SONIC CORP
Form 10-Q
January 10, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the period ended November 30, 2002

OR

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 0-18859

SONIC CORP.

(Exact Name of Registrant as Specified in Its Charter)

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

101 Park Avenue
Oklahoma City, Oklahoma **73102**

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (405) 280-7654

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

As of November 30, 2002, the Registrant had 38,860,668 shares of common stock issued and outstanding (excluding 9,632,411 shares of common stock held as treasury stock).

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SONIC CORP.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	(Unaudited) November 30, 2002	August 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 3,909**	$ 8,951
Accounts and notes receivable, net	**12,192**	13,755
Other current assets	**7,099**	7,267
Total current assets	**23,200**	29,973
Property, equipment and capital leases	**414,926**	406,799
Less accumulated depreciation and amortization	**(107,426)**	(101,513)
Property, equipment and capital leases, net	**307,500**	305,286
Goodwill, net	**47,004**	46,826

Trademarks, trade names and other intangible assets, net	**6,708**	6,755
Investment in deferred financing leases and noncurrent portion of notes receivable	**16,219**	15,666
Other assets, net	**777**	850
Intangibles and other assets, net	**70,708**	70,097
Total assets	**$ 401,408**	$ 405,356
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 5,450**	$ 6,799
Deposits from franchisees	**1,311**	1,015
Accrued liabilities	**20,283**	28,968
Income taxes payable	**7,931**	5,061
Obligations under capital leases and long-term debt due within one year	**1,052**	1,072
Total current liabilities	**36,027**	42,915
Obligations under capital leases due after one year	**11,672**	11,991
Long-term debt due after one year	**121,057**	109,250
Other noncurrent liabilities	**10,815**	10,530
Stockholders' equity:		
Preferred stock, par value $.01; 1,000,000 shares authorized; none outstanding		
Common stock, par value $.01; 100,000,000 shares authorized; 48,493,079 shares issued (48,477,652 shares issued at August 31, 2002)	**485**	485
Paid-in capital	**86,842**	86,563
Retained earnings	**246,767**	236,126
	334,094	323,174
Treasury stock, at cost; 9,632,411 common shares (8,736,701 shares at August 31, 2002)	**(112,257)**	(92,504)
Total stockholders' equity	**221,837**	230,670
Total liabilities and stockholders' equity	**$ 401,408**	$ 405,356

See accompanying notes.

SONIC CORP.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	(Unaudited) Three months ended November 30, 2002	2001
Revenues:		
Company-owned restaurant sales	**$ 81,574**	$ 71,721
Franchised restaurants:		
Franchise royalties	**14,960**	13,774
Franchise fees	**1,027**	1,049
Other	**1,024**	785

	98,585	87,329
Costs and expenses:		
Company-owned restaurants:		
Food and packaging	**21,179**	19,090
Payroll and other employee benefits	**24,817**	20,733
Other operating expenses	**16,302**	14,199
	62,298	54,022
Selling, general and administrative	**8,222**	7,658
Depreciation and amortization	**6,973**	6,255
Minority interest in earnings of restaurants	**2,575**	2,598
	80,068	70,533
Income from operations	**18,517**	16,796
Interest expense	**1,847**	1,827
Interest income	**(288)**	(258)
Net interest expense	**1,559**	1,569
Income before income taxes	**16,958**	15,227
Provision for income taxes	**6,317**	5,672
Net income	**$ 10,641**	$ 9,555
Net income per share - basic	**$ .27**	$ .24
Net income per share - diluted	**$ .26**	$ .23

See accompanying notes.

SONIC CORP.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	(Unaudited) Three months ended November 30, 2002	**2001**
Cash flows from operating activities:		
Net income	**$ 10,641**	$ 9,555
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**6,973**	6,255
Other	**(886)**	(1,109)
Decrease in operating assets	**1,459**	758
(Decrease) increase in operating liabilities	**(1,481)**	7,789
Total adjustments	**6,065**	13,693
Net cash provided by operating activities	**16,706**	23,248

Cash flows from investing activities:		
Purchases of property and equipment	**(9,972)**	(12,688)
Other	**979**	504
Net cash used in investing activities	**(8,993)**	(12,184)
Cash flows from financing activities:		
Payments on long-term debt	**(36,139)**	(40,277)
Proceeds from long-term borrowings	**47,929**	36,365
Purchases of treasury stock	**(24,596)**	(8,849)
Other	**51**	566
Net cash used in financing activities	**(12,755)**	(12,195)
Net decrease in cash and cash equivalents	**(5,042)**	(1,131)
Cash and cash equivalents at beginning of period	**8,951**	6,971
Cash and cash equivalents at end of period	**$ 3,909**	$ 5,840
Supplemental cash flow information:		
Cash paid during the period for:		
Payment of obligation to acquire treasury stock accrued in fiscal 2002	**$ 8,729**	
Noncash financing activities:		
Obligation to acquire treasury stock	**$ 3,886**	

See accompanying notes.

SONIC CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share data)

Note 1

The unaudited Condensed Consolidated Financial Statements include all adjustments, consisting of normal, recurring accruals which Sonic Corp. (the Company) considers necessary for a fair presentation of the financial position and the results of operations for the indicated periods. In certain situations, these accruals, including franchise royalties, are based on more limited information at interim reporting dates than at the Company s fiscal year end due to the abbreviated reporting period. Actual results may differ from these estimates. The notes to the condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements contained in the Company s Form 10-K for the fiscal year ended August 31, 2002. The results of operations for the three months ended November 30, 2002, are not necessarily indicative of the results to be expected for the full year ending August 31, 2003.

During fiscal year 2002, the Company acquired 23 existing franchise restaurants located in the Wichita, Kansas market, from franchisees 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. See Note 1 of Notes to Consolidated Financial Statements in the Company s Form 10-K for the fiscal year ended August 31, 2002, for more information regarding the acquisitions.

Note 2

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.

Note 3

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended November 30, 2002	2001
Numerator:		
Net income	**$ 10,641**	$ 9,555
Denominator:		
Weighted average shares outstanding - basic	**39,216**	39,990
Effect of dilutive employee stock options	**1,755**	1,930
Weighted average shares - diluted	**40,971**	41,920
Net income per share - basic	**$ .27**	$ .24
Net income per share - diluted	$ **.26**	$ .23

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Note 4

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.

Note 5

Subsequent to November 30, 2002, the Company, through numerous transactions, has acquired $5.9 million of treasury stock.

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

This Form 10-Q contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements represent the Company s expectations or beliefs 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 resource 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 and its franchisees to manage the anticipated expansion and hire and train personnel, the financial viability of the Company s franchisees, particularly multi-unit operators, and general economic and business conditions. Accordingly, such forward-looking statements do not purport to be predictions of future events or circumstances and may not be realized.

Results of Operations

The Company derives its revenues primarily from Company-owned restaurant sales and royalty fees from franchisees. The Company also receives revenues from initial franchise fees, area development fees, and the selling and leasing of signs and real estate. 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.

PERCENTAGE RESULTS OF OPERATIONS

	Three months ended November 30, 2002	2001
INCOME STATEMENT DATA:		
Revenues:		
Company-owned restaurant sales	**82.8%**	82.1%
Franchised restaurants:		
Franchise royalties	**15.2**	15.8
Franchise fees	**1.0**	1.2
Other	**1.0**	0.9
	100.0%	100.0%
Costs and expenses:		
Company-owned restaurants [1]:		
Food and packaging	**26.0%**	26.6%
Payroll and other employee benefits	**30.4**	28.9
Other operating expenses	**20.0**	19.8
	76.4%	75.3%
Selling, general and administrative	**8.3**	8.8
Depreciation and amortization	**7.1**	7.2
Minority interest in earnings of restaurants [1]	**3.2**	3.6
Income from operations	**18.8**	19.2
Net interest expense	**1.6**	1.8
Net income	**10.8%**	10.9%
RESTAURANT OPERATING DATA:		
RESTAURANT COUNT [2]:		
Company-owned restaurants:		
Core markets	**355**	317
Developing markets	**105**	86
All markets	**460**	403
Franchise restaurants	**2,116**	2,003
System-wide restaurants	**2,576**	2,406
SALES DATA ($ in thousands):		
System-wide sales	**$ 536,487**	$ 498,578
Percentage increase [3]	**7.6%**	10.9%

Average sales per restaurant:		
Company-owned	**$ 180**	$ 180
Franchise	**218**	216
System-wide	**211**	210
Change in comparable restaurant sales [4]:		
Company-owned restaurants [5]:		
Core markets	**1.8%**	1.3%
Developing markets	**(9.7)**	(6.7)
All markets	**(0.3)**	(0.3)
Franchise	**(0.2)**	2.6
System-wide	**(0.2)**	2.1

(1) As a percentage of Company-owned restaurant sales.
(2) Number of restaurants open at end of period based on a state determination.
(3) Represents percentage increase from the comparable period in the prior year.
(4) Represents percentage increase (decrease) for restaurants open in both the current and prior year.
(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.

Comparison of the First Fiscal Quarter of 2003 to the First Fiscal Quarter of 2002

Total revenues increased 12.9% to $98.6 million in the first fiscal quarter of 2003 from $87.3 million in the first fiscal quarter of 2002. Company-owned restaurant sales increased 13.7% to $81.6 million in the first fiscal quarter of 2003 from $71.7 million in the first fiscal quarter of 2002. Of the $9.9 million increase in Company-owned restaurant sales, $10.1 million was due to the net addition of 67 Company-owned restaurants since the beginning of fiscal year 2002, partially offset by average sales decreases of 0.3% by stores open the full reporting periods of fiscal years 2003 and 2002 in the amount of $0.2 million. The Company expects to achieve low single-digit increases in same-store sales in future quarters as a result of sales driving initiatives including increased media spending, continued focus on strong promotions and new products, and the impact of expanding the Company s breakfast program to additional markets during March and April 2003. However, same-store sales in the second quarter may be below the targeted range as a result of continued weakness in consumer sentiment, strong performance in the second quarter of fiscal year 2001, and the potential for adverse weather.

Franchise royalties increased 8.6% to $15.0 million in the first fiscal quarter of 2003, compared to $13.8 million in the first fiscal quarter of 2002 primarily as a result of an increase in the number of franchise restaurants operating in fiscal year 2003 compared to fiscal year 2002. The Company expects royalty revenues to grow between $6.0 to $7.0 million for fiscal year 2003 as a result of continued volume increases, new store openings, ongoing conversions of older license agreements to newer agreements with higher royalty rates, and the automatic step-up feature contained in many older license agreements. Franchise fees remained relatively flat as 36 franchise drive-ins opened in the first fiscal quarter of 2003 and 2002.

Other income increased 30.4% to $1.0 million in the first fiscal quarter of 2003 compared to $0.8 million in the first fiscal quarter of 2002 primarily resulting from a gain on the sale of two non-strategic stores to franchisees early in the quarter. The Company expects other income of $0.8 million to $0.9 million per quarter for the balance of fiscal year 2003.

Restaurant cost of operations, as a percentage of Company-owned restaurant sales, was 76.4% in the first fiscal quarter of 2003 compared to 75.3% in the first fiscal quarter of 2002. Food and packaging costs, as a percentage of Company-owned restaurant sales, improved 65 basis points as a result of lower unit level costs for several items including beef and dairy costs. Looking forward, the Company expects the overall food cost environment to remain relatively favorable, producing slightly lower food and packaging costs particularly in the second and possibly third fiscal quarters of 2003.

Payroll and employee benefits, as a percentage of Company-owned restaurant sales, increased 151 basis points as a result of ongoing investment in store-level management infrastructure and the variability of sales in late October and early November caused by adverse weather conditions. The Company plans to continue to invest heavily in store-level labor as a part of its commitment to outstanding customer service in addition to an increase in training and store-level management for the rollout of the breakfast program. The Company expects these factors, combined with an increase in the workers compensation rates, to increase labor costs year-over-year by approximately 50 basis points or greater for the next few quarters.

Other operating expenses, as a percentage of Company-owned restaurant sales, increased 19 basis points primarily due to an increase in property taxes and the de-leveraging effect of lower sales volumes. The Company expects some improvement in other operating expenses due to operating at higher sales volumes, particularly in the third and fourth fiscal quarters of 2003. Overall, the Company anticipates that favorable food costs and the leverage of operating at higher sales volumes will partially offset the continued investment in store-level labor to produce slightly worse restaurant-level margins over the next two to three quarters.

Selling, general and administrative expenses decreased, as a percentage of total revenues, to 8.3% in the first fiscal quarter of 2003, compared with 8.8% in the first fiscal quarter of 2002. The Company anticipates that selling, general and administrative expenses will grow by 8% to 10% on a year-over-year basis during fiscal year 2003.

Depreciation and amortization expense increased 11.5% or $0.7 million in the first fiscal quarter of 2003 over the comparable quarter in 2002. The increase in depreciation resulted primarily from new drive-in development and store acquisitions during fiscal year 2002. With planned capital expenditures of $60 to $70 million for fiscal year 2003, the Company expects depreciation and amortization to grow by approximately 12%, year-over-year, for the balance of the fiscal year.

Minority interest in earnings of restaurants, as a percentage of Company-owned restaurant sales, was 3.2% in the first fiscal quarter of 2003, compared to 3.6% in the first fiscal quarter of 2002, as a result of the deterioration in restaurant level margins. Looking forward, the Company believes minority interest, as a percentage of Company-owned restaurant sales, will remain flat or decline slightly, on a year-over-year basis, for the balance of the fiscal year, mirroring the anticipated change in overall restaurant level margins during fiscal year 2003.

Income from operations increased 10.2% to $18.5 million in the first fiscal quarter of 2003 from $16.8 million in the first fiscal quarter of 2002 due primarily to the growth in revenues and other matters discussed above.

Net interest expense remained flat at $1.6 million in the first fiscal quarter of 2003 and 2002. While amounts outstanding increased under the line of credit due to share repurchases in the fourth fiscal quarter of 2002 and first fiscal quarter of 2003, the benefit of a year-over-year decline in short-term interest rates offset the incremental borrowings. The Company expects net interest expense to increase in future quarters, particularly the second fiscal quarter of 2003, as a result of the increased borrowings and less benefit from the year-over-year decline in interest rates. Seasonally strong cash flow and the refinancing of $20.0 million in higher-interest senior notes maturing in April 2003 will mitigate all or part of the increase in the latter part of fiscal year 2003.

Provision for income taxes reflects an effective federal and state tax rate of 37.25% for the first fiscal quarter of 2003, consistent with the same period in fiscal year 2002.

Net income increased 11.4% over the comparable period in 2002. Diluted earnings per share increased to $0.26 per share in the first fiscal quarter of 2003, compared to $0.23 per share in the first fiscal quarter of 2002, for an increase of 13.0%.

Liquidity and Sources of Capital

Net cash provided by operating activities decreased $6.5 million or 28.1% during the first fiscal quarter of 2003 as compared to the same period in fiscal year 2002, primarily as the result of a decrease in accounts payable and accrued liabilities in the first fiscal quarter of 2003 as compared to an increase in fiscal year 2002.

The Company opened 10 newly constructed restaurants in the first fiscal quarter of 2003. The Company funded total capital additions for the first fiscal quarter of 2003 of $10.0 million, which included the cost of newly opened restaurants, new equipment for existing restaurants, retrofits of existing restaurants, restaurants under construction, and other capital expenditures, from cash generated by operating activities and through borrowings under the Company s line of credit. During the three months ended November 30, 2002, the Company purchased the real estate for four of the 10 newly constructed 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 0.9 million shares of common stock at an aggregate cost of $19.8 million during the first fiscal quarter of 2003, leaving approximately $29.6 million available under the share repurchase program as of the end of quarter. As of November 30, 2002, the Company s total cash balance of $3.9 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 November 30, 2002, the Company s outstanding borrowings under the line of credit were $40.8 million, at an effective borrowing rate of 3.2%, as well as $0.2 million in outstanding letters of credit. The amount available under the line of credit as of November 30, 2002, was $39.0 million. See Note 9 of the Notes to Consolidated Financial Statements in the Company s Form 10-K for the fiscal year ended August 31, 2002 for additional information regarding the Company s long-term debt.

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 unsecured revolving credit facility and cash flow from operations. The Company expects to refinance $20.0 million of long-term debt maturing in 2003 under its senior unsecured notes with its line of credit and plans to extend the line of credit under existing renewal options and 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 included in this Form 10-Q and in the Company s Form 10-K for the fiscal year ended August 31, 2002 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 effect 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 in the Company s Form 10-K for the fiscal year ended August 31, 2002), 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 restaurant s 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes in the Company s exposure to market risk for the quarter ended November 30, 2002.

Item 4. Controls and Procedures

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rule 13a-14 under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective. There were no significant changes in the Company s internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

During the fiscal quarter ended November 30, 2002, Sonic Corp. (the Company) did not have any new material legal proceedings brought against it, its subsidiaries or their properties. In addition, no material developments occurred in connection with any previously reported legal proceedings against the Company, its subsidiaries or their properties during the last fiscal quarter.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

Exhibits.

99.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
99.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

Form 8-K Reports. The Company did not file any Form 8-K reports during the fiscal quarter ended November 30, 2002.

SIGNATURES

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

SONIC CORP.

By: /s/ W. Scott McLain

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

Date: January 10, 2003

CERTIFICATION

I, J. Clifford Hudson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sonic Corp.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4.

The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: January 10, 2003

/s/ J. Clifford Hudson

J. Clifford Hudson
Chief Executive Officer

CERTIFICATION

I, W. Scott McLain, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sonic Corp.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: January 10, 2003

/s/ W. Scott McLain

W. Scott McLain
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number and Description	
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