed in the financial statements and accompanying notes. Actual results may differ from those estimates, and such differences may be material to the financial statements.

*Inventories*

Inventories consist principally of food and supplies which are carried at the lower of cost (first-in, first-out basis) or market.

*Property, Equipment and Capital Leases*

Property and equipment are recorded at cost, and leased assets under capital leases are recorded at the present value of future minimum lease payments. Depreciation of property and equipment and capital leases are computed by the straight-line method over the estimated useful lives or initial terms of the leases, respectively, and are combined for presentation in the financial statements.

*Accounting for Long-Lived Assets*

The company reviews long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. Assets are grouped and evaluated for impairment at the lowest level for

## Notes to Consolidated Financial Statements

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which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets, which generally represents the individual restaurant. The company's primary test for an indicator of potential impairment is operating losses. If an indication of impairment is determined to be present, the company estimates the future cash flows expected to be generated from the use of the asset and its eventual disposal. If the sum of undiscounted future cash flows is less than the carrying amount of the asset, an impairment loss is recognized. The impairment loss is measured by comparing the fair value of the asset to its carrying amount. The fair value of the asset is measured by either calculating the present value of estimated future cash flows using a discount rate equivalent to the rate of return the company expects to achieve from its investment in newly-constructed restaurants or appraisals.

Assets held for disposal are carried at the lower of depreciated cost or fair value less cost to sell. Fair values are estimated based upon appraisals or independent assessments of the assets' estimated sales values. During the period in which assets are being held for disposal, depreciation and amortization of such assets are not recognized.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 requires that an impairment loss be recognized only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and that the measurement of any impairment loss be the difference between the carrying amount and the fair value of the asset. The company adopted the Statement effective September 1, 2002, which did not result in a material impact on its consolidated financial position or results of operation.

*Goodwill and Other Intangible Assets*

The company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," effective September 1, 2001. Statement No. 142 eliminates the amortization for goodwill and other intangible assets with indefinite lives. Intangible assets with lives restricted by contractual, legal, or other means will continue to be amortized over their useful lives. Goodwill and other intangible assets not subject to amortization are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. SFAS No. 142 requires a two-step process for testing impairment. First, the fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If an impairment is indicated, then the fair value of the reporting unit's goodwill is determined by allocating the unit's fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying value over its fair value. No such impairment losses were recorded upon the initial adoption of SFAS No. 142. Prior to the adoption of SFAS No. 142, goodwill was being amortized on a straight-line basis over periods not exceeding 40 years.

The company's intangible assets subject to amortization under SFAS No. 142 consist primarily of acquired franchise agreements, franchise fees, and other intangibles. Amortization expense is calculated using the straight-line method over the expected period of benefit, not exceeding 15 years. The company's trademarks and trade names were deemed to have indefinite useful lives and are not subject to amortization. See Note 5 for additional disclosures related to goodwill and other intangibles.

*Franchise Fees and Royalties*

Initial franchise fees are nonrefundable and are recognized in income when all material services or conditions relating to the sale of the franchise have been substantially performed or satisfied by the company. Area development fees are nonrefundable and are recognized in income on a pro rata basis when the conditions for revenue recognition under the individual development agreements are met. Both initial franchise fees and area development fees are generally recognized upon the opening of a franchise drive-in or upon termination of the agreement between the company and the franchisee.

The company's franchisees are required under the provisions of the license agreements to pay the company royalties each month based on a percentage of actual net royalty sales. However, the royalty payments and supporting financial statements are not due until the 20th of the following month. As a result, the company accrues royalty revenue in the month earned based on estimates of franchise store sales. These estimates are based on actual sales at company-owned stores and projections of average unit volume growth at franchise stores.

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*Advertising Costs*

Costs incurred in connection with advertising and promotion of the company's products are expensed as incurred. Such costs amounted to $16,544, $13,283, and $11,531 for fiscal years 2002, 2001 and 2000, respectively.

Under the company's license agreements, each drive-in, either company-owned or franchise, must contribute a minimum percentage of revenues to a national media production fund (Sonic Advertising Fund) and spend an additional minimum percentage of gross revenues on local advertising, either directly or through company-required participation in advertising cooperatives. A portion of the local advertising contributions is redistributed to a System Marketing Fund, which purchases advertising on national cable and broadcast networks and other national media and sponsorship opportunities. As stated in the terms of existing license agreements, these funds do not constitute assets of the company and the company acts with limited agency in the administration of these funds. Accordingly, neither the revenues and expenses nor the assets and liabilities of the advertising cooperatives, the Sonic Advertising Fund, or the System Marketing Fund are included in the company's consolidated financial statements. However, all advertising contributions by company-owned restaurants are recorded as expense on the company's financial statements.

*Cash Equivalents*

Cash equivalents consist of highly liquid investments with a maturity of three months or less from date of purchase.

### 2. Net Income Per Share

The following table sets forth the computation of basic and diluted earnings per share for the years ended August 31:

| | **2002** | 2001 | 2000 |
|---|---|---|---|
| Numerator: | | | |
| Net income | **$ 47,692** | $ 38,956 | $ 32,627 |
| Denominator: | | | |
| Weighted average shares outstanding - basic | **40,155,522** | 39,848,519 | 40,396,452 |
| Effect of dilutive employee stock options | **2,051,227** | 1,883,269 | 1,548,203 |
| Weighted average shares – diluted | **42,206,749** | 41,731,788 | 41,944,655 |
| Net income per share – basic | **$ 1.19** | $ .98 | $ .81 |
| Net income per share – diluted | **$ 1.13** | $ .93 | $ .78 |
| Anti-dilutive employee stock options excluded | **104,806** | 14,630 | 452,457 |

See Note 12 for information regarding shares available for grant under the 2001 Sonic Corp. Stock Option Plan and the 2001 Sonic Corp. Directors' Stock Option Plan.

### 3. Impairment of Long-Lived Assets

As of August 31, 2002 and 2001, the company had identified certain underperforming restaurants whose operating results indicated that certain assets of these restaurants might be impaired. The buildings and improvements of these restaurants had combined carrying amounts of $1,990 and $3,956 respectively. During fiscal years 2002 and 2001, the company performed quarterly analyses of these and other restaurants which had incurred operating losses. As a result of these analyses, the company determined that certain restaurants with then-existing carrying amounts of $1,139 and $971, respectively, were impaired and wrote them down by $970 and $792, respectively, to their fair values. In addition, estimates were revised on three stores which were previously impaired under FAS 121 resulting in additional provisions totaling $291 in fiscal year 2002. Management's estimate of undiscounted future cash flows indicates that the remaining carrying amounts as of August 31, 2002 are expected to be recovered. However, it is reasonably possible that the estimate of cash flows may change in the near future resulting in the need to write-down one or more of the identified assets to fair value.

# Notes to Consolidated Financial Statements

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## 4. Accounts and Notes Receivable

Accounts and notes receivable consist of the following at August 31, 2002 and 2001:

| | 2002 | 2001 |
|---|---|---|
| Royalties and other trade receivables | **$ 7,701** | $ 7,187 |
| Notes receivable – current | **2,290** | 1,797 |
| Other | **5,252** | 4,039 |
| | **15,243** | 13,023 |
| Less allowance for doubtful accounts and notes receivable | **1,488** | 881 |
| | **$ 13,755** | $ 12,142 |
| Notes receivable – noncurrent | **$ 9,034** | $ 7,761 |
| Less allowance for doubtful notes receivable | **505** | 386 |
| | **$ 8,529** | $ 7,375 |

The company collects royalties from franchisees and provides for estimated losses for receivables that are not likely to be collected. General allowances for uncollectible receivables are estimated based on historical trends.

Most supervisors and managers of company-owned restaurants own an equity interest in the restaurant, which is financed by the company. These notes are typically financed for a term of five years, bear interest at market rates, and are secured by the partner's equity interest. The company evaluates whether the partner notes are collectible and makes estimates of bad debts based on the restaurant's financial performance and collection history with individual partners.

As of August 31, 2002 and 2001, notes receivable from one franchisee totaled $3,420 and $3,725, respectively. The underlying restaurant assets collateralize these notes.

## 5. Goodwill, Intangibles and Other Assets

The gross carrying amount of franchise agreements, franchise fees and other intangibles subject to amortization was $2,749 and $2,827 at August 31, 2002 and 2001, respectively. Accumulated amortization related to these intangible assets was $2,038 and $1,891 at August 31, 2002 and 2001, respectively. The carrying amount of trademarks and trade names not subject to amortization was $6,044 at August 31, 2002 and 2001.

The following tables disclose what reported net income would have been for fiscal years ending August 31, 2002 and 2001 exclusive of amortization expense (including any related tax effects) recognized in those periods related to goodwill and intangible assets that are no longer being amortized. Similarly adjusted per-share amounts have also been presented.

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Reported net income | **$ 47,692** | $ 38,956 | $ 32,627 |
| Add back: Goodwill amortization | **–** | 1,266 | 732 |
| Add back: Trademarks and trade names amortization | **–** | 139 | 139 |
| Adjusted net income | **$ 47,692** | $ 40,361 | $ 33,498 |
| Net income per share – basic: | | | |
| Reported net income | **$ 1.19** | $ .98 | $ .81 |
| Goodwill amortization | **–** | .03 | .02 |
| Trademarks and trade names amortization | **–** | – | – |
| Adjusted net income | **$ 1.19** | $ 1.01 | $ .83 |
| Net income per share – diluted: | | | |
| Reported net income | **$ 1.13** | $ .93 | $ .78 |
| Goodwill amortization | **–** | .03 | .02 |
| Trademarks and trade names amortization | **–** | – | – |
| Adjusted net income | **$ 1.13** | $ .96 | $ .80 |

## Notes to Consolidated Financial Statements

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Aggregate amortization expense related to intangible assets was $319 and $288 in fiscal years 2002 and 2001, respectively. Estimated amortization expense for the next five fiscal years beginning with fiscal year 2003 is as follows:

| | | |
|---|---|---|
| For the year ending August 31, 2003 | $ | 289 |
| For the year ending August 31, 2004 | $ | 278 |
| For the year ending August 31, 2005 | $ | 202 |
| For the year ending August 31, 2006 | $ | 193 |
| For the year ending August 31, 2007 | $ | 209 |

The changes in the carrying amount of goodwill for fiscal years ending August 31, 2002 and 2001 were as follows:

| | **2002** | 2001 |
|---|---|---|
| Balance as of September 1, | **$ 38,850** | $ 16,227 |
| Goodwill acquired during the year | **8,174** | 24,666 |
| Impairment losses | **–** | – |
| Amortization of goodwill prior to adoption of SFAS 142 | **–** | (2,018) |
| Goodwill disposed of related to the sale of restaurants | **(198)** | (25) |
| Balance as of August 31, | **$ 46,826** | $ 38,850 |

### 6. Leases

*Description of Leasing Arrangements*

The company's leasing operations consist principally of leasing certain land, buildings and equipment (including signs) and subleasing certain buildings to franchise operators. The land and building portions of these leases are classified as operating leases and expire over the next 15 years. The equipment portions of these leases are classified principally as direct financing leases and expire principally over the next 10 years. These leases include provisions for contingent rentals which may be received on the basis of a percentage of sales in excess of stipulated amounts. Income is not recognized on contingent rentals until sales exceed the stipulated amounts. Some leases contain escalation clauses over the lives of the leases. Most of the leases contain one to four renewal options at the end of the initial term for periods of five years. These options enable the company to retain use of properties in desirable operating areas.

Certain company-owned restaurants lease land and buildings from third parties. These leases, which expire over the next nineteen years, include provisions for contingent rentals which may be paid on the basis of a percentage of sales in excess of stipulated amounts. The land portions of these leases are classified as operating leases and the buildings portions are classified as capital leases.

*Direct Financing Leases*

Components of net investment in direct financing leases are as follows at August 31, 2002 and 2001:

| | **2002** | 2001 |
|---|---|---|
| Minimum lease payments receivable | **$ 12,390** | $ 12,656 |
| Less unearned income | **4,451** | 4,825 |
| Net investment in direct financing leases | **7,939** | 7,831 |
| Less amount due within one year | **802** | 683 |
| Amount due after one year | **$ 7,137** | $ 7,148 |

Initial direct costs incurred in the negotiations and consummations of direct financing lease transactions have not been material. Accordingly, no portion of unearned income has been recognized to offset those costs.

## Notes to Consolidated Financial Statements

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Future minimum rental payments receivable as of August 31, 2002 are as follows:

| | Operating | Direct Financing |
|---|---|---|
| Year ending August 31: | | |
| 2003 | $ 1,243 | $ 1,854 |
| 2004 | 1,157 | 1,825 |
| 2005 | 615 | 1,795 |
| 2006 | 595 | 1,782 |
| 2007 | 576 | 1,733 |
| Thereafter | 3,815 | 3,401 |
| | 8,001 | 12,390 |
| Less unearned income | – | 4,451 |
| | $ 8,001 | $ 7,939 |

*Capital Leases*

Components of obligations under capital leases are as follows at August 31, 2002 and 2001:

| | **2002** | 2001 |
|---|---|---|
| Total minimum lease payments | **$ 21,393** | $ 23,321 |
| Less amount representing interest averaging 9.4% in 2002 and 10% in 2001 | **8,455** | 9,633 |
| Present value of net minimum lease payments | **12,938** | 13,688 |
| Less amount due within one year | **947** | 887 |
| Amount due after one year | **$ 11,991** | $ 12,801 |

Maturities of these obligations under capital leases and future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of August 31, 2002 are as follows:

| | Operating | Capital |
|---|---|---|
| Year ending August 31: | | |
| 2003 | $ 6,307 | $ 2,112 |
| 2004 | 6,642 | 2,119 |
| 2005 | 6,582 | 1,963 |
| 2006 | 6,578 | 1,896 |
| 2007 | 6,364 | 1,714 |
| Thereafter | 52,803 | 11,589 |
| | 85,276 | 21,393 |
| Less amount representing interest | – | 8,455 |
| | $ 85,276 | $ 12,938 |

Total rent expense for all operating leases and capital leases consists of the following for the years ended August 31:

| | **2002** | 2001 | 2000 |
|---|---|---|---|
| Operating leases: | | | |
| Minimum rentals | **$ 6,574** | $ 5,012 | $ 3,810 |
| Contingent rentals | **145** | 147 | 146 |
| Sublease rentals | **(407)** | (414) | (412) |
| Capital leases: | | | |
| Contingent rentals | **684** | 412 | 262 |
| | **$ 6,996** | $ 5,157 | $ 3,806 |

The aggregate future minimum rentals receivable under noncancelable subleases of operating leases as of August 31, 2002 was $1,452.

# Notes to Consolidated Financial Statements

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## 7. Property, Equipment and Capital Leases

Property, equipment and capital leases consist of the following at August 31, 2002 and 2001:

| | Estimated Useful Life | 2002 | 2001 |
|---|---|---|---|
| Home office: | | | |
| Land and leasehold improvements | Life of lease | **$ 1,697** | $ 1,545 |
| Computer and other equipment | 2 – 5 yrs | **24,662** | 24,727 |
| Restaurants, including those leased to others: | | | |
| Land | | **94,148** | 81,522 |
| Buildings | 15 – 25 yrs | **168,055** | 142,395 |
| Equipment | 5 – 7 yrs | **101,788** | 88,145 |
| Property and equipment, at cost | | **390,350** | 338,334 |
| Less accumulated depreciation | | **96,107** | 77,124 |
| Property and equipment, net | | **294,243** | 261,210 |
| Leased restaurant buildings and equipment under capital leases, including those held for sublease | Life of lease | **16,449** | 16,540 |
| Less accumulated amortization | | **5,406** | 4,552 |
| Capital leases, net | | **11,043** | 11,988 |
| Property, equipment and capital leases, net | | **$ 305,286** | $ 273,198 |

Land, buildings and equipment with a carrying amount of $26,238 at August 31, 2002 were leased under operating leases to franchisees or other parties. The accumulated depreciation related to these buildings and equipment was $3,962 at August 31, 2002. As of August 31, 2002, the company had restaurants under construction with costs to complete which aggregated $9,308.

## 8. Accrued Liabilities

Accrued liabilities consist of the following at August 31, 2002 and 2001:

| | 2002 | 2001 |
|---|---|---|
| Wages and other employee benefits | **$ 5,003** | $ 4,022 |
| Taxes, other than income taxes | **7,752** | 6,030 |
| Income taxes payable | **5,061** | 1,210 |
| Accrued interest | **1,618** | 1,852 |
| Obligation to acquire treasury stock | **8,729** | – |
| Other | **5,866** | 5,266 |
| | **$ 34,029** | $ 18,380 |

## 9. Long-Term Debt

Long-term debt consists of the following at August 31, 2002 and 2001:

| | 2002 | 2001 |
|---|---|---|
| Senior unsecured notes (A) | **$ 50,000** | $ 50,000 |
| Borrowings under line of credit (B) | **29,000** | 28,600 |
| Senior unsecured notes (C) | **30,000** | 30,000 |
| Other | **375** | 568 |
| | **109,375** | 109,168 |
| Less long-term debt due within one year | **125** | 196 |
| Long-term debt due after one year | **$ 109,250** | $ 108,972 |

## Notes to Consolidated Financial Statements

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(A) The company has $50,000 of senior unsecured notes with $20,000 of Series A notes maturing in April 2003 and $30,000 of Series B notes maturing in April 2005. The company has the intent and ability to refinance the $20,000 of Series A notes maturing in 2003 and has classified that amount as long-term debt as of August 31, 2002 on the consolidated balance sheet. The company expects to refinance amounts maturing in fiscal year 2003 with its line of credit. Interest is payable semi-annually and accrues at 6.65% for the Series A notes and 6.76% for the Series B notes. The related agreement requires, among other things, the company to maintain equity of a specified amount, maintain ratios of debt to total capital and fixed charge coverage and limits additional borrowings.

(B) The company has an agreement with a group of banks which provides for an $80,000 line of credit, including a $2,000 sub-limit for letters of credit, expiring in July 2004. The agreement allows for annual renewal options, subject to approval by the banks. The company plans to use the line of credit to finance the opening of newly-constructed restaurants, acquisitions of existing restaurants, purchases of the company's common stock, retirement of senior notes and for general corporate purposes. Borrowings under the line of credit are unsecured and bear interest at a specified bank's prime rate or, at the company's option, LIBOR plus 0.50% to 1.25%. In addition, the company pays an annual commitment fee ranging from .125% to .25% on the unused portion of the line of credit. As of August 31, 2002, the company's effective borrowing rate was 3.9%. As of August 31, 2002 there were $266 in letters of credit outstanding under the line of credit. The agreement requires, among other things, the company to maintain equity of a specified amount, maintain ratios of debt to EBITDA and fixed charge coverage and limits additional borrowings and acquisitions of businesses.

(C) The company has $30,000 of senior unsecured notes with $5,000 of Series A notes maturing in August 2008 and $25,000 of Series B notes maturing in August 2011. Interest is payable semi-annually and accrues at 6.58% for the Series A notes and 6.87% for the Series B notes. Required annual prepayments amount to $1,000 from August 2004 to August 2007 on the Series A notes and $3,571 from August 2005 to August 2010 on the Series B notes. The related agreement requires, among other things, the company to maintain equity of a specified amount, and maintain ratios of debt to equity and fixed charge coverage.

Maturities of long-term debt for each of the five years after August 31, 2002 are $125 in 2003, $50,086 in 2004, $34,624 in 2005, $4,590 in 2006, and $4,592 in 2007 and $15,358 thereafter.

### 10. Other Noncurrent Liabilities

Other noncurrent liabilities consist of the following at August 31, 2002 and 2001:

| | **2002** | 2001 |
|---|---|---|
| Minority interest in consolidated restaurants | **$ 2,836** | $ 3,000 |
| Deferred area development fees | **1,162** | 1,061 |
| Other | **1,809** | 1,177 |
| | **$ 5,807** | $ 5,238 |

### 11. Income Taxes

The components of the provision for income taxes consists of the following for the years ended August 31:

| | **2002** | 2001 | 2000 |
|---|---|---|---|
| Current: | | | |
| Federal | **$ 23,690** | $ 22,696 | $ 17,182 |
| State | **1,726** | 1,901 | 1,305 |
| | **25,416** | 24,597 | 18,487 |
| Deferred: | | | |
| Federal | **2,517** | (1,279) | 766 |
| State | **378** | (192) | 115 |
| | **2,895** | (1,471) | 881 |
| Provision for income taxes | **$ 28,311** | $ 23,126 | $ 19,368 |

## Notes to Consolidated Financial Statements

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The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate due to the following for the years ended August 31:

| | **2002** | 2001 | 2000 |
|---|---|---|---|
| Amount computed by applying a tax rate of 35% | **$ 26,601** | $ 21,729 | $ 18,198 |
| State income taxes (net of federal income tax benefit) | **1,368** | 1,110 | 923 |
| Other | **342** | 287 | 247 |
| Provision for income taxes | **$ 28,311** | $ 23,126 | $ 19,368 |

Deferred tax assets and liabilities consist of the following at August 31, 2002 and 2001:

| | **2002** | 2001 |
|---|---|---|
| Current deferred tax assets (liabilities): | | |
| Allowance for doubtful accounts and notes receivable | **$ 116** | $ 133 |
| Property, equipment and capital leases | **162** | 118 |
| Accrued litigation costs | **206** | 139 |
| Other | **(3)** | (2) |
| Current deferred tax assets, net | **$ 481** | $ 388 |
| | | |
| Noncurrent deferred tax assets (liabilities): | | |
| Net investment in direct financing leases including differences related to capitalization and amortization | **$ (2,426)** | $ (2,047) |
| Investment in partnerships, including differences in capitalization and depreciation related to direct financing leases and different year ends for financial and tax reporting purposes | **(3,008)** | 497 |
| State net operating losses | **2,567** | 1,967 |
| Property, equipment and capital leases | **(936)** | (391) |
| Allowance for doubtful accounts and notes receivable | **194** | 148 |
| Deferred income from affiliated franchise fees | **897** | – |
| Accrued liabilities | **223** | – |
| Intangibles and other assets | **45** | (25) |
| Other | **288** | 83 |
| | **(2,156)** | 232 |
| Valuation allowance | **(2,567)** | (1,967) |
| Noncurrent deferred tax liabilities, net | **$ (4,723)** | $ (1,735) |
| | | |
| Deferred tax assets and (liabilities): | | |
| Deferred tax assets (net of valuation allowance) | **$ 1,987** | $ 1,072 |
| Deferred tax liabilities | **(6,229)** | (2,419) |
| Net deferred tax liabilities | **$ (4,242)** | $ (1,347) |

State net operating loss carryforwards expire generally beginning in 2010. Management does not believe the company will be able to realize the state net operating loss carryforwards and therefore has provided a valuation allowance as of August 31, 2002 and 2001.

# Notes to Consolidated Financial Statements

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## 12. Stockholders' Equity

On November 14, 2000, the company's board of directors authorized a three-for-two stock split in the form of a stock dividend. A total of 10,441,611 shares of common stock were issued on November 30, 2000 in connection with the split. The stated par value of each share was not changed from $.01. An aggregate amount equal to the par value of the common stock issued of $104 was reclassified from paid-in capital to common stock.

On January 17, 2002, the company's board of directors authorized a three-for-two stock split in the form of a stock dividend. A total of 16,051,750 shares of common stock were issued on February 8, 2002 in connection with the split, and an aggregate amount equal to the par value of the common stock issued of $161 was reclassified from paid-in capital to common stock. In addition, shareholders approved an increase in common stock authorized from 40,000,000 to 100,000,000 shares. The stated par value of each share was not changed from $.01.

All references in the accompanying consolidated financial statements to weighted average numbers of shares outstanding, per share amounts and Stock Purchase Plan and Stock Options share data have been adjusted to reflect the stock splits on a retroactive basis.

*Stock Purchase Plan*

The company has an employee stock purchase plan for all full-time regular employees. Employees are eligible to purchase shares of common stock each year through a payroll deduction not in excess of the lesser of 10% of compensation or $25. The aggregate amount of stock that employees may purchase under this plan is limited to 506,250 shares. The purchase price will be between 85% and 100% of the stock's fair market value and will be determined by the company's board of directors.

*Stock Options*

In January 2001 the stockholders of the company adopted the 2001 Sonic Corp. Stock Option Plan (the "2001 Employee Plan") and the 2001 Sonic Corp. Directors' Stock Option Plan (the "2001 Directors' Plan"). (The 2001 Employee Plan and the 2001 Directors' Plan are referred to collectively as the "2001 Plans.") The 2001 Plans were adopted to replace the 1991 Sonic Corp. Stock Option Plan and the 1991 Sonic Corp. Directors' Stock Option Plan (collectively, the "1991 Plans"), because the 1991 Plans were expiring after 10 years as required by the Internal Revenue Code. Options previously granted under the 1991 Plans continue to be outstanding after the adoption of the 2001 Plans and are exercisable in accordance with the original terms of the applicable 1991 Plan.

Under the 2001 Employee Plan, the company is authorized to grant options to purchase up to 2,700,000 shares of the company's common stock to employees of the company and its subsidiaries. Under the 2001 Directors' Plan, the company is authorized to grant options to purchase up to 450,000 shares of the company's common stock to the company's outside directors. At August 31, 2002, 1,619,890 shares were available for grant under the 2001 Employee Plan and 337,500 shares were available for grant under the 2001 Director's Plan. The exercise price of the options to be granted is equal to the fair market value of the company's common stock on the date of grant. Unless otherwise provided by the company's Stock Plan Committee, options under both plans become exercisable ratably over a three-year period or immediately upon change in control of the company, as defined by the plans. All options expire at the earlier of 30 days after termination of employment or 10 years after the date of grant.

The company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for its stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123, "Accounting for Stock-Based Compensation," requires the use of option valuation models that were not developed for use in valuing such stock options. Under APB 25, because the exercise price of the company's stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net income and net income per share is required by Statement 123, which also requires that the information be determined as if the company has accounted for its stock options granted subsequent to August 31, 1995 under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for fiscal years 2002, 2001, and 2000 respectively: risk-free interest rates of 4.4%, 5.0%, and 6.6%; a dividend yield of 0%; volatility factors of the expected market price of the company's common stock of 46.3%, 48.5%, and 45.7%; and a weighted average expected life of the options of 5.3, 5.2, and 4.5 years.

## Notes to Consolidated Financial Statements

August 31, 2002, 2001 and 2000 (In thousands, except share data)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The company's pro forma information was as follows for the years ended August 31:

| | **2002** | 2001 | 2000 |
|---|---|---|---|
| Pro forma net income | **$ 45,087** | $ 37,197 | $ 29,912 |
| Pro forma net income per share-diluted | **$ 1.07** | $ .89 | $ .71 |

A summary of the company's stock option activity (adjusted for the stock splits), and related information was as follows for the years ended August 31:

| | **2002** | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|
| | **Options** | **Weighted Average Exercise Price** | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| Outstanding – beginning of year | **4,418,910** | **$ 10.00** | 4,666,239 | $ 8.24 | 4,172,574 | $ 7.13 |
| Granted | **538,853** | **27.35** | 825,720 | 17.13 | 850,221 | 13.18 |
| Exercised | **(606,641)** | **7.95** | (883,769) | 6.60 | (307,728) | 6.22 |
| Forfeited | **(167,925)** | **14.95** | (189,280) | 13.62 | (48,828) | 12.23 |
| Outstanding – end of year | **4,183,197** | **$ 12.33** | 4,418,910 | $ 10.00 | 4,666,239 | $ 8.24 |
| Exercisable at end of year | **2,986,886** | **$ 8.85** | 2,917,661 | $ 7.41 | 3,065,510 | $ 6.18 |
| Weighted average fair value of options granted during the year | **$ 12.94** | | $ 8.45 | | $ 6.11 | |

A summary of the company's options was as follows as of August 31, 2002:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Options | Weighted Average Remaining Contractual Life (Yrs.) | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| **$ 3.36 to $ 5.33** | **977,477** | **2.80** | **$ 4.75** | **977,477** | **$ 4.75** |
| **$ 5.70 to $ 9.56** | **896,896** | **4.67** | **7.37** | **896,896** | **7.37** |
| **$ 10.97 to $ 12.89** | **895,808** | **7.08** | **12.51** | **739,231** | **12.45** |
| **$ 13.58 to $ 20.99** | **944,184** | **8.43** | **16.80** | **373,282** | **15.99** |
| **$ 24.20 to $ 29.31** | **468,832** | **9.64** | **28.26** | **–** | **–** |
| **$ 3.36 to $ 29.31** | **4,183,197** | **6.16** | **$ 12.33** | **2,986,886** | **$ 8.85** |

## Notes to Consolidated Financial Statements

August 31, 2002, 2001 and 2000 (In thousands, except share data)

*Stockholder Rights Plan*

The company has a stockholder rights plan which is designed to deter coercive takeover tactics and to prevent a potential acquirer from gaining control of the company without offering a fair price to all of the company's stockholders.

The plan provided for the issuance of one common stock purchase right for each outstanding share of the company's common stock. Each right initially entitles stockholders to buy one unit of a share of preferred stock for $85. The rights will be exercisable only if a person or group acquires beneficial ownership of 15% or more of the company's common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 15% or more of the company's common stock. At August 31, 2002, 50,000 shares of preferred stock have been reserved for issuance upon exercise of these rights.

If any person becomes the beneficial owner of 15% or more of the company's common stock, other than pursuant to a tender or exchange offer for all outstanding shares of the company approved by a majority of the independent directors not affiliated with a 15%-or-more stockholder, then each right not owned by a 15%-or-more stockholder or related parties will then entitle its holder to purchase, at the right's then current exercise price, shares of the company's common stock having a value of twice the right's then current exercise price. In addition, if, after any person has become a 15%-or-more stockholder, the company is involved in a merger or other business combination transaction with another person in which the company does not survive or in which its common stock is changed or exchanged, or sells 50% or more of its assets or earning power to another person, each right will entitle its holder to purchase, at the right's then current exercise price, shares of common stock of such other person having a value of twice the right's then current exercise price. Unless a triggering event occurs, the rights will not trade separately from the common stock.

The company will generally be entitled to redeem the rights at $0.01 per right at any time until 10 days (subject to extension) following a public announcement that a 15% position has been acquired. The rights expire on June 16, 2007.

### 13. Net Revenue Incentive Plan

The company has a Net Revenue Incentive Plan (the "Incentive Plan"), as amended, which applies to certain members of management and is at all times discretionary with the company's board of directors. If certain predetermined earnings goals are met, the Incentive Plan provides that a predetermined percentage of the employee's salary may be paid in the form of a bonus. The company recognized as expense incentive bonuses of $2,264, $1,876, and $1,606 during fiscal years 2002, 2001 and 2000, respectively.

### 14. Employment Agreements

The company has employment contracts with its Chairman and Chief Executive Officer and several members of its senior management. These contracts provide for use of company automobiles or related allowances, medical, life and disability insurance, annual base salaries, as well as an incentive bonus. These contracts also contain provisions for payments in the event of the termination of employment and provide for payments aggregating $5,734 at August 31, 2002 due to loss of employment in the event of a change in control (as defined in the contracts).

### 15. Contingencies

The company is involved in various legal proceedings and has certain unresolved claims pending. The company's ultimate liability, if any, for the aggregate amounts claimed cannot be determined at this time. Management believes that all claims currently pending are either adequately covered by insurance or would not have a material adverse effect on the company's business or financial condition.

The company has entered into agreements with several lenders pursuant to which such lenders may make loans to qualified franchisees. Under the terms of these agreements, the company provides certain guarantees of a portion of the outstanding balances of the loans to franchisees. In addition, the company has other repurchase obligations related to a franchisee's restaurant development loans. At August 31, 2002 these guarantees and repurchase obligations totaled $5,796, none of which were in default.

## Notes to Consolidated Financial Statements

August 31, 2002, 2001 and 2000 (In thousands, except share data)

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

| | First Quarter | | Second Quarter | | Third Quarter | | Fourth Quarter | | Full Year | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2002** | 2001 | **2002** | 2001 | **2002** | 2001 | **2002** | 2001 | **2002** | 2001 |
| Income statement data: | | | | | | | | | | |
| Company-owned restaurant sales | **$ 71,721** | $ 55,562 | **$ 67,355** | $ 50,618 | **$ 92,280** | $ 75,270 | **$ 99,351** | $ 86,013 | **$ 330,707** | $ 267,463 |
| Other | **15,608** | 15,462 | **14,221** | 12,571 | **19,011** | 16,369 | **20,615** | 18,773 | **69,455** | 63,175 |
| Total revenues | **87,329** | 71,024 | **81,576** | 63,189 | **111,291** | 91,639 | **119,966** | 104,786 | **400,162** | 330,638 |
| Company-owned restaurants operating expenses | **54,022** | 42,178 | **51,835** | 38,580 | **64,972** | 52,938 | **71,364** | 61,642 | **242,193** | 195,338 |
| Selling, general and administrative | **7,658** | 6,813 | **7,786** | 7,092 | **8,729** | 8,109 | **9,271** | 8,588 | **33,444** | 30,602 |
| Other | **8,853** | 7,264 | **9,119** | 7,398 | **12,321** | 10,756 | **11,910** | 11,673 | **42,203** | 37,091 |
| Total expenses | **70,533** | 56,255 | **68,740** | 53,070 | **86,022** | 71,803 | **92,545** | 81,903 | **317,840** | 263,031 |
| Income from operations | **16,796** | 14,769 | **12,836** | 10,119 | **25,269** | 19,836 | **27,421** | 22,883 | **82,322** | 67,607 |
| Interest expense, net | **1,569** | 1,219 | **1,517** | 1,321 | **1,536** | 1,540 | **1,697** | 1,445 | **6,319** | 5,525 |
| Income before income taxes | **15,227** | 13,550 | **11,319** | 8,798 | **23,733** | 18,296 | **25,724** | 21,438 | **76,003** | 62,082 |
| Provision for income taxes | **5,672** | 5,047 | **4,216** | 3,278 | **8,841** | 6,815 | **9,582** | 7,986 | **28,311** | 23,126 |
| Net income | **$ 9,555** | $ 8,503 | **$ 7,103** | $ 5,520 | **$ 14,892** | $ 11,481 | **$ 16,142** | $ 13,452 | **$ 47,692** | $ 38,956 |
| Net income per share: | | | | | | | | | | |
| Basic | **$ .24** | $ .21 | **$ .18** | $ .14 | **$ .37** | $ .29 | **$ .40** | $ .34 | **$ 1.19** | $ .98 |
| Diluted | **$ .23** | $ .21 | **$ .17** | $ .13 | **$ .35** | $ .27 | **$ .38** | $ .32 | **$ 1.13** | $ .93 |
| Weighted average shares outstanding: | | | | | | | | | | |
| Basic | **39,990** | 39,576 | **40,022** | 39,706 | 40,298 | 39,925 | 40,312 | 40,187 | **40,156** | 39,849 |
| Diluted | **41,920** | 41,399 | **42,126** | 41,566 | 42,430 | 41,784 | 42,351 | 42,178 | **42,207** | 41,732 |

### 17. Fair Values of Financial Instruments

The following discussion of fair values is not indicative of the overall fair value of the company's consolidated balance sheet since the provisions of SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," do not apply to all assets, including intangibles.

The following methods and assumptions were used by the company in estimating its fair values of financial instruments:

*Cash and cash equivalents* – Carrying value approximates fair value due to the short duration to maturity.

*Notes receivable* – For variable rate loans with no significant change in credit risk since the loan origination, fair values approximate carrying amounts. Fair values for fixed rate loans are estimated using discounted cash flow analysis, using interest rates which would currently be offered for loans with similar terms to borrowers of similar credit quality and/or the same remaining maturities.

As of August 31, 2002 and 2001, carrying values approximate their estimated fair values.

*Borrowed funds* – Fair values for fixed rate borrowings are estimated using a discounted cash flow analysis that applies interest rates currently being offered on borrowings of similar amounts and terms to those currently outstanding. Carrying values for variable rate borrowings approximate their fair values.

The carrying amounts, including accrued interest, and estimated fair values of the company's fixed rate borrowings at August 31, 2002 were $81,513 and $85,697, respectively, and at August 31, 2001 were $81,513 and $81,049, respectively.

### 18. Subsequent Events

Subsequent to August 31, 2002, the company, through numerous transactions, has acquired $17.6 million of treasury stock.

## Report of Independent Auditors

**The Board of Directors and Stockholders**
**Sonic Corp.**

We have audited the accompanying consolidated balance sheets of Sonic Corp. as of August 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended August 31, 2002. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sonic Corp. at August 31, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended August 31, 2002, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Oklahoma City, Oklahoma
October 11, 2002

# Directors and Officers

## Board of Directors

J. Clifford Hudson
*Chairman and Chief Executive Officer*
*Sonic Corp.*

Margaret M. Blair [1, 2]
*Visiting Professor*
*Georgetown University Law Center*
*Research Director*
*Sloan-GULC Project on Business Institutions*

Leonard Lieberman [1, 3]
*Private Investor*

Pattye L. Moore
*President*
*Sonic Corp.*

Federico F. Peña [1, 3]
*Managing Director*
*Vestar Capital Partners*

H. E. "Gene" Rainbolt [1, 2]
*Chairman*
*BancFirst*

Frank E. Richardson [1, 3]
*Chairman*
*F. E. Richardson & Co., Inc.*

Robert M. Rosenberg [1, 2]
*Retired President and Chief Executive Officer*
*Allied-Domecq Retailing U.S.A.*

E. Dean Werries [1, 2]
*Retired Chairman and Chief Executive Officer*
*Fleming Companies, Inc.*

[1] Member of the Nominating and Corporate Governance Committee
[2] Member of the Audit Committee
[3] Member of the Compensation Committee

## Chairman Emeritus

Troy N. Smith, Sr.
*Founder of Sonic Drive-Ins*

## Officers

J. Clifford Hudson
*Chairman and Chief Executive Officer*

Pattye L. Moore
*President*

Ronald L. Matlock
*Senior Vice President, General Counsel and Secretary*

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

Frank B. Young, Jr.
*Senior Vice President of Operations*

William T. Pierquet
*Senior Vice President of Development*

G. Dwayne Chambers
*Vice President of Marketing*

Mitchell W. Gregory
*Vice President of Information Services*

Keith O. Jossell
*Vice President of Franchise Finance*

Richard G. McElhaney
*Vice President of New Franchise Services*

Michael A. Perry
*Vice President of Franchise Services*

Diane L. Prem
*Vice President of Operation Services*

Stephen P. Reed
*Vice President of Purchasing & Distribution*

Andrew G. Ritger, Jr.
*Vice President of Franchise Development*

Nancy L. Robertson
*Vice President of People & Communications*

E. Edward Saroch
*Vice President of Operations*

Richard A. Schwabauer
*Vice President of Operations*

Stephen C. Vaughan
*Vice President of Planning & Analysis and Treasurer*

David A. Vernon
*Vice President of Franchise Sales*

J. Alan Walker
*Vice President of Operations*

Terry D. Harryman
*Controller*

M. Anne Burkett
*Internal Auditor*

# Corporate Information

### Corporate Offices
101 Park Avenue
Oklahoma City, Oklahoma 73102
405/280-7654

### Web Address
www.sonicdrivein.com

### Stock Transfer Agent
UMB Bank, N.A.
928 Grand Boulevard
Kansas City, Missouri 64106
800/884-4225

### Independent Auditors
Ernst & Young LLP
Oklahoma City, Oklahoma

### Corporate Counsel
Phillips, McFall, McCaffrey,
McVay, & Murrah, P.C.
Oklahoma City, Oklahoma

### Annual Meeting
The 2003 Annual Meeting of Stockholders will be held at 1:30 p.m. Central Time on January 28, 2003, in Meeting Room 5 of the Cox Business Services Convention Center, corner of Sheridan and Broadway, Oklahoma City, Oklahoma.

### Stock Market Information
The company's common stock trades on the NASDAQ National Market System under the symbol SONC. At November 29, 2002, the company had approximately 22,000 stockholders, including beneficial owners holding shares in nominee or "street" name.

The table below sets forth the high and low stock prices, adjusted for stock splits, during the past two fiscal years:

| Quarter Ended | High | Low |
|---|---|---|
| November 30, 2000 | $17.750 | $13.833 |
| February 28, 2001 | $17.792 | $14.209 |
| May 31, 2001 | $19.233 | $15.292 |
| August 31, 2001 | $21.267 | $17.067 |
| | | |
| November 30, 2001 | $23.493 | $17.513 |
| February 28, 2002 | $25.280 | $25.090 |
| May 31, 2002 | $30.210 | $24.950 |
| August 31, 2002 | $31.940 | $23.400 |

The company currently anticipates that it will retain all of its earnings to support its operations and develop its business. Therefore, the company does not pay any cash dividends on its outstanding common stock. Future cash dividends, if any, will be at the discretion of the company's Board of Directors and will depend upon, among other things, future operations and earnings, capital requirements, general financial conditions, contractual restrictions, and other factors that the Board may consider relevant.

### Annual Report on Form 10-K
A copy of the company's Annual Report on Form 10-K for the year ended August 31, 2002, as filed with the Securities and Exchange Commission, may be obtained without charge upon written request to W. Scott McLain, Senior Vice President and Chief Financial Officer, at the company's corporate offices. A link to the 2002 Form 10-K also is available via the Internet at www.sonicdrivein.com.

### Forward-Looking Statements
Statements contained in this report that are not based on historical facts are forward-looking statements and are subject to uncertainties and risks. See Management's Discussion and Analysis for a more complete discussion of forward-looking statements, how they may be identified, and the risks and uncertainties that may cause the company's future results to differ materially from those anticipated and discussed in the forward-looking statements.

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