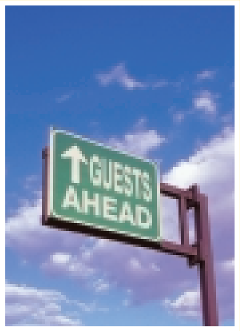
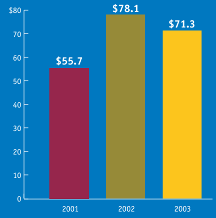


A Successful Journey With All The Right Signs

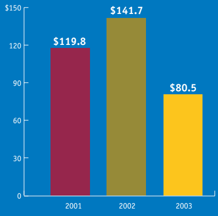
IHOP Corp. Annual Report 2003

Financial and Operational Highlights

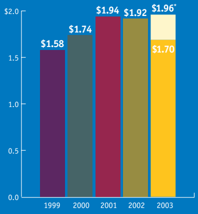
(In thousands, except per share and restaurant amounts)	Year Ended December 31, 2003	2002
Income Statement Data		
Total revenues	$ 404,805	$ 365,874
Income before income taxes	58,850	65,357
Net income	$ 36,782	$ 40,848
Net income per share		
Basic	$ 1.72	$ 1.95
Diluted	$ 1.70	$ 1.92
Dividends declared per share	$ 0.75	$ —
Dividends paid per share	$ 0.75	$ —
Sales Data		
System-wide sales	$1,695,026	$1,478,567
Average sales per effective restaurant	$ 1,499	$ 1,419
Restaurant Data		
At year-end	1,165	1,103
Total restaurants opened	74	101
Total restaurants franchised	104	100



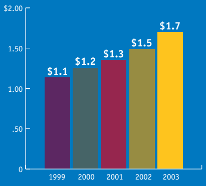
Cash From Operations (In Millions)



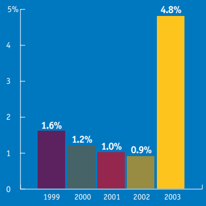
Capital Expenditures (In Millions)



Diluted Earnings Per Share
* Excludes Restructuring Charges of $0.26



System-Wide Sales
(In Billions)



Same-Store Sales Growth

A Letter to the IHOP Family of Shareholders from the Chief Executive Officer

As IHOP continues its journey to become #1 in family dining, we are moving full speed ahead to deliver the promise of a re-energized brand to our guests, franchisees and shareholders. In 2003, we experienced an incredible year filled with impressive accomplishments that included strong annual sales growth, operational improvements, training enhancements and record-breaking promotional sales. Through these efforts, we produced exceptional same-store sales results that reached 4.8% for 2003, outpacing our competitors and producing IHOP's strongest performance in more than 10 years.

In 2003, we dedicated ourselves to marketing, operations, training and product R&D, as we transitioned away from the restaurant development focus that had previously dominated our business approach. By shifting our attention toward these brand-building activities, we created a real sense of "contagious momentum" that has re-energized the IHOP system. Our success reflects more than just great commercials, or a slogan that resonates with guests, or an item on our menu that motivates people to come to IHOP. Yet they all play a part in it. IHOP's brand is everything our guests experience when they visit. It's the feeling of family and the sense of magic we create when they're at IHOP. Our invitation to our guests in 2003 was to "come hungry" and "leave happy." We exceeded their expectations in 2003.

When we consider our accomplishments, how we achieved these positive results is just as important as the results themselves. As we set out in our new strategic direction, our Company values served as a compass on our journey to become #1 in family dining. Our core values:

- Customer Focus: We are always focused on satisfying the needs of our customers.
- Shareholder Benefit: We make every decision with the long-term benefits of our shareholders in mind.
- Pursuit of Excellence: We are passionate about excellence—we continually strive to be the best.
- Respectful Interaction: We treat everyone with respect, and we value their unique contributions to IHOP's success.
- Ethical Behavior: We are committed to the highest standards of honesty, integrity and professional ethics.

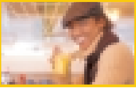
These values are part of our heritage and reflective of what we hold dear as a Company today. More important, our franchisees and restaurant team members recognize and share these core values. We expect our values to continue to be a guiding force behind how we achieve our results in 2004.

Clearly, we accomplished a great deal last year. But now the job will be even tougher. We need to stay on top as the competition starts to fight back. We will meet this challenge by continuing to execute the proven business strategies responsible for re-energizing our Company to date. Our guests have

The IHOP family continues to grow...

Angel and Carlos

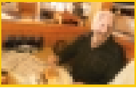
Juliet



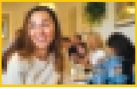
Stephanie and Tom

Chelsea

Warren



Angela



an ever-increasing number of options for choosing where to dine, and we know it takes more than just great food to earn their loyalty. We must deliver on our promise of good, hearty food and genuine, caring service at a great value. That's how we earned the trust of our guests over the past year, and it is the reason they are now returning to IHOP more often.

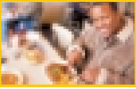
We've only just begun to realize the potential of our business model change and brand. There remains a great deal of upside to capture and we expect to continue to see improvements in every area of our business. The management team and I firmly believe that our long-term success is integrally tied to the ongoing execution of our business strategies, as well as the introduction of new and complementary initiatives to optimize our performance.

Lastly, I want to acknowledge and thank our franchisees and restaurant team members for their passion and tireless efforts in 2003. Their dedication is what made our success possible. I look forward to another great year in 2004 as we work together to realize our vision to become #1 in family dining.

Sincerely,

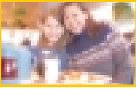
Julia A. Stewart
President and Chief Executive Officer
IHOP Corp.

Brian

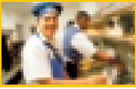


Tony and Jim

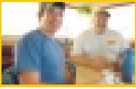
Monica and Mary



Angel

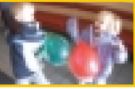


Brad and Bryan

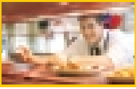


Dana, Mary and Cherylle

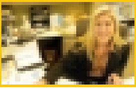
Lucas and Haleigh



Justin



Mary Elizabeth

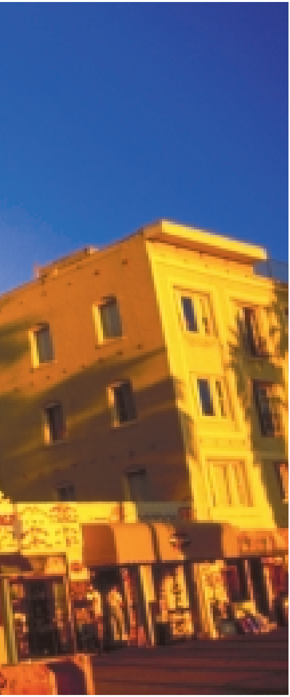


John and Richard

Harry

Cathy

The IHOP brand has always been fundamentally sound, but last year we recognized a need for a new direction to return excitement and growth to our Company. We accomplished this by marketing our brand in new and creative ways. We introduced national limited-time promotional offers that created excitement and gave guests new reasons to visit IHOP more often. We maintained our dominance at breakfast while beginning to capitalize on our growth opportunities at lunch and dinner. We re-focused on the guest experience and emphasized hospitality. We listened to and collaborated with our franchisees and produced strong sales performance by using revitalizing strategies that were developed and implemented through a team effort.

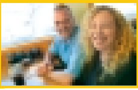


In 2003, we introduced far-reaching initiatives that touched every part of our business. We took the bold step of changing our business model as we dedicated additional resources to focused marketing efforts, improved operations support, enhanced training programs, and innovative product and menu development. In the process, we strengthened our working relationship with our franchisees by providing them with new training and operational improvement assistance aimed at making each IHOP restaurant more successful.

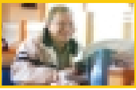
We adopted an organizational focus designed to better support our brand. We transformed our corporate headquarters into the Restaurant Support Center. The idea behind the Restaurant Support Center is much more than a new name. It is about an attitude toward, and a dedication to, serving our franchisees and, by extension, our restaurant guests. By concentrating on the needs of our franchisees, we enable them to provide the level of hospitality and service IHOP guests expect and deserve.

The changes were big. Some were aggressive. But all were aimed at our goal: to become #1 in family dining.

Raul and Jessica

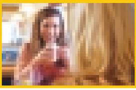


Larry

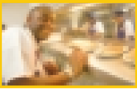


Daniel and Fransisco

Kristine



Edward

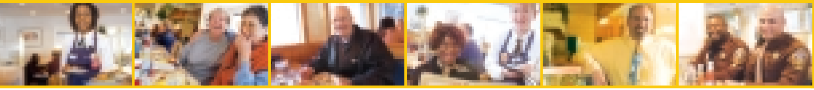


Colleen

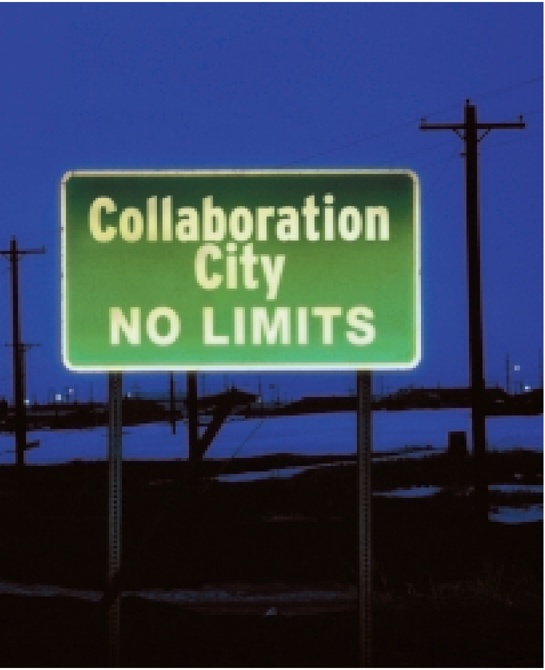
For IHOP, the strength of our franchise system centers on serving the needs of our franchisees through collaboration and teamwork. From our business model change to new product promotion introductions, we reach out to hear our franchisees' perspectives. We ensure that each change makes good business sense to our operators and will be widely accepted and embraced within our system.

We work to create an environment in which everyone has a voice and can influence change within our system. We believe that by teaching, sharing and learning, we ensure alignment among the Restaurant Support Center and our franchisees. Along the way, we generate excitement by encouraging everyone involved with our brand to communicate ideas, ask questions, and be engaged. This process allows us to reinforce our values and measure our progress toward realizing our vision to become #1.

Sharae *Corina and Elizabeth* *Frank* *Mami and Kathy* *Mark* *Nick and Tony*

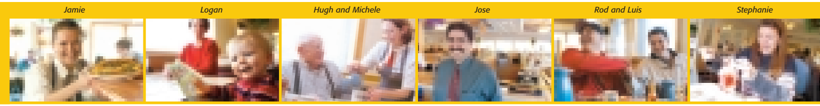


Every year, our National Franchise Conference provides a forum for franchisees to gather from around the U.S. and Canada. They arrive hungry to learn about best demonstrated practices to help them enhance and grow their business as well as plan for the future. We take the time to recognize, celebrate and reward outstanding performances within our system. Most importantly, we listen to our franchisees and learn from their experiences.

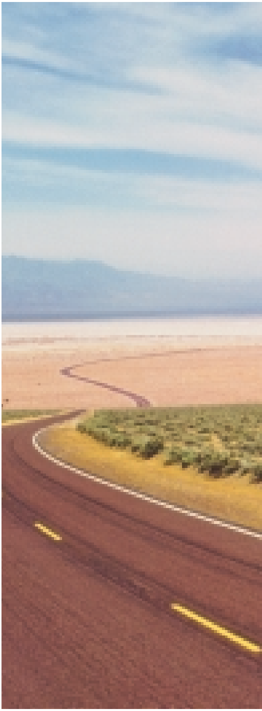


We regularly meet with our franchise Board of Advisors, who represent the franchise community and their perspectives. Together, we have set higher standards and raised performance expectations for each IHOP restaurant.

This collaborative approach has made change possible and is responsible for the dramatic improvements we enjoyed in 2003. It has fostered renewed confidence within our franchise community that should lead to even greater success for IHOP as we optimize our business strategies in 2004.



In 2003, we supported our brand with clear focus and direction that has IHOP moving at a whole new pace. We elevated the effectiveness of our marketing efforts with compelling advertising, strategic media buying and new product promotion strategies that re-energized our brand message and motivated guests to visit IHOP more often.



"Come hungry. Leave happy." is more than a slogan. It's a promise we make to our guests to expect a great meal and an excellent experience at our restaurants. Our advertising campaign is humorous and memorable, and is expected to serve as a platform for our brand for years to come. The use of network media for the first time brought a whole new dimension to our re-energizing efforts, as more consumers saw our ads than ever before. We featured great new product promotions as limited-time offers to encourage new and repeat visits to our restaurants. This combination of strategies contributed to our strong 4.8% same-store sales growth for 2003.

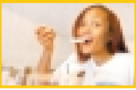
Our advertising campaign achieved international recognition, winning a bronze Medallion at the 2004 AME Awards for Advertising and Marketing Effectiveness. The judges assessed commercials from all over the world, evaluating them for effectiveness as well as creativity. Winning the Medallion is a tremendous accomplishment for the first year of our new advertising campaign.

We are committed to a guest-driven menu and product development process, and we will ensure that our core products keep pace with our guests' evolving expectations. We will continue to introduce new signature products on network television with advertising that grabs consumers' attention and makes them hungry for these great-tasting items.

We are taking the opportunity to grow beyond breakfast and build on the momentum we've created. Our commitment to changing the way our guests think about IHOP is a necessary step for our brand, as every successful organization must risk change if it is to realize its full potential. That time has come for IHOP.

Alberto and Victor

Auviiya



Jonté

Art and Leslie

Carlo

Marie

Esther

Maria and Robert

Henry and Mike

Chris

Atlanta Team

Jenn Michelle

"Come hungry. Leave happy." means we are 100% committed to satisfying our guests. We know our guests come to IHOP for delicious, hearty American food, and we promise to serve our guests in a way that leaves them feeling great about the time they spend with us at IHOP. Our goal is to "wow" our guests with a warm, friendly experience that exceeds their expectations every time.

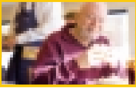
To ensure we stay on target, we successfully implemented a nationwide mystery shop program in 2003. The feedback from the mystery shops has been incredibly valuable, in terms of letting us know what we are doing well and, more importantly, what needs to be done better. Our franchisees have wholeheartedly embraced the program, and use the mystery shop reports to set goals for operational and service improvements.

We also recognized the need to address a handful of poorly performing restaurant operators. From a grading system based on operating criteria, we identified these operators, put improvement plans in place, and systematically attacked the problems. There were terrific success stories of operators who had not been

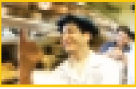
Luis, Monte and John

Deborah and Betty

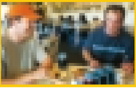
James



Emilio



Mike and Lance

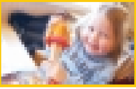


Steve

performing up to our standards recommitting to the IHOP system and producing significant improvements in their restaurants. However, others were unable to meet our performance expectations. We have already removed some of them from our system, and are actively working to remove the remainder.

We retooled our entire product promotion training process by using a "Train the Trainer" approach that reached more than 50,000 team members five times during 2003. The Training Department also rolled out an improved Opening Program. This resulted in reduced turnover and better operations at new locations as we instilled a passion for great service at our restaurants. We expect this enthusiasm, coupled with an added emphasis on hospitality, to continue as our restaurant team members increase their confidence and knowledge of guest service.

Our integrated operations and training approach ensures that our guests leave happy. As we look to build new business at lunch and dinner, this will become even more important. We will demonstrate that IHOP is a great dining choice any time of day.

Jordan


Michael


Sara


George Washington Tennis Team


Kristen


Jesus and Darren


Joseph and Don

Sheila

Trey and Larry

Alene

Dennis and Willy

Don

Exceptional sales results in 2003 are just the beginning. The benefits of shifting our business model are many, and the financial impact has been significant for our Company, our franchisees and our shareholders.

Since announcing the decision to transition away from the financing and developing of new IHOP restaurants, our franchisees have committed to developing nearly 230 new restaurants over the next 12 years. This is significant progress, as we look to develop the approximately 400 to 800 additional IHOP locations we believe possible within the U.S. These commitments include larger Multi-Store Development Agreements in defined trade areas, as well as Single-Store Development Agreements that will provide incremental growth in IHOP's more mature markets. While most of the new development agreements are with existing IHOP franchisees, we have been pleased to experience increasing interest from prospective new franchise developers.

As franchisees drive system expansion, our cash flow position should steadily improve. Historically, we invested substantial funds each year to finance and develop new IHOP restaurants. With our franchisees now using their own investment capital for development, we should see our cash receipts substantially exceed our capital expenditures, leaving IHOP with excess cash flow for strategic uses, including returning cash to shareholders in the form of a quarterly dividend and our ongoing share-repurchase program.

We do expect to experience flat earnings growth during 2004, as revenue streams associated with our old business model are eliminated. As we reach "steady state" sometime in 2005, we expect to return to positive earnings per share growth. Together, our significant cash generation, dividend payment, share repurchase and near-term return to earnings growth offer a compelling investment proposition.

Tracy and Gina

Nancy

Scott and Dewayne

Michelle and Doris

Geday Family

Michael and Eric

While we achieved great success in 2003, we have only just begun to optimize the power of our brand. In 2004, we will focus on three initiatives: driving sales, supporting franchisee development, and strategically investing in the business.

We will introduce a third segment of network advertising and continue to optimize our local media spending. We will offer six limited-time product promotions in 2004, some of which will focus on lunch and dinner. And product R&D will continue to develop menu improvements, including seamless enhancements to existing menu items, the revitalization of our most popular offerings, and the addition of exciting new product promotions to our core menu throughout the year.

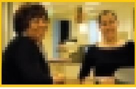
We will continue to use mystery shops to elevate operational standards in our system, and we expect to substantially complete the removal of substandard operators in 2004. We also expect to see the benefit of the value-added focus of our field consultants during 2004 as they look to achieve a greater business partner relationship with our franchisees and drive performance at the restaurant level.

We will take advantage of every opportunity to improve the hospitality focus of our restaurant team members. Our mystery shop program has identified hospitality as an area where we could

Nancy and Donald

Juan

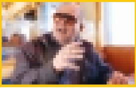
Jewel and Zima



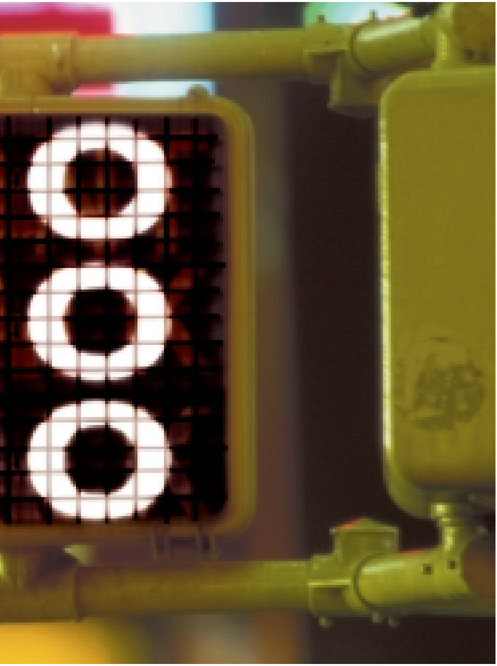
Chris

Russell

Jack



meaningfully improve our guests' perceptions of IHOP. We are dedicated to delivering the promise of a great guest experience.



Our restaurant development progress is a critical success factor as we complete the transition away from Company-financed restaurant growth. Our Franchise and Development Department has been equipped with additional resources and staffing to drive this effort. We have also strengthened our recruiting strategy to attract existing and new franchisees who possess the financial and operational ability to develop and finance IHOP restaurants in the target markets that represent our largest franchise opportunities.

We will invest in the development of a Company market in Cincinnati, where we plan to develop "best in class" operational initiatives and training programs, as well as test new products and marketing programs for use throughout the country. We will also strategically invest in Information Technology, as we have a tremendous opportunity to leverage technology in our restaurants to make a real, quantifiable business impact.

For IHOP, 2004 is all about reaching a higher level of execution. We will continue to deliver the promise of our brand's full potential. The best is yet to come.

Rene and Valencia

Martha

Dean and Jim

Carina

Doc

Jacob and Jodi

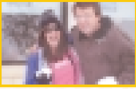
Financials

Rima

Adrianne and Angelah

Victor

Lea and Glen



Kelly and Brian

Amberly

Five-Year Financial Summary

	Year Ended December 31,				
	2003	2002	2001	2000	1999
(In thousands, except per share amounts)					
Revenues					
Franchise revenues	$ 140,131	$ 123,050	$ 111,129	$ 102,624	$ 93,081
Rental income	117,258	99,595	84,037	69,914	60,640
Company restaurant sales	74,880	74,433	68,810	72,818	70,204
Financing revenues	72,536	68,796	60,460	57,888	49,310
Total revenues	404,805	365,874	324,436	303,244	273,235
Costs and expenses					
Franchise expenses	64,265	55,139	48,269	44,699	40,956
Rental expenses	86,620	73,812	59,882	48,026	41,665
Company restaurant expenses	81,737	78,422	72,819	76,961	72,380
Financing expenses	43,619	38,185	33,442	33,998	26,455
General and administrative expenses	54,575	49,526	41,964	37,991	35,889
Other (income) expense, net	6,054	5,433	3,599	4,109	3,654
Reorganization charges	9,085	—	—	—	—
Total costs and expenses	345,955	300,517	259,975	245,784	220,999
Income before income taxes	58,850	65,357	64,461	57,460	52,236
Provision for income taxes	22,068	24,509	24,173	22,122	20,111
Net income	$ 36,782	$ 40,848	$ 40,288	$ 35,338	$ 32,125
Net income per share					
Basic	$ 1.72	$ 1.95	$ 1.98	$ 1.77	$ 1.61
Diluted	$ 1.70	$ 1.92	$ 1.94	$ 1.74	$ 1.58
Weighted average shares outstanding					
Basic	21,424	20,946	20,398	20,017	19,983
Diluted	21,614	21,269	20,762	20,263	20,358
Dividends declared per share(a)	$ .75	—	—	—	—
Dividends paid per share(a)	$ .75	—	—	—	—
Balance Sheet Data (end of period)					
Cash and cash equivalents	$ 27,996	$ 98,739	$ 6,252	$ 7,208	$ 4,176
Marketable securities	45,537	—	—	—	—
Property and equipment, net	314,221	286,226	238,026	193,624	177,743
Total assets	843,004	819,800	641,429	562,212	520,402
Long-term debt	139,615	145,768	50,209	36,363	41,218
Capital lease obligations	177,664	171,170	168,105	167,594	165,557
Stockholders' equity(a)	382,360	364,389	312,430	259,995	226,480

(a) In March 2003, the board of directors declared its first quarterly cash dividend of $.25 per common share which was paid in the second quarter. The board of directors indicated its intention to declare recurring quarterly dividends in the future, however, any future dividend declarations will be made at the discretion of the board of directors and will be based on the Company's earnings, financial condition, cash requirements, future prospects and other factors.

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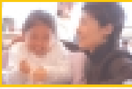

Management's Discussion

and Analysis of Financial Condition and Results of Operations.

Forward-Looking Statements

The following discussion and analysis provides information we believe is relevant to an assessment and understanding of IHOP's consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and notes thereto. Certain forward-looking statements are contained in this report. They use such words as "may," "will," "expect," "believe," "plan," or other similar terminology. These statements involve known and unknown risks, uncertainties and other factors that may cause the actual results to be materially different than those expressed or implied in such statements. These factors include, but are not limited to: risks associated with the implementation of the Company's strategic growth plan; the ability to continue to attract qualified franchisees; availability of suitable locations and terms for the sites designated for development; legislation and government regulation, including the ability to obtain satisfactory regulatory approvals; conditions beyond IHOP's control such as weather, natural disasters or acts of war or terrorism; availability and cost of materials and labor; cost and availability of capital; competition; continuing acceptance of the International House of Pancakes brand and concept by guests and franchisees; IHOP's overall marketing, operational and financial performance; economic and political conditions; adoption of new, or changes in, accounting policies and practices and other factors discussed from time to time in our press releases, public statements and/or filings with the Securities and Exchange Commission. Forward-looking information is provided by us pursuant to the safe harbor established under the Private Securities Litigation Reform Act of 1995 and should be evaluated in the context of these factors. In addition, we disclaim any intent or obligation to update these forward-looking statements.

General

In January 2003, we announced significant changes in the way we conduct our business. These changes included a transition from Company-financed restaurant development (the "Old Model") to a more traditional franchise development model, in which franchisees finance and develop new restaurants (the "New Model"). It was the Company's intention to complete the transition from Company development to franchisee development by the end of 2003. Due to construction delays, we expect to complete the development and franchising of the final four restaurants under the Old Model in 2004.

Franchising

Our franchising activities in 2003 included both Company financed and franchisee financed development. For clarity of presentation, the discussion below is separated between those activities specific to the Old Model and those which apply to the New Model.

Old Model

Under the Old Model, when we develop a restaurant we identify the site for the new restaurant, purchase the site or lease it from a third party, and build the restaurant and equip it with all required equipment. We select and train the franchisee and supervisory personnel who will operate the restaurant. In addition, we typically finance approximately 80% of the franchise fee, and lease the restaurant and equipment to the franchisee. In accordance with GAAP, the equipment lease between the Company and the franchisee is treated as a sale in our financial statements. After the franchisee is operating the restaurant, we provide continuing support with respect to operations, marketing and new product development.

Our involvement in the development of new restaurants allows IHOP to charge a franchise and development fee ranging from $200,000 to $550,000. In addition, we derive income from the financing of the franchise fee and from the leasing of property and equipment to franchisees. However, we also incur obligations in the development, franchising and start-up operations of the new restaurants.

The franchisee typically pays approximately 20% of the initial franchise fee in cash, and we finance the remaining amount over five to eight years. We also receive continuing revenues from the franchisee as follows: (1) a royalty equal to 4.5% of the restaurant's sales; (2) income from the leasing of the restaurant property and related equipment; (3) revenue from the sale of certain proprietary products, primarily pancake mixes; (4) a local advertising fee equal to about 2% of the restaurant's sales, which is usually collected by IHOP and then paid to a local advertising cooperative; and (5) a national advertising fee equal to 1% of the restaurant's sales. In some cases, we have agreed to accept reduced royalties for a period of time from franchisees in order to assist them in establishing their businesses, where business conditions justify it.

New Model

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

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

While there is no specific profile for franchise candidates, the Company primarily markets franchises to existing operators who currently own and operate one or more restaurants in the IHOP system and operators, that meet our operating standards, in other non-competing segments of the restaurant business, such as quick service or casual dining restaurants.

Segment Reporting

IHOP's revenues and expenses are recorded in four categories: Franchise Operations, Rental Operations, Company Restaurant Operations and Financing Operations.

Franchise Operations revenue consists primarily of royalty revenues, sales of proprietary products, advertising fees and the portion of the franchise fees allocated to the Company's intellectual property. Franchise expenses include advertising expense and the cost of proprietary products.

Rental Operations revenue includes revenue from operating leases and interest income from direct financing leases. Rental expenses are costs of operating leases and interest expense on capital leases on franchisee-operated restaurants.

Company restaurant sales are retail sales at IHOP-operated restaurants. Company restaurant expenses are operating expenses at IHOP-operated restaurants and include food, labor and benefits, utilities, rent and other real estate related costs.

Financing Operations revenue consists of the portion of franchise fees not allocated to the Company's intellectual property, sales of equipment as well as interest income from the financing of franchise fee and equipment leases. Financing expenses are primarily the cost of restaurant equipment and interest expense not associated with capital leases.

Comparable Store Sales

Beginning in the second quarter of 2003, IHOP changed its methodology for calculating comparable store sales from a 12-month basis to an 18-month basis. Under the new methodology, we compare year over year retail sales of restaurants which have been open continuously for 18 months or more. Prior year information has been restated for ease of comparison. The Company believes this provides a more accurate view of its system's performance by excluding the impact of high sales levels typically seen during the first months of operations at new restaurants. All same-store sales information in this Annual Report on Form 10-K is presented using the 18-month methodology.

Results of Operations

The following table sets forth certain operating data for IHOP restaurants.

(Dollars in thousands)	2003	2002	2001
	Year Ended December 31,		
Restaurant Data			
Effective restaurants(a)(d)			
Franchise	931	843	767
Company	72	76	72
Area license	128	123	131
Total	1,131	1,042	970
System-wide			
Sales(b)(d)	$ 1,695,026	$1,478,567	$1,345,757
Percent increase	14.6%	9.9 %	8.0 %
Average sales per effective restaurant(d)	$ 1,499	$ 1,419	$ 1,387
Percent increase	5.6%	2.3 %	2.6 %
Comparable average sales percent increase(c)	4.8%	0.9 %	1.0 %
Franchise			
Sales	$ 1,481,251	$ 1,278,103	$ 1,146,124
Percent increase	15.9%	11.5 %	11.6 %
Average sales per effective restaurant	$ 1,591	$ 1,516	$ 1,494
Percent increase	4.9%	1.5 %	1.3 %
Comparable average sales percent increase(c)	4.8%	0.9 %	1.1 %
Company			
Sales	$ 74,880	$ 74,433	$ 68,810
Percent increase (decrease)	0.6%	8.2 %	(5.5%)
Average sales per effective restaurant	$ 1,040	$ 979	$ 956
Percent increase (decrease)	6.2%	2.4 %	(0.2%)
Area License			
Sales(d)	$ 138,895	$ 126,031	$ 130,823
Percent increase (decrease)	10.2%	(3.7%)	(10.7%)
Average sales per effective restaurant(d)	$ 1,085	$ 1,025	$ 999
Percent increase	5.9%	2.6 %	2.3 %

(a) "Effective restaurants" are the number of restaurants in a given fiscal period adjusted to account for restaurants open for only a portion of the period.

(b) "System-wide sales" are retail sales of franchisees and area licensees, as reported to IHOP, and sales by Company-operated restaurants.

(c) "Comparable sales percentage change" reflects the percentage change in sales for restaurants that have been operated for the entire fiscal period in which they are being compared and have been continuously open for at least 18 months. Because of new unit openings and store closures, the restaurants opened for an entire fiscal period being compared will be different from period-to-period. Comparable average sales do not include data on restaurants located in Florida.

(d) During 2001, the Company's area licensee in Japan negotiated an early termination of its area license agreement. As part of this early termination, the area licensee discontinued operations of its 32 IHOP restaurants. Sales in 2001 include sales in Japan until the closing of the restaurants.

The following table summarizes IHOP's restaurant development and franchising activity:

	Year Ended December 31,				
	2003	2002	2001	2000	1999
Restaurant Development Activity					
IHOP—beginning of year	1,103	1,017	968	903	835
New openings					
IHOP-developed	56	86	76	70	65
Franchisee-developed	13	10	12	10	7
Area license	5	5	5	4	4
Total new openings	74	101	93	84	76
Closings					
Company and franchise	(12)	(13)	(11)	(16)	(8)
Area license	—	(2)	(33)	(3)	—
IHOP—end of year	1,165	1,103	1,017	968	903
Summary—end of year					
Franchise	991	902	823	747	678
Company	44	76	72	71	76
Area license	130	125	122	150	149
Total IHOP	1,165	1,103	1,017	968	903
Restaurant Franchising Activity					
IHOP-developed	72	80	74	70	61
Franchisee-developed	13	10	12	10	7
Rehabilitated and refranchised	19	10	9	15	6
Total restaurants franchised	104	100	95	95	74
Reacquired by IHOP	(11)	(10)	(12)	(19)	(14)
Closed	(4)	(11)	(7)	(7)	(6)
Net addition	89	79	76	69	54

Critical Accounting Policies

We prepare our Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires senior management to make estimates, assumptions and subjective or complex judgments that are inherently uncertain and may significantly impact the reported amounts of assets, liabilities, revenue and expenses during the reporting period. Changes in the estimates, assumptions and judgments affecting the application of these policies may result in materially different amounts being reported under different conditions or using different assumptions. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our Consolidated Financial Statements.

Accounting for Long-Lived Assets

We regularly evaluate our long-lived assets for impairment at the individual restaurant level. Restaurant assets are evaluated for impairment on a quarterly basis or whenever events or circumstances indicate that the carrying value of a restaurant may not be recoverable. We consider factors such as the number of years the restaurant has been operated by the Company, sales trends, cash flow trends, remaining lease life, and other factors which may apply on a case by case basis. These impairment evaluations require an estimation of cash flows over the remaining useful life of the asset.

Recoverability of the restaurant's assets is measured by comparing the assets carrying value to the undiscounted future cash flows expected to be generated over the assets remaining useful life. If the total expected undiscounted future cash flows are less than the carrying amount of the asset, the carrying amount is written down to the estimated fair value, and a loss resulting from impairment is recognized by a charge to earnings. The fair value is determined by discounting the future cash flows based on our cost of capital.

The Company may elect to close certain Company-operated restaurants. Typically such decisions are based on operating performance or strategic considerations. In these instances, we reserve, or write-off, the full carrying value of these restaurants as impaired.

Periodically, the Company will reacquire a previously franchised restaurant. At the time of reacquisition, the franchise will be recorded at the lower of (1) the sum of the franchise receivables and costs of reacquisition, or (2) the estimated net realizable value. The net realizable value of a reacquired franchise is based on the Company's average five-year historical franchise resale value. The historical resale value used for each restaurant in 2003 was $220,000. An impairment loss will be recognized equal to the amount by which the reacquisition value exceeds the historical resale value.

Judgments and estimates made by the Company related to long-lived assets are affected by factors such as economic conditions, changes in franchise historical resale values, and changes in operating performance. As the Company assesses the ongoing expected cash flows and carrying value of its long-lived assets, these factors could cause the Company to realize impairment charges.

Self-Insurance Liability

We are self-insured for a significant portion of our employee health and workers' compensation obligations. The Company maintains stop-loss coverage with third party insurers to limit its total exposure. The accrued liability associated with these programs is based on our estimate of the ultimate costs to be incurred to settle known claims and claims incurred but not reported as of the balance sheet date. Our estimated liability is not discounted and is based on a number of assumptions and factors, including historical trends, actuarial assumptions and economic conditions. If actual trends, including the severity or frequency of claims, differ from our estimates, our financial results could be impacted.

Income Taxes

We estimate certain components of our provision for income taxes. These estimates include, but are not limited to, effective state and local income tax rates, allowable tax credits for items such as work opportunity tax credits, FICA taxes paid on reported tip income, and estimates related to depreciation expense allowable for tax purposes. Our estimates are made based on the best available information at the time that we prepare the provision. All tax returns are subject to audit within the statute of limitations by the federal and state governments, and could be subject to differing interpretations of the tax laws.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") issued FIN 46, "Consolidation of Variable Interest Entities." FIN 46 establishes a new and far-reaching consolidation accounting model. Although FIN 46 was initially focused on special purpose entities, the applicability of FIN 46 goes beyond such entities and can have applicability to franchise arrangements, regardless of whether the Company has voting or ownership control of the franchises. In response to a number of comment letters and implementation questions, in December 2003 the FASB issued FIN 46R, which delays the effective date of FIN 46 for certain entities until March 31, 2004, as well as provides clarification regarding franchise considerations and other implementation issues. To determine the applicability of FIN 46 and 46R, the Company is currently evaluating financial information recently received from its franchisees to determine if the Company is the "primary beneficiary" (as such term is defined by FIN 46) which would require consolidation of those franchisees that qualify as variable interest entities. However, FIN 46R does provide relief if, after making an exhaustive effort, the Company is unable to obtain the required financial information from franchisees. The Company is currently evaluating whether it will qualify for this scope exclusion.

In May 2003, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This statement did not have any impact on our Consolidated Financial Statements. This statement establishes standards for the classification and measurement of certain financial instruments with the characteristics of both liabilities and equity. The adoption of SFAS No. 150 is effective for financial statements issued after May 2003.

Comparison of the fiscal years ended December 31, 2003 and 2002

IHOP's fiscal year ends on the Sunday nearest to December 31 of each year. For convenience, we report all fiscal years as ending on December 31. Each of the years ended December 31, 2003 and 2002 were comprised of 52 weeks (364 days).

System-Wide Retail Sales

System-wide retail sales include the sales of all IHOP restaurants as reported to IHOP by its franchisees, area licensees and Company-operated restaurants. System-wide retail sales grew by 14.6% or $216.5 million to $1.7 billion in 2003 over the same period in 2002. The growth in system-wide sales was primarily due to an increase in the number of effective restaurants, and a 4.8% increase in comparable restaurant sales. "Effective restaurants" are the number of restaurants in operation in a given fiscal period, adjusted to account for restaurants in operation for only a portion of the fiscal period. Effective restaurants grew by 8.5% from 1,042 to 1,131 in 2003 over 2002 due to new restaurant development. The increase in comparable sales was primarily attributable to new limited time promotions, network advertising, and improved operations of our restaurants.

In 2004, we expect system-wide sales to be in the range of $1.8 billion to $1.9 billion. System-wide sales growth is expected to be driven by the annualized effect of new restaurant openings in 2003, expected new restaurant openings in 2004 and expected improvement in same-store sales. In addition, the anticipated increase in system-wide sales will be due in part to the benefit of a 53 rd week in fiscal 2004. We utilize a weekly fiscal calendar to close our books. In order to align our fiscal year end to the calendar year, we utilize a 53-week fiscal calendar approximately every six years to account for this required adjustment. As such, we will record an additional week of retail sales in fiscal 2004.

Franchise Operations

Franchise revenues are the revenues received by IHOP from its franchisees and area licensees and include royalties, sales of proprietary products, advertising fees and core franchise fees ("Core Franchise Fees" are the portion of total franchise fees allocable to the license to franchisees to use the Company's intellectual property. Franchise revenues grew by 13.9% from $123.1 million in 2002 to $140.1 million in 2003. Franchise revenues grew primarily due to an increase in franchise restaurant retail sales of 15.9% from $1,278.1 million in 2002 to $1,481.3 million in 2003. The increase in franchise restaurant retail sales was primarily due to a 10.4% increase in the number of effective franchise restaurants from 843 in 2002 to 931 in 2003 and a 4.8% increase in comparable franchise restaurant retail sales from 2002 to 2003.

Franchise expenses consist primarily of advertising and the cost of proprietary products, which are variable in nature and are expected to fluctuate with franchise revenues. Franchise expenses increased by 16.6% to $64.3 million in 2003 from $55.1 million in 2002. The increase in franchise expenses was primarily a result of the increase in franchise revenues mentioned above. In addition, IHOP contributed $2.0 million in 2003 towards advertising expense compared to $0.8 million in 2002. The additional contribution is consistent with our strategic decisions to strengthen our IHOP brand. In 2004, it is expected that the Company will contribute no more than $1.5 million. In addition, we sometimes offer financial assistance relief for a limited time to certain franchisees whose units are not currently profitable. This short-term subsidy is aimed at minimizing the losses of these franchisees. In 2003, we granted $2.2 million in financial assistance relief to the operators of 38 restaurants as compared to $1.2 million granted to the operators of 28 restaurants in 2002.

Franchise operations profit increased by 11.7% from $67.9 million in 2002 to $75.9 million in 2003.

In the third and fourth quarters of 2003, we refranchised 36 Company-operated restaurants. This was done for both strategic and financial reasons. In order to refranchise many of these restaurants, we lowered royalty rates and accepted reduced franchise fees. Because of these transactions in 2003, we believe that in 2004, our system-wide overall average royalty rate will be approximately 4.3% as compared with 4.4% in 2002.

In 2004, franchise operations segment profit is expected to increase slightly. The increase will be due to increased sales expected at franchise restaurants from annualized restaurant growth in 2003 and new development in 2004. Franchise operations margin is expected to decline in 2004 primarily due to lower royalty rates from refranchised restaurants and lower franchise fees due to a decrease in the number of restaurants we expect to franchise.

Rental Operations

Rental revenue includes rental income from operating leases and interest income from direct financing leases. Rental revenues increased by 17.7% to $117.3 million in 2003 from $99.6 million in 2002. The increase in rental income is associated with an increase in the number of operating leases associated with new restaurants. In addition, rent receipts under most leases are tied to sales of the restaurants, and accordingly the increase is also partially due to improved same-store sales.

Rental expenses consist primarily of rental expense associated with operating leases and interest expense on direct financing leases. Rental expenses increased by 17.4% to $86.6 million in 2003 from $73.8 million in of 2002. An increase in rental costs associated with an increase in the number of operating leases, was the primary cause of the increase in rental expense.

Rental operations profit increased by 18.8% from $25.8 million in 2002 to $30.6 million in 2003.

In 2004, rental operations segment profit is expected to increase by approximately 15% due to the anticipated increase in the number of operating leases associated with the refranchising of Company-operated restaurants and the annualized effect of restaurant openings in 2003.

Company Restaurant Operations

Company restaurant operations revenues are retail sales to guests at restaurants operated by IHOP. Company restaurant operations revenues increased by 0.6% to $74.9 million in 2003 from $74.4 million in 2002. The increase in revenue is primarily due to an increase in average sales per effective Company restaurant of 6.2% partially offset by a 5.3% decrease in the number of effective IHOP-operated restaurants from 76 in 2002 to 72 in 2003. "Effective restaurants" are the number of restaurants in a given fiscal period adjusted to account for restaurants open for only a portion of the period.

Company restaurant expenses include primarily food, labor and benefits, incentives, utilities, rent and other real estate related costs. Company restaurant expenses increased by 4.2% to $81.7 million in 2003 from $78.4 million in 2002. Company restaurant expenses were impacted by higher labor, workers' compensation, performance incentive, franchise incentive, and transition costs associated with the refranchising of Company-operated restaurants.

Company restaurant operations loss was $6.9 million in 2003, or 71.9% greater than the loss of $4.0 million in 2002.

In 2004, the loss on Company operations will be substantially reduced due to the decrease in the number of Company-operated restaurants as a result of our refranchising efforts. We have also established a separate management team exclusively for Company-operated restaurants. The new Company operations management team is charged with improving revenue and profitability through better operational execution. We believe that this move allows us to more effectively improve the performance of Company-operated restaurants.

Financing Operations

The Financing Operations segment consists of the portion of franchise fees not allocated to the Company's intellectual property, sales of equipment as well as interest income from the financing of franchise fee and equipment leases. Finance operations revenues increased by 5.4% to $72.5 million in 2003 from $68.8 million in 2002. The increase in revenues was primarily due to an increase in franchise and equipment notes interest income associated with newly franchised restaurants.

Financing operations costs and expenses are primarily the cost of restaurant equipment and interest expense not associated with capital leases. Finance operations costs and expenses increased by 14.2% to $43.6 million in 2003 from $38.2 million in 2002. This is primarily due to an increase to $5.2 million in 2003 from $916,000 in 2002 in interest expense associated with the senior notes issued in the November 2002 private placement.

Financing operations profit decreased by 5.5% to $28.9 million in 2003 from $30.6 million in 2002. The primary reason for the decrease in finance operations profit was the additional interest expense of $5.2 million discussed above.

In 2004, financing operations profit is expected to decrease significantly due to the planned reduction in the number of units for which we will receive development and financing fees. In 2003, the Company developed and franchised 56 restaurants for which it received development and franchising fees. It is expected that in 2004, the number of transactions for which such fees will be received will decline to four. The elimination of development and financing fees will lead to a margin decline in this segment. This will be partially offset by increased interest income received due to the increased number of restaurants developed in 2003.

General and Administrative Expenses

General and administrative expenses increased $5.0 million, or 10.2%, from $49.5 million in the twelve months ended December 31, 2002 to $54.6 million in the same period of 2003. The increase in general and administrative expenses was due primarily to higher bonus expense, normal increases in salaries and wages, the mystery shop program and additional costs associated with the new initiatives in the areas of Marketing, Operations, Training, Research and Development, and Information Technology. Corporate bonus, which was based on financial performance, was $3.5 million in 2003. There was no Corporate bonus expense in 2002.

In 2004, we expect that general and administrative expenses will be between $53 million and $58 million in 2004.

Other (Income) Expense, Net

Other (income) expense, net, increased by $0.6 million or 11.4%, from $5.4 million in 2002 to $6.1 million in 2003. This is primarily due to an increase in asset impairment losses of $1.7 million from $0.5 million in 2002 to $2.2 million in 2003 on IHOP-operated restaurants, partially offset by an increase in interest income generated primarily from our investments in marketable securities.

Reorganization Charges

In January 2003, the Company adopted a new operating model, moving from Company-developed and financed restaurant growth to franchisee-financed development. As a result, 2003 financial results were impacted by certain transition and reorganization charges. In 2003, we incurred $9.1 million in reorganization charges. $5.5 million of these expenses were related to the write-off of development costs associated with potential sites that we are no longer going to develop as a result of the adoption of our new business model. In addition, we incurred $3.6 million in management consulting, legal fees, severance costs and other expenses. Almost all of the anticipated reorganization charges were incurred in 2003.

Provision for Income Taxes

The Company's effective tax rate was 37.5% for both 2003 and 2002.

Balance Sheet Accounts

Cash and cash equivalents at December 31, 2003 decreased to $28.0 million from $98.7 million at December 31, 2002, primarily due to the purchase of highly liquid marketable securities of $45.5 million.

Marketable securities at December 31, 2003 increased to $45.5 million from zero at December 31, 2002, primarily due to the purchase of short-term investment grade corporate bonds maturing at various dates through December 2004.

Property and equipment, net at December 31, 2003 increased 9.8% to $314.2 million from $286.2 million at December 31, 2002, primarily due to new restaurant development.

Other assets at December 31, 2003 increased to $27.7 million from $16.1 million at December 31, 2002, primarily due to an $11.0 million increase in deferred rent on operating subleases. Rental income on operating subleases is reflected in the income statement on a straight-line basis in accordance with generally accepted accounting principles. Deferred rent on operating subleases is the difference between straight-line rent and the actual amount received. As a result of its franchising efforts in 2003, the Company had an increase of 91 new operating subleases.

Other liabilities at December 31, 2003 increased to $25.8 million from $15.3 million at December 31, 2002, primarily due to a $7.0 million increase in deferred rent on operating prime leases. Rental expense on operating prime leases is reflected in the income statement on a straight-line basis in accordance with generally accepted accounting principles. Deferred rent on operating prime leases is the difference between straight-line rent and the actual amount paid. As a result of its development efforts in 2003, the Company had an increase of 37 new operating prime leases.

Stockholders' Equity: On January 13, 2003, the Company announced that the Board of Directors had authorized the repurchase of up to 2.6 million shares of IHOP Corp. common stock. For the year ended December 31, 2003, the Company repurchased 0.6 million shares of its common stock for a total of $19.4 million. Also, in 2003, the Company began paying a quarterly cash dividend of $.25 per share of common stock. See Note 9 to the Consolidated Financial Statements in this Annual Report on Form 10-K for more details.

Comparison of the year ended December 31, 2002 and 2001

Each of the fiscal years ended December 31, 2002 and 2001 were comprised of 52 weeks (364 days).

System-Wide Retail Sales

System-wide retail sales include the sales from all IHOP restaurants as reported to IHOP by its franchisees, area licensees, and Company-operated restaurants. System-wide retail sales grew by 9.9% to $1.48 billion in 2002 over the same period in 2001. Growth in the number of effective restaurants from 970 to 1,042 and increases in average sales per effective restaurant from $1,387,000 to $1,419,000 primarily caused the growth in system-wide retail sales. "Effective restaurants" are the number of restaurants in operation in a given fiscal period, adjusted to account for restaurants in operation for only a portion of the fiscal period. Effective restaurants grew by 7.4% in 2002 over the same period in 2001 due to new restaurant development. Average sales per effective restaurant increased by 2.3% in 2002 over the prior year period. Newly developed restaurants generally have seating capacities and sales greater than the system-wide averages.

Franchise Operations

Franchise operations revenues are the revenues received by IHOP from its franchisees and include rent, royalties, sales of proprietary products, advertising fees and interest income. Franchise operations revenues grew by 14.3% to $238.4 million in 2002 over the same period in 2001. Franchise operations revenues grew primarily due to an increase in retail sales in franchise restaurants of 11.5% in 2002 over the same period in 2001. Retail sales in franchised restaurants grew primarily due to a 9.9% increase from 767 to 843 in the number of effective franchise restaurants and a 1.5% increase from $1,494,000 to $1,516,000 in average sales per effective restaurant in 2002 over the same period in 2001, respectively.

Franchise operations costs and expenses include facility rent, advertising, the cost of proprietary products, and other direct costs associated with franchise operations. Franchise operations costs and expenses increased by 22.7% to $105.7 million in 2002 from $86.1 million in 2001. The increase in franchise operating costs was primarily a result of the increases in rent expense, due to the increase in the number of effective restaurants.

Sublease transactions with franchisees are structured with little or no margin at inception of the sublease, but with margin improvement anticipated over the life of the lease as retail sales increase (primarily because excess rent provisions in the subleases are tied to retail sales). New unit development will therefore have a negative effect on rent margin percentages. Rent margin percentages decreased from 42.4% in 2001 to 38.3% in 2002.

Franchise operations margin was $132.7 million or 55.7% of franchise operations revenues in 2002, compared with $122.5 million or 58.7% in 2001. The decrease in the margin percentage was primarily due to the increased rent expense mentioned above.

Sales of Franchises and Equipment

Sales of franchises and equipment increased by 12.8% to $53.0 million in 2002 from $47.0 million in 2001. The increase in sales was primarily due to an 8.1% increase in the sale of IHOP-developed restaurants from 74 in 2001 to 80 in 2002.

Cost of sales of franchises and equipment increased by 13.5% to $35.3 million in 2002 from $31.1 million in 2001. The increase in cost of sales of franchises and equipment was primarily due to changes in the number of restaurants franchised in 2002, compared to the same period in 2001. IHOP franchised 100 restaurants in 2002 as compared to 95 in 2001.

Margin on sales of franchises and equipment was $17.7 million or 33.4% of revenues from sales of franchises and equipment in 2002, compared with $15.9 million or 33.9% in 2001, respectively. The decrease in margin percentage primarily resulted from the mix of units franchised as well as higher preopening costs.

Company Operations

Company operations revenues are retail sales to guests at restaurants operated by IHOP. Company operations revenues increased by 8.2% to $74.4 million in 2002 from $68.8 million in the prior year. Increases in the number of effective IHOP-operated restaurants coupled with the increase in the average sales per IHOP-operated restaurant caused the revenue increase. Effective IHOP-operated restaurants increased from 72 to 76 or 5.6% in 2002 from 2001. Average sales per effective IHOP-operated restaurant increased from approximately $.96 million in 2001 to $.98 million in 2002 or 2.4%.

Company operations costs and expenses include food, labor and benefits, utilities, rent and other real estate related costs. Company operations costs increased by 9.0% to $72.3 million in 2002 from $66.3 million in 2001. Company operations costs increased primarily as a result of the above changes in revenues. However, Company operations costs and expenses were also impacted by higher labor costs primarily due to the hiring of Assistant General Managers in our Company-operated restaurants in 2002.

Company operations margin is Company operations revenues less Company operations costs and expenses. Company operations margin was $2.2 million in 2002, compared to $2.5 million in 2001. Company operations margin percentage was 2.9% of Company operations revenues in 2002, compared with 3.6% in the same period in 2001. Company operations margin was lower in 2002 compared to the same period of 2001 primarily due to higher labor costs.

In assessing the performance of its Company operations, management considers various other costs and expenses not included in Company operations margin. IHOP owns some of the real property of the Company-operated restaurants and internally charges those restaurants market rents. These rent expenses are eliminated in consolidation. The buildings, leasehold improvements and equipment employed in these restaurants are depreciated or amortized in accordance with our policies, and this expense is reflected in the statement of operations as depreciation and amortization. Interest expense related to capital leases on real property of certain Company-operated restaurant leases is also viewed by management as expense related to the Company-operated restaurants, but is included as interest expense in the statement of operations. In addition, employee benefit expenses related to IHOP's employee stock ownership plan ("ESOP") are included in Company operations margin, but are excluded from management's assessment of the performance of Company-operated restaurants.

Intercompany real estate charges were $1.5 million in 2002 and $0.9 million in 2001. Depreciation and amortization expense was $4.5 million in 2002 and $4.2 million in 2001. Interest expense was $2.1 million in 2002 and $2.4 million in 2001. ESOP related costs were $0.5 million in 2002 and $0.5 million in 2001. After reflecting these other costs and expenses (i.e. rent, depreciation and interest) as part of Company operations and excluding ESOP related costs, the loss before income taxes from Company operations was $5.0 million in 2002 compared to $4.4 million in 2001.

Other Costs and Expenses

Field, corporate and administrative costs and expenses increased by 18.8% to $48.3 million in 2002 from $40.6 million in 2001. The rise in expenses was primarily due to higher consulting, consumer research and compensation expenses. Field, corporate and administrative expenses were 3.3% of system-wide sales in 2002, compared to 3.0% in 2001.

During 2002, the Company engaged consulting firms to assist in evaluating its current business, conducting consumer research, and developing a new long-term strategy. Approximately $2.4 million of costs related to this project were incurred in 2002. Excluding these costs, field, corporate and administrative expenses were 3.1% of system-wide sales in 2002.

IHOP believes that field, corporate and administrative costs and expenses will continue to grow at a rate which exceeds the rate of growth in revenues for at least the next 12 months. The growth in costs and expenses will be aimed at enhancing future earnings and same-store sales growth. After 2003, we expect that the rate of growth in field, corporate and administrative costs and expenses will be less than the growth in revenue.

Depreciation and amortization expense increased by 7.8% to $16.0 million in 2002 from $14.8 million in 2001. The increases were caused primarily by the addition of new restaurants to the IHOP chain from our restaurant development program.

Income Tax Provision

The Company's effective tax rate was 37.5% for both 2002 and 2001.

Balance Sheet Accounts

The balance of cash and cash equivalents at December 31, 2002 increased to $98.7 million from $6.3 million at December 31, 2001, primarily due to the funds provided by our $100 million private placement in November 2002.

The balance of property and equipment, net at December 31, 2002, increased 20.2% to $286.2 million from $238.0 million at December 31, 2001, primarily due to new restaurant development.

The balance of long-term receivables at December 31, 2002 increased 8.1% to $332.8 million from $307.9 million in 2001 primarily due to IHOP's financing activities associated with the sales of franchises and equipment. Given our new operating model, we expect our long-term receivables to increase at a lower rate in 2003, and begin to decline in 2004 and thereafter.

The balance of long-term debt increased by 190.3% in 2002 primarily due to the $100 million private placement in November 2002.

Liquidity and Capital Resources

In 2003, cash and cash equivalents decreased by $70.7 million or 71.6% from $98.7 million in 2002 to $28 million in 2003. The Company ended the period with $28 million in total cash and cash equivalents and $45.5 million in liquid investments.

Cash provided by operating activities in fiscal 2003 totaled $71.3 million and resulted primarily from net income of $36.8 million, non-cash charges of $32.6 million and other balance sheet changes of $1.9 million. The decrease in prepaid expenses contributed $5.8 million primarily due to the application of income tax overpayments to the current year tax liability. The increase in accrued compensation and benefits contributed $4.3 million due primarily to the accrual of incentive bonuses for 2003. The decrease in accounts payable of $10.2 million reflects the decrease in construction activity at year-end 2003 due to the transition to our new model.

In 2003, we opened 56 IHOP-developed restaurants. We funded total capital additions in 2003 of $80.5 million, which included the cost of the newly-opened restaurants, new equipment for existing restaurants, remodels of existing restaurants, restaurants under construction, and other capital expenditures. This amount is down significantly from the $141.7 million invested for these purposes in 2002.

In January 2003, our Board of Directors approved an increase in our stock repurchase program that permits the purchase of up to 2.6 million shares. During 2003, we repurchased approximately 0.6 million shares of common stock under our stock repurchase program at an aggregate cost of $19.4 million. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time to time without prior notice.

In 2004, capital expenditures are expected to be approximately $10 million to $15 million. These capital expenditures include costs associated with the development of four restaurants under the "Old Model," the development of restaurants in IHOP's new Company operations market in Cincinnati, Ohio and investment in information technology.

The Internal Revenue Service ("IRS") has proposed adjustments in connection with its examination of the Company's 2000 and 2001 federal income tax returns. The proposed adjustments would accelerate the tax years in which the Company reports initial franchise fee income for federal income tax purposes. If the IRS is successful, the Company would be required to report additional income for its 2000 tax year of approximately $45.2 million and additional income for its 2001 tax year of approximately $4.8 million. The Company's federal income tax liability with respect to the proposed adjustments, exclusive of interest, penalties and any related state tax liability, would be approximately $15.8 million for 2000 and $1.7 million for 2001. The Company is currently contesting the proposed adjustments through IRS administrative proceedings.

For the tax years under audit, and potentially for subsequent tax years, such proposed adjustments could result in material cash payments by the Company. The Company had previously recorded in its consolidated financial statements the expected federal and state deferred income tax liability. Therefore, the proposed adjustments relate only to a timing issue. Although the Company cannot determine at this time the resolution of this matter, we do not believe that the proposed adjustments, if upheld, will have a material adverse effect on our financial condition or results of operations.

We expect to fund our liquidity needs, including operating expenses, capital expenditures, the repayment of long-term debt and capital lease obligations, stock repurchases and required income tax payments, from a combination of existing cash balances, cash flows from operating activities and principal receipts from notes and equipment contracts receivable. In 2004, we expect cash from operations of $50 million to $55 million, and principal receipts from notes and equipment contracts receivable of $17 million to $22 million.

As an additional source of liquidity, we have a $25 million line of credit which expires in May 2005. Borrowings under the revolving line of credit agreement bear interest at the bank's reference rate (prime) or, at IHOP's option, at the bank's quoted rate or at a Eurodollar rate. There was no balance outstanding under this agreement at December 31, 2003 nor were there any borrowings under the agreement during the year.

The following table presents the contractual principal receipts on various receivables due from our franchisees as of December 31, 2003.

(In thousands)

Principal Receipts Due By Period

	2004	2005	2006	2007	2008	Thereafter	Total
Equipment leases(1)	$ 5,368	$ 5,806	$ 6,220	$ 6,342	$ 6,338	$150,031	$180,105
Direct financing leases(2)	1,425	1,802	2,138	2,534	3,129	120,226	131,254
Franchise notes and other(3)	13,569	11,382	9,927	8,886	7,541	11,734	63,039
Total	$ 20,362	$ 18,990	$ 18,285	$ 17,762	$ 17,008	$281,991	$374,398

(1) Equipment leases receivable extend throughout the year 2027.
(2) Direct financing leases receivable extend through the year 2024.
(3) Franchise notes receivable extend through the year 2010.

The above trend primarily reflects the decrease in long-term receivables attributable to the Company's decision to no longer finance the development of restaurants.

Off-Balance Sheet Arrangements

The Company does not have any other off-balance sheet arrangements other than the purchase commitments that are disclosed under "Disclosure of Contractual Obligations".

Disclosure of Contractual Obligations

The following are our significant contractual obligations and payments as of December 31, 2003:

(In thousands)	Payments Due By Period				
Contractual Obligations	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
Debt excluding capital leases	$ 5,731	$ 25,397	$ 39,660	$ 74,558	$ 145,346
Operating leases	59,152	117,118	117,642	888,706	1,182,618
Capital leases	22,537	45,803	46,033	298,599	412,972
Purchase commitments	2,416	—	—	—	2,416
Total	$ 89,836	$ 188,318	$ 203,335	$ 1,261,863	$ 1,743,352

Quantitative and Qualitative Disclosures about Market Risk.

The Company is exposed to interest rate risk for its investments in marketable securities. At December 31, 2003, the Company had $45.5 million in marketable securities maturing at various dates through December 2004. The Company's investments are comprised primarily of highly liquid investment grade corporate bonds. The Company generally holds investments until maturity, and therefore should not bear any interest risk due to early disposition. Any premium or discount recognized upon the purchase of an investment is amortized over the term of the investment. At December 31, 2003, the fair value of investments approximated the carrying value.

IHOP is exposed to market risk from changes in interest rates on debt and changes in commodity prices. IHOP's exposure to interest rate risk relates to its $25 million revolving line of credit agreement and its $12 million mortgage term loan with its banks. Borrowings under the revolving line of credit agreement bear interest at the bank's reference rate (prime) or, at IHOP's option, at the bank's quoted rate or at a Eurodollar rate. There was no balance outstanding under this agreement at December 31, 2003 nor were there any borrowings under the agreement during 2003. Borrowings under the mortgage term loan agreement bear interest at the London Interbank Offered Rate ("LIBOR") plus the applicable margin. The applicable margin will be a function of the funded debt to EBITDA ratio as defined under the loan agreement. The impact on our results of operations due to a hypothetical 1% interest rate change would be immaterial.

In March 2002, IHOP entered into a $17.2 million variable rate term loan also included in leasehold mortgage term loans. This loan, which accrues interest at one-month LIBOR, will amortize over twelve years and has a maturity date of April 1, 2014. The outstanding balance as of December 31, 2003, was $15.6 million. The interest rate was 3.66% at December 31, 2003. The lending institution required IHOP to enter into an interest rate swap agreement for 50%, or $8.6 million, of the loan as a means of reducing IHOP's interest rate exposures. This strategy will effectively use an interest rate swap to convert $8.6 million in variable rate borrowings into fixed rate liabilities. The interest rate swap agreement is considered to be a hedge against changes in the amount of future cash flows associated with interest payments on this variable rate loan.

Many of the food products purchased by IHOP and its franchisees and area licensees are affected by commodity pricing and are, therefore, subject to unpredictable price volatility. We attempt to mitigate price fluctuations by entering into forward purchase agreements on all our major products. None of these food product contracts or agreements is a derivative instrument. Extreme changes in commodity prices and/or long-term changes could affect IHOP's franchisees, area licensees and Company-operated restaurants adversely. We expect that in most cases the IHOP system would be able to pass increased commodity prices through to its consumers via increases in menu prices. From time to time, competitive circumstances could limit short-term menu price flexibility, and in those cases margins would be negatively impacted by increased commodity prices. This would be mitigated by the fact that the majority of IHOP restaurants are franchised and IHOP's revenue stream from franchisees is based on the gross sales of the restaurants. We believe that any changes in commodity pricing that cannot be adjusted for by changes in menu pricing or other strategies would not be material to either IHOP's financial condition, results of operations or cash flows.

In some instances, the Company is required to enter into commitments to purchase food and other items on behalf of the IHOP system as a whole. At December 31, 2003, our outstanding purchase commitments were $2.4 million. The Company has developed processes to facilitate the liquidation of these commitments to minimize financial exposure.

Consolidated Balance Sheets

(In thousands, except share amounts)

	December 31, 2003	December 31, 2002
Assets		
Current assets		
Cash and cash equivalents	$ 27,996	$ 98,739
Marketable securities	45,537	—
Receivables, net	47,116	46,740
Reacquired franchises and equipment held for sale, net	1,597	2,619
Inventories	556	889
Prepaid expenses	4,279	10,114
Total current assets	127,081	159,101
Long-term receivables	354,036	332,792
Property and equipment, net	314,221	286,226
Reacquired franchises and equipment held for sale, net	9,153	14,842
Excess of costs over net assets acquired	10,767	10,767
Other assets	27,746	16,072
Total assets	$843,004	$819,800
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	$ 5,731	$ 5,949
Accounts payable	13,840	24,079
Accrued employee compensation and benefits	11,962	7,625
Other accrued expenses	8,924	11,936
Deferred income taxes	1,760	1,370
Capital lease obligations	3,156	2,605
Total current liabilities	45,373	53,564
Long-term debt	139,615	145,768
Deferred income taxes	72,225	69,606
Capital lease obligations	177,664	171,170
Other liabilities	25,767	15,303
Commitments and contingencies (Notes 7 and 13)		
Stockholders' equity		
Preferred stock, $1 par value, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.01 par value, 40,000,000 shares authorized; 2003: 21,994,068 shares issued and 21,389,939 shares outstanding; 2002: 21,427,287 shares issued and 21,279,500 shares outstanding	220	214
Additional paid-in-capital	104,661	90,770
Retained earnings	295,448	274,768
Deferred compensation	(191)	(434)
Accumulated other comprehensive loss	(545)	(680)
Treasury stock, at cost (2003: 604,129 shares; 2002: 147,787 shares)	(19,443)	(2,247)
Contribution to ESOP	2,210	1,998
Total stockholders' equity	382,360	364,389
Total liabilities and stockholders' equity	$843,004	$819,800

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Operations

(In thousands, except per share amounts)

	Year Ended December 31,		
	2003	2002	2001
Revenues			
Franchise revenues	$140,131	$123,050	$111,129
Rental income	117,258	99,595	84,037
Company restaurant sales	74,880	74,433	68,810
Financing revenues	72,536	68,796	60,460
Total revenues	404,805	365,874	324,436
Costs and Expenses			
Franchise expenses	64,265	55,139	48,269
Rental expenses	86,620	73,812	59,882
Company restaurant expenses	81,737	78,422	72,819
Financing expenses	43,619	38,185	33,442
General and administrative expenses	54,575	49,526	41,964
Other (income) expense, net	6,054	5,433	3,599
Reorganization charges	9,085	—	—
Total costs and expenses	345,955	300,517	259,975
Income before income taxes	58,850	65,357	64,461
Provision for income taxes	22,068	24,509	24,173
Net income	$ 36,782	$ 40,848	$ 40,288
Net income per share			
Basic	$ 1.72	$ 1.95	$ 1.98
Diluted	$ 1.70	$ 1.92	$ 1.94
Weighted average shares outstanding			
Basic	21,424	20,946	20,398
Diluted	21,614	21,269	20,762
Dividends declared per share	$ .75	—	—
Dividends paid per share	$ .75	—	—

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(In thousands, except share amounts)

	Common Stock Issued Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive (Loss)	Treasury Stock	Contribution To ESOP	Total
Balance, December 31, 2000	20,299,091	$203	$ 69,655	$193,632	$ —	$ —	$(5,170)	$1,675	$259,995
Net income	—	—	—	40,288	—	—	—	—	40,288
Repurchase of treasury shares	—	—	—	—	—	—	(23)	—	(23)
Reissuance of treasury shares to ESOP	—	—	(132)	—	—	—	1,807	(1,675)	—
Issuance of shares pursuant to stock plans	619,192	6	7,123	—	—	—	—	—	7,129
Tax benefit from stock options Exercised	—	—	3,191	—	—	—	—	—	3,191
Contribution to ESOP	—	—	—	—	—	—	—	1,850	1,850
Balance December 31, 2001	20,918,283	209	79,837	233,920	—	—	(3,386)	1,850	312,430
Net income	—	—	—	40,848	—	—	—	—	40,848
Unrealized (loss) on interest rate swap, net of tax	—	—	—	—	—	(680)	—	—	(680)
Comprehensive income									40,168
Reissuance of treasury shares to ESOP	—	—	711	—	—	—	1,139	(1,850)	—
Issuance of shares pursuant to stock plans	509,004	5	7,556	—	—	—	—	—	7,561
Tax benefit from stock options Exercised	—	—	2,000	—	—	—	—	—	2,000
Deferred compensation resulting from grant of options	—	—	666	—	(666)	—	—	—	—
Amortization of deferred Compensation	—	—	—	—	232	—	—	—	232
Contribution to ESOP	—	—	—	—	—	—		1,998	1,998
Balance, December 31, 2002	21,427,287	214	90,770	274,768	(434)	(680)	(2,247)	1,998	364,389
Net income	—	—	—	36,782	—	—	—	—	36,782
Unrealized gain on interest rate swap, net of tax	—	—	—	—	—	135	—	—	135
Comprehensive income									36,917
Repurchase of treasury shares	—	—	—	—	—	—	(18,634)	—	(18,634)
Reissuance of treasury shares to ESOP	—	—	560	—	—	—	1,438	(1,998)	—
Issuance of shares pursuant to stock plans	588,081	6	10,256	—	—	—	—	—	10,262
Repurchase and retirement of common stock	(21,300)	—	—	—	—	—	—	—	—
Tax benefit from stock options Exercised	—	—	3,130	—	—	—	—	—	3,130
Deferred compensation resulting from grant/cancellation of options	—	—	(55)	—	48	—	—	—	(7)
Dividends—common stock	—	—	—	(16,102)	—	—	—	—	(16,102)
Amortization of deferred Compensation	—	—	—	—	195	—	—	—	195
Contribution to ESOP	—	—	—	—	—	—	—	2,210	2,210
Balance, December 31, 2003	21,994,068	$220	$104,661	$295,448	$(191)	$(545)	$(19,443)	$2,210	$382,360

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

(In thousands)

	Year Ended December 31, 2003	2002	2001
Cash flows from operating activities			
Net income	$ 36,782	$ 40,848	$ 40,288
Adjustments to reconcile net income to cash flows provided by operating activities			
Depreciation and amortization	18,625	15,967	14,818
Reorganization charges	5,632	—	—
Deferred income taxes	3,009	10,763	9,671
Contribution to ESOP	2,210	1,998	1,850
Tax benefit from stock options exercised	3,130	2,000	3,191
Changes in operating assets and liabilities			
Accounts receivable	3,231	(2,465)	(4,252)
Inventories	333	(52)	(146)
Prepaid expenses	5,835	(3,775)	(4,555)
Accounts payable	(10,239)	7,413	(3,922)
Accrued employee compensation and benefits	4,337	4	845
Other accrued expenses	(3,012)	4,698	(597)
Other, net	1,437	713	(1,488)
Cash flows provided by operating activities	71,310	78,112	55,703
Cash flows from investing activities			
Additions to property and equipment	(80,545)	(141,740)	(119,797)
Additions to notes	(13,700)	(16,533)	(14,993)
Purchase of investment securities, net	(45,537)	—	—
Principal receipts from notes and equipment contracts receivable	16,342	17,344	14,668
Additions to reacquired franchises held for sale	(1,987)	(641)	(2,320)
Cash flows used in investing activities	(125,427)	(141,570)	(122,442)
Cash flows from financing activities			
Proceeds from issuance of long-term debt	—	117,203	26,532
Proceeds from sale and leaseback arrangements	16,724	58,542	45,652
Repayment of long-term debt	(6,371)	(25,406)	(11,915)
Principal payments on capital lease obligations	(2,505)	(1,955)	(1,592)
Dividends paid	(16,102)	—	—
Purchase of treasury stock	(18,634)	—	(23)
Proceeds from stock options exercised	10,262	7,561	7,129
Cash flows (used in) provided by financing activities	(16,626)	155,945	65,783
Net change in cash and cash equivalents	(70,743)	92,487	(956)
Cash and cash equivalents at beginning of period	98,739	6,252	7,208
Cash and cash equivalents at end of period	$ 27,996	$ 98,739	$ 6,252
Supplemental disclosures			
Interest paid, net of amounts capitalized	$ 27,283	$ 20,196	$ 21,238
Income taxes paid	15,946	14,286	15,257
Capital lease obligations incurred	10,277	5,534	2,388

See the accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Operations

IHOP Corp. and its subsidiaries ("IHOP" or the "Company") engage exclusively in the food-service industry, primarily in the United States, wherein we franchise and operate restaurants. In January 2003, we announced significant changes in the way we conduct our business. These changes included a transition from Company financed restaurant development (the "Old Model") to a more traditional franchise development model, in which franchisees finance and develop new restaurants (the "New Model").

Basis of Presentation

The consolidated financial statements include the accounts of IHOP Corp. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Fiscal Periods

IHOP's fiscal year ends on the Sunday nearest to December 31 of each year. For convenience, we report all fiscal years as ending on December 31 and fiscal quarters as ending on March 31, June 30 and September 30.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires IHOP management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. They also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

IHOP at times purchases highly liquid, investment-grade securities with an original maturity of three months or less. These cash equivalents are stated at cost which approximates market value. We do not believe that we are exposed to any significant credit risk on cash and cash equivalents. At times, cash and cash equivalent balances may be in excess of FDIC insurance limits.

Marketable Securities

Investment securities consist primarily of short-term investment grade corporate bonds with maturities of 12 months or less that are classified as "held-to-maturity" and carried at amortized cost which approximates fair value.

Inventories

Inventories consisting of merchandise and supplies are stated at the lower of cost (on a first-in, first-out basis) or market.

Property and Equipment

Property and equipment are stated at cost and depreciated on the straight-line method over the estimated useful lives as follows:

Category	Depreciable Life
Buildings and improvements	Shorter of lease term or 40 years
Leaseholds and improvements	Shorter of lease term or 3—25 years
Equipment and fixtures	3—10 years
Properties under capital lease	Primary lease term

Leaseholds and improvements are amortized over a period not exceeding the primary term of the lease.

Accounting for Long-Lived Assets

We regularly evaluate our long-lived assets for impairment at the individual restaurant level. Restaurant assets are evaluated for impairment on a quarterly basis or whenever events or circumstances indicate that the carrying value of a restaurant may not be recoverable. We consider factors such as the number of years the restaurant has been operated by the Company, sales trends, cash flow trends, remaining lease life, and site specific considerations which may apply on a case by case basis. These impairment evaluations require an estimation of cash flows over the remaining useful life of the asset.

Recoverability of a restaurant's assets is measured by comparing the assets carrying value to the undiscounted future cash flows expected to be generated over the assets remaining useful life. If the total expected undiscounted future cash flows are less than the carrying amount of the asset, the carrying amount is written down to the estimated fair value, and a loss resulting from impairment is recognized by a charge to earnings. The fair value is determined by discounting the future cash flows based on our cost of capital.

The Company may elect to close certain Company-operated restaurants. Typically such decisions are based on operating performance or strategic considerations. In these instances, we reserve, or write-off, the full carrying value of these restaurants as impaired.

Periodically, the Company will reacquire a previously franchised restaurant. At the time of reacquisition, the franchise will be recorded at the lower of (1) the sum of the franchise receivables and costs of reacquisition, or (2) the estimated net realizable value. The net realizable value of a reacquired franchise is based on the Company's average five-year historical franchise resale value. The historical resale value used in 2003 was $220,000. An impairment loss will be recognized equal to the amount by which the reacquisition value exceeds the historical resale value.

Judgments and estimates made by the Company related to long-lived assets are affected by factors such as economic conditions, changes in franchise historical resale values, and changes in operating performance. As the Company assesses the ongoing expected cash flows and carrying value of its long-lived assets, these factors could cause the Company to realize impairment charges.

Excess of Costs Over Net Assets Acquired

In June 2001, Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets," were issued and are effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated or completed after June 30, 2001. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. As a result, the Company's amortization of goodwill in the amount of $107,000 ($67,000 net of income taxes) per quarter ceased effective January 1, 2002. Upon adoption of SFAS No. 142, the Company was required to reassess the useful lives of its other intangible assets as well as perform a transitional impairment test of indefinite-lived intangible assets. Since the Company does not have any intangible assets other than goodwill, the adoption of the provisions of the statement affecting other intangible assets had no impact on the Company's financial position, results of operations or cash flows.

Also, in connection with the adoption of SFAS No. 142, the Company was required to carry out a transitional goodwill impairment evaluation, which required an assessment of whether there was an indication that goodwill was impaired as of the date of adoption. Initially, the Company identified its reporting units and determined the carrying value of each reporting unit by assigning the assets and liabilities (excluding goodwill) to those reporting units as of the date of adoption. All existing goodwill at the date that SFAS No. 142 was adopted is assigned to one or more reporting units in a reasonable and supportable manner as prescribed by the standard.

During the second quarter of 2002, the Company completed its transitional goodwill impairment evaluation, and determined that none of the recorded goodwill was impaired. In accordance with SFAS No. 142, goodwill is tested for impairment at least annually and more frequently if circumstances indicate that it may be impaired.

Self-Insurance Liability

We are self-insured for a significant portion of our employee health and workers' compensation obligations. The Company maintains stop-loss coverage with third party insurers to limit its total exposure. The accrued liability associated with these programs is based on our estimate of the ultimate costs to be incurred to settle known claims and claims incurred but not reported as of the balance sheet date. Our estimated liability is not discounted and is based on a number of assumptions and factors, including historical trends, actuarial assumptions and economic conditions. If actual trends, including the severity or frequency of claims, differ from our estimates, our financial results could be impacted.

Revenue Recognition

IHOP's revenues and expenses are recorded in four categories: franchise operations, rental operations, Company restaurant operations and financing operations.

The Franchise Operations segment consists primarily of royalty revenues, sales of proprietary products, advertising fees and the portion of the franchise fees allocated to the Company's intellectual property. Rental revenue includes revenue from operating leases and interest income from direct financing leases. Company restaurant sales are retail sales at IHOP-operated restaurants. The Financing Operations segment consists of the portion of franchise fees not allocated to the Company's intellectual property, of sales of equipment as well as interest income from the financing of franchise fee and equipment leases.

Sales by Company-operated restaurants are recognized on a cash basis. Revenues from franchised and area licensed restaurants include continuing rent and service fees and initial franchise fees. Continuing fees are recognized in the period earned. Initial franchise fees are recognized upon the opening of a restaurant, which is when the Company has performed substantially all initial services required by the franchise agreement. Fees from Development Agreements are deferred and recorded into income when a restaurant under the Development Agreement is opened.

Leases

The Company leases the majority of its restaurants with the exception of those where a franchisee enters into a lease directly with a landlord, those associated with area license agreements or those where IHOP owns the land. The leased restaurants are either sublet to franchisees or operated by IHOP. IHOP's leases generally provide for an initial term of 15 to 25 years, with most having one or more five-year renewal options in favor of the Company. The rental payments or receipts on those property leases that meet the capital lease criteria will result in the recognition of interest expense or interest income and a reduction of capital lease obligation or financing lease receivable. Capital lease obligations are amortized based on IHOP's incremental borrowing rate and direct financing leases are amortized using the implicit interest rate. Assets under capital leases are included in Property, Plant, and Equipment and are depreciated over the shorter of their useful lives or the life of the lease. The rental payments or receipts on leases that meet the operating lease criteria are recorded as rental expense or rental income. Rental expense and rental income for these operating leases are recognized on a straight-line basis over the original terms of the leases. The difference between straight-line rent expense or income is reflected in the balance sheet as deferred rent.

Preopening Expenses

Expenditures related to the opening of new restaurants, other than those for capital assets, are charged to expense when incurred.

Advertising

Advertising expenses included in Company Restaurant Operations and Franchise Operations for the years ended December 31, 2003, 2002 and 2001 were $5.1 million, $3.8 million and $3.6 million, respectively. In addition, significant advertising expenses are also incurred by franchisees through local advertising cooperatives and a national advertising fund.

Income Taxes

Deferred income taxes are determined using the liability method. A deferred tax asset or liability is determined based on the difference between the financial statement and tax basis of assets and liabilities as measured by the enacted tax rates that are expected to be in effect when these differences reverse. Deferred tax expense is the result of changes in the deferred tax asset or liability. If necessary, valuation allowances are established to reduce deferred tax assets to their expected realizable values.

Net Income Per Share

Basic net income per share is computed by dividing the net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income attributable to common stockholders by the weighted average number of common and common equivalent shares outstanding during the period. Common share equivalents included in the diluted computation represent shares issuable upon assumed exercises of outstanding stock options using the treasury stock method.

Comprehensive Income

Comprehensive income includes net income and other comprehensive income components which, under GAAP, bypass the income statement and are reported in the balance sheet as a separate component of stockholders' equity. As of December 31, 2003, our swap liability was $0.9 million. In 2003, the Company had other comprehensive income of $135,000 due to an interest rate swap that the Company entered into during 2002. In 2002, the Company had other comprehensive losses of $680,000 due to this swap agreement. For the period ended December 31, 2001, IHOP had no other comprehensive income components, as defined by GAAP. As a result, net income is the same as comprehensive income for the year ended December 31, 2001.

Stock Based Compensation

In accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," we have elected to account for our stock-based employee compensation plans under the intrinsic value method which requires compensation expense to be recorded only if, on the date of grant, the current market price of the Company's common stock exceeds the exercise price the employee must pay for the stock. The Company's policy is to grant stock options at the fair market value of the underlying stock at the date of grant.

Had compensation cost for IHOP's stock option plans been determined based on the fair value at the grant date for awards during each of the three years in the period ended December 31, 2003, consistent with the provisions of SFAS No. 123, IHOP's net income and diluted net income per share would have been reduced to the pro forma amounts indicated below:

(In thousands, except per share amounts)	2003	2002	2001
Net income, as reported	$36,782	$40,848	$40,288
Add stock-based compensation expense included in reported net income, net of tax	118	144	—
Less stock-based compensation expense determined under the fair-value accounting method, net of tax	(1,610)	(1,532)	(960)
Net income, pro forma	$35,290	$39,460	$39,328
Net income per share — diluted, as reported	$ 1.70	$ 1.92	$ 1.94
Net income per share — diluted, pro forma	$ 1.63	$ 1.86	$ 1.89

Derivative and Financial Instruments

In 2001, IHOP adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts. During 2001, IHOP purchased natural gas contracts equal to 25% of estimated requirements through December 2002 to limit exposure to market increases in natural gas prices for IHOP-operated restaurants only. These derivative instruments do not qualify under SFAS No. 133 as either a fair value or cash flow hedge. They are valued at fair value with the resultant gain or loss recognized in current earnings. In 2003, we did not purchase any natural gas contracts. The adoption of SFAS No. 133 had no material impact on IHOP's results of operations, financial position or cash flows.

IHOP does not hold or issue financial instruments for trading purposes. The estimated fair values of all cash and cash equivalents, notes receivable and equipment contracts receivable as of December 31, 2003 and 2002, approximated their carrying amounts in the Consolidated Balance Sheets as of those dates. The estimated fair values of notes receivable and equipment leases receivable are based on current interest rates offered for similar loans in our present lending activities.

The estimated fair values of long-term debt are based on current rates available to IHOP for similar debt of the same remaining maturities. The carrying values of long-term debt at December 31, 2003 and 2002 were $139,615,000 and $145,768,000, respectively, and the fair values at those dates were $148,096,000 and $154,162,000, respectively.

Reclassification

Certain reclassifications have been made to prior year information to conform to the current year presentation.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") issued FIN 46, "Consolidation of Variable Interest Entities." FIN 46 establishes a new and far-reaching consolidation accounting model. Although FIN 46 was initially focused on special purpose entities, the applicability of FIN 46 goes beyond such entities and can have applicability to franchise arrangements, regardless of whether the Company has voting or ownership control of such franchisee. In response to a number of comment letters and implementation questions, in December 2003 the FASB issued FIN 46R, which delays the effective date of FIN 46 for certain entities until March 31, 2004, as well as provides clarification regarding franchise considerations and other implementation issues. To determine the applicability of FIN 46 and 46R, the Company is currently evaluating financial information recently received from its franchisees to determine if the Company is the "primary beneficiary" (as such term is defined by FIN 46) which would require consolidation of those franchisees that qualify as variable interest entities. However, FIN 46R does provide relief if, after making an exhaustive effort, the Company is unable to obtain the required financial information from franchisees. The Company is currently evaluating whether it will qualify for this scope exclusion.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This statement did not have any impact on our Consolidated Financial Statements. This statement establishes standards for the classification and measurement of certain financial instruments with the characteristics of both liabilities and equity. The adoption of SFAS No. 150 is effective for financial statements issued after May 2003.

2. Marketable Securities

Marketable securities are classified as "held-to-maturity" and carried at amortized cost which approximates fair value. The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2003. There were no marketable securities as of December 31, 2002.

(In thousands)	Less than 12 months	
Description of Securities	Fair Value	Unrealized Losses
Corporate Bonds	$45,324	$ (109)
Other	104	—
	$45,428	$ (109)

3. Receivables

(In thousands)	2003	2002
Accounts receivable	$ 28,075	$ 31,656
Notes receivable	63,039	57,522
Equipment leases receivable	180,105	158,221
Direct financing leases receivable	131,254	133,804
	402,473	381,203
Less allowance for doubtful accounts	(1,321)	(1,671)
	401,152	379,532
Less current portion	(47,116)	(46,740)
Long-term receivables	$354,036	$332,792

Accounts receivable primarily includes receivables due from franchisees and distributors. Notes receivable include franchise fee notes in the amount of $59,344,000 and $55,571,000 at December 31, 2003 and 2002, respectively. Franchise fee notes are due in equal weekly installments, primarily bear interest averaging 10.27% per annum, and are collateralized by the franchise. The term of an equipment contract coincides with the term of the corresponding restaurant building lease. Equipment contracts are due in equal weekly installments, primarily bear interest averaging 10.84% per annum, and are collateralized by the equipment. Where applicable, franchise fee notes, equipment contracts and building leases contain cross-default provisions wherein a default under one constitutes a default under all. There is not a disproportionate concentration of credit risk in any geographic area.

4. Property and Equipment, at Cost

(In thousands)	2003	2002
Land	$ 33,060	$ 25,857
Buildings and improvements	60,824	46,225
Leaseholds and improvements	223,596	189,870
Equipment and fixtures	15,497	18,506
Construction in progress	4,804	29,983
Properties under capital lease obligations	54,907	43,784
	392,688	354,225
Less accumulated depreciation and amortization	(78,467)	(67,999)
Property and equipment, net	$314,221	$286,226

Buildings and improvements are structures, and improvements to structures, on land owned by the Company. Leaseholds and improvements are structures, and improvements to structures, on land leased by the Company. Properties under capital lease represent the values of property leased under a capital lease. The value of leased property is recorded at the lower of the fair value of the leased property, or the present value of the minimum lease payments, at the inception of the lease.

Accumulated depreciation and amortization includes accumulated amortization for properties under capital lease obligations in the amount of $9,930,000 and $7,837,000 at December 31, 2003 and 2002, respectively.

5. Reacquired Franchises and Equipment Held for Sale

Reacquired franchises and equipment held for sale are accounted for on the specific identification basis. At the date of reacquisition, the franchise and equipment are recorded at the lower of (1) the sum of the franchise receivables and costs of reacquisition, or (2) the estimated net realizable value. Pending the sale of such franchise, the carrying value is amortized ratably over the remaining life of the asset or lease and the estimated net realizable value is evaluated in conjunction with our impairment evaluation of long-lived assets. The estimated net realizable value used in 2003 was $220,000 for each franchise held for resale.

(In thousands)	2003	2002
Franchises	$ 6,341	$ 11,370
Equipment	10,284	14,272
	16,625	25,642
Less amortization	(5,875)	(8,181)
	10,750	17,461
Less current portion	(1,597)	(2,619)
Long-term reacquired franchises and equipment held for sale, net	$ 9,153	$ 14,842

6. Debt

Debt consists of the following components:

(In thousands)	2003	2002
Senior Notes due November 2008, payable in equal annual installments commencing November 2000, at a fixed interest rate of 7.42%	$ 19,445	$ 23,333
Senior Notes Series A due October 2012, at a fixed interest rate of 5.88%	5,000	5,000
Senior Notes Series B due October 2012, at a fixed interest rate of 5.20%	95,000	95,000
Leasehold mortgage term loans	25,840	27,496
Other	61	888
Total debt	145,346	151,717
Less current maturities	(5,731)	(5,949)
Long-term debt	$139,615	$145,768

The Senior Notes due in 2008 are non-collateralized.

In 2002, IHOP completed a private placement of $100 million of non-collateralized senior notes in two tranches ($5 million and $95 million) due October 2012. The notes have an average fixed interest rate of 5.234% with annual principal payments of $13.6 million commencing October 2006. Proceeds from the sale of the senior notes were intended to be used to fund capital expenditures for new restaurants and for general corporate purposes.

Included in leasehold mortgage term loans is a loan amount totaling $10.2 million and $10.9 million as of December 31, 2003 and 2002, respectively, due May 2013. The loan is collateralized by certain IHOP restaurants. Borrowings under this loan agreement bear interest at the London Interbank Offered Rate ("LIBOR") plus the applicable margin. The applicable margin will be a function of the funded debt to EBITDA as defined under the loan agreement. This rate was 3.63% and 3.17% at December 31, 2003 and 2002, respectively.

On March 13, 2002, IHOP entered into a $17.2 million variable rate term loan also included in leasehold mortgage term loans. This loan, which accrues interest at one-month LIBOR, will amortize over twelve years and has a maturity date of April 1, 2014. The outstanding balance as of December 31, 2003 was $15.6 million. The interest rate was 3.66% at December 31, 2003. The lending institution required IHOP to enter into an interest rate swap agreement for 50%, $8.6 million, of the loan as a means of reducing IHOP's interest rate exposure. This strategy will effectively use an interest rate swap to convert $8.6 million in variable rate borrowings into fixed rate liabilities. The interest rate swap agreement is considered to be a hedge against changes in the amount of future cash flows associated with interest payments on this variable rate loan. As a result, the interest rate swap agreement is stated at fair value and the related net loss of $0.5 million on this agreement as of December 31, 2003 is reflected in stockholders' equity as a component of comprehensive income (loss).

IHOP has a non-collateralized revolving credit agreement with a bank in the amount of $25 million with a maturity date of May 31, 2004. Borrowings under the agreement bear interest at the bank's reference rate (prime) or, at our option, at the bank's quoted rate or at a Eurodollar rate. A commitment fee of 0.375% per annum is payable on unborrowed funds available under the agreement.

The prime rate was 4.00% at December 31, 2003 and 4.25% at December 31, 2002. There was no outstanding balance under the agreement at December 31, 2003 nor were there any borrowings under the agreement during 2003. There was no outstanding balance at December 31, 2002 and the largest amount outstanding under the agreement during 2002 was $15 million.

Financial covenants in the purchase agreements governing our 5.20% senior notes, our 5.88% senior notes, and our 7.42% senior notes; our leasehold mortgage term loans; and our revolving credit agreement limit our ability to pay dividends. As of December 31, 2003, the most restrictive of our covenants with respect to dividends were contained in our leasehold mortgage term loans. These loans required that we maintain a fixed charge coverage ratio of at least 1.35 to 1, with the amount of cash dividends deducted from the numerator used to calculate this ratio. During the fourth quarter of 2003, IHOP violated these affirmative covenants due to the declaration of a quarterly cash dividend in the fourth quarter of 2003. The creditor has issued a waiver for the covenant violation for the fiscal year ended December 31, 2003. Effective March 8, 2004, the leasehold mortgage term loans were amended so that cash dividends would no longer be deducted from the numerator in calculating this ratio. After giving effect to this amendment, the Company's most restrictive covenant requires the Company to maintain a ratio of consolidated debt to total capitalization of 0.5 to 1.0. Under this test, as of December 31, 2003 the Company had $90.4 million in retained earnings available for payment as dividends.

IHOP's long term debt maturities are as follows:

(In thousands)	
2004	$ 5,731
2005	5,839
2006	19,558
2007	19,732
2008	19,928
Thereafter	74,558
	$ 145,346

7. Leases

The Company leases the majority of its restaurants with the exception of those where a franchisee enters into a lease directly with a landlord and those associated with area license agreements. The restaurants are subleased to franchisees or operated by IHOP. These noncancelable leases and subleases consist primarily of land, buildings and improvements.

The following is the Company's net investment in direct financing lease receivables:

(In thousands)	2003	2002
Total minimum rents receivable	$ 349,224	$ 372,893
Less unearned income	(217,970)	(239,089)
Net investment in direct financing lease receivables	131,254	133,804
Less current portion	(1,425)	(1,202)
Long-term direct financing lease receivables	$ 129,829	$ 132,602

Contingent rental income for the years ended December 31, 2003, 2002 and 2001 was $29,348,000, $23,393,000 and $21,899,000, respectively.

The following is the Company's net investment in equipment leases receivable:

(In thousands)	2003	2002
Total minimum leases receivable	$ 430,156	$ 373,828
Less unearned income	(250,051)	(215,607)
Net investment in equipment leases receivables	180,105	158,221
Less current portion	(5,368)	(4,960)
Long-term equipment leases receivable	$ 174,737	$ 153,261

The following are minimum future lease payments on the Company's noncancelable leases as lessee at December 31, 2003:

(In thousands)	Capital Leases	Operating Leases
2004	$ 22,537	$ 59,152
2005	22,899	58,806
2006	22,904	58,312
2007	22,944	58,785
2008	23,089	58,857
Thereafter	298,599	888,706
Total minimum lease payments	412,972	$ 1,182,618
Less interest	(232,152)	
Capital lease obligations	180,820	
Less current portion	(3,156)	
Long-term capital lease obligations	$ 177,664	

The asset cost and carrying amount on IHOP-owned property leased at December 31, 2003, was $88.0 million and $80.3 million, respectively.

The minimum future lease payments shown above have not been reduced by the following future minimum rents to be received on noncancelable subleases and leases of owned property at December 31, 2003:

(In thousands)	Direct Financing Leases	Operating Leases
2004	$ 18,551	$ 83,116
2005	18,774	84,046
2006	18,847	84,773
2007	19,032	85,907
2008	19,294	86,873
Thereafter	254,726	1,554,083
Total minimum rents receivable	$ 349,224	$ 1,978,798

IHOP has noncancelable leases, expiring at various dates through 2032, that require payment of contingent rents based upon a percentage of sales of the related restaurant as well as property taxes, insurance and other charges. Subleases to franchisees of properties under such leases are generally for the full term of the lease obligation at rents that include IHOP's obligations for property taxes, insurance, contingent rents and other charges. Generally, the noncancelable leases include renewal options. Contingent rent expense for all noncancelable leases for the years ended December 31, 2003, 2002 and 2001 was $2,779,000, $2,713,000 and $2,902,000, respectively. Minimum rent expense for all noncancelable operating leases for the years ended December 31, 2003, 2002 and 2001 was $59,460,000, $50,988,000 and $40,312,000, respectively.

8. Reorganization Charges

In January 2003, the Company adopted a new operating model, moving from Company-developed and financed restaurant growth to franchisee-financed development. As a result, the 2003 financial results were impacted by certain transition and reorganization charges. For the twelve months ended December 31, 2003, we incurred $9.1 million in reorganization charges. $5.5 million of these expenses were related to the write-off of development costs associated with potential sites that we are no longer going to develop as a result of the adoption of our new business model. In addition, we incurred $3.6 million in management consulting, legal fees, severance costs and other expenses associated with the transition to our new business model. Almost all of the anticipated reorganization charges were incurred in 2003.

9. Stockholders' Equity

In March 2003 the Board of Directors declared a quarterly cash dividend of $.25 per share, paid on May 19, 2003 to stockholders of record on May 1, 2003. Subsequent to this declaration of a quarterly dividend, the Company declared a quarterly cash dividend of $0.25 per common share paid on August 18, 2003 to stockholders of record as of August 1, 2003; and declared a third quarterly cash dividend of $0.25 per common share paid on November 21, 2003 to stockholders of record as of November 3, 2003.

The Stock Incentive Plan (the "1991 Plan") was adopted in 1991 and amended and restated in 1998 to authorize the issuance of up to 3,760,000 shares of common stock pursuant to options, restricted stock, and other long-term stock-based incentives to officers and key employees of IHOP. The 2001 Stock Incentive Plan (the "2001 Plan") was adopted in 2001 to authorize the issuance of up to 1,200,000 shares of common stock. No option can be granted at an option price of less than the fair market value at the date of grant as defined by the Plan. Exercisability of options is determined at, or after, the date of grant by the administrator of both Plans. All options granted under both Plans through December 31, 2003, become exercisable one-third after one year, two-thirds after two years and 100% after three years or immediately upon a change in control of IHOP, as defined by both Plans.

The Stock Option Plan for Non-Employee Directors (the "Directors Plan") was adopted in 1994 and amended and restated in 1999 to authorize the issuance of up to 400,000 shares of common stock pursuant to options to non-employee members of IHOP's Board of Directors. Options are to be granted at an option price equal to 100% of the fair market value of the stock on the date of grant. Options granted pursuant to the Directors Plan vest and become exercisable one-third after one year, two-thirds after two years and 100% after three years. Options for the purchase of shares are granted to each non-employee Director under the Directors Plan as follows: (1) an option to purchase 15,000 shares on February 23, 1995, or on the Director's election to the Board of Directors if he or she was not a Director on such date, and (2) an option to purchase 5,000 shares annually in conjunction with IHOP's Annual Meeting of Stockholders for that year.

On January 13, 2003, the Company announced that the Board of Directors had authorized the repurchase of up to 2.6 million shares of IHOP Corp. common stock. For the twelve months ended December 31, 2003, the Company had cumulatively repurchased 0.6 million shares of its common stock.

Information regarding activity for stock options outstanding under IHOP's stock option plans is as follows:

Shares Under Option	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2000	1,906,563	$ 14.59
Granted	323,000	23.64
Exercised	(619,192)	11.53
Terminated	(22,001)	17.37
Outstanding at December 31, 2001	1,588,370	17.58
Granted	354,000	28.66
Exercised	(509,004)	14.93
Terminated	(48,165)	25.31
Outstanding at December 31, 2002	1,385,201	21.12
Granted	301,750	25.35
Exercised	(588,081)	17.72
Terminated	(90,827)	24.20
Outstanding at December 31, 2003	1,008,043	$ 24.09
Exercisable at December 31, 2003	479,326	$ 21.71

Information regarding options outstanding and exercisable at December 31, 2003 is as follows:

Range of Exercise Prices	Number Outstanding as of 12/31/03	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable As of 12/31/03	Weighted Average Exercise Price
$13.50 - $20.31	263,097	5.13	$17.33	231,783	$16.95
$21.06 - $24.00	293,116	8.17	$23.35	74,034	$22.03
$24.10 - $28.11	258,332	8.37	$26.73	121,668	$26.88
$28.75 - $35.25	193,498	8.45	$30.90	51,841	$30.41
$13.50 - $35.25	1,008,043	7.48	$24.09	479,326	$21.71

The fair value of each option grant issued during each of the three years in the period ended December 31, 2003, reflecting the basis for the proforma disclosure in Note 1, is estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2003	2002	2001
Risk free interest rate	2.63%—3.25%	3.50%	5.75%
Expected volatility	37.0%	37.0%	37.0%
Dividend yield	0%—3.56%	—	—
Weighted average expected life	5 Years	5 Years	5 Years
Weighted average fair value of options granted	$25.35	$30.25	$24.18

10. Income Taxes

The provision for income taxes is as follows:

(In thousands)	Year Ended December 31, 2003	2002	2001
Provision for income taxes:			
Current			
Federal	$15,418	$ 11,714	$13,008
State and foreign	3,641	2,032	1,494
	19,059	13,746	14,502
Deferred			
Federal	3,876	9,778	8,224
State	(867)	965	1,447
	3,009	10,763	9,671
Provision for income taxes	$22,068	$ 24,509	$24,173

The provision for income taxes differs from the expected federal income tax rates as follows:

	2003	2002	2001
Statutory federal income tax rate	35.0%	35.0%	35.0%
State and other taxes, net of federal tax benefit	2.5	2.5	2.5
Effective tax rate	37.5%	37.5%	37.5%

Deferred tax assets consist of the following components:

(In thousands)	2003	2002
Differences in capitalization and depreciation and amortization of reacquired franchises and equipment	$10,826	$ 9,137
Differences in capitalization and depreciation and application of cash receipts and disbursements of direct financing leases and capital lease obligations	19,613	15,817
Other	6,919	510
	$37,358	$ 25,464

Deferred tax liabilities consist of the following components:

(In thousands)	2003	2002
Differences between financial and tax accounting in the recognition of franchise and equipment sales	$ 94,750	$ 84,597
Differences between book and tax basis of property and equipment	13,152	6,821
Deferred dividends	3,441	5,022
	$111,343	$ 96,440

The Internal Revenue Service ("IRS") has proposed adjustments in connection with its examination of the Company's 2000 and 2001 federal income tax returns. The proposed adjustments would accelerate the tax years in which the Company reports initial franchise fee income for federal income tax purposes. If the IRS is successful, the Company would be required to report additional income for its 2000 tax year of approximately $45.2 million and additional income for its 2001 tax year of approximately $4.8 million. The Company's federal income tax liability with respect to the proposed adjustments, exclusive of interest, penalties and any related state tax liability, would be approximately $15.8 million for 2000 and $1.7 million for 2001. The Company is currently contesting the proposed adjustments through IRS administrative proceedings.

For the tax years under audit, and potentially for subsequent tax years, such proposed adjustments could result in material cash payments by the Company. The Company had previously recorded in its consolidated financial statements the expected federal and state deferred income tax liability. Therefore, the proposed adjustments relate only to a timing issue. Although the Company cannot determine at this time the resolution of this matter, we do not believe that the proposed adjustments, if upheld, will have a material adverse effect on our financial condition or results of operations.

11. Employee Benefit Plans

In 1987, IHOP adopted a noncontributory Employee Stock Ownership Plan ("ESOP"). The ESOP is a stock bonus plan under Section 401(a) of the Internal Revenue Code. The plan covers IHOP employees who meet the minimum credited service requirements of the plan. Employees whose terms of service are covered by a collective bargaining agreement are not eligible for the ESOP unless the terms of such agreement specifically provide for participation in the ESOP.

The cost of the ESOP is borne by IHOP through contributions determined by the Board of Directors in accordance with the ESOP provisions and Internal Revenue Service regulations. The contributions to the plan for the years ended December 31, 2003, 2002 and 2001 were $2,210,000, $1,998,000 and $1,850,000, respectively. The contribution for the year ended December 31, 2003 will be made in shares of IHOP Corp. common stock.

Shares of stock acquired by the ESOP are allocated to each eligible employee and held by the ESOP. Upon the employee's termination after vesting, or in certain other limited circumstances, the employee's shares are distributed to the employee according to his or her direction.

In 2001, IHOP adopted a defined contribution plan authorized under Section 401(k) of the Internal Revenue Code. The plan covers IHOP employees who meet the minimum credited service requirements of the 401(k) plan. Employees whose terms of service are covered by a collective bargaining agreement are not eligible. Employees may contribute up to 15 percent of their pre-tax covered compensation subject to limitations of the tax code. IHOP Corp. common stock is not an investment option for employees in the 401(k) plan. The administrative cost of the 401(k) plan is borne by IHOP. The Company does not contribute towards the plan.

12. Related Party Transactions

On December 26, 2001, the Company loaned $1.2 million to its President and Chief Executive Officer. A portion of the loan ($600,000) was a personal loan. Pursuant to the employment agreement signed by the President and Chief Executive Officer in December 2001, this personal loan is interest free and forgiven in annual increments of $100,000. As of December 31, 2003 and 2002 the outstanding balance of this personal loan was $400,000 and $500,000, respectively. The other portion of the loan ($600,000) was an interest free bridge loan used to fund a portion of the down payment on a new home. In early 2002, $490,000 of this loan was repaid and $110,000, which represents the decline in the value of a former residence, was forgiven by the Company, upon the recommendation of the compensation committee of the Board of Directors. As of December 31, 2003 and 2002, the remaining balance of this loan was zero.

13. Commitments and Contingencies

IHOP is subject to various claims and legal actions that have arisen in the ordinary course of business. We believe such claims and legal actions, individually or in the aggregate, will not have a material adverse effect on our financial condition, results of operations, or cash flows.

14. Segment Reporting

On January 13, 2003 we announced significant changes in the way the Company conducts business. These include a transition from Company-financed restaurant development to a more traditional franchise development model, in which franchisees finance and develop their new restaurants. As a result of the change in IHOP's business model, the Company has also changed the presentation of its segment information. IHOP identifies its operating segments based on the organizational units used by management to monitor performance and make operating decisions. The Franchise Operations segment includes restaurants operated by franchisees and area licensees in the United States and Canada. The Franchise Operations segment consists primarily of royalty revenues, sales of proprietary products, advertising fees and franchise fees. The Rental Operations segment consists of rental income and expense and direct financing lease interest income and capital lease interest expense on restaurants operated by franchisees. The Company Restaurant Operations segment includes Company-operated restaurants in the United States. The Finance Operations segment consists of sales of franchises and equipment as well as interest income from the financing of franchise fee and equipment contract notes. Prior period segment information has been restated to conform with the current year presentation. Information on segments and a reconciliation to income before income taxes are as follows:

(In thousands)	Franchise Operations	Rental Operations	Company Restaurant Operations	Financing Operations	General and Administrative and Other	Consolidated Total
Year Ended December 31, 2003						
Revenues from external customers	$ 140,131	$117,258	$ 74,880	$72,536	$ —	$ 404,805
Intercompany real estate charges	—	16,096	1,563	—	(17,659)	—
Depreciation & amortization	—	4,871	3,937	—	9,817	18,625
Interest expense	—	17,911	1,619	7,364	—	26,894
Reorganization charges	—	—	—	—	9,085	9,085
Income tax expense	—	—	—	—	22,068	22,068
Income (loss) before income taxes	75,866	18,172	(7,763)	28,917	(56,342)	58,850
Year Ended December 31, 2002						
Revenues from external customers	$123,050	$ 99,595	$ 74,433	$68,796	$ —	$ 365,874
Intercompany real estate charges	—	6,045	1,546	—	(7,591)	—
Depreciation & amortization	—	6,659	4,490	—	4,818	15,967
Interest expense	—	16,591	2,093	2,891	—	21,575
Income tax expense	—	—	—	—	24,509	24,509
Incomes (loss) before income taxes	67,911	19,738	(5,036)	30,611	(47,867)	65,357
Year Ended December 31, 2001						
Revenues from external customers	$ 111,129	$ 84,037	$ 68,810	$60,460	$ —	$ 324,436
Intercompany real estate charges	—	6,083	901	—	(6,984)	—
Depreciation & amortization	—	5,703	4,157	—	4,958	14,818
Interest expense	—	16,311	2,437	2,359	—	21,107
Income tax expense	—	—	—	—	24,173	24,173
Income (loss) before income taxes	62,860	18,073	(4,447)	27,018	(39,043)	64,461

15. Selected Quarterly Financial Data (Unaudited)

(In thousands, except per share amounts)	Revenues	Operating Margin	Net Income	Net Income Per Share—Basic(a)	Net Income Per Share—Diluted(a)
2003					
1st Quarter	$ 93,991	$30,864	$ 5,963	$0.28	$ 0.28
2nd Quarter	103,284	32,808	10,972	0.51	0.51
3rd Quarter	104,762	33,957	11,044	0.51	0.51
4th Quarter	102,768	30,935	8,803	0.41	0.41
2002					
1st Quarter	$ 81,540	$27,706	$ 9,756	$0.47	$ 0.46
2nd Quarter	84,859	28,534	9,300	0.44	0.44
3rd Quarter	92,083	30,424	9,838	0.47	0.46
4th Quarter	107,392	33,652	11,954	0.57	0.56

(a) The quarterly amounts may not add to the full year amount due to rounding.

Report of Independent Auditors

To the Stockholders and Board of Directors of IHOP Corp.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity, and cash flows present fairly, in all material respects, the financial position of IHOP Corp. and its subsidiaries (the "Company") at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audits 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Los Angeles, California
February 13, 2004, except for the loan amendment
discussed in Note 6 for which the date is March 8, 2004

Marianne and Nikki


Craig


Stacy


Patrick


Virginia


Yvonne


Corporate Profile

Board of Directors

Larry Alan Kay
Chairman of the Board, IHOP Corp.

Julia A. Stewart
President and
Chief Executive Officer,
IHOP Corp.

H. Frederick Christie
Independent Consultant;
Former President and
Chief Executive Officer,
The Mission Group

Richard J. Dahl
Senior Vice President and Chief
Financial Officer, Dole Food
Company, Inc.

Frank Edelstein
Independent Consultant;
Former Vice President,
Kelso & Company, Inc.

Michael S. Gordon
Chairman, StoneCreek Capital, Inc.

Neven C. Hulsey
Retired; Former
Chairman of the Board,
Earle M. Jorgensen Company

Caroline W. Nahas
Managing Director,
Southwest Region,
Korn/Ferry International

Patrick W. Rose
Private Investor;
Former Chairman
of the Board,
President and
Chief Executive Officer,
Van Camp Seafoods, Inc.

Officers

Julia A. Stewart
President, Chief Executive
Officer and Director

Richard C. Celio
Vice President, Franchise and
Development

Thomas G. Conforti
Chief Financial Officer

Robin L. Elledge
Vice President, Human
Resources

Rand M. Ferris
Vice President,
Franchise Operations

John F. Koch
Vice President,
Product, Menu and Purchasing

Patrick J. Piccininno
Vice President,
Information Technology

Mark D. Weisberger
Vice President, Legal, Secretary
and General Counsel

Corporate Offices
IHOP Corp.
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Glendale, CA 91203-2306
818/240-6055
www.ihop.com

Stock Transfer Agent
Mellon Investor Service LLC
P.O. Box 3315
South Hackensack, NJ 07660
800/356-2017
www.melloninvestor.com

Independent Accountants
PricewaterhouseCoopers LLP
Los Angeles, California

Form 10-K
A shareholder may receive, without charge, a copy of our report filed with the Securities and Exchange Commission on Form 10-K by written request addressed to the Investor Relations Department at our Corporate Offices.

Pictured left to right, front row: John Koch, Julia Stewart, Patrick Piccininno, Robin Elledge, Rick Celio, Tom Conforti. Back row: Mark Weisberger, Rand Ferris

Stock Information

Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "IHP". As of January 31, 2004, there were approximately 7,618 stockholders, including the beneficial owners of shares held in "street name." The following table sets forth the high and low prices of IHOP's common stock for each quarter of 2003 and 2002 as reported by the New York Stock Exchange.

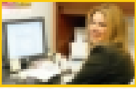
	Fiscal Year 2003			Fiscal Year 2002		
	Prices			Prices		
Quarter	High	Low	Dividends Paid	High	Low	Dividends Paid
First	$25.14	$20.98	—	$33.92	$27.40	—
Second	32.64	22.42	$0.25	36.46	28.42	—
Third	36.65	31.31	0.25	29.50	23.38	—
Fourth	39.40	32.80	0.25	25.44	21.08	—

Patricia

Patrick

John

Gail



Nicole and Susie

Allen and Pascale

Come hungry. IHOP RESTAURANT Leave happy.℠

IHOP Corp. 450 North Brand Boulevard, Glendale, CA 91203-2306 818-240-6055
www.ihop.com