

CEC ENTERTAINMENT INC
Form 10-Q
November 04, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 3, 2010

OR

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

For the transition period from _____ to _____

Commission File Number: 001-13687

CEC ENTERTAINMENT, INC.
(Exact name of registrant as specified in its charter)

Kansas
(State or other jurisdiction of incorporation
or organization)

48-0905805
(IRS Employer Identification No.)

4441 West Airport Freeway
Irving, Texas
(Address of principal executive offices)

75062
(Zip Code)

(972) 258-8507
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of October 25, 2010, an aggregate of 20,539,333 shares of the registrant's common stock, par value \$0.10 per share were outstanding.

CEC ENTERTAINMENT, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements.

CEC ENTERTAINMENT, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share information)

	October 3, 2010	January 3, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$18,733	\$17,361
Accounts receivable	14,419	27,031
Inventories	17,368	18,016
Prepaid expenses	15,618	13,915
Deferred tax asset	3,392	3,392
Total current assets	69,530	79,715
Property and equipment, net	669,856	662,747
Other noncurrent assets	6,673	1,804
Total assets	\$746,059	\$744,266
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Capital lease obligations, current portion	\$935	\$881
Accounts payable	35,146	32,754
Accrued expenses	38,111	33,927
Unearned revenues	8,637	7,641
Accrued interest	1,869	1,077
Derivative instrument liability	3,181	4,459
Total current liabilities	87,879	80,739
Capital lease obligations, less current portion	9,938	10,629
Revolving credit facility borrowings	356,500	354,300
Deferred rent liability	50,440	48,758
Deferred landlord contributions	27,511	28,220
Deferred tax liability	33,246	33,690
Accrued insurance	12,510	12,068
Derivative instrument liability	-	1,154
Other noncurrent liabilities	6,985	6,795
Total liabilities	585,009	576,353
Commitments and contingencies (Note 5)		
Stockholders' equity:		

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Common stock, \$0.10 par value; authorized 100,000,000 shares; 61,401,172 and 61,120,018 shares issued, respectively	6,140	6,112
Capital in excess of par value	433,204	425,717
Retained earnings	753,635	702,414
Accumulated other comprehensive income	2,982	1,140
Less treasury stock, at cost; 40,861,839 and 38,944,354 shares, respectively	(1,034,911)	(967,470)
Total stockholders' equity	161,050	167,913
Total liabilities and stockholders' equity	\$746,059	\$744,266

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

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CEC ENTERTAINMENT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)
(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
REVENUES				
Food and beverage sales	\$99,452	\$95,060	\$309,532	\$314,662
Entertainment and merchandise sales	106,747	101,860	321,996	313,117
Company store sales	206,199	196,920	631,528	627,779
Franchise fees and royalties	945	898	2,929	2,967
Total revenues	207,144	197,818	634,457	630,746
OPERATING COSTS AND EXPENSES				
Company store operating costs:				
Cost of food and beverage (exclusive of items shown separately below)	22,143	21,868	69,729	69,626
Cost of entertainment and merchandise (exclusive of items shown separately below)	8,906	8,947	26,692	28,071
Cost of food, beverage, entertainment and merchandise	31,049	30,815	96,421	97,697
Labor expenses	55,740	54,593	168,112	167,538
Depreciation and amortization	19,903	19,232	59,345	57,186
Rent expense	17,719	17,010	52,645	50,643
Other store operating expenses	36,025	32,226	96,757	92,635
Total company store operating costs	160,436	153,876	473,280	465,699
Advertising expense	9,870	9,179	27,292	27,860
General and administrative expenses	12,176	11,328	37,297	37,583
Asset impairments	936	-	936	-
Total operating costs and expenses	183,418	174,383	538,805	531,142
Operating income	23,726	23,435	95,652	99,604
Interest expense	2,951	2,769	9,063	8,938
Income before income taxes	20,775	20,666	86,589	90,666
Income taxes	8,194	7,955	35,368	34,909
Net income	\$12,581	\$12,711	\$51,221	\$55,757
Earnings per share:				
Basic	\$0.60	\$0.55	\$2.38	\$2.43
Diluted	\$0.60	\$0.55	\$2.38	\$2.42
Weighted average common shares outstanding:				

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Basic	20,844	22,971	21,488	22,949
Diluted	20,877	23,021	21,525	23,080

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

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CEC ENTERTAINMENT, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 For the Nine Months Ended October 3, 2010
 (Unaudited)

	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
Balance at January 4, 2010	61,120,018	\$6,112	\$425,717	\$702,414	\$ 1,140	38,944,354	\$(967,470)	\$167,913
Net income	-	-	-	51,221	-	-	-	51,221
Change in fair value of cash flow hedge, net of income taxes of \$(489)	-	-	-	-	(802)	-	-	(802)
Hedging loss realized in earnings, net of income taxes of \$1,411	-	-	-	-	2,312	-	-	2,312
Foreign currency translation adjustments, net of income taxes of \$54	-	-	-	-	332	-	-	332
Comprehensive income								53,063
Stock-based compensation costs	-	-	5,654	-	-	-	-	5,654
Stock options exercised	147,957	15	4,722	-	-	-	-	4,737
Restricted stock issued, net of forfeitures	192,428	19	(19)	-	-	-	-	-
Tax shortfall from stock options and restricted stock	-	-	(722)	-	-	-	-	(722)
Restricted stock returned for taxes	(78,123)	(8)	(2,749)	-	-	-	-	(2,757)
	18,892	2	601	-	-	-	-	603

Common stock issued under 401(k) plan								
Purchases of treasury stock	-	-	-	-	-	1,917,485	(67,441)	(67,441)
Balance at October 3, 2010	61,401,172	\$6,140	\$433,204	\$753,635	\$ 2,982	40,861,839	\$(1,034,911)	\$161,050

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

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CEC ENTERTAINMENT, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)
 (in thousands)

	Nine Months Ended	
	October 3, 2010	September 27, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$51,221	\$55,757
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	60,013	57,859
Deferred income taxes	(2,220)	8,628
Stock-based compensation expense	5,511	5,974
Amortization of landlord contributions	(1,532)	(1,506)
Amortization of deferred debt financing costs	211	211
Loss on asset disposals, net	3,106	2,128
Other adjustments	15	(8)
Changes in operating assets and liabilities:		
Accounts receivable	6,949	13,803
Inventories	694	(2,138)
Prepaid expenses	(1,677)	(3,455)
Accounts payable	3,840	(5,910)
Accrued expenses	1,972	1,110
Unearned revenues	993	(1,029)
Accrued interest	724	(2,022)
Income taxes payable	5,547	(2,373)
Deferred rent liability	1,646	991
Deferred landlord contributions	777	(589)
Net cash provided by operating activities	137,790	127,431
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(70,685)	(51,167)
Other investing activities	(2,451)	119
Net cash used in investing activities	(73,136)	(51,048)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from (repayments on) revolving credit facility	2,200	(62,250)
Payments on capital lease obligations	(654)	(602)
Exercise of stock options	4,737	18,282
Excess tax benefit realized from stock-based compensation	619	2,037
Payment of taxes for returned restricted shares	(2,757)	(1,364)
Treasury stock acquired	(67,441)	(33,571)
Net cash used in financing activities	(63,296)	(77,468)
Effect of foreign exchange rate changes on cash	14	(645)
Change in cash and cash equivalents	1,372	(1,730)

Cash and cash equivalents at beginning of period	17,361	17,769
Cash and cash equivalents at end of period	\$ 18,733	\$ 16,039
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 8,128	\$ 9,231
Income taxes paid, net	\$ 31,851	\$ 18,845
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Accrued construction costs	\$ 6,339	\$ 6,455
Common stock issued under 401(k) plan	\$ 603	\$ 577

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

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CEC ENTERTAINMENT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Recently Issued Accounting Guidance:

The use of the terms “CEC Entertainment,” “Company,” “we,” “us” and “our” throughout these Notes to Condensed Consolidated Financial Statements refer to CEC Entertainment, Inc. and its subsidiaries.

All of our stores utilize a consistent restaurant-entertainment format that features both family dining and entertainment areas where each store offers the same general mix of food, beverages, entertainment and merchandise. The economic characteristics, products and services, preparation processes, distribution methods and types of customers are substantially similar for each of our stores. Therefore, we aggregate each store’s operating performance into one reportable operating segment for financial reporting purposes.

Our consolidated financial statements include the accounts of the Company and the International Association of CEC Entertainment, Inc. (the “Association”), a variable interest entity in which we have a controlling financial interest. The Association primarily administers the collection and disbursement of funds (the “Association Funds”) used for advertising, entertainment and media programs that benefit both us and our franchisees. We and our franchisees are required to contribute a percentage of gross sales to these funds and could be required to make additional contributions to fund any deficits that may be incurred by the Association. We include the Association in our consolidated financial statements because we concluded that we are the primary beneficiary of its variable interests because we (a) have the power to direct the majority of its significant operating activities, (b) provide it unsecured lines of credit and (c) own the majority of the store locations that benefit from the Association’s advertising and media expenditures. The assets, liabilities and operating results of the Association are not material to our consolidated financial statements. We provide unsecured lines of credit to the Association which it uses to fund deficiencies in its media and advertising funds.

Because the Association Funds are required to be segregated and used for specified purposes, we do not reflect franchisee contributions as revenue, but rather as an offset to reported expenses. Our contributions to the Association Funds eliminate in consolidation. Contributions to the advertising and media funds from our franchisees reflected as offsets to reported advertising expenses were approximately \$0.5 million each for the three months ended October 3, 2010 and September 27, 2009 and approximately \$1.7 million each for the nine months ended October 3, 2010 and September 27, 2009.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements as of October 3, 2010 and for the three and nine month periods ended October 3, 2010 and September 27, 2009 are presented in accordance with the requirements for quarterly reports on Form 10-Q and, consequently, do not include all of the information and footnote disclosures required by accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, such financial statements include all adjustments (consisting solely of normal recurring adjustments) necessary for the fair statement of the financial information included herein in accordance with GAAP and the rules and regulations of the Securities and Exchange Commission (the “SEC”). The balance sheet at January 3, 2010 has been derived from the audited financial statements at that date, but does not include all of the information and footnote disclosures required by GAAP for complete financial statements. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Results of operations for interim periods are not necessarily indicative of results for the full year. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K filed with the SEC for the fiscal year ended January 3, 2010.

Recently Issued Accounting Guidance

Newly Adopted Accounting Guidance: As of the beginning of our 2010 fiscal year, we adopted a new accounting standard amending the consolidation accounting requirements for a variable interest entity (“VIE”) which now prescribes a qualitative assessment for determining whether a variable interest gives an enterprise a controlling financial interest in a VIE. This new guidance also requires separate presentation of the assets and liabilities of a consolidated VIE on the face of the balance sheet if specific criteria are met. Our adoption of this new standard did not have a material impact on our consolidated financial statements.

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CEC ENTERTAINMENT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

1. Basis of Presentation and Recently Issued Accounting Guidance (continued):

Accounting Guidance Not Yet Adopted: In October 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update 2009-13 which amends the accounting and reporting guidance for arrangements comprised of multiple products or services (“deliverables”). The FASB’s revised guidance clarifies how an entity determines separate units of accounting in a multiple-deliverable arrangement and requires that revenue be allocated to all arrangement deliverables using the relative selling price method. The revised guidance is effective for the first annual reporting period beginning on or after June 15, 2010 and may be applied prospectively as of the adoption date or retrospectively for all periods presented. Early adoption is permitted provided that the revised guidance is retroactively applied to the beginning of the year of adoption. We will apply this guidance prospectively as of the start of our 2011 fiscal year. We have evaluated this new accounting guidance and our adoption will not have a material effect on our consolidated financial statements.

2. Inventories:

Inventories consisted of the following:

	October 3, 2010	January 3, 2010
	(in thousands)	
Food and beverage	\$3,777	\$4,934
Entertainment and merchandise	13,591	13,082
	\$17,368	\$18,016

Food and beverage inventories include food, beverage, paper products and other supplies needed for our food service operations. Entertainment and merchandise inventories consist primarily of novelty toy items used as redemption prizes for certain games that may also be sold to our customers and birthday party and other supplies needed for our entertainment operations.

3. Revolving Credit Facility:

	October 3, 2010	January 3, 2010
	(in thousands)	
Revolving credit facility borrowings	\$356,500	\$354,300

We have a revolving credit facility providing for total borrowings of up to \$550.0 million. The credit facility, which matures in October 2012, also includes an accordion feature allowing us, subject to lender approval, to request an additional \$50.0 million in borrowings at any time. As of October 3, 2010, there were \$356.5 million of borrowings outstanding and \$10.7 million of letters of credit issued but undrawn under the credit facility. Based on the type of borrowing, the credit facility bears interest at the London Interbank Offered Rate (“LIBOR”) plus an applicable margin of 0.625% to 1.25% determined based on our financial performance and debt levels, or alternatively, the higher of (a) the prime rate or (b) the Federal Funds rate plus 0.50%. As of October 3, 2010, borrowings under the credit facility

incurred interest at LIBOR (ranging from 0.26% - 0.31%) plus 1.00% or prime (3.25%). A commitment fee of 0.1% to 0.3%, depending on our financial performance and debt levels, is payable on a quarterly basis on any unused credit line. All borrowings under the credit facility are unsecured, but we have agreed not to pledge any of our existing assets to secure future indebtedness.

Including the effect of our interest rate swap contract discussed in Note 4 "Derivative Instrument," the weighted average effective interest rate incurred on borrowings under our revolving credit facility was 2.9% for the three months ended October 3, 2010 and September 27, 2009, and was 3.0% and 2.9% for the nine months ended October 3, 2010 and September 27, 2009, respectively.

The revolving credit facility agreement contains certain restrictions and conditions that, among other things, require us to comply with financial covenant ratios, including a minimum fixed charge coverage ratio of 1.5 to 1.0 and a maximum leverage ratio of 3.0 to 1.0, as defined in the revolving credit facility agreement. Additionally, the terms of the revolving credit facility agreement limit the amount of our repurchases of our common stock and cash dividends we may pay on our common stock based on certain financial covenants and criteria. As of October 3, 2010, we were in compliance with these covenants.

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CEC ENTERTAINMENT, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
 (Unaudited)

4. Derivative Instrument:

Interest Rate Risk Management

Our revolving credit facility bears interest at variable rates and therefore exposes us to the impact of interest rate changes. To manage this risk, we use an interest rate swap contract to mitigate the variability of the interest payment cash flows and to reduce our exposure to adverse interest rate changes.

Cash Flow Hedge

We have entered into a \$150.0 million notional amount interest rate swap contract to effectively convert a portion of our variable rate revolving credit facility debt to a fixed interest rate. The contract, which matures in May 2011, requires us to pay a fixed rate of 3.62% while receiving variable payments from the counterparty at the three-month LIBOR rate. Including the 1.00 percentage point applicable margin incurred on our revolving credit facility, the effective interest rate of the swap contract was 4.62% at October 3, 2010. The differential amounts receivable or payable under the swap contract are recorded over the life of the contract as adjustments to interest expense.

We have designated the swap contract as a cash flow hedge. Accordingly, gains or losses from changes in its fair value that are determined to be effective in mitigating our exposure to changes in interest payments on the hedged amount of revolving credit facility debt are reported on the Consolidated Balance Sheets as a component of "Accumulated other comprehensive income." Throughout the term of the swap contract, the unrealized gains or losses we have reported in accumulated other comprehensive income will be recognized in earnings when the variable interest rate of the debt affects earnings. The ineffective portion of any gains or losses would be recorded immediately in earnings.

The following table summarizes the location and fair value of the derivative instrument in our unaudited Condensed Consolidated Balance Sheets:

Balance Sheet Location	October 3, 2010	January 3, 2010
	(in thousands)	
Derivative designated as hedging instrument:		
Interest rate swap contract	\$3,181	\$5,613

- (1) As of October 3, 2010, the estimated fair value was recorded as a \$3.2 million current liability.
 As of January 3, 2010, the estimated fair value was comprised of a \$4.5 million current liability and a \$1.2 million noncurrent liability.
- (2) million noncurrent liability.

The following table summarizes the effect of the derivative instrument on other comprehensive income ("OCI") and income:

	Three Months Ended September October 3,	Nine Months Ended September October 3,
	27,	27,

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	2010	2009	2010	2009
	(in thousands, excluding income tax effects)			
Derivative in cash flow hedging relationship:				
Loss recognized in accumulated OCI – effective portion:				
Interest rate swap contract	\$(408)	\$(1,116)	\$(1,291)	\$(2,274)
Loss reclassified from accumulated OCI into income – effective portion:				
Interest expense	\$(1,213)	\$(1,159)	\$(3,723)	\$(2,814)

There were no ineffective gains or losses recognized during the three and nine months ended October 3, 2010 and September 27, 2009. We expect that approximately \$2.0 million, net of taxes, of the change in fair value of the swap contract included in “Accumulated other comprehensive income” as of October 3, 2010 will be realized in earnings as additional interest expense within the next 12 months.

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CEC ENTERTAINMENT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

4. Derivative Instrument (continued):

Fair Value Measurement

Our interest rate swap contract is not traded on a public exchange. Therefore, its fair value is determined using the present value of expected future cash flows arising from the contract which approximates an amount to be received from or paid to a market participant for this instrument. This valuation methodology utilizes forward interest rate yield curves obtained from an independent pricing service's quotes of three-month forward LIBOR rates through the swap contract's maturity. Accordingly, the inputs to our fair value measurement of the interest rate swap are classified within Level 2 of the fair value hierarchy. For more information regarding fair value measurements, refer to Note 1 "Fair Value Measurements" to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

5. Commitments and Contingencies:

Legal Proceedings

From time to time, we are involved in various inquiries, investigations, claims, lawsuits, and other legal proceedings that are incidental to the conduct of our business. These matters typically involve claims from customers, employees or other third parties involved in operational issues common to the retail, restaurant and entertainment industries. Such matters typically represent actions with respect to contracts, intellectual property, taxation, employment, employee benefits, personal injuries and other matters. A number of such claims may exist at any given time and there are currently a number of claims and legal proceedings pending against us.

In the opinion of our management, after consultation with legal counsel, the amount of ultimate liability with respect to claims or proceedings currently pending against us is not expected to have a material adverse effect on our financial condition, results of operations or cash flows.

6. Income Taxes:

Our liability for uncertain tax positions increased from \$5.1 million as of January 3, 2010 to \$7.9 million as of October 3, 2010, primarily in connection with the current Internal Revenue Service examination of our 2006 and 2007 tax years. In addition, we have recognized additional estimated interest expense of approximately \$0.8 million related to these matters. Also, during the third quarter of 2010, we paid \$0.6 million in connection with the settlement of a state tax audit.

7. Asset Impairments:

During the third quarter of 2010, we recognized asset impairment charges of \$0.9 million related to three stores we continue to operate due to the adverse impact of various economic factors in the markets in which the properties are located and resulting decline in the stores' financial performance. Based on these factors, we determined that the stores' forecasted cash flows were insufficient to recover the carrying amount of their long-lived assets. Asset impairments represent adjustments we recorded to write down the carrying amount of the property and equipment at these stores to their estimated fair value.

Fair Value Measurement

We estimate the fair value of a store's long-lived assets by discounting the expected future cash flows of the store using a weighted average cost of capital over its remaining lease term. Our estimate of cash flows used to determine fair value is developed from the highest and best use of the store from the perspective of market participants, which may differ from the basis of our own internal expectations of the store's future cash flows. Accordingly, the inputs to our fair value measurement of the stores we have recognized impairment charges for are classified within Level 3 of the fair value hierarchy. For more information regarding fair value measurements, refer to Note 1 "Fair Value Measurements" to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

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CEC ENTERTAINMENT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

8. Earnings Per Share:

Basic earnings per share (“EPS”) is computed by dividing net income by the weighted average number of common shares outstanding during the period. Common shares outstanding consist of shares of our common stock and certain unvested shares of restricted stock containing nonforfeitable dividend rights. Diluted EPS is computed using the weighted average number of common shares and dilutive potential common shares outstanding during the period using the treasury stock method. Potential common shares consist of dilutive stock options and unvested shares of restricted stock that are not considered to be participating securities.

The following table sets forth the computation of EPS, basic and diluted:

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
	(in thousands, except per share amounts)			
Numerator:				
Net income	\$12,581	\$12,711	\$51,221	\$55,757
Denominator:				
Basic weighted average common shares outstanding	20,844	22,971	21,488	22,949
Potential common shares for stock options and restricted stock	33	50	37	131
Diluted weighted average common shares outstanding	20,877	23,021	21,525	23,080
Earnings per share:				
Basic	\$0.60	\$0.55	\$2.38	\$2.43
Diluted	\$0.60	\$0.55	\$2.38	\$2.42

Stock options to purchase 54,270 shares and 685,400 shares of common stock for the three months ended October 3, 2010 and September 27, 2009, respectively, and 119,267 shares and 705,080 shares for the nine months ended October 3, 2010 and September 27, 2009, respectively, were not included in the diluted EPS computations because the exercise prices of these options were greater than the average market price of the common shares and, therefore, their effect would be antidilutive.

9. Stock-Based Compensation:

We have stock-based compensation plans pursuant to which we may grant awards of restricted stock and, prior to fiscal 2006, stock options to our employees and non-employee directors. The fair value of all stock-based awards, less estimated forfeitures, is recognized as stock-based compensation expense in the financial statements over the vesting period of the award.

The following table summarizes total pre-tax stock-based compensation expense recognized in the unaudited condensed consolidated financial statements:

	Three Months Ended	Nine Months Ended
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	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
	(in thousands)			
Total stock-based compensation cost	\$1,906	\$1,846	\$5,654	\$6,132
Portion capitalized as property and equipment(1)	(48)	(55)	(143)	(158)
Pre-tax stock-based compensation expense recognized(2)	\$ 1,858	\$ 1,791	\$ 5,511	\$ 5,974

- (1) We capitalize the portion of stock-based compensation costs related to our design, construction, facilities and legal departments that are directly attributable to our store development projects, such as the design and construction of a new store and the remodeling and expansion of our existing stores. Capitalized stock-based compensation is included in “Property and equipment, net” on the unaudited Condensed Consolidated Balance Sheets.
- (2) Included in “General and administrative expense” in the unaudited Condensed Consolidated Statements of Earnings.

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CEC ENTERTAINMENT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

9. Stock-Based Compensation (continued):

As of October 3, 2010, there was \$14.7 million of unrecognized pre-tax stock-based compensation cost related to restricted stock that will be recognized over a weighted average remaining vesting period of 1.7 years. All previously granted and currently outstanding stock options are fully vested. As such there is no unrecognized stock-based compensation cost related to stock options.

10. Stockholders' Equity:

Stock Repurchase Program

Our Board of Directors (the "Board") has approved a program for us to repurchase shares of our common stock. On July 25, 2005, the Board approved a stock repurchase program which authorized us to repurchase from time to time up to \$400 million of our common stock and on October 22, 2007 and October 27, 2009 authorized \$200 million increases each. During the nine months ended October 3, 2010, we repurchased 1,917,485 shares of our common stock at an aggregate purchase price of approximately \$67.4 million under the repurchase program. As of October 3, 2010, approximately \$151.3 million remained available for share repurchases under our repurchase authorization.

The share repurchase authorization approved by the Board does not have an expiration date and the pace of our repurchase activity will depend on factors such as our working capital needs, our debt repayment obligations, our stock price, and economic and market conditions. Our share repurchases may be effected from time to time through open market purchases, accelerated share repurchases or in privately negotiated transactions. Our share repurchase program may be accelerated, suspended, delayed or discontinued at any time.

Stock Options

During the nine months ended October 3, 2010, 147,957 shares of common stock were issued from the exercise of stock options for cash proceeds of \$4.7 million.

Restricted Stock

The following table summarizes restricted stock activity during the nine months ended October 3, 2010 (not presented in thousands):

	Restricted Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock awards, January 3, 2010	712,227	\$27.68
Granted	241,392	\$35.72
Vested	(257,867)	\$29.23
Forfeited	(48,964)	\$30.27
Unvested restricted stock awards, October 3, 2010	646,788	\$29.87

During the nine months ended October 3, 2010, employees and non-employee directors tendered 78,123 shares of common stock to satisfy tax withholding requirements on the vesting of restricted stock at an average price per share of \$35.20.

401(k) Plan Contribution

During the nine months ended October 3, 2010, we contributed 18,892 shares of our common stock at a cost of approximately \$0.6 million to the CEC Entertainment 401(k) Plan in connection with our annual match of employee contributions for the 2009 plan year.

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

As used in this report, the terms “CEC Entertainment,” “we,” “Company,” “us” and “our” refer to CEC Entertainment, Inc. and its subsidiaries.

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is intended to provide the readers of our financial statements with a narrative from the perspective of our management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Our MD&A should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 “Financial Statements” of this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. Our MD&A is presented in the following sections:

- Executive Summary
- Overview of Operations
- Results of Operations
- Financial Condition, Liquidity and Capital Resources
- Off-Balance Sheet Arrangements and Contractual Obligations
- Critical Accounting Policies and Estimates
- Recently Issued Accounting Guidance

Executive Summary

- Revenues increased 4.7% during the third quarter of 2010 compared to the same period in 2009.
 - Comparable store sales on a fiscal week basis increased 3.9%.
 - Comparable store sales on a same calendar week basis increased 3.8%.
 - Weighted average Company-owned store count increased by approximately four stores.
 - Menu prices increased on average 3.3%.
- Company store operating costs as a percentage of Company store sales decreased 0.3 percentage points during the third quarter of 2010 primarily due to the effect of menu price increases, improved labor utilization and certain cost savings initiatives we implemented during the year. These factors were partially offset by an increase in the price of cheese, increases in our self-insurance costs and a charge incurred to transition to a new soft drink supplier.
- During the third quarter of 2010, we recognized asset impairment charges of \$0.9 million related to three of our stores.
- Diluted earnings per share for the third quarter of 2010 increased 9.1% to \$0.60 compared to \$0.55 in the same period in 2009. Earnings per share benefited from our cumulative repurchase of 3,047,574 shares of our common stock since the beginning of the third quarter of 2009.
- We repurchased approximately 1.0 million shares of our common stock during the third quarter of 2010 at an average price of \$32.03 a share.
- During the third quarter of 2010, we completed 44 capital initiatives, including three major remodels, nine expansions and 32 game enhancements.
 - We acquired two stores from a franchisee during the third quarter of 2010.

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Overview of Operations

We develop, operate and franchise family dining and entertainment centers under the name “Chuck E. Cheese’s®” in 48 states and six foreign countries or territories. Chuck E. Cheese’s stores feature musical and comic entertainment by robotic and animated characters, arcade-style and skill oriented games, video games, rides and other activities intended to appeal to our primary customer

base of families with children between two and 12 years of age. All of our stores offer dining selections consisting of a variety of beverages, pizzas, sandwiches, appetizers, a salad bar, and desserts.

The following table summarizes information regarding the number of Company-owned and franchised stores for the periods presented:

	Three Months Ended		Nine Months Ended	
	October 3,	September	October 3,	September
	2010	27,	2010	27,
		2009		2009
Number of Company-owned stores:				
Beginning of period	498	496	497	495
New	1	-	1	1
Acquired from franchisees	2	-	3	-
Closed	(1)	(1)	(1)	(1)
End of period	500	495	500	495
Number of franchised stores:				
Beginning of period	48	48	48	46
New	-	-	1	2
Acquired by the Company	(2)	-	(3)	-
Closed	-	-	-	-
End of period	46	48	46	48

Comparable store sales. We define comparable store sales as the percentage change in sales for our domestic Company-owned stores that have been open for more than 18 months as of the beginning of each respective fiscal year or 12 months for acquired stores (our “comparable store base”). Relocated stores are excluded from the comparable store base until they are open for more than 18 months as of the beginning of a respective fiscal year. Comparable store sales is a key performance indicator used within our industry and is a critical factor when evaluating our performance as it is indicative of acceptance of our strategic initiatives and local economic and consumer trends.

As a result of the 53 week fiscal year in 2009 (see “–Fiscal Year” below), our 2010 fiscal year began one week later than our 2009 fiscal year. In order to provide useful information to investors to better analyze our business, we have provided below comparable store sales presented on both a fiscal week basis and calendar week basis. Comparable store sales on a fiscal week basis compares the results of our fiscal periods ended October 3, 2010 and September 27, 2009. Comparable store sales for the three months ended October 3, 2010 on a calendar week basis compares the results for the period from July 5, 2010 through October 3, 2010 (weeks 27 through 39 of our 2010 fiscal year) to the results for the period from July 6, 2009 through October 4, 2009 (weeks 28 through 40 of our 2009 fiscal year). Comparable store sales for the nine months ended October 3, 2010 on a calendar week basis compares the results for the period from January 4, 2010 through October 3, 2010 (weeks 1 through 39 of our 2010 fiscal year) to the results for the period from January 5, 2009 through October 4, 2009 (weeks 2 through 40 of our 2009 fiscal year). We believe comparable store sales calculated on a same calendar week basis is more indicative of the health of our

business. However, we also recognize that comparable store sales growth calculated on a fiscal week basis is a useful measure when analyzing year-over-year changes in our financial statements.

Revenues. Our primary source of revenues is from sales at our Company-owned stores (“Company store sales”) and consists of the sale of food, beverages, game-play tokens and merchandise. A portion of Company store sales comes from sales of value-priced combination packages generally comprised of food, beverage and game tokens (“package deals”), which we promote through in-store menu pricing or coupon offerings. Food and beverage sales include all revenue recognized with respect to stand-alone food and beverage sales as well as the portion of revenue that is allocated from package deals. Entertainment and merchandise sales include all revenue recognized with respect to stand-alone game token sales as well as the portion of revenue that is allocated from package deals. This revenue caption also includes sales of merchandise at our stores. We allocate the revenue recognized from the sale of our package deals between “Food and beverage sales” and “Entertainment and merchandise sales” based upon the price charged for each component when it is sold separately, or in limited circumstances our best estimate of selling price if a component is not sold on a stand-alone basis, which we believe approximates each component’s fair value.

Franchise fees and royalties include area development and initial franchise fees received from franchisees to establish new stores and royalties charged to franchisees based on a percentage of a franchised store’s sales.

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Company store operating costs. Certain costs and expenses relate only to the operation of our Company-owned stores and are as follows:

- Cost of food and beverage includes all direct costs of food, beverages and costs of related paper and birthday supplies, less rebates from suppliers;
- Cost of entertainment and merchandise includes all direct costs of prizes provided and merchandise sold to our customers, as well as the cost of tickets dispensed to customers and redeemed for prize items;
- Labor expenses consist of salaries and wages, related payroll taxes and benefits for store personnel;
- Depreciation and amortization expenses that pertain directly to our store assets primarily consisting of leasehold improvements, game and ride equipment, furniture, fixtures and other equipment;
- Rent expense includes lease costs for Company-owned stores, excluding common occupancy costs (e.g. common area maintenance (“CAM”) charges, property taxes, etc.); and
- Other store operating expenses which include utilities, repair costs, liability and property insurance, CAM charges, property taxes, preopening expenses, store asset disposal gains and losses, and all other costs directly related to the operation of a store.

Our “Cost of food and beverage” and “Cost of entertainment and merchandise” mentioned above do not include an allocation of (i) store employee payroll, related taxes and benefit costs and (ii) depreciation and amortization expense associated with Company-store assets. We believe that presenting store-level labor costs and depreciation and amortization expense in the aggregate provides the most informative financial reporting presentation.

Advertising expense. Advertising expense includes production costs for television commercials, newspaper inserts, Internet advertising, coupons and media expenses for national and local advertising, with offsetting contributions from our franchisees.

General and administrative expenses. General and administrative expenses represent all costs associated with our corporate office operations, including regional and district management and corporate personnel payroll and benefits, depreciation and amortization of corporate assets and other administrative costs not directly related to the operation of a store location.

Asset impairments. Asset impairments (if any) represent non-cash charges we record to write down the carrying amount of long-lived assets within stores that are not expected to generate sufficient projected cash flows in order to recover their net book value.

Seasonality

Our operating results fluctuate seasonally due to the timing of school vacations, holidays and changing weather conditions. As a result, we typically generate higher sales volumes during the first and third quarters of each fiscal year. School operating schedules, holidays and weather conditions may affect sales volumes in some operating regions differently than others. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

Fiscal Year

We operate on a 52 or 53 week fiscal year that ends on the Sunday nearest to December 31. Each quarterly period has 13 weeks, except for a 53 week year when the fourth quarter has 14 weeks. Our 2010 fiscal year will consist of 52 weeks and our 2009 fiscal year consisted of 53 weeks.

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Results of Operations

The following table summarizes our principal sources of Company store sales expressed in dollars and as a percentage of total Company store sales for the periods presented:

	Three Months Ended						Nine Months Ended					
	October 3, 2010		September 27, 2009		October 3, 2010		September 27, 2009		October 3, 2010		September 27, 2009	
	(in thousands, except percentages)											
Food and beverage sales	\$99,452	48.2	%	\$95,060	48.3	%	\$309,532	49.0	%	\$314,662	50.1	%
Entertainment and merchandise sales	106,747	51.8	%	101,860	51.7	%	321,996	51.0	%	313,117	49.9	%
Company store sales	\$206,199	100.0	%	\$196,920	100.0	%	\$631,528	100.0	%	\$627,779	100.0	%

The following table summarizes our revenues and expenses expressed in dollars and as a percentage of total revenues (except as otherwise noted) for the periods presented:

	Three Months Ended						Nine Months Ended					
	October 3, 2010		September 27, 2009		October 3, 2010		September 27, 2009		October 3, 2010		September 27, 2009	
	(in thousands, except percentages)											
Company store sales	\$206,199	99.5	%	\$196,920	99.5	%	\$631,528	99.5	%	\$627,779	99.5	%
Franchising activities	945	0.5	%	898	0.5	%	2,929	0.5	%	2,967	0.5	%
Total revenues	207,144	100.0	%	197,818	100.0	%	634,457	100.0	%	630,746	100.0	%
Company store operating costs:												
Cost of food and beverage (1)	22,143	22.3	%	21,868	23.0	%	69,729	22.5	%	69,626	22.1	%
Cost of entertainment and merchandise (2)	8,906	8.3	%	8,947	8.8	%	26,692	8.3	%	28,071	9.0	%
Cost of food, beverage, entertainment and merchandise (3)	31,049	15.1	%	30,815	15.6	%	96,421	15.3	%	97,697	15.6	%
Labor expenses (3)	55,740	27.0	%	54,593	27.7	%	168,112	26.6	%	167,538	26.7	%
Depreciation and amortization (3)	19,903	9.7	%	19,232	9.8	%	59,345	9.4	%	57,186	9.1	%
Rent expense (3)	17,719	8.6	%	17,010	8.6	%	52,645	8.3	%	50,643	8.1	%
Other store operating expenses (3)	36,025	17.5	%	32,226	16.4	%	96,757	15.3	%	92,635	14.8	%
Total Company store operating costs (3)	160,436	77.8	%	153,876	78.1	%	473,280	74.9	%	465,699	74.2	%

Advertising expense	9,870	4.8	%	9,179	4.6	%	27,292	4.3	%	27,860	4.4	%
General and administrative expenses	12,176	5.9	%	11,328	5.7	%	37,297	5.9	%	37,583	6.0	%
Asset impairments	936	0.5	%	-	0.0	%	936	0.1	%	-	0.0	%
Total operating costs and expenses	183,418	88.5	%	174,383	88.2	%	538,805	84.9	%	531,142	84.2	%
Operating income	23,726	11.5	%	23,435	11.8	%	95,652	15.1	%	99,604	15.8	%
Interest expense	2,951	1.4	%	2,769	1.4	%	9,063	1.4	%	8,938	1.4	%
Income before income taxes	\$20,775	10.0	%	\$20,666	10.4	%	\$86,589	13.6	%	\$90,666	14.4	%

- (1) Percent amount expressed as a percentage of food and beverage sales.
(2) Percent amount expressed as a percentage of entertainment and merchandise sales.
(3) Percent amount expressed as a percentage of Company store sales.

Due to rounding, percentages presented in the table above may not add. The percentage amounts for the components of cost of food, beverage, entertainment and merchandise do not sum due to the fact that cost of food and beverage and cost of entertainment and merchandise are expressed as a percentage of related food and beverage and entertainment and merchandise sales, as opposed to total Company store sales.

Three Months Ended October 3, 2010 Compared to Three Months Ended September 27, 2009

Revenues

Company store sales increased 4.7% to \$206.2 million during the third quarter of 2010 compared to \$196.9 million in the third quarter of 2009 primarily due to a 3.9% increase in fiscal week comparable store sales and a weighted average net increase of approximately four Company-owned stores. On a same calendar week basis, which we believe to be more indicative of the health of our business, comparable store sales increased 3.8%. Menu prices increased approximately 3.3% during the third quarter of 2010 as compared to the third quarter of 2009. The current economic environment continues to be challenging, however in addition to menu price increases, we believe our implementation of various strategies including the ongoing capital initiatives at our existing stores, expanded television advertising promoting value to the consumer, and our improved birthday party packages, which have increased our birthday party sales compared to the same period last year, helped us achieve a 3.8% growth in comparable store sales on a same calendar week basis during the third quarter of 2010.

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Company Store Operating Costs

Cost of food and beverage as a percentage of food and beverage sales decreased 0.7 percentage points to 22.3% during the third quarter of 2010 compared to 23.0% in the third quarter of 2009 primarily due to menu price increases and the implementation of certain cost savings initiatives which have resulted in reductions in paper supplies and beverage costs, partially offset by higher cheese prices. During the third quarter of 2010, the average price per pound of cheese increased approximately \$0.38, or 31%, compared to prices paid in the third quarter of 2009.

Cost of entertainment and merchandise as a percentage of entertainment and merchandise sales decreased 0.5 percentage points to 8.3% during the third quarter of 2010 from 8.8% in the third quarter of 2009, primarily due to margin pressure in the third quarter of 2009 associated with incremental prize merchandise awarded to our guests from promotional in-store token distributions which did not occur in 2010, and higher costs incurred in the prior year associated with an attraction that dispensed novelty photo cards.

Labor expenses as a percentage of Company store sales decreased 0.7 percentage points to 27.0% during the third quarter of 2010 compared to 27.7% in the third quarter of 2009 primarily due to improved labor utilization of our hourly labor force during the third quarter of 2010 and leverage obtained from higher sales on the fixed component of our labor costs. Partially offsetting these factors were a 2.0% increase in average hourly wage rates at our stores and higher incentive compensation payable to our store employees primarily due to an increase in our store level financial performance during the third quarter of 2010.

Depreciation and amortization expense related to our stores increased \$0.7 million to \$19.9 million during the third quarter of 2010 compared to \$19.2 million in the third quarter of 2009 primarily due to the ongoing capital investment initiatives occurring at our existing stores and new store development.

Store rent expense increased \$0.7 million to \$17.7 million during the third quarter of 2010 compared to \$17.0 million in the third quarter of 2009 primarily due to an increase in our leased properties resulting from new store development and expansions of existing stores.

Other store operating expenses as a percentage of Company store sales increased 1.1 percentage points to 17.5% during the third quarter of 2010 compared to 16.4% in the third quarter of 2009 primarily due to higher insurance related costs and a charge incurred to transition soft drink suppliers. Insurance related costs were approximately \$0.9 million, or approximately 0.4 percentage points, higher during the third quarter of 2010 compared to the same period in 2009 primarily due to an increase in our self-insurance reserves in the third quarter of 2010 due to the unfavorable development of certain general liability claims. Also during the third quarter of 2010, we incurred a charge of approximately \$0.9 million to transition to a new soft drink supplier.

Advertising Expense

Advertising expense as a percentage of total revenues increased 0.2 percentage points to 4.8% during the third quarter of 2010 from 4.6% in the third quarter of 2009 primarily due to increased expenditures for local television advertising and online media associated with our expanded marketing activities during the third quarter of 2010. These increases were partially offset by the leveraging effect of higher sales during the third quarter of 2010.

General and Administrative Expenses

General and administrative expenses increased \$0.8 million to \$12.2 million during the third quarter of 2010 from \$11.3 million in the third quarter of 2009 primarily due to a favorable \$0.9 million adjustment to a tax penalty reserve recorded in the third quarter of 2009 resulting from the settlement of a federal income tax examination.

Asset Impairments

During the third quarter of 2010, we recognized asset impairment charges of \$0.9 million for three of our stores based on the determination that they had been adversely impacted by various economic factors in the markets in which they are located. Due to a decline in the financial performance of these stores, management determined that the estimated fair value of the stores' long-lived assets (determined from discounted expected operating cash flows of the store over its remaining lease term) had declined below their carrying amount. For additional information about these impairment charges, refer to Note 7 "Asset Impairments" of our unaudited condensed consolidated financial statements included in Part I, Item 1 "Financial Statements" of this Quarterly Report on Form 10-Q.

Interest Expense

Interest expense increased to \$3.0 million during the third quarter of 2010 compared to \$2.8 million in the third quarter of 2009 primarily due to interest charges incurred pursuant to additional tax reserves we had initially established during the second quarter of 2010 in connection with the current Internal Revenue Service ("IRS") examination of prior tax years.

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Income Taxes

Our effective income tax rate was 39.4% and 38.5% during the third quarter of 2010 and 2009, respectively. The increase in our effective tax rate was primarily due to various federal and state tax adjustments recorded during the third quarter of 2010, partially offset by the recognition of certain state enterprise zone tax credits.

Diluted Earnings Per Share

Diluted earnings per share increased to \$0.60 per share for the third quarter of 2010 from \$0.55 per share in the third quarter of 2009 primarily due to a 9.3% decrease in the number of weighted average diluted shares outstanding between the two periods, partially offset by a 1.0% decrease in our net income. The increase in diluted earnings per share between the two periods was impacted by our repurchase of approximately 3.0 million shares of our common stock since the beginning of the third quarter of 2009. We estimate that the decrease in the number of weighted average diluted shares outstanding during the third quarter of 2010 attributable solely to these repurchases benefited our earnings per share in the third quarter of 2010 by approximately \$0.04. Our estimate is based on the weighted average number of shares repurchased since the beginning of the third quarter of 2009 and includes consideration of the estimated additional interest expense attributable to increased borrowings under our revolving credit facility to finance the repurchases. Our computation does not include the effect of share repurchases prior to the third quarter of 2009, or the effect of the issuance of restricted stock or exercise of stock options subsequent to the third quarter of 2009.

Nine Months Ended October 3, 2010 Compared to Nine Months Ended September 27, 2009

Revenues

Company store sales increased 0.6% to \$631.5 million during the first nine months of 2010 compared to \$627.8 million in the first nine months of 2009 primarily due to a weighted average net increase of approximately three Company-owned stores during the first nine months of 2010, partially offset by a comparable store sales decrease on a fiscal week basis of 0.4%. On a same calendar week basis, which we believe to be more indicative of the health of our business, comparable store sales grew 0.8%. The difference between fiscal week and calendar week comparable store sales is primarily attributable to the effect of an additional operating week in our 2009 fiscal year which caused the seasonally strong first week of the 2010 calendar year to shift into the fourth quarter of 2009. Menu prices increased approximately 2.4% during the first nine months of 2010 as compared to the first nine months of 2009.

While we increased our same calendar week comparable store sales during the first nine months of 2010 by 0.8%, we believe this moderate growth reflects the difficult economic environment in which we have operated throughout the year. In addition to menu price increases, we believe our implementation of various strategies including, the ongoing capital initiatives at our existing stores, expanded television advertising promoting value to the consumer and our improved birthday party packages, which have increased our birthday party sales compared to the same period last year, led to the positive growth in our same calendar week comparable store sales for the year.

Our sales for the first nine months of 2010 also includes a \$0.6 million adjustment we recorded in food and beverage sales during the second quarter of 2010 for the initial recognition of breakage income related to unredeemed gift card balances. The recognition of initial breakage income during the first nine months of 2010 is not included in either the fiscal week or calendar week comparable store sales figures. Refer to "Critical Accounting Policies and Estimates" of our MD&A for more information regarding our initial recognition of gift card breakage income.

Our Company store sales mix was 49.0% food and beverage sales and 51.0% entertainment and merchandise sales during the first nine months of 2010 compared to 50.1% and 49.9%, respectively, in the first nine months of 2009. We

believe the sales mix shift from food and beverage to entertainment and merchandise is primarily the result of increased birthday party packages that contained greater components of merchandise and game tokens as compared to the packages offered in the first nine months of 2009, as well as increased token sales in the current year.

Company Store Operating Costs

Cost of food and beverage as a percentage of food and beverage sales increased 0.4 percentage points to 22.5% during the first nine months of 2010 from 22.1% in the first nine months of 2009 primarily due to an increase in cheese prices. During the first nine months of 2010, the average price per pound of cheese increased approximately \$0.29, or 24%, compared to prices paid in the first nine months of 2009. This increase was partially offset by menu price increases and the implementation of certain cost savings initiatives which have resulted in reductions in paper supplies and beverage costs during the first nine months of 2010.

Cost of entertainment and merchandise as a percentage of entertainment and merchandise sales decreased 0.7 percentage points to 8.3% during the first nine months of 2010 from 9.0% in the first nine months of 2009. This decrease is primarily due to margin

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pressure associated with incremental prize merchandise awarded to our guests in the first nine months of 2009 from promotional in-store token distributions which did not occur in 2010, as well as, from the liquidation of certain prize inventory in the first quarter of 2009. Additionally, higher costs were incurred in the first nine months of 2009 associated with an attraction that dispensed novelty photo cards.

Labor expenses as a percentage of Company store sales decreased 0.1 percentage point to 26.6% during the first nine months of 2010 compared to 26.7% in the first nine months of 2009 primarily due to improved labor utilization of our hourly labor force during the first nine months of 2010 and leverage obtained from higher sales on the fixed component of our labor costs. Partially offsetting these factors were a 3.1% increase in average hourly wage rates at our stores, higher incentive compensation payable to our store employees primarily due to an increase in our store level financial performance during 2010 and increased unemployment taxes and other benefits.

Depreciation and amortization expense related to our stores increased \$2.2 million to \$59.3 million during the first nine months of 2010 compared to \$57.2 million in the first nine months of 2009 primarily due to the ongoing capital investment initiatives occurring at our existing stores and new store development.

Store rent expense increased \$2.0 million to \$52.6 million during the first nine months of 2010 compared to \$50.6 million in the first nine months of 2009 primarily due to an increase in our leased properties resulting from new store development and expansions of existing stores.

Other store operating expenses as a percentage of Company store sales increased 0.5 percentage points to 15.3% during the first nine months of 2010 compared to 14.8% in the first nine months of 2009 primarily due to higher insurance related costs and a charge incurred to transition soft drink suppliers. Insurance related costs were approximately \$2.0 million, or 0.3 percentage points, higher during the first nine months of 2010 compared to the same period in 2009 primarily due to the unfavorable development of certain general liability claims. Additionally, during the third quarter of 2010, we incurred a charge of approximately \$0.9 million to transition to a new soft drink supplier.

Advertising Expense

Advertising expense as a percentage of total revenues decreased 0.1 percentage points to 4.3% during the first nine months of 2010 from 4.4% in the first nine months of 2009 primarily due to lower television media costs compared to the same period last year and reductions in certain media expenditures during the first nine months of 2010. These decreases were partially offset by additional local television advertising during the first nine months of 2010.

General and Administrative Expenses

General and administrative expenses decreased \$0.3 million to \$37.3 million during the first nine months of 2010 from \$37.6 million in the first nine months of 2009 primarily due to the effect of a net reduction in various corporate office overhead costs during the first nine months of 2010 as compared to the same period in 2009, partially offset by a favorable \$0.9 million adjustment to a tax penalty reserve we recorded during the third quarter of 2009 resulting from the settlement of a federal income tax examination.

Asset Impairments

During the third quarter of 2010, we recognized asset impairment charges of \$0.9 million for three of our stores based on the determination that they had been adversely impacted by various economic factors in the markets in which they are located. Due to a decline in the financial performance of these stores, management determined that the estimated fair value of the stores' long-lived assets (determined from discounted expected operating cash flows of the store over

its remaining lease term) had declined below their carrying amount. For additional information about these impairment charges, refer to Note 7 "Asset Impairments" of our unaudited condensed consolidated financial statements included in Part I, Item 1 "Financial Statements" of this Quarterly Report on Form 10-Q.

Interest Expense

Interest expense increased to \$9.1 million during the first nine months of 2010 compared to \$8.9 million in the first nine months of 2009 due to interest charges incurred pursuant to additional tax reserves established in connection with the current IRS examination of prior tax years in excess of amounts recognized in the first nine months of 2009. This increase was partially offset by a decrease in interest expense incurred on our revolving credit facility which was primarily attributable to a decrease in the average debt balance outstanding between the two periods. During the first nine months of 2010, the average debt balance outstanding under our revolving credit facility was \$325.2 million compared to \$347.5 million during the first nine months of 2009.

Income Taxes

Our effective income tax rate increased to 40.8% during the first nine months of 2010 compared to 38.5% for the first nine months of 2009, primarily due to unfavorable discrete adjustments of approximately \$2.4 million we recorded

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to income tax expense during the second quarter of 2010 in connection with the current IRS examination of our 2006 and 2007 tax years.

Diluted Earnings Per Share

Diluted earnings per share decreased to \$2.38 per share for the first nine months of 2010 from \$2.42 per share in the first nine months of 2009 primarily due to a 8.1% decrease in our net income, partially offset by a 6.7% decrease in the number of weighted average diluted shares outstanding between the two periods. The decrease in diluted earnings per share between the two periods was impacted by our repurchase of approximately 3.7 million shares of our common stock since the beginning of the first quarter of 2009. We estimate that the decrease in the number of weighted average diluted shares outstanding during the first nine months of 2010 attributable solely to these repurchases benefited our earnings per share in the first nine months of 2010 by approximately \$0.16. Our estimate is based on the weighted average number of shares repurchased since the beginning of the first quarter of 2009 and includes consideration of the estimated additional interest expense attributable to increased borrowings under our revolving credit facility to finance the repurchases. Our computation does not include the effect of share repurchases prior to the 2009 fiscal year, or the effect of the issuance of restricted stock or exercise of stock options subsequent to the beginning of the first quarter of 2009.

Financial Condition, Liquidity and Capital Resources

Overview of Liquidity

Funds generated by our operating activities, available cash and cash equivalents, and our revolving credit facility continue to be our most significant sources of liquidity. We believe funds generated from our expected results of operations and available cash and cash equivalents will be sufficient to finance our business development strategies and capital initiatives for the next year. Our revolving credit facility is also available for additional working capital needs and investment opportunities. However, in the event of a material decline in our sales trends, there can be no assurance that we will generate cash flows at or above our current levels.

Our primary requirements for cash provided by operating activities relate to planned capital expenditures and servicing our debt. We may also use cash from operations to make repurchases of our common stock.

Our customers pay for their purchases in cash or credit cards at the time of the sale. Rapid inventory turnover results in limited investment in inventories, and cash from sales is usually received before related accounts payable for food, supplies and payroll become due. As a result, we are able to frequently operate with a working capital deficit, and we can do so without incurring significant short-term or long-term borrowings.

We do not enter into any material development or contractual purchase obligations in connection with our business development strategy. As a result, with respect to our planned capital expenditures, including spending that pertains to our new store development and capital initiatives, we believe that we have the flexibility necessary to manage our liquidity by promptly deferring or curtailing our capital spending.

The following tables present summarized financial information that we believe is helpful in evaluating our liquidity and capital resources:

Nine Months Ended	
	September
October 3,	27,
2010	2009

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(in thousands)

Net cash provided by operating activities	\$137,790	\$127,431
Net cash used for investing activities	(73,136)	(51,048)
Net cash used for financing activities	(63,296)	(77,468)
Effect of foreign exchange rate changes on cash	14	(645)
Change in cash and cash equivalents	\$1,372	\$(1,730)

Interest paid	\$8,128	\$9,231
Income taxes paid, net	\$31,851	\$18,845

October 3, January 3,
2010 2010
(in thousands)

Cash and cash equivalents	\$18,733	\$17,361
Revolving credit facility borrowings	\$356,500	\$354,300
Available unused commitments under revolving credit facility	\$182,841	\$185,743

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Cash Flows – Operating Activities

Net cash provided by operating activities increased \$10.4 million to \$137.8 million during the first nine months of 2010 from \$127.4 million in the first nine months of 2009. The increase was primarily attributable to the increase in our Company store sales, the receipt of a \$1.8 million franchise development fee during the first quarter of 2010 and a \$1.1 million increase in the amount of vendor rebates received during the first nine months of 2010 compared to the same period in 2009.

Our cash interest payments decreased \$1.1 million to \$8.1 million during the first nine months of 2010 from \$9.2 million in the first nine months of 2009 primarily due to a reduction in the average debt balance outstanding under our revolving credit facility between the two periods.

Our cash payments for income taxes, net of refunds received, increased \$13.0 million to \$31.9 million during the first nine months of 2010 from \$18.8 million in the first nine months of 2009 primarily due to the non recurrence of a \$5.5 million refund of excess federal income taxes we received in the first quarter of 2009, combined with increases in our current year federal estimated and state tax payments during the first nine months of 2010. Also, during the third quarter of 2010, we paid \$0.6 million in connection with the settlement of a state tax audit.

Cash Flows – Investing Activities

Net cash used in investing activities increased \$22.1 million to \$73.1 million during the first nine months of 2010 from \$51.0 million in the first nine months of 2009, primarily due to an increase in the number of capital spending initiatives for our existing stores which affected 157 stores during the first nine months of 2010 compared to 107 stores during the same period in 2009 and cash payments associated with our acquisition of former franchised store locations during the first nine months of 2010.

The following table summarizes information regarding the number of capital spending initiatives we completed during each of the periods presented:

	Nine Months Ended	
	October 3,	September
	2010	2009
Existing Company-owned store initiatives:		
Major remodels	9	6
Store expansions	19	15
Game enhancements	129	86
Total completed	157	107
Company-owned stores added (1)	4	1

(1) Company-owned stores added during the nine months ended October 3, 2010 include three stores we acquired from franchisees.

Cash Flows – Financing Activities

Net cash used in financing activities decreased \$14.2 million to \$63.3 million during the first nine months of 2010 from \$77.5 million in the first nine months of 2009 primarily due to a reduction in our net repayments on our

revolving credit facility during the first nine months of 2010, partially offset by an increase in our share repurchase activity and a decrease in proceeds obtained through the exercise of employee stock options. During the first nine months of 2010, we increased the outstanding borrowings under our revolving credit facility by \$2.2 million, compared to the same period in 2009 when we made repayments of \$62.3 million. This increase in borrowings was primarily related to our share repurchases during 2010. During the first nine months of 2010, our repurchases of our common stock increased \$33.9 million to \$67.4 million compared to \$33.6 million during the same period last year. Also, during the first nine months of 2010, cash proceeds received through the exercise of employee stock options decreased \$13.5 million compared to the same period in 2009 due to a decline in the number of exercisable awards outstanding.

Sources of Liquidity

We currently finance our business activities through cash flows provided by our operations and, as necessary, from borrowings under our revolving credit facility.

Our requirement for working capital is not significant since our customers pay for their purchases in cash or credit cards at the time of the sale, enabling us to monetize many of our inventory items before we have to pay suppliers for such items. We attempt to maintain only sufficient inventory of supplies in our stores to satisfy current operational needs. Since our accounts payable are generally due in five to 30 days, we are able to operate with a net working capital deficit (current liabilities in excess of current assets). Our net working capital deficit increased to \$18.3 million at October 3, 2010 from \$1.0 million at January 3, 2010 primarily

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due to variations in the timing and amount of payments for accounts payable, income taxes and vendor rebate collection, combined with an increase in our accrued expenses attributed to an unfavorable adjustment to our income tax liability during the second quarter of 2010.

Our ability to access our revolving credit facility is subject to our compliance with the terms and conditions of the credit facility agreement, including our maintenance of certain prescribed financial ratio covenants, as more fully described below.

Debt Financing

We have a revolving credit facility providing for total borrowings of up to \$550.0 million. The credit facility, which matures in October 2012, also includes an accordion feature allowing us, subject to lender approval, to request an additional \$50.0 million in borrowings at any time. As of October 3, 2010, there were \$356.5 million of borrowings outstanding and \$10.7 million of letters of credit issued but undrawn under the credit facility. Based on the type of borrowing, the credit facility bears interest the London Interbank Offered Rate (“LIBOR”) plus an applicable margin of 0.625% to 1.25% determined based on our financial performance and debt levels, or alternatively, the higher of (a) the prime rate or (b) the Federal Funds rate plus 0.50%. As of October 3, 2010, borrowings under the credit facility incurred interest at LIBOR (ranging from 0.26% - 0.31%) plus 1.00% or prime (3.25%). A commitment fee of 0.1% to 0.3%, depending on our financial performance and debt levels, is payable on a quarterly basis on any unused credit line. All borrowings under the credit facility are unsecured, but we have agreed not to pledge any of our existing assets to secure future indebtedness.

During the first nine months of 2010, we increased the outstanding debt balance under our revolving credit facility by \$2.2 million to \$356.5 million from \$354.3 million as of January 3, 2010. Including the effect of our interest rate swap contract, the weighted average effective interest rate incurred on borrowings under our revolving credit facility was 2.9% for the three months ended October 3, 2010 and September 27, 2009, and was 3.0% and 2.9% for the nine months ended October 3, 2010 and September 27, 2009, respectively.

Our revolving credit facility agreement contains a number of covenants that, among other things, require us to comply with the following financial ratios as of the end of any fiscal quarter:

- a consolidated fixed charge coverage ratio of not less than 1.5 to 1.0, based upon the ratio of (a) consolidated EBITR (as defined in the revolving credit facility agreement) for the last four fiscal quarters to (b) the sum of consolidated interest charges plus consolidated rent expense during such period.
- a consolidated leverage ratio of not greater than 3.0 to 1.0, based upon the ratio of (a) the quarter-end consolidated funded indebtedness (as defined in the revolving credit facility agreement) to (b) consolidated EBITDA (as defined in the revolving credit facility agreement) for the last four fiscal quarters.

Our revolving credit facility is the primary source of committed funding from which we finance our planned capital expenditures, strategic initiatives, such as repurchases of our common stock, and certain working capital needs. Non-compliance with the financial covenant ratios could prevent us from being able to access further borrowings under our revolving credit facility, require us to immediately repay all amounts outstanding under the revolving credit facility, and increase our cost of borrowing. As of October 3, 2010, we were in compliance with these covenant ratios, with a consolidated fixed charge coverage ratio of 2.29 to 1 and a consolidated leverage ratio of 1.92 to 1.

Interest Rate Swap

We have entered into an interest rate swap contract to effectively convert \$150.0 million of our variable rate revolving credit facility debt to a fixed interest rate. The contract, which matures in May 2011, requires us to pay a fixed rate of 3.62% while receiving variable payments from the counterparty at the three-month LIBOR rate. Including the 1.00 percentage point applicable margin incurred on our revolving credit facility, the effective interest rate of the swap contract was 4.62% as of October 3, 2010. The differential amounts receivable or payable under the swap contract are recorded over the life of the contract as adjustments to interest expense.

As of October 3, 2010, the estimated fair value of the swap contract was a liability of approximately \$3.2 million. Refer to Note 4 "Derivative Instrument" of our condensed consolidated financial statements for a more complete discussion of our interest rate swap contract.

Capital Expenditures

Our future capital expenditures are expected to be primarily for reinvestment into our existing Company-owned store base through various capital initiatives and the development or acquisition of additional Company stores. We estimate capital expenditures in 2010 will total approximately \$103.0 million to \$105.0 million, including approximately \$64.0 million related to

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capital initiatives for our existing stores, approximately \$23.0 million to \$25.0 million related to new store development and the acquisition of franchise stores, and the remainder for other store initiatives, general store requirements and corporate capital expenditures. We plan to fund these capital expenditures through cash flow from operations and, if necessary, borrowings under our revolving credit facility.

The following tables summarize information regarding the expected number of and estimated average cost for our projected capital expenditures activities during each of the periods presented:

	Completed Through Third Quarter 2010	Projection for Remainder of Fiscal Year 2010	Projected Completions Fiscal Year 2010	Estimated Average Cost Per Project (in millions)
Investment in existing Company-owned stores:				
Major remodels	9	6	15	\$0.6
Store expansions	19	10	29	\$1.0
Game enhancements	129	67	196	\$0.2
Total	157	83	240	
New Company store development and franchise store acquisitions				
	4	6 to 8	10 to 12	2.1 to \$2.2
		Projected Completions Fiscal Year 2010	Actual Completions Fiscal Year 2009	Increase Over Prior Fiscal Year
Investment in existing Company-owned stores:				
Major remodels		15	9	6
Store expansions		29	26	3
Game enhancements		196	125	71
Total		240	160	80
New Company store development and franchise store acquisitions				
		10 to 12	3	7 to 9

Investment in Existing Company-owned Stores. We believe that in order to maintain consumer demand for and the appeal of our concept, we must continually reinvest in our existing Company-owned stores. For our existing stores, we currently utilize the following capital initiatives: (a) major remodels, (b) store expansions, and (c) game enhancements. We believe these capital initiatives are essential to preserving our existing sales and cash flows and provide a solid foundation for long term revenue growth.

Major remodels. We undertake periodic major remodels when there is a need to improve the overall appearance of a store or when we introduce concept changes or enhancements to our stores. A major remodel initiative typically includes interior design modifications that allow us to more effectively utilize space allocated to the playroom area of

the store, increasing the number of games and rides, and developing a new exterior and interior identity.

Store expansions. We believe store expansions improve the quality of our guests' experience because the additional square footage allows us to increase the number and variety of games, rides and other entertainment offerings in our stores. In addition to expanding the square footage of a store, store expansions typically include all components of a major remodel and generally result in an increase in the store's seat count. We consider our investments in store expansions to generally be discretionary in nature. In undertaking store expansions, our objective is to improve the appeal of our stores and to respond to sales growth opportunities as they arise.

Game enhancements. We believe game enhancements are necessary to maintain the relevance and appeal of our games and rides. In addition, game enhancements counteract general wear and tear on the equipment and incorporate improvements in game and ride technology.

Since the lifecycles of our store format and our games are largely driven by changes in consumer behaviors and preferences, we believe that our capital initiatives involving major remodels and game enhancements are required in order to keep pace with consumer entertainment expectations. As a result, we view our major remodel and game enhancement initiatives as a means to maintaining and protecting our existing sales and cash flows. While we are hopeful that our major remodels and game enhancements will contribute to incremental sales growth, we believe that our capital spending with respect to expansions of existing stores will more directly lead to growth in our comparable store sales and cash flow. We typically invest in expansions when we believe there is a potential for sales

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growth and, in some instances, in order to maintain sales in stores that compete with other large-box competitors. We believe that expanding the square footage and entertainment space of a store increases our guest traffic and enhances the overall customer experience, which we believe will contribute to the growth of our long-term comparable store sales. The objective of an expansion or remodel that increases space available for entertainment is not intended to exclusively improve our entertainment sales, but rather is focused on impacting overall Company store sales through increased guest traffic and satisfaction.

New Company store development. Our plan for new store development is typically focused on opening high sales volume stores in densely populated areas and during fiscal 2010 includes our acquisition of certain existing franchise locations. We expect the cost of opening new stores will vary depending upon many factors including the size of the store, whether we acquire land and whether the store is located in an in-line or freestanding building. During fiscal 2010, we estimate that we will add 10 to 12 Company-owned stores including one relocated store and three to five stores acquired from our franchisees.

Share Repurchases

Our Board of Directors (the “Board”) has approved a program for us to repurchase shares of our common stock. On July 25, 2005, the Board approved a stock repurchase program which authorized us to repurchase from time to time up to \$400 million of our common stock and on October 22, 2007 and October 27, 2009 authorized \$200 million increases each. During the nine months ended October 3, 2010, we repurchased 1,917,485 shares of our common stock at an aggregate purchase price of approximately \$67.4 million, and as of October 3, 2010, approximately \$151.3 million remained available for share repurchases under our repurchase authorization.

The share repurchase authorization approved by the Board does not have an expiration date and the pace of our repurchase activity will depend on factors such as our working capital needs, our debt repayment obligations, our stock price, and economic and market conditions. Our share repurchases may be effected from time to time through open market purchases, accelerated share repurchases or in privately negotiated transactions. Our share repurchase program may be accelerated, suspended, delayed or discontinued at any time.

Off-Balance Sheet Arrangements and Contractual Obligations

As of October 3, 2010, we had no off-balance sheet financing arrangements as described in Regulation S-K Item 303(a)(4)(ii) and we believe there has been no material change in our contractual obligations since the end of fiscal year 2009.

For information regarding our contractual obligations, refer to “Off Balance Sheet Arrangements and Contractual Obligations” in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements are prepared in accordance with GAAP which requires us to make estimates and assumptions that affect the reported values of assets and liabilities at the date of the financial statements, the reported amount of revenues and expenses during the reporting period, and the related disclosures of contingent assets and liabilities. The use of estimates is pervasive throughout our financial statements and is affected by management judgment and uncertainties. Our estimates, assumptions and judgments are based on historical experience, current market trends and other factors that we believe to be relevant and reasonable at the time the consolidated financial statements are prepared. We continually evaluate the information used to make these estimates as our business and the economic environment change. Actual results may differ materially from these estimates under

different assumptions or conditions. Results of operations of interim periods are not necessarily indicative of results for the full year.

Information with respect to our critical accounting policies and estimates which we believe could have the most significant effect on our reported results and require difficult, subjective or complex judgment by management are described under “Critical Accounting Policies and Estimates” in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. We believe that as of October 3, 2010 there has been no material change to the information concerning our critical accounting policies and estimates, with the exception of our estimate for gift card breakage discussed below.

We sell gift cards to our customers in our stores and through certain third party distributors which do not expire or incur a service fee on unused balances. Gift card sales are recorded as an unearned gift card revenue liability when sold and are recognized as revenue when: (i) the gift card is redeemed by the customer, or (ii) the likelihood of the gift card being redeemed by the customer is remote (“gift card breakage”) and we determine that we do not have a legal obligation to remit the value of the unredeemed gift card under applicable state unclaimed property escheat statutes. Gift card breakage is determined based upon historical redemption patterns of our gift cards. During the second quarter of 2010, we concluded that we had sufficient historical transaction data to estimate breakage for gift cards we have been selling in our stores and through certain third-party distributors, and based on our analysis we

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recorded a cumulative gift card breakage adjustment of \$0.6 million. Breakage income from gift cards is included in “Food and beverage sales.”

Recently Issued Accounting Guidance

Refer to Note 1 “Basis of Presentation and Recently Issued Accounting Guidance” of our unaudited condensed consolidated financial statements included in Part I, Item 1 “Financial Statements” of this Quarterly Report on Form 10-Q for a description of the recently issued accounting guidance that we have not yet adopted, including a discussion of our expected date of adoption and anticipated effects on our results of operations and financial position and the new accounting guidance we have recently adopted.

Cautionary Note Regarding Forward-Looking Statements

Certain statements in this report, other than historical information, may be considered “forward-looking statements” within the meaning of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, and are subject to various risks, uncertainties and assumptions. Statements that are not historical in nature, and which may be identified by the use of words such as “may,” “should,” “could,” “believe,” “predict,” “potential,” “continue,” “plan,” “intend,” “anticipate,” “future,” “project,” “estimate” and similar expressions (or the negative of such expressions) are forward-looking statements. Forward-looking statements are made based on management’s current expectations and beliefs concerning future events and, therefore, involve a number of assumptions, risks and uncertainties, including the risk factors described in Item 1A “Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ from those anticipated, estimated or expected. Factors that could cause actual results to differ materially from those contemplated by forward-looking statements include, but are not limited to:

- Changes in consumer discretionary spending and general economic conditions;
- Disruptions in the financial markets affecting the availability and cost of credit and our ability to maintain adequate insurance coverage;
- Our ability to successfully implement our business development strategies;
- Costs incurred in connection with our business development strategies;
- Competition in both the restaurant and entertainment industries;
- Loss of certain key personnel;
- Increases in food, labor and other operating costs;
- Changes in consumers’ health, nutrition and dietary preferences;
- Negative publicity concerning food quality, health, safety and other issues;
- Continued existence or occurrence of certain public health issues;
- Disruption of our commodity distribution system;
- Our dependence on a few global providers for the procurement of games and rides;

- Adverse affects of local conditions, events and natural disasters;
- Fluctuations in our quarterly results of operations due to seasonality;
- Conditions in foreign markets;
- Risks in connection with owning and leasing real estate;
- Our ability to adequately protect our trademarks or other proprietary rights;
- Government regulations, litigation, product liability claims and product recalls;
- Disruptions of our information technology systems;
- Application of and changes in generally accepted accounting principles; and
- Failure to establish, maintain and apply adequate internal control over financial reporting.

The forward-looking statements made in this report relate only to events as of the date on which the statements were made. Except as may be required by law, we undertake no obligation to update our forward-looking statements to reflect events and circumstances after the date on which the statements were made or to reflect the occurrence of unanticipated events.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate and commodity price changes and foreign currency fluctuation.

Interest Rate Risk

We are exposed to market risk from changes in the variable interest rates (primarily LIBOR) incurred on our revolving line of credit, which at October 3, 2010 had borrowings outstanding of \$356.5 million. We have entered into an interest rate swap contract which effectively fixes the LIBOR component of our interest rate to a fixed rate of 3.62% on \$150.0 million of our borrowings, leaving us with \$206.5 million of variable rate debt as of October 3, 2010. After giving effect to the interest rate swap, a 100 basis point increase in the variable interest rates on our revolving line of credit at October 3, 2010, assuming no change in our outstanding debt balance, would increase our annual interest expense by approximately \$2.1 million.

Commodity Price Risk

Commodity prices of certain food products that we purchase, primarily cheese and dough, vary throughout the year due to changes in demand, supply and other factors. We currently have not entered into any hedging arrangements to reduce the volatility of the commodity prices from period to period. The estimated increase in our food costs from a hypothetical 10 percent increase in the average cheese block price per pound (approximately \$0.15 as of October 3, 2010) would have been approximately \$0.8 million for the first nine months of 2010. The estimated increase in our food costs from a hypothetical 10 percent increase in the average dough price per pound (approximately \$0.04 as of October 3, 2010) would have been approximately \$0.4 million for the first nine months of 2010.

Foreign Currency Risk

As of October 3, 2010, we operated a total of 14 Company-owned stores in Canada. As a result, we have market risk associated with changes in the value of the Canadian dollar. These changes result in cumulative translation adjustments, which are included in "Accumulated other comprehensive income", and potentially result in transaction gains or losses, which are included in our earnings. During the first nine months of 2010, our Canada stores represented approximately 0.6% of our operating income. A hypothetical 10 percent devaluation in the average quoted U.S. dollar-equivalent of the Canadian dollar exchange rate during the first nine months of 2010 would have reduced our reported operating income by less than \$0.1 million.

ITEM 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, has concluded that our disclosure controls and procedures were effective as of October 3, 2010 to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, was (1) recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the quarterly period covered by this report there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1. Legal Proceedings.

From time to time, we are involved in various inquiries, investigations, claims, lawsuits, and other legal proceedings that are incidental to the conduct of our business. These matters typically involve claims from customers, employees or other third parties involved in operational issues common to the retail, restaurant and entertainment industries. Such matters typically represent actions with respect to contracts, intellectual property, taxation, employment, employee benefits, personal injuries and other matters. A number of such claims may exist at any given time and there are currently a number of claims and legal proceedings pending against us.

In the opinion of our management, after consultation with legal counsel, the amount of ultimate liability with respect to claims or proceedings currently pending against us is not expected to have a material adverse effect on our financial condition, results of operations or cash flows.

ITEM 1A. Risk Factors.

We believe there have been no material changes in our risk factors from those disclosed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended January 3, 2010. The risks set forth in those risk factors are not the only risks we face in conducting our business. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table presents information related to repurchases of our common stock during the third quarter of 2010 and the maximum dollar value of shares that may yet be purchased pursuant to our share repurchase program:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased(1)	Average Price Paid Per Share(1)	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs(2)
July 5 - August 1, 2010	396	\$35.73	-	\$183,204,441
August 2 - August 29, 2010	633,407	\$31.63	633,391	\$163,168,688
August 30 - October 3, 2010	362,105	\$32.73	362,105	\$151,318,128
Total	995,908	\$32.03	995,496	\$151,318,128

(1) For the periods ended August 1 and August 29, 2010, the total number of shares purchased included 396 shares and 16 shares, respectively, tendered by employees and non-employee directors at an average price per share of \$35.73 and \$35.25, respectively, to satisfy tax withholding requirements on the vesting of restricted stock awards, which are not deducted from shares available to be purchased

under our share repurchase program. Shares tendered by employees and non-employee directors to satisfy tax withholding requirements were considered purchased at the closing price of our common stock on the date of vesting.

We may repurchase shares of our common stock under a plan authorized by our Board of Directors (the "Board"). On July 25, 2005, the Board approved a stock repurchase program which authorized us to repurchase from time to time up to \$400 million of our common stock and on October 22, 2007 and October 27, 2009 authorized \$200 million increases each. The stock repurchase program, which does not have a stated expiration date, authorizes us to make repurchases in the open market, through (2) accelerated share repurchases or in privately negotiated transactions.

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ITEM 6. Exhibits.

EXHIBIT INDEX

Exhibit Number	Description
3.1	Second Restated Articles of Incorporation of CEC Entertainment, Inc. (the “Company”) dated May 4, 2010 (incorporated by reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K (File No. 001-13687) as filed with the Securities and Exchange Commission (the “Commission”) on May 6, 2010)
3.2	Amended and Restated Bylaws of the Company dated May 4, 2010 (incorporated by reference to Exhibit 3.2 to the Company’s Current Report on Form 8-K (File No. 001-13687) as filed with the Commission on May 6, 2010)
4.1	Specimen form of Certificate representing \$.10 par value Common Stock (incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 10-Q (File No. 001-13687) as filed with the Commission on October 29, 2009)
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS †	XBRL Instance Document
101.SCH †	XBRL Taxonomy Extension Schema Document
101.CAL †	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF †	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB †	XBRL Taxonomy Extension Label Linkbase Document
101.PRE †	XBRL Taxonomy Extension Presentation Linkbase Document

- * Filed herewith.
- ** Furnished herewith.
- § Management contract or compensatory plan, contract or arrangement.
- † Pursuant to Item 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CEC ENTERTAINMENT, INC.

November 4, 2010	By: /s/ Michael H. Magusiak Michael H. Magusiak President and Chief Executive Officer (Principal Executive Officer)
November 4, 2010	/s/ Tiffany B. Kice Tiffany B. Kice Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer)
November 4, 2010	/s/ Darin E. Harper Darin E. Harper Vice President, Controller (Principal Accounting Officer)

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