BRINKER INTERNATIONAL INC
Form 10-Q
February 02, 2015
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 December 24, 2014
Commission File Number 1-10275

BRINKER INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	75-1914582 (I.R.S. Employer Identification No.)
6820 LBJ FREEWAY, DALLAS, TEXAS (Address of principal executive offices)	75240 (Zip Code)

(972) 980-9917
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
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 x No o
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 definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x		Accelerated filer	o
Non-accelerated filer	o	(Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class	Outstanding at January 26, 2015
Common Stock, $0.10 par value	63,118,600 shares

Table of Contents

BRINKER INTERNATIONAL, INC.
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
BRINKER INTERNATIONAL, INC.
Consolidated Balance Sheets
(In thousands, except share and per share amounts)
(Unaudited)

	December 24, 2014	June 25, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$78,409	$57,685
Accounts receivable	100,501	47,850
Inventories	25,158	23,643
Prepaid expenses and other	64,103	65,506
Deferred income taxes	17,282	16,170
Total current assets	285,453	210,854
Property and Equipment, at Cost:		
Land	148,054	149,184
Buildings and leasehold improvements	1,522,354	1,483,894
Furniture and equipment	604,192	593,344
Construction-in-progress	14,558	32,844
	2,289,158	2,259,266
Less accumulated depreciation and amortization	(1,243,711)	(1,202,812)
Net property and equipment	1,045,447	1,056,454
Other Assets:		
Goodwill	132,823	133,434
Deferred income taxes	32,947	30,090
Intangibles, net	17,587	18,841
Other	35,574	40,931
Total other assets	218,931	223,296
Total assets	$1,549,831	$1,490,604
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Current installments of long-term debt	$28,036	$27,884
Accounts payable	77,561	102,931
Accrued liabilities	397,551	328,017
Income taxes payable	7,961	7,278
Total current liabilities	511,109	466,110
Long-term debt, less current installments	901,241	832,302
Other liabilities	132,540	129,098
Commitments and Contingencies (Note 9)		
Shareholders' Equity:		
Common stock—250,000,000 authorized shares; $0.10 par value; 176,246,649 shares issued and 63,194,877 shares outstanding at December 24, 2014, and 176,246,649 shares issued and 64,558,909 shares outstanding at June 25, 2014	17,625	17,625
Additional paid-in capital	480,625	484,320
Accumulated other comprehensive loss	(5,276)	(940)
Retained earnings	2,344,026	2,306,532
	2,837,000	2,807,537

Less treasury stock, at cost (113,051,772 shares at December 24, 2014 and 111,687,740 shares at June 25, 2014)	(2,832,059)	(2,744,443)
Total shareholders' equity	4,941	63,094
Total liabilities and shareholders' equity	$1,549,831	$1,490,604

See accompanying notes to consolidated financial statements.

3

Table of Contents

BRINKER INTERNATIONAL, INC.
Consolidated Statements of Comprehensive Income
(In thousands, except per share amounts)
(Unaudited)

	Thirteen Week Periods Ended		Twenty-Six Week Periods Ended	
	December 24, 2014	December 25, 2013	December 24, 2014	December 25, 2013
Revenues:				
Company sales	$717,768	$684,385	$1,404,632	$1,348,887
Franchise and other revenues	25,130	21,277	49,284	41,435
Total revenues	742,898	705,662	1,453,916	1,390,322
Operating costs and expenses:				
Company restaurants (excluding depreciation and amortization)				
Cost of sales	193,762	185,179	378,547	365,837
Restaurant labor	227,733	219,919	455,009	438,635
Restaurant expenses	178,898	171,144	354,436	338,834
Company restaurant expenses	600,393	576,242	1,187,992	1,143,306
Depreciation and amortization	36,072	33,538	71,614	66,694
General and administrative	32,660	30,362	65,294	64,783
Other gains and charges	8,291	1,221	9,224	2,227
Total operating costs and expenses	677,416	641,363	1,334,124	1,277,010
Operating income	65,482	64,299	119,792	113,312
Interest expense	7,349	7,047	14,348	14,060
Other, net	(611)	(461)	(1,114)	(1,043)
Income before provision for income taxes	58,744	57,713	106,558	100,295
Provision for income taxes	17,438	17,969	32,514	31,339
Net income	$41,306	$39,744	$74,044	$68,956
Basic net income per share	$0.65	$0.59	$1.15	$1.03
Diluted net income per share	$0.64	$0.58	$1.13	$1.00
Basic weighted average shares outstanding	63,590	66,811	64,129	66,752
Diluted weighted average shares outstanding	64,963	68,628	65,613	68,715
Other comprehensive loss:				
Foreign currency translation adjustment	$(3,529)	$(819)	$(4,336)	$(754)
Other comprehensive loss	(3,529)	(819)	(4,336)	(754)
Comprehensive income	$37,777	$38,925	$69,708	$68,202
Dividends per share	$0.28	$0.24	$0.56	$0.48

See accompanying notes to consolidated financial statements.

Table of Contents

BRINKER INTERNATIONAL, INC.
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Twenty-Six Week Periods Ended	
	December 24, 2014	December 25, 2013
Cash Flows from Operating Activities:		
Net income	$74,044	$68,956
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	71,614	66,694
Stock-based compensation	6,992	8,196
Deferred income taxes	(3,969)	2,318
Restructure charges and other impairments	8,326	2,091
Net loss on disposal of assets	2,974	2,051
Gain on equity investments	(188)	(206)
Other	418	331
Changes in assets and liabilities:		
Accounts receivable	(49,665)	(49,444)
Inventories	(1,564)	185
Prepaid expenses and other	2,495	3,617
Intangibles and other assets	(2,018)	(1,708)
Accounts payable	(12,107)	(10,512)
Accrued liabilities	60,569	51,071
Current income taxes	(2,286)	5,285
Other liabilities	6,830	(1,604)
Net cash provided by operating activities	162,465	147,321
Cash Flows from Investing Activities:		
Payments for property and equipment	(79,481)	(69,692)
Proceeds from sale of assets	1,950	833
Net cash used in investing activities	(77,531)	(68,859)
Cash Flows from Financing Activities:		
Purchases of treasury stock	(112,789)	(93,101)
Borrowings on revolving credit facility	83,000	80,000
Payments of dividends	(35,409)	(31,345)
Excess tax benefits from stock-based compensation	10,351	14,569
Payments on long-term debt	(13,338)	(13,260)
Proceeds from issuances of treasury stock	3,975	7,963
Payments on revolving credit facility	0	(40,000)
Net cash used in financing activities	(64,210)	(75,174)
Net change in cash and cash equivalents	20,724	3,288
Cash and cash equivalents at beginning of period	57,685	59,367
Cash and cash equivalents at end of period	$78,409	$62,655

See accompanying notes to consolidated financial statements.

Table of Contents

BRINKER INTERNATIONAL, INC.
Notes to Consolidated Financial Statements
(Unaudited)

1. BASIS OF PRESENTATION

References to “Brinker,” the "Company," “we,” “us” and “our” in this Form 10-Q are references to Brinker International, Inc. and its subsidiaries and any predecessor companies of Brinker International, Inc.

Our consolidated financial statements as of December 24, 2014 and June 25, 2014 and for the thirteen week and twenty-six week periods ended December 24, 2014 and December 25, 2013 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). We are principally engaged in the ownership, operation, development, and franchising of the Chili’s Grill & Bar (“Chili’s”) and Maggiano’s Little Italy (“Maggiano’s”) restaurant brands. At December 24, 2014, we owned, operated or franchised 1,634 restaurants in the United States and 29 countries and two territories outside of the United States.

We discovered an immaterial error related to the classification of certain revenues and expenses in the consolidated statements of comprehensive income in the previously issued financial statements for the year ended June 25, 2014 primarily related to Maggiano’s delivery services. The amounts had previously been reported net instead of gross. The error did not impact net income as previously reported or any prior amounts reported on the consolidated balance sheets, statements of cash flows or statements of shareholders' equity. We corrected the error by adjusting the previously reported consolidated statement of comprehensive income for the thirteen week and twenty-six week periods ended December 25, 2013, which resulted in a $1.3 million and a $2.0 million increase in franchise and other revenues and restaurant expenses, respectively.

The foreign currency translation adjustment included in comprehensive income on the consolidated statements of comprehensive income represents the unrealized impact of translating the financial statements of the Canadian restaurants and the Mexican joint venture from their respective functional currencies to U.S. dollars. This amount is not included in net income and would only be realized upon disposition of the businesses. The accumulated other comprehensive loss is presented on the consolidated balance sheets. We reinvest foreign earnings, therefore, United States deferred income taxes have not been provided on foreign earnings.

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles in the United States of America 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 consolidated financial statements and the reported amounts of revenues and costs and expenses during the reporting period. Actual results could differ from those estimates.

The information furnished herein reflects all adjustments (consisting only of normal recurring accruals and adjustments) which are, in our opinion, necessary to fairly state the interim operating results for the respective periods. However, these operating results are not necessarily indicative of the results expected for the full fiscal year. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to SEC rules and regulations. The notes to the consolidated financial statements (unaudited) should be read in conjunction with the notes to the consolidated financial statements contained in the June 25, 2014 Form 10-K. We believe the disclosures are sufficient for interim financial reporting purposes.

Table of Contents

2. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the reporting periods. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted earnings per share, the basic weighted average number of shares is increased by the dilutive effect of stock options and restricted share awards determined using the treasury stock method. We had approximately 235,000 stock options and restricted share awards outstanding at December 24, 2014 and 271,000 stock options and restricted share awards outstanding at December 25, 2013 that were not included in the dilutive earnings per share calculation because the effect would have been anti-dilutive.

Basic weighted average shares outstanding is reconciled to diluted weighted average shares outstanding as follows (in thousands):

	Thirteen Week Periods Ended		Twenty-Six Week Periods Ended	
	December 24, 2014	December 25, 2013	December 24, 2014	December 25, 2013
Basic weighted average shares outstanding	63,590	66,811	64,129	66,752
Dilutive stock options	673	918	663	925
Dilutive restricted shares	700	899	821	1,038
	1,373	1,817	1,484	1,963
Diluted weighted average shares outstanding	64,963	68,628	65,613	68,715

3. LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	December 24, 2014	June 25, 2014
3.88% notes	$299,751	$299,736
2.60% notes	249,882	249,864
Term loan	175,000	187,500
Revolving credit facility	163,000	80,000
Capital lease obligations	41,644	43,086
	929,277	860,186
Less current installments	(28,036)	(27,884)
	$901,241	$832,302

During the first six months of fiscal 2015, $83 million was drawn from the $250 million revolving credit facility primarily to fund share repurchases, leaving $87 million of credit available under the revolving credit facility as of December 24, 2014.

The term loan and revolving credit facility bear interest of LIBOR plus an applicable margin, which is a function of our credit rating and debt to cash flow ratio, but is subject to a maximum of LIBOR plus 2.50%. Based on our current credit rating, we are paying interest at a rate of LIBOR plus 1.63%. One month LIBOR at December 24, 2014 was approximately 0.17%. Our debt agreements contain various financial covenants that, among other things, require the maintenance of certain leverage and fixed charge coverage ratios. We are currently in compliance with all financial covenants.

Table of Contents

4. OTHER GAINS AND CHARGES

Other gains and charges consist of the following (in thousands):

	Thirteen Week Periods Ended		Twenty-Six Week Periods Ended	
	December 24, 2014	December 25, 2013	December 24, 2014	December 25, 2013
Litigation reserves	$5,800	$0	$5,800	$0
Restaurant impairment charges	747	1,285	747	1,285
Restaurant closure charges	509	265	1,381	1,107
Loss (Gain) on the sale of assets, net	1,069	(579)	1,093	(579)
Impairment of liquor licenses	175	0	175	0
Other	(9)	250	28	414
	$8,291	$1,221	$9,224	$2,227

In the second quarter of fiscal 2015, the Hohnbaum case was finalized resulting in an additional charge of approximately $5.8 million to adjust our previous estimate of the final settlement amount. See Note 9 for additional disclosures. Additionally, we recorded restaurant impairment charges of $0.7 million related to underperforming restaurants that either continue to operate or are scheduled to close and $0.2 million for the excess of the carrying amount of a transferable liquor license over the fair value. We also recorded a $1.1 million charge primarily related to the sale of two company owned restaurants located in Mexico and restaurant closure charges of $0.5 million primarily related to lease termination charges.

In the second quarter of fiscal 2014, we recorded restaurant impairment charges of $1.3 million related to underperforming restaurants that either continue to operate or are scheduled to close. We also recorded $0.3 million of restaurant closure charges consisting primarily of lease termination charges and a $0.6 million gain primarily related to land sales in the second quarter.

Restaurant closure charges for the first six months of fiscal 2015 and 2014 are $1.4 million and $1.1 million and consist primarily of lease termination charges and other costs associated with closed restaurants.

5. ACCRUED AND OTHER LIABILITIES

Accrued liabilities consist of the following (in thousands):

	December 24, 2014	June 25, 2014
Gift cards	$166,671	$104,378
Payroll	72,913	77,585
Litigation reserves	45,175	39,500
Sales tax	20,914	19,622
Insurance	21,933	20,652
Property tax	16,239	14,209
Dividends	17,752	15,625
Other	35,954	36,446
	$397,551	$328,017

Table of Contents

Other liabilities consist of the following (in thousands):

	December 24, 2014	June 25, 2014
Straight-line rent	$58,947	$57,462
Insurance	33,993	36,352
Landlord contributions	25,972	23,404
Unrecognized tax benefits	6,424	5,247
Other	7,204	6,633
	$132,540	$129,098

6. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. In determining fair value, the accounting standards establish a three level hierarchy for inputs used in measuring fair value, as follows:

- Level 1 – inputs are quoted prices in active markets for identical assets or liabilities.
- Level 2 – inputs are observable for the asset or liability, either directly or indirectly, including quoted prices in active markets for similar assets or liabilities.
- Level 3 – inputs are unobservable and reflect our own assumptions.

(a) Non-Financial Assets Measured on a Non-Recurring Basis

We review the carrying amount of property and equipment and transferable liquor licenses semi-annually or when events or circumstances indicate that the carrying amount may not be recoverable. If the carrying amount is not recoverable, we record an impairment charge for the excess of the carrying amount over the fair value.

We determine fair value of property and equipment based on projected discounted future operating cash flows of the restaurants over their remaining service life using a risk adjusted discount rate that is commensurate with the risk inherent in our current business model. Based on our semi-annual review, during fiscal 2015, long-lived assets with a carrying value of $0.7 million, primarily related to two underperforming restaurants, were determined to have no fair value resulting in an impairment charge of $0.7 million. During fiscal 2014, long-lived assets with a carrying value of $2.6 million, primarily related to four underperforming restaurants, were written down to their fair value of $1.3 million resulting in an impairment charge of $1.3 million.

We determine fair value of transferable liquor licenses based on prices in the open market for licenses in same or similar jurisdictions. Based on our semi-annual review, during fiscal 2015, one transferable liquor license with a carrying value of $225,000 was written down to the fair value of $50,000 resulting in an impairment charge of $175,000. During fiscal 2014, we reviewed the transferable liquor licenses and determined there was no impairment.

All impairment charges related to underperforming restaurants and liquor licenses were included in other gains and charges in the consolidated statement of comprehensive income for the periods presented.

The following table presents fair values for those assets measured at fair value on a non-recurring basis at December 24, 2014 and December 25, 2013 (in thousands):

	Fair Value Measurements Using			
	(Level 1)	(Level 2)	(Level 3)	Total
Long-lived assets held for use:				
At December 24, 2014	$0	$0	$0	$0
At December 25, 2013	$0	$0	$1,342	$1,342
Liquor licenses:				
At December 24, 2014	$0	$50	$0	$50
At December 25, 2013	$0	$0	$0	$0

9

Table of Contents

We review the carrying amount of goodwill and reacquired franchise rights annually or when events or circumstances indicate that the carrying amount may not be recoverable. If the carrying amount is not recoverable, we record an impairment charge for the excess of the carrying amount over the fair value. We determined that there was no impairment of goodwill during our annual test in fiscal 2015 and fiscal 2014 as the fair value of our reporting units was substantially in excess of the carrying value. We also determined that there was no impairment of reacquired franchise rights during our annual test in fiscal 2015 and fiscal 2014. No indicators of impairment were identified through the end of the second quarter of fiscal 2015.

(b) Other Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The fair values of cash and cash equivalents, accounts receivable and accounts payable approximate their carrying amounts because of the short maturity of these items. The fair values of the 2.60% notes and 3.88% notes are based on quoted market prices and are considered Level 2 fair value measurements. At December 24, 2014, the 2.60% notes had a carrying value of $249.9 million and a fair value of $248.6 million and the 3.88% notes had a carrying value of $299.8 million and a fair value of $296.2 million. At June 25, 2014, the 2.60% notes had a carrying value of $249.9 million and a fair value of $250.4 million and the 3.88% notes had a carrying value of $299.7 million and a fair value of $290.2 million. The carrying amount of debt outstanding pursuant to the term loan and revolving credit facility approximates fair value as interest rates on these instruments approximate current market rates (Level 2).

7. SHAREHOLDERS’ EQUITY

In August 2014, our Board of Directors authorized a $350.0 million increase to our existing share repurchase program. We repurchased approximately 2.2 million shares of our common stock for $112.8 million during the first two quarters of fiscal 2015 including 2.0 million shares purchased under the share repurchase program. As of December 24, 2014, approximately $553.9 million was available under our share repurchase authorizations. Our stock repurchase plan has been and will be used to return capital to shareholders and to minimize the dilutive impact of stock options and other share-based awards. We evaluate potential share repurchases under our plan based on several factors, including our cash position, share price, operational liquidity, proceeds from divestitures, borrowings, and planned investment and financing needs. Repurchased common stock is reflected as a reduction of shareholders’ equity.

During the first two quarters of fiscal 2015, we granted approximately 226,000 stock options with a weighted average exercise price of $49.18 and a weighted average fair value of $11.64, and approximately 227,000 restricted share awards with a weighted average fair value of $49.05. Additionally, during the first two quarters of fiscal 2015, approximately 172,000 stock options were exercised resulting in cash proceeds of approximately $4.0 million. We received an excess tax benefit from stock-based compensation of approximately $10.4 million during the first two quarters primarily as a result of the normally scheduled vesting and distribution of restricted stock grants and performance shares. The excess tax benefit from stock-based compensation represents the additional income tax benefit received resulting from the increase in the fair value of awards from the time of grant to the exercise date.

During the first two quarters of fiscal 2015, we paid dividends of $35.4 million to common stock shareholders, compared to $31.3 million in the prior year. Additionally, our Board of Directors approved a 17 percent increase in the quarterly dividend from $0.24 to $0.28 per share effective with the dividend declared in August 2014. We also declared a quarterly dividend of $17.8 million in October 2014 which was paid on December 26, 2014. The dividend accrual was included in accrued liabilities on our consolidated balance sheet as of December 24, 2014.

Table of Contents

8. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for income taxes and interest in the first two quarters of fiscal 2015 and 2014 are as follows (in thousands):

	December 24, 2014	December 25, 2013
Income taxes, net of refunds	$26,643	$7,182
Interest, net of amounts capitalized	13,002	12,766

Non-cash investing and financing activities for the first two quarters of fiscal 2015 and 2014