

BRINKER INTERNATIONAL INC  
Form 10-Q  
November 06, 2006

**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 September 27, 2006**

**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 75240**

(Address of principal executive offices)

(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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

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Yes ☐ No ☒

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

**Class**

Common Stock, \$0.10 par value

**Outstanding at November 1, 2006**

81,894,600 shares

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**BRINKER INTERNATIONAL, INC.**

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

	<b>September 27, 2006 (Unaudited)</b>	<b>June 28, 2006</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 59,651	\$ 55,615
Accounts receivable	45,445	52,540
Inventories	38,239	40,330
Prepaid expenses and other	79,665	85,187
Deferred income taxes	11,588	8,638
Total current assets	234,588	242,310
Property and Equipment, at Cost:		
Land	279,215	279,369
Buildings and leasehold improvements	1,767,065	1,715,917
Furniture and equipment	735,611	745,812
Construction-in-progress	84,996	94,734
	2,866,887	2,835,832
Less accumulated depreciation and amortization	(1,051,350)	(1,043,108)
Net property and equipment	1,815,537	1,792,724
Other Assets:		
Goodwill	145,347	145,479
Deferred income taxes	3,546	
Other	44,029	41,266
Total other assets	192,922	186,745
Total assets	\$ 2,243,047	\$ 2,221,779
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Current installments of long-term debt	\$ 2,175	\$ 2,197
Accounts payable	145,049	151,216
Accrued liabilities	293,284	314,509
Income taxes payable	52,194	29,453
Total current liabilities	492,702	497,375
Long-term debt, less current installments	504,860	500,515
Deferred income taxes		7,016
Other liabilities	148,231	141,041
Commitments and Contingencies (Note 7)		
Shareholders' Equity:		
Common stock 250,000,000 authorized shares; \$0.10 par value; 117,499,541 shares issued and 82,741,879 shares outstanding at September 27, 2006, and 117,499,541 shares issued and 83,539,647 shares outstanding at June 28, 2006	11,750	11,750
Additional paid-in capital	418,776	406,626
Accumulated other comprehensive income	699	773
Retained earnings	1,647,909	1,608,661
	2,079,134	2,027,810

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Less:

Treasury stock, at cost (34,757,662 shares at September 27, 2006 and 33,959,894 shares at June 28, 2006)	(981,880	)	(951,978	)
Total shareholders' equity	1,097,254		1,075,832	
Total liabilities and shareholders' equity	\$	2,243,047	\$	2,221,779

See accompanying notes to consolidated financial statements.

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

	<b>Thirteen Week Periods Ended</b>	
	<b>September 27, 2006</b>	<b>September 28, 2005</b>
Revenues	\$ 1,039,935	\$ 975,896
Operating Costs and Expenses:		
Cost of sales	285,507	275,158
Restaurant expenses	580,579	542,772
Depreciation and amortization	48,231	46,711
General and administrative	50,265	47,138
Restructure charges and other impairments		1,167
Total operating costs and expenses	964,582	912,946
Operating income	75,353	62,950
Interest expense	6,237	5,367
Other, net	(837 )	(164 )
Income before provision for income taxes	69,953	57,747
Provision for income taxes	22,314	19,305
Income from continuing operations	47,639	38,442
Loss from discontinued operations, net of taxes		(6,688 )
Net income	\$ 47,639	\$ 31,754
Basic net income per share:		
Income from continuing operations	\$ 0.57	\$ 0.44
Loss from discontinued operations	\$ 0.00	\$ (0.08 )
Net income per share	\$ 0.57	\$ 0.36
Diluted net income per share:		
Income from continuing operations	\$ 0.57	\$ 0.43
Loss from discontinued operations	\$ 0.00	\$ (0.07 )
Net income per share	\$ 0.57	\$ 0.36
Basic weighted average shares outstanding	82,853	87,807
Diluted weighted average shares outstanding	84,065	89,233

See accompanying notes to consolidated financial statements.

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

	<b>Thirteen Week Periods Ended</b>	
	<b>September 27, 2006</b>	<b>September 28, 2005</b>
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 47,639	\$ 31,754
Adjustments to reconcile net income to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	48,231	46,711
Restructure charges and other impairments		1,167
Stock-based compensation	11,963	7,791
Deferred income taxes	(13,468 )	(8,201 )
Gain on sale of assets	(582 )	(3,272 )
Loss from discontinued operations, net of taxes		6,688
Changes in assets and liabilities, excluding effects of dispositions:		
Receivables	7,216	(1,866 )
Inventories	1,813	10,212
Prepaid expenses and other	5,983	4,819
Other assets	(3,408 )	(2,349 )
Current income taxes	22,203	2,697
Accounts payable	(6,167 )	3,085
Accrued liabilities	(19,709 )	29,927
Other liabilities	7,181	(25,791 )
Net cash provided by operating activities of continuing operations	108,895	103,372
<b>Cash Flows from Investing Activities:</b>		
Payments for property and equipment	(90,875 )	(75,719 )
Proceeds from sale of assets	20,123	9,845
Net cash used in investing activities of continuing operations	(70,752 )	(65,874 )
<b>Cash Flows from Financing Activities:</b>		
Purchases of treasury stock	(38,863 )	(139,140 )
Proceeds from issuances of treasury stock	8,020	4,248
Payments of dividends	(8,266 )	
Net borrowings on credit facilities	4,874	100,750
Excess tax benefits from stock-based compensation	538	270
Payments on long-term debt	(410 )	(320)
Net cash used in financing activities of continuing operations	(34,107 )	(34,192 )
<b>Cash Flows from Discontinued Operations (Revised - Note 1):</b>		
Net cash provided by operating activities of discontinued operations		1,938
Net cash used in investing activities of discontinued operations		(3,106 )
Net cash used in discontinued operations		(1,168 )
Net change in cash and cash equivalents	4,036	2,138
Cash and cash equivalents at beginning of period	55,615	41,859
Cash and cash equivalents at end of period	\$ 59,651	\$ 43,997

See accompanying notes to consolidated financial statements.





**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 predecessor companies of Brinker International, Inc.

Our consolidated financial statements as of September 27, 2006 and June 28, 2006 and for the thirteen week periods ended September 27, 2006 and September 28, 2005 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). We own, operate, or franchise various restaurant brands under the names of Chili's Grill & Bar ( Chili's ), Romano's Macaroni Grill ( Macaroni Grill ), Maggiano's Little Italy ( Maggiano's ), and On The Border Mexican Grill & Cantina ( On The Border ). In September 2005, we entered into an agreement to sell Corner Bakery Cafe ( Corner Bakery ). The sale of the brand was completed in February 2006. As a result, Corner Bakery is presented as discontinued operations in the accompanying consolidated financial statements.

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 28, 2006 Form 10-K. We believe the disclosures are sufficient for interim financial reporting purposes.

Certain prior year amounts in the accompanying consolidated financial statements have been reclassified to conform with fiscal 2007 classifications. We have also revised our statement of cash flows for the thirteen week period ended September 28, 2005 to separately disclose the operating and investing cash flows attributable to discontinued operations, which was reported on a combined basis as a single amount in the prior period. These changes have no effect on our net income or financial position as previously reported.

**2. STOCK-BASED COMPENSATION**

Effective June 30, 2005, we adopted SFAS No. 123 (Revised 2004), Share-Based Payment, ( SFAS 123R ), which requires the measurement and recognition of compensation cost at fair value for all share-based payments, including stock options. Stock-based compensation for the first quarter of fiscal 2007 includes compensation expense, recognized over the applicable vesting periods, for new share-based awards and for share-based awards granted prior to, but not yet vested, as of June 29, 2005. Stock-based compensation totaled approximately \$12.0 million and \$7.8 million for the first quarter of fiscal 2007 and 2006, respectively.

**3. EARNINGS PER SHARE**

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. 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 net income 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 2.5 million and 2.0 million stock options outstanding at September 27, 2006 and September 28, 2005, respectively, that were not included in the dilutive earnings per share calculation because the effect would have been antidilutive.

**4. DISPOSITION OF CORNER BAKERY**

In September 2005, we entered into an agreement to sell Corner Bakery. The sale of the brand was completed in February 2006. There was no operating activity during the first quarter of fiscal 2007 related to Corner Bakery. We have reported the results of operations of Corner Bakery as discontinued operations in the first quarter of fiscal 2006 which consist of the following (in thousands):

	<b>Thirteen Week Period Ended September 28, 2005</b>
Revenues	\$ 44,375
Income before income tax expense from discontinued operations	\$ 4,306
Income tax expense	1,619
Net income from discontinued operations	2,687
Loss on sale of Corner Bakery, net of taxes (1)	(9,375 )
Loss from discontinued operations, net of taxes	\$ (6,688 )

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(1) The sale of Corner Bakery resulted in a taxable gain due to \$11.0 million of goodwill not being deductible for tax purposes. The loss on sale includes tax expense totaling \$983,000.

**5. SHAREHOLDERS EQUITY**

The Board of Directors authorized an increase in the stock repurchase plan of \$450.0 million in August 2006, bringing the total to \$1,760.0 million. Pursuant to our stock repurchase plan, we repurchased approximately 1.1 million shares of our common stock for \$38.9 million during the first quarter of fiscal 2007. As of September 27, 2006, approximately \$530.5 million was available under our share repurchase authorizations. Our stock repurchase plan will be used to return capital to shareholders and to minimize the dilutive impact of stock options and other share-based awards. We will consider additional share repurchases based on several factors, including our cash position, share price, operational liquidity, and planned investment and financing needs. The repurchased common stock is reflected as a reduction of shareholders equity.

## 6. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes for the first quarter of fiscal 2007 and 2006 is as follows (in thousands):

	September 27, 2006	September 28, 2005
Income taxes, net of refunds	\$ 11,303	\$ 27,141
Interest, net of amounts capitalized	1,917	1,818

Non-cash investing and financing activities for the first quarter of fiscal 2007 and 2006 are as follows (in thousands):

	September 27, 2006	September 28, 2005
Retirement of fully depreciated assets	\$ 30,364	\$ 35,153
Decrease in fair value of interest rate swaps		(3,165 )
Dividends payable		8,604

## 7. CONTINGENCIES

As of September 27, 2006, we guaranteed lease payments totaling \$—89.3 million as a result of the sale of certain brands and the sale of restaurants to franchisees. This amount represents the maximum potential liability of future payments under the guarantees. These leases have been assigned to the buyers and expire at the end of the respective lease terms, which range from fiscal 2007 through fiscal 2020. We remain secondarily liable for the leases; however, no liability has been recorded as the likelihood of the buyers defaulting on the leases is considered negligible.

Certain current and former hourly restaurant employees filed a lawsuit against us in California Superior Court alleging violations of California labor laws with respect to meal and rest breaks. The lawsuit seeks penalties and attorney's fees and was certified as a class action in July 2006. Discovery is under way and we intend to vigorously defend our position. It is not possible at this time to reasonably estimate the possible loss or range of loss, if any.

We are engaged in various legal proceedings and have certain unresolved claims pending. The ultimate liability, if any, for the aggregate amounts claimed cannot be determined at this time. However, based upon consultation with legal counsel, we are of the opinion that there are no matters pending or threatened which are expected to have a material adverse effect, individually or in the aggregate, on our consolidated financial condition or results of operations.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following table sets forth selected operating data as a percentage of total revenues for the periods indicated. All information is derived from the accompanying consolidated statements of income.

	<b>Thirteen Week Periods Ended</b>			
	<b>September 27, 2006</b>		<b>September 28, 2005</b>	
Revenues	100.0	%	100.0	%
Operating Costs and Expenses:				
Cost of sales	27.5	%	28.2	%
Restaurant expenses	55.8	%	55.6	%
Depreciation and amortization	4.7	%	4.8	%
General and administrative	4.8	%	4.8	%
Restructure charges and other impairments	0.0	%	0.1	%
Total operating costs and expenses	92.8	%	93.5	%
Operating income	7.2	%	6.5	%
Interest expense	0.6	%	0.5	%
Other, net	(0.1)	)%	0.0	%
Income before provision for income taxes	6.7	%	6.0	%
Provision for income taxes	(2.1)	)%	(2.0)	)%
Income from continuing operations	4.6	%	4.0	%
Loss from discontinued operations, net of taxes	0.0	%	(0.7)	)%
Net income	4.6	%	3.3	%

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The following table details the number of restaurant openings during the first quarter, total restaurants open at the end of the first quarter, and total projected openings in fiscal 2007.

	First Quarter Openings Fiscal 2007	Fiscal 2006	Total Open at End Of First Quarter Fiscal 2007	Fiscal 2006	Projected Openings Fiscal 2007
<b>Chili's:</b>					
Company-owned	28	22	916	830	125-130
Franchised	4	7	198	165	10-15
Total	32	29	1,114	995	135-145
<b>Macaroni Grill:</b>					
Company-owned	2	4	223	223	4-5
Franchised			11	6	3-4
Total	2	4	234	229	7-9
<b>Maggiano's</b>	1	2	38	35	4-5
<b>On The Border:</b>					
Company-owned	2	2	125	119	12-14
Franchised	2	1	23	19	4-6
Total	4	3	148	138	16-20
<b>Corner Bakery:</b>					
Company-owned		3		90	
Franchised				3	
Total		3		93	
<b>International:</b>					
Company-owned			5		
Franchised	4	3	123	113	38-41
Total	4	3	128	113	38-41
<b>Grand Total</b>	<b>43</b>	<b>44</b>	<b>1,662</b>	<b>1,603</b>	<b>200-220</b>

At September 27, 2006, we owned the land and buildings for 315 of the 1,307 company-owned restaurants. The net book value of the land and buildings associated with these restaurants totaled \$266.4 million and \$271.0 million, respectively.

## OVERVIEW

At September 27, 2006, we owned, operated, or franchised 1,662 restaurants. We intend to continue the expansion of our restaurant brands by opening units in strategically desirable markets. The restaurant site selection process is critical to our long-term success and we devote significant effort to the investigation of new locations utilizing a variety of sophisticated analytical techniques. We intend to concentrate on the development of certain identified markets to achieve penetration levels deemed desirable in order to improve competitive position, marketing potential and profitability. Expansion efforts will be focused not only on major metropolitan areas, but also on smaller market areas and non-traditional locations (such as airports and food courts) that can adequately support any of our restaurant brands. In addition, we intend to pursue domestic and international franchise expansion to achieve our goal of increasing franchise ownership of our brands from 20% to approximately 30% through an active program of franchising company-owned restaurants and accelerated development commitments from franchisees. Future franchise development agreements are expected to remain limited to enterprises having significant restaurant or enterprise management experience and proven financial ability to develop multi-unit operations. The specific rate at which we are able to open new restaurants is determined by our success in locating satisfactory sites, negotiating acceptable lease or purchase terms, securing appropriate local governmental permits and approvals, and by our capacity to supervise construction and recruit and train management personnel.

The restaurant industry is a highly competitive business, which is sensitive to changes in economic conditions, trends in lifestyles and fluctuating costs. Operating margins for restaurants are susceptible to fluctuations in prices of commodities, which include among other things, beef, pork, chicken, seafood, dairy, cheese, produce, energy and other necessities to operate a restaurant. Additionally, the restaurant industry is characterized by a high initial capital investment, coupled with high labor costs.

## REVENUES

Revenues for the first quarter of fiscal 2007 increased to \$1,039.9 million, 6.6% over the \$975.9 million generated for the same quarter of fiscal 2006. The increase was primarily attributable to a net increase of 100 company-owned restaurants (excluding Corner Bakery) since September 28, 2005, partially offset by a decrease in comparable store sales. We increased our capacity for the first quarter of fiscal 2007 by 7.3% compared to the respective prior year period. Comparable store sales decreased 2.1% for the first quarter from the same period of fiscal 2006. Menu prices in the aggregate increased 2.8% in the first quarter of fiscal 2007 as compared to the same period of fiscal 2006.

## COSTS AND EXPENSES

Cost of sales, as a percent of revenues, decreased 0.7% for the first quarter of fiscal 2007 as compared to the same period of fiscal 2006. The decrease was primarily due to the increase in menu prices and favorable commodity prices and product mix shift.

Restaurant expenses, as a percent of revenues, increased 0.2% for the first quarter of fiscal 2007 as compared to the same period of fiscal 2006. The increase was primarily due to an increase in repair and maintenance expenses, partially offset by a \$3.2 million gain related to the termination of interest rate swaps on an operating lease commitment. Restaurant expense recorded during the first quarter of fiscal 2006 included a \$3.3 million gain on the sale of real estate.

Depreciation and amortization increased \$1.5 million for the first quarter of fiscal 2007 as compared to the same period of fiscal 2006. The increase in depreciation expense was due to new unit construction and ongoing remodel costs, partially offset by a decrease in depreciation related to store closures and dispositions and a declining depreciable asset base for older units.

General and administrative expenses increased \$3.1 million for the first quarter of fiscal 2007 as compared to the same period of fiscal 2006. The increase was primarily due to the change in our annual grant date for stock-based compensation.

Restructure charges and other impairments recorded during the first quarter of fiscal 2006 include a \$1.2 million charge related to previously closed restaurants consisting primarily of decreases in the estimated sales value of owned units.

Interest expense increased \$870,000 for the first quarter of fiscal 2007 as compared to the same period of fiscal 2006. The increase was primarily due to increased average borrowings and interest rates on our lines-of-credit.

## INCOME TAXES

The effective income tax rate related to continuing operations decreased to 31.9% from 33.4% for the first quarter of fiscal 2007 as compared to the same quarter last year. The decrease in the tax rate was primarily due to a decrease in stock-based compensation related to incentive stock options and benefits from state income tax planning.

## LIQUIDITY AND CAPITAL RESOURCES

The working capital deficit increased to \$258.1 million at September 27, 2006 from \$255.1 million at June 28, 2006. Net cash provided by operating activities of continuing operations increased to \$108.9 million for the first quarter of fiscal 2007 from \$103.4 million during the same period in fiscal 2006 due to increased profitability and the timing of operational receipts and payments. We believe that our various sources of capital, including availability under existing credit facilities, ability to raise additional financing, and cash flow from operating activities of continuing operations, are adequate to finance operations as well as the repayment of current debt obligations.

Capital expenditures consist of purchases of land for future restaurant sites, new restaurants under construction, purchases of new and replacement restaurant furniture and equipment, and ongoing remodeling programs. Capital expenditures were \$90.9 million for the first quarter of fiscal 2007 compared to \$75.7 million for the same period of fiscal 2006. We estimate that our capital expenditures during the second quarter of fiscal 2007 will be approximately \$110.0 million and will be funded entirely from operations and existing credit facilities.

We sold fifteen Chili's restaurants to a franchisee for cash proceeds of \$20.1 million during the first quarter of fiscal 2007.

In August 2006, we announced the declaration of a dividend to common stock shareholders in the amount of \$0.10 per share. The dividend was paid in September 2006 and totaled approximately \$8.3 million. On November 1, 2006, the Board of Directors authorized an increase in the quarterly dividend payable in November 2006 resulting in an estimated aggregate payout of approximately \$11.1 million.

We entered into an agreement for a one-year unsecured committed credit facility of \$400.0 million on August 28, 2006. The facility bears interest at LIBOR plus 0.55% (5.87% as of September 27, 2006) with a maximum rate of LIBOR plus 1.0%. There were no amounts outstanding under the facility at September 27, 2006. Depending upon the amount utilized, we may pursue a refinancing of this credit facility subject to market conditions.

The Board of Directors authorized an increase in the stock repurchase plan of \$450.0 million in August 2006, bringing the total to \$1,760.0 million. Pursuant to our stock repurchase plan, we repurchased approximately 1.1 million shares of our common stock for \$38.9 million during the first quarter of fiscal 2007. As of September 27, 2006, approximately \$530.5 million was available under our share repurchase authorizations. Our stock repurchase plan will be used to primarily return capital to shareholders and to minimize the dilutive impact of stock options and other share-based awards. We will consider additional share repurchases based on several factors, including our cash position, share price, operational liquidity, and planned investment and financing needs. The repurchased common stock is reflected as a reduction of shareholders' equity.

On August 28, 2006, we announced a plan to return capital to shareholders through a modified Dutch auction tender offer for up to approximately 11.7 million shares of common stock. On October 18, 2006, we accepted for purchase approximately 1.3 million shares of common stock at a purchase price of \$40.00 per share, for a total cost of \$50.4 million excluding related transaction costs. The tender offer was funded through existing lines of credit.

We are not aware of any other event or trend that would potentially affect our liquidity. In the event such a trend develops, we believe that there are sufficient funds available under our credit facilities and from our internal cash generating capabilities to adequately manage the expansion of our business.

#### **RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. This interpretation also provides guidance on derecognition, classification, accounting in interim periods, and expanded disclosure requirements. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently in the process of assessing the impact that FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements, ( SFAS 157 ). SFAS 157 clarifies the definition of fair value, describes methods used to appropriately measure fair value, and expands fair value disclosure requirements. This statement applies under other accounting pronouncements that currently require or permit fair value measurements and is effective for fiscal years beginning after November 15, 2007. We are currently in the process of assessing the impact that SFAS 157 will have on our consolidated financial statements.

#### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in our quantitative and qualitative market risks since the prior reporting period.

#### **Item 4. CONTROLS AND PROCEDURES**

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934 [the Exchange Act ]), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective.

There were no changes in our internal control over financial reporting during our first quarter ended September 27, 2006, that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.



## FORWARD-LOOKING STATEMENTS

We wish to caution you that our business and operations are subject to a number of risks and uncertainties. The factors listed below are important factors that could cause actual results to differ materially from our historical results and from those projected in forward-looking statements contained in this report, in our other filings with the SEC, in our news releases, written or electronic communications, and verbal statements by our representatives.

You should be aware that forward-looking statements involve risks and uncertainties. These risks and uncertainties may cause our or our industry's actual results, performance or achievements to be materially different from any future results, performances or achievements contained in or implied by these forward-looking statements. Forward-looking statements are generally accompanied by words like believes, anticipates, estimates, predicts, expects, and other similar expressions that convey uncertainty about future events or outcomes.

### Risks Related to Our Business

*Competition may adversely affect our operations and financial results.*

The restaurant business is highly competitive as to price, service, restaurant location, nutritional and dietary trends and food quality, and is often affected by changes in consumer tastes, economic conditions, population and traffic patterns. We compete within each market with locally-owned restaurants as well as national and regional restaurant chains, some of which operate more restaurants and have greater financial resources and longer operating histories than ours. There is active competition for management personnel and hourly employees, and for attractive commercial real estate sites suitable for restaurants.

*Our sales volumes generally decrease in winter months.*

Our sales volumes fluctuate seasonally and are generally higher in the summer months and lower in the winter months, which may cause seasonal fluctuations in our operating results.

*Changes in governmental regulation may adversely affect our ability to open new restaurants and our existing and future operations.*

Each of our restaurants is subject to licensing and regulation by alcoholic beverage control, health, sanitation, safety and fire agencies in the state, county and/or municipality where the restaurant is located. We generally have not encountered any material difficulties or failures in obtaining the required licenses and approvals that could delay or prevent the opening of a new restaurant, or impact the continuing operations of an existing restaurant. Although we do not, at this time, anticipate any occurring in the future, we cannot assure you that we will not experience material difficulties or failures that could delay the opening of restaurants in the future, or impact the continuing operations of an existing restaurant.

We are subject to federal and state environmental regulations, and although these have not had a material negative effect on our operations, we cannot ensure that there will not be a material negative effect in the future. More stringent and varied requirements of local and state governmental bodies with respect to zoning, land use and environmental factors could delay or prevent development of new restaurants in particular locations.

We are subject to the Fair Labor Standards Act, which governs such matters as minimum wages, overtime and other working conditions, along with the Americans with Disabilities Act, various family leave mandates and a variety of other laws enacted, or rules and regulations promulgated, by federal, state and local governmental authorities that govern these and other employment matters. We expect increases in payroll expenses as a result of federal and state mandated increases in the minimum wage, and although such increases are not expected to be material, we cannot assure you that there will not be material increases in the future. In addition, our vendors may be affected by higher minimum wage standards, which may increase the price of goods and services they supply to us.

*Inflation may increase our operating expenses.*

We have not experienced a significant overall impact from inflation. Inflation can cause increased food, labor and benefits costs and can increase our operating expenses. As operating expenses increase, we, to the extent permitted by competition, recover increased costs by increasing menu prices, or by reviewing, then implementing, alternative products or processes, or by implementing other cost reduction procedures. We cannot ensure, however, that we will be able to continue to recover increases in operating expenses due to inflation in this manner.

*Our profitability may be adversely affected by increases in energy costs.*

Our success depends in part on our ability to absorb increases in utility costs. Various regions of the United States in which we operate multiple restaurants have experienced significant increases in utility prices. If these increases continue to occur, it would have an adverse effect on our profitability.

*Successful mergers, acquisitions, divestitures and other strategic transactions are important to our future growth and profitability.*

We evaluate potential mergers, acquisitions, joint venture investments, and divestitures as part of our strategic planning initiative. These transactions involve various inherent risks, including accurately assessing:

- the value, future growth potential, strengths, weaknesses, contingent and other liabilities and potential profitability of acquisition candidates;
- our ability to achieve projected economic and operating synergies; unanticipated changes in business and economic conditions affecting an acquired business; and
- our ability to complete divestitures on acceptable terms and at or near the prices estimated as attainable by us.

*If we are unable to meet our growth plan, our profitability in the future may be adversely affected.*

Our ability to meet our growth plan is dependent upon, among other things, our ability to:

- identify available, suitable and economically viable locations for new restaurants,
- obtain all required governmental permits (including zoning approvals and liquor licenses) on a timely basis,
- hire all necessary contractors and subcontractors, and
- meet construction schedules.

The costs related to restaurant and brand development include purchases and leases of land, buildings and equipment and facility and equipment maintenance, repair and replacement. The labor and materials costs involved vary geographically and are subject to general price increases. As a result, future capital expenditure costs of restaurant development may increase, reducing profitability. We cannot assure you that we will be able to expand our capacity in accordance with our growth objectives or that the new restaurants and brands opened or acquired will be profitable.

*Unfavorable publicity relating to one or more of our restaurants in a particular brand may taint public perception of the brand.*

Multi-unit restaurant businesses can be adversely affected by publicity resulting from poor food quality, illness or health concerns or operating issues stemming from one or a limited number of restaurants. In particular, since we depend heavily on the Chili's brand for a majority of our revenues, unfavorable publicity relating to one or more Chili's restaurants could have a material adverse effect on the Chili's brand, and consequently on our business, financial condition and results of operations.

*Identification of material weakness in internal control may adversely affect our financial results.*

We are subject to the ongoing internal control provisions of Section 404 of the Sarbanes-Oxley Act of 2002. Those provisions provide for the identification of material weaknesses in internal control. If such a material weakness is identified, it could indicate a lack of adequate controls to generate accurate financial statements. We routinely assess our internal controls, but we cannot assure you that we will be able to timely remediate any material weaknesses that may be identified in future periods, or maintain all of the controls necessary for continued compliance. Likewise, we cannot assure you that we will be able to retain sufficient skilled finance and accounting personnel, especially in light of the increased demand for such personnel among publicly traded companies.

*Other risk factors may adversely affect our financial performance.*

Other risk factors that could cause our actual results to differ materially from those indicated in the forward-looking statements by affecting, among many things, pricing, consumer spending and consumer confidence, include, without limitation, changes in economic conditions, increased fuel costs and availability for our employees, customers and suppliers, health epidemics or pandemics or the prospects of these events (such as recent reports on avian flu), consumer perceptions of food safety, changes in consumer tastes and behaviors, governmental monetary policies, changes in demographic trends, availability of employees, terrorist acts, energy shortages and rolling blackouts, and weather (including, major hurricanes and regional snow storms) and other acts of God.

**PART II. OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

Information regarding legal proceedings is incorporated by reference from Note 7 to our consolidated financial statements set forth in Part I of this report.

**Item 1A. RISK FACTORS**

There has been no material change in the risk factors set forth in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended June 28, 2006.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Shares repurchased during the first quarter of fiscal 2007 are as follows (in thousands, except share and per share amounts):

	<b>Total Number of Shares Purchased (a)</b>	<b>Average Price  Paid per Share</b>	<b>Maximum Dollar Value that May Yet be Purchased  Under the Program</b>
June 29, 2006 through August 2, 2006	875,000	\$ 34.25	\$ 89,407
August 3, 2006 through August 30, 2006	240,000	\$ 36.93	\$ 530,537
August 31, 2006 through September 27, 2006			\$ 530,537
	1,115,000	\$ 34.83	

(a) All of the shares purchased during the first quarter of fiscal 2007 were purchased as part of the publicly announced programs described in part I of this report.

**Item 6. EXHIBITS**

- 10(a) \$350,000,000 Fixed Rate Promissory Note, dated August 15, 2006, by Brinker International, Inc., as payor, to JP Morgan Chase Bank, National Association, as payee.
- 10(b) \$50,000,000 Uncommitted Line of Credit Agreement, dated August 17, 2006, by Brinker International, Inc., as borrower, and Bank of America, N.A., as lender, and related Master Promissory Note, dated August 17, 2006.
- 31(a) Certification by Douglas H. Brooks, Chairman of the Board, President and Chief Executive Officer of the Registrant, pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a).
- 31(b) Certification by Charles M. Sonsteby, Executive Vice President and Chief Financial Officer of the Registrant, pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a).
- 32(a) Certification by Douglas H. Brooks, Chairman of the Board, President and Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32(b) Certification by Charles M. Sonsteby, Executive Vice President and Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, we have duly caused this report to be signed on our behalf by the undersigned thereunto duly authorized.

BRINKER INTERNATIONAL, INC.

Date: November 6, 2006

By: /s/ Douglas H. Brooks  
Douglas H. Brooks,  
Chairman of the Board,  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 6, 2006

By: /s/ Charles M. Sonsteby  
Charles M. Sonsteby,  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer)