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EAT - Q1 2017 Brinker International Inc Earnings Call

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OVERVIEW:

Co. reported 1Q17 revenues of $758m and adjusted EPS, before special items, of $0.49. Expects FY17 adjusted EPS to be $3.40-3.50.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brinker International Q1 earnings call.

(Operator Instructions)

It is now my pleasure to turn the floor over to your host Joe Taylor. Sir, the floor is yours.

Joe Taylor - *Brinker International, Inc. - VP of IR*

Thank you, Kate. Good morning, everyone, and welcome to the quarterly earnings call for Brinker International's first quarter of FY17.

I am Joe Taylor, Vice President of Investor Relations. And joining me this morning here in Dallas are Wyman Roberts, our Chief Executive Officer, and Tom Edwards our Chief Financial Officer. Wyman will begin the comment portion of the call with an overview of the first quarter, and will provide an update on the implementation of several strategic initiatives. Tom will provide further Q1 insights, update on our recently completed financings, and share insights as to our outlook for the rest of the fiscal year.

Before beginning our comments, please let me remind everyone of our Safe Harbor regarding forward-looking statements. During our call, management may discuss certain items which are not based entirely on historical facts. Any such items should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

All such statements are subject to risks and uncertainties which could cause actual results to differ from those anticipated. Such risks and uncertainties include factors more completely described in this morning's press release and the Company's filings with the SEC. On the call, we may refer to certain non-GAAP financial measures that management uses in its review of the business and believes will provide insight into the Company's ongoing operations.

With that, I will turn the call over to Wyman.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks Joe. Good morning, everyone, and thanks for joining us on the call today.

I will spend most of our time updating you on the strategic initiatives we introduced during our investor day back in June. We will focus primarily on efforts to drive relevance, value and convenience at convenience at Chili's. We're pleased with the progress we're making as our initiatives continue to gain momentum and give us the confidence we will deliver on our guidance for the fiscal year.

First, let's take a quick look at the quarter. Who'd have thought the last time we talked with you that we were heading into the toughest quarter casual dining has seen in five years?

We started off strong, we had positive comps, we were taking share, we had a new value platform and momentum on our side. And then August hit, and sales got real challenging. Not just for us, but for the industry.

Since August is already one of our lower-volume months, it added pressure to our margins, so we didn't deliver the level of margins we were anticipating during the quarter. But as the quarter continued and we made progress on our initiatives, our results started to improve.

We continue to see sequential improvement, and we are back to performing better than the category. So we feel good about how the initiatives have set us up for growth and the balance of the fiscal year and beyond. Tom will provide more first-quarter detail, so let's talk about our initiatives.

First, Chili's bar, a big relevance play for the brand's future growth, and we continue to see positive results from our efforts here. Alcohol mix is up 30 basis points year over year due to happy hour promotions like our $5 margarita Thursdays, the introduction of our bar menu, and even more importantly, by implementing craft beers on tap.

During the quarter, we doubled the number of beer taps in about half our restaurants. Now we're offering local craft beers on tap, making Chili's a more relevant player in the bar space. And performance in expanded tap restaurants is encouraging, comp sales are positive and outperforming the rest of the Company.

We're still on track to complete our craft beer program during Q2, which gives us the opportunity to then market those products broadly. We believe our work in the bar will strengthen the brand, and further differentiate us in the category. So we're also continuing to evaluate additional enhancements to the bar business and the building to make our bar experience even more compelling, especially for our millennial consumers.

We're also focused on better meeting the increasing demand for convenience from Chili's guests. Our To-Go business was more than 5% positive this quarter. And now that we've implemented the new engine for online To-Go system, we can get even more aggressive with marketing and product offerings to support this fast-growing segment.

From a value perspective, we know we have a strong value platform in 3 For Me, which we introduced with burgers during the quarter. And while it performed well at the $10-price point, we strengthened the value by offering fajitas at the same price point, including a salad and dessert. Going forward, we will continue to lean into our core equities to keep our value offering fresh and relevant.

We've also increased our media spend, and will couple that investment with our compelling new ad campaign to drive traffic. We are working closely with our agency Partners to optimize our marketing strategy, putting the dollars where they make the most sense in terms of weight level then mediums to use for the balance of this fiscal year.

Now on a global front, the team delivered solid results for the quarter, with comp sales up nearly 1%. We opened four new restaurants during the quarter, and we're on our way to 35 to 40 new openings for the full year.

We recently signed a development agreement with a new Partner in Bolivia, expanded a development agreement in Mexico, and are progressing with several more opportunities for development in new countries. We're excited about the increasing growth outlook for us internationally.

At Maggiano's, the brand delivered a solid quarter, driven largely by performance in the banquet business. The brand has done a great job expanding consumer appeal by improving our banquet menu with a number of new offerings, and strengthening the effectiveness of their marketing. Since our last call, we opened two new locations, one during the quarter and one just yesterday in Summerlin, outside of Las Vegas.

We've really dialed in this smaller footprint with dedicated flex space where we can service moderately sized banquets as needed, but can also use the space as additional dining room seating. It's a much more flexible model that's delivering on our expectations, as well as our guest's needs. We're optimizing all aspects that make Maggiano's such a unique and strong brand, from the dining room, to banquets, to delivery, to create this growth vehicle for a strong business model that allow us to take the brand forward.

Just as we said last quarter, these continue to be challenging times across casual dining. We're already seeing some of the weaker players struggle with their viability in this choppy environment. My belief is that at the end of the day, strong brands that are run well will succeed.

We have got strong brands, run by smart leaders and great operators. We have the right game plan, designed to weather the storm and come out stronger on the other side. We'll continue to stay true to our strategies to invest in driving top line growth, keeping the business model intact and keeping our financials strong.

That's our mission, that is what our metrics are aligned around, and I'll hand the call over to Tom to walk you through the financials. Tom?

Tom Edwards - *Brinker International, Inc. - CFO*

Thanks, Wyman, and good morning, everyone.

Today I'd like to walk through our first-quarter performance, provide an update on the recapitalization announced in August, and finally, share our outlook for Q2 and full year of FY17.

Our first-quarter adjusted earnings per share before special items was $0.49, a 13% decrease compared to prior year. Q1 results were below our expectations, as lower sales in August resulted in P&L deleverage in our seasonally lowest volume quarter. However, we remain on track for full-year adjusted EPS guidance of $3.40 to $3.50, reflecting favorable results from our recapitalization, as well as the smaller relative impact of Q1 on the full year.

First-quarter revenues were $758 million, a decrease of 0.5% over prior year. This reflects lower reported comp sales of 1.3%, partially offset by increased restaurant capacity of about 0.7%.

Q1 comp sales were choppy. We exited in July with solid momentum, but compared to our expectations saw a sharp slowdown in August before performance improved, in September.

Starting with Maggiano's, the brand's comp sales were down 0.6%, reflecting lower category sales and negative mix due to large-party dining room performance. Mix improved through the quarter, and ended running positive behind our new bruschetta program. Maggiano's delivery and to-go business, which makes up over 10% of total sales, grew comp sales 640 basis points and remains a bright spot.

Chili's comp restaurant sales declined 1.4%, reflecting a 4.1% decline in traffic, partially offset by 1.5% improvement in mix and a 1.2% increase in price. One thing I'd like to note before getting into the drivers of Chili's comp sales is the difference between reported and calendar comp sales for FY17.

As a result of comparing against the 53-week year in FY16, our reported weeks are not aligned on a calendar basis. For instance, in Q1, the start of the school year is not lined up, so reported comp sales look lower than calendar basis comp sales. On this apples to apples, a calendar basis, Chili's comp sales were down 0.7% in Q1.

Looking at the brand's comp sales gap to the industry on a calendar basis, Chili's ran a positive 60 basis point gap for the quarter with the largest positive cap in September. Chili's comp traffic continues to be impacted by overall industry trends, but we were encouraged by the positive response in July of our new advertising, 3 For Me value bundle and craft burgers with transparent ingredient options.

Oil-related markets, which represent about 17% of our system, continued to improve sequentially. Oil markets were down 4.1% during the quarter, an improvement of about 40 basis points compared to last quarter.

Chili's delivered a positive mix of 150 basis points in Q1, driven by continued successful contests and merchandising as well as the initial positive response to our craft beer and happy hour rollouts. Chili's price increase of 1.2% reflects higher menu pricing, partially offset by alcohol offers, and overall is in line with our expectations.

Now let's turn to Q1 margin performance. Overall restaurant operating margin decreased 130 basis points to 13.3%. Seasonally, Q1 is our lowest margin quarter, and year-over-year results primarily reflect higher advertising behind our new Chillin' Since '75 campaign and higher labor costs.

Cost of sales margin was favorable by 50 basis points, primarily reflecting favorable commodity pricing for ground beef, chicken and cheese, partially offset by higher avocado costs. Currently, we are 77% contracted for commodities in Q2, with 61% contracted in Q3.

Restaurant labor margin was unfavorable 70 basis points, primarily reflecting a wage rate increase of 3.3%. This wage change is expected to be higher in the first half of our fiscal year, given timing of minimum wage increases that lap in January. Restaurant expense margin was unfavorable by 110 basis points, primarily reflecting higher advertising of 80 basis points and higher maintenance spending.

To complete the Q1 review, I'd like to provide some details on our recent financings. In August, we announced a recapitalization plan to increase leverage approximately half a turn, and return additional capital to shareholders in FY17.

During the quarter, we successfully completed three transactions. We upsized and extended our revolving credit capacity from $750 million to $1 billion. We issued an eight-year $350 million bond at a 5% coupon, and following the bond closing, we entered into a $300 million accelerated share repurchase program that will be completed in 4 to 6 months.

We believe the completion of these transactions positions us with a more optimal capital structure, while maintaining an overall strong financial foundation for executing our strategic initiatives. We're also confident in our ability to generate substantial ongoing free cash flow that provides flexibility and supports our consistent capital allocation policy.

Apart from moderately higher leverage, our policy has been changed and includes the following priorities: first, investing in the business to sustain and grow our brands, second, targeting a dividend payout around 40% of earnings, and growing our dividend as we grow earnings, and finally, returning excess cash to shareholders in the form of share repurchase.

During the quarter, we repurchased 5.6 million shares, including 4.6 million shares from the ASR. This initial delivery of shares from the ASR represents about 80% of anticipated ultimate shares. And since it happened just a few days before the close of Q1, we will see the reduction in weighted average share count in subsequent quarters.

Now I'd like to provide some comments on our outlook for Q2 and the full year. We continue to forecast comp sales growth of 1.5% to 2% for the full year, but will be lower in the range given Q1 performance. We've started Q2 with stronger comp sales for Chili's, and expect total Q2 comp sales to be positive, which will support our full-year guidance range.

From a quarterly pacing perspective, we expect comp sales to build through the year as we continue progress on the initiatives Wyman discussed. We continue to forecast adjusted EPS of $3.40 to $3.50 for the year. This is supported by favorable refinancing results and some additional commodity savings, partially offset by lower Q1 sales flow through.

We project a weighted average share count for full-year FY17 to be near the bottom of our $50 million to $53 million range. Just to recap, while Q1 was choppy and below our expectations, our initiatives are delivering share gains, generating stronger comp sales as we enter Q2, and are expected to build sequentially through the year with new capabilities and offerings.

And with that, I will open up the line for questions.

Wyman Roberts - *Brinker International, Inc. - CEO*

Kate, we will take questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jeff Farmer.

Jeff Farmer - *Wells Fargo Securities, LLC - Analyst*

Great, Wells Fargo. So over the last few years, Chili's has seen a platform push into both Fresh Mex and Fresh Tex among several other things, but now it looks like you guys are -- a bigger piece of your Chili's positioning is focused on Chili's Since '75 I believe and a lot of product focus on grass-fed beef burgers and craft beers. I guess I'm just curious with all those changes, do believe it's clear to consumers what the concept stands for or for which consumers it is appealing to?

Wyman Roberts - *Brinker International, Inc. - CEO*

Hey, Jeff, Wyman. I don't think there's a lot of confusion out there. Again, the Chillin' Since '75 is a really campaign that's more about the authenticity and the history of the brand which resonates very well with a broad base of consumers as all our testing has shown.

Our food positioning around Fresh Tex and Fresh Mex doesn't change, and aspects of that are highlighted through various food innovation aspects. And obviously, beer positioning around Fresh Tex and Fresh Mex we don't think is very -- is complementary.

So beer, margarita, Fresh Tex Fresh Mex is a platform, a concept that is consistent and congruent with each other. And all the work that we have done says it's not only not confusing for consumers, it aligns with what their expectations are for Chili's and it's got a basis in history as the Chillin' Since '75 campaign really points out.

So I don't think we are confusing consumers as to exactly what Chili's stands for. I think we're, if anything, dialing in on what differentiates it from others in the bar and grill category, and then just upping our game on how we deliver those products, quality, freshness, transparency, those all line up with those fundamental platforms. So that I don't think is an issue for us.

Jeff Farmer - *Wells Fargo Securities, LLC - Analyst*

Thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Jeff.

Operator

Will Slaybaugh.

Will Slabaugh - *Stephens Inc. - Analyst*

Thanks, with Stephens. Could you talk a little bit more about what you saw work well in the quarter, and what that means for your promotional activity on the value and premium side as well? And if that -- how that might coincide with your advertising platforms?

Wyman Roberts - *Brinker International, Inc. - CEO*

I think what worked well was the 3 For Me value platform, we feel really good about that value proposition and we're going to continue to lean into value as a mainstay for our marketing going forward. In this environment, we think consumers are looking for value. There's obviously an opportunity there, and we think this offer gives us breadth as well as some uniqueness to deliver. So that worked well.

We think the advertising is working well for us. We know that where we have implemented the beer program with the expanded taps for craft beer that that's working well for us. So several of the initiatives are working fairly well for us.

And we feel confident that as we continue to expand them, just more of about how to market those things to the consumers on a national and a local level that we'll continue to see momentum and be able to take share and move the brand forward. So those are a couple of the big things.

Will Slabaugh - *Stephens Inc. - Analyst*

Got it. And if I could follow up on the grass-fed beef comment, I am curious how that success looks versus your expectations initially and what that tells you about your ability to push further into the all-natural food categories?

Wyman Roberts - *Brinker International, Inc. - CEO*

It really was our first adventure into being more overt about transparency of product and bringing in a grass-fed antibiotic hormone-free alternative patty. And that, the acceptance was good. We learned quite a bit from it, and we are excited about modifying how we bring that to our guests.

We've already changed how we market it and merchandising the restaurant, and it's significantly increased the number of guests that are now eating it this quarter versus last quarter. So we're continuing to evolve that aspect of the business.

It's going to be a journey with regard to understanding what consumer's expectations are around transparency, and how we can fulfill those needs and still be true to the brand. And so, we were happy with our first marketing effort around that and we're going to continue to learn and get smarter about how to do that.

Will Slabaugh - *Stephens Inc. - Analyst*

Thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thank you.

Operator

Karen Holthouse.

Karen Holthouse - *Goldman Sachs - Analyst*

Goldman Sachs. So there was a comment about on the to-go platform now that the transition to [olo] has been made and you can go and start advertising this that part of that push is going to be product platforms that are conducive to a to-go business. So I guess what do you really mean by that?

Is there a focus on food that travels better, is it coming up with an option that can better target a B2B lunch day part? What need do you think the current menu isn't necessarily selling? Thanks.

Wyman Roberts - *Brinker International, Inc. - CEO*

Hey, Karen. Again just to reiterate, until we had the olo platform, we were hard pressed. Our old platform was pretty much at its limitations, and so pushing a higher volumes through it was not really an option for us, especially on peak days. So now that we've got excess capacity and confidence in the system, we can push it several different ways.

And I don't want to get too specific, because obviously those our proprietary ideas and some of them are based around some product ideas like you mentioned, some of them could be based around more consumer-friendly operational approaches to the to-go business. And really addressing convenience in another way.

And using this platform and our online and mobile technology now to make the online experience even more convenient and sticky, if you will, for consumers. So until we had the infrastructure right where we needed it, we were limited and now we don't have that limitation. So we will be much more aggressively looking to push this business, which is again growing organically.

Karen Holthouse - *Goldman Sachs - Analyst*

As a quick follow up, with the growth that was over 5% in the quarter and the transition or the platform transition occurring intra quarter, would it be safe to say that number improved throughout the quarter?

Tom Edwards - *Brinker International, Inc. - CFO*

Karen, it is Tom here. I think we've been running fairly strong to go in this mid single digits area over the course of the last couple of quarters. So I wouldn't say it improved significantly within the quarter, but I would say, as Wyman noted, that we now have the platform and some other operational and product ideas to help build it even beyond that.

Karen Holthouse - *Goldman Sachs - Analyst*

Great, thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks.

Operator

Sara Senatore.

Sara Senatore - *Bernstein - Analyst*

I'm with Bernstein. I had a couple of follow-ups on the comp and advertising in particular. I know you had talked about stepping advertising up this year, it looked like that happened in the first quarter. But the same-store sales, granted a tough industry, but maybe were a little bit softer than expected.

So I guess the two questions I had are, one, is that the kind of thing where we would expect to see the impact on more of a lagged basis of the step up in advertising? And two is, I guess what do we need to assume to assume a continuous acceleration in comps? Does the industry have to get better, is it more of your own initiatives?

Just trying to understand the underpinnings of accelerating comps through the year. Thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Sure, Sara. I think with regard to the advertising, we're relatively responsive immediately to increases in traditional media weight and we saw that early in the quarter. Again, the challenge for the Chili's business specifically was mid to late August, and it was fairly focused in that time period where things got soft.

And again, back to a -- we're not exactly sure what the impact of the Olympics were on us, and we don't really want to go there for a major cause because we know that only viewership was down. But there were a couple of weeks in that month where things just got softer for us relative to our performance in general, and relative to the category that's inconsistent with what we had been seeing and inconsistent with what we are seeing now and experiencing now.

So there was this definite opportunity within the marketing and media world at that point in time in the quarter. We anticipate being able to continue to increase the marketing spend, and getting smarter with how it works for us and expect to see the impact of that again rather directly in the quarters that we spend in.

With regard to our expectations for the industry, we don't know exactly. But we're not counting on a significant turnaround, some strengthening in the back half of our fiscal year, but nothing dramatic.

And with regard to our performance, we know we have opportunities in our back half that are less challenging than the first half and we also have our initiatives peaking more towards the back half. So that's what's giving us confidence that again we will continue to see positive momentum. As Tom mentioned, our expectation is to see positive comp sales this quarter and then continue to move out through the year.

Karen Holthouse - *Goldman Sachs - Analyst*

Thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Sara.

Operator

Robert Derrington.

Robert Derrington - *Telsey Advisory Group - Analyst*

Hello, Telsey Advisory. Wyman, one thing I'm especially curious about is the happy hour program, the new beer taps, that as well as the margaritas. How do you best take advantage of that and market it to a crowd who historically really hasn't found your restaurants to be real cool?

Is that possible? What's the recipe that you expect to be able to use to do that?

Wyman Roberts - *Brinker International, Inc. - CEO*

Hey, Bob. It's a great question and I think there is a fundamental maybe flaw in that assumption, and that I assume you're talking about millennials and younger demographics and Chili's. And there actually is a pretty wide acceptance of millennials in our brand. I think it's not that -- again, there are parts of the country maybe in some urban markets where the Chili's brand doesn't carry quite the cache, but in a lot of the markets we are in we are a viable bar and a good bar.

We've got to do some things both operationally and as from a concept to become more viable and to address some of those issues. But with the last reimage we put in, our video component for example and our music component is much more compelling.

We just now are offering better products with regard to craft beers, and stepping up the service aspect and we're also looking at other alternatives that we need to consider to take it to that next level. So I don't think there is a fundamental broad, again and we're talking across the country issue, with acceptance of Chili's as a place to come and drink and hang out with your friends and enjoy some bar food.

That's really the essence of what the brand started with, and getting it to work for millennials isn't a big a stretch as I think some might think. Especially in the markets where we are in. Again, I think you have to almost look at it from market by market and trade area by trade area, but we're excited about the opportunity.

Robert Derrington - *Telsey Advisory Group - Analyst*

Go ahead.

Wyman Roberts - *Brinker International, Inc. - CEO*

We're just excited about that opportunity of doing that.

Robert Derrington - *Telsey Advisory Group - Analyst*

Given the transformation that I have seen at that location down in Dallas recently, it certainly looks exciting. So good luck. We hope it works well.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Bob. We are too.

Operator

Peter Saleh.

Peter Saleh - *BTIG - Analyst*

Yes, BTIG. I just wanted to ask about two things really on the pricing side. How are you guys thinking about pricing?

Your pricing seems to be I guess towards the low end of what we're seeing in the industry. You guys think you're taking enough price? What are you thinking about price going forward, you think you'll take some more or will you let more pricing roll off?

Tom Edwards - *Brinker International, Inc. - CFO*

Peter, it's Tom here. We've stated before, pricing target with menu pricing is in the 1.5% to 2% range, and we're still comfortable with that and that is the pricing that we are actually taking for items on the menu. What we have seen this quarter is as we have worked through and rolled out some successful activity around the alcohol for both happy hour and in others activities. We've done a little discounting there that has reduced the headline of pricing to the 1.2% as opposed to the actual menu pricing for other items on the menu.

So our plan is to continue in that 1.5% to 2% range, and we're very comfortable with that. And understand how that works and the impact it has on our guests, and then we'll also works to build traffic with some of these initiatives that we have just been talking about around happy hour, craft beer, other things happening in the restaurant around the bar and other activities that warrant that investment.

Peter Saleh - *BTIG - Analyst*

So just so we're clear, should we expect the net pricing to mirror what we're seeing in 1Q for the rest of the year given the discounts?

Tom Edwards - *Brinker International, Inc. - CFO*

I would think you should expect to see the net pricing slightly higher than what we're seeing in Q1. So take it in the 1.5% to 2%, maybe a little bit higher in that menu range and then a discount off of that for some of the activity in the bar.

Peter Saleh - *BTIG - Analyst*

All right. Then just wanted to ask on the loyalty program, we've been hearing a lot about Plenti for several quarters now. Can you give us an update on the Plenti program, and what your expectations are for that going forward over the next couple quarters?

Wyman Roberts - *Brinker International, Inc. - CEO*

Yes, Peter. So we're on track, again you have been hearing a lot about it because we've been working really hard to put the infrastructure in place to create a unique situation in our restaurants. So we have in several restaurants today finalizing the technology solution that allow our guests to convert the My Chili's Rewards currency over to Plenti. Also it allows our guests to sign up for Plenti if they haven't signed up for Plenti in the past and become Plenti members.

So the integration between all these systems to take place at the tabletop has been no small endeavor, and we have invested in that work and now are testing it right now. And expect it to be completed in the second quarter, and we will start the transition and really starting to leverage end market against our My Chili's Reward program and the Plenti coalition here in the second half. We're excited about that opportunity.

Peter Saleh - *BTIG - Analyst*

All right, thank you very much.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Peter.

Operator

Stephen Anderson.

Stephen Anderson - *Maxim Group - Analyst*

Yes, from Maxim Group. Just taking a look at some of the line items, I saw that they a fairly decent job in the non-labor restaurant expenses, and I saw that in the release that you attribute that to advertising as well as repair and maintenance. Should we expect to see that big jump in subsequent quarters, and how much of that is Chili's advertising versus the repair and maintenance line? Thanks.

Tom Edwards - *Brinker International, Inc. - CFO*

Sure Steve. This is Tom here.

With regard to advertising, that will be up across the year, and that's consistent with our increase -- approximately 17% increase on the dollar basis of advertising year over year. And as I mentioned in the remarks, it's about 80 basis points for this quarter. So I think you should expect to see that as we move through the year.

The other piece was repair and maintenance, and that was approximately 30 basis points in the quarter. That we shouldn't expect to see going forward.

We had some equipment timing wise coming off of warranty at the same time, and resulted in some higher maintenance and repair costs in the quarter. We don't expect that that will continue through the year at this level.

Stephen Anderson - *Maxim Group - Analyst*

All right, thank you.

Operator

Jeff Bernstein.

Jeff Bernstein - *Barclays Capital - Analyst*

Great, thank you, Barclays. And I had two questions for you. One just on the comp just to make sure I understand.

If we look at the press release, without your commentary, it looked like you started the quarter taking share as you commented on I guess through early August. And then it would seem like then all of a sudden you were losing share the rest of the quarter. So I'm just wondering whether that's fair, or whether you really just think it was August?

Because I know you then said something about the calendar basis. So maybe I misinterpreted, and you are saying you actually took share each month of the quarter when you adjust for the calendar. Maybe that's why you are more confident in the positive in the second quarter than we were expecting?

Wyman Roberts - *Brinker International, Inc. - CEO*

Yes, Jeff, Wyman. So If you adjust for the quarter, and there's a couple of different trackers as you know out there and one adjustment doesn't -- you look at the adjusted numbers. We took share throughout the quarter by month.

But we did have a more challenging August, so we saw some deceleration there. But yes, it was monthly fairly consistent when you adjust for the calendar. You don't adjust for the calendar, then August was a little bit of a give back.

Jeff Bernstein - *Barclays Capital - Analyst*

Got it. But then the confidence on the second quarter being positive just because I know we started last quarter with good confidence, and then it seemed like industry challenges prevailed. So what gives you that confidence maybe the calendar shift reverses or the school shift reverses?

Wyman Roberts - *Brinker International, Inc. - CEO*

No, there is no calendar shifts. We actually still have a little bit of headwind again in the second quarter with this 53rd-week adjustment. But we're confident how we started the quarter, again, first quarter we started off fairly well too so you know it's not a guarantee.

But we are confident in how we started. We're confident in the plans we've got going forward, and we think a lot of the industry work is starting to -- a lot of the industry headwinds are at least stabilizing. So we don't see it getting worse.

Jeff Bernstein - *Barclays Capital - Analyst*

Got it. And then, Tom, just because of the confusion regarding the share count and the ASR, I just want to make sure I understand. I think you announced at the low end of $53 million for full year. Perhaps you can give us your expectation for what you think the second quarter will play out, because it sounds like really all of the ASR or a good portion of it is coming in the second quarter?

Tom Edwards - *Brinker International, Inc. - CFO*

Sure. We bought back those shares at the very end of Q1, so they will come out 100% in Q2. And just to give you some idea, we ended the quarter on an absolute diluted share count basis of about 50.8 million shares end of Q1. So that's our starting point for Q2.

Jeff Bernstein - *Barclays Capital - Analyst*

So that reflects the full reduction even though it happened very late, so that's a reasonable number as a starting point?

Tom Edwards - *Brinker International, Inc. - CFO*

That reflects the 80% that we received up front from the accelerated share repurchase, and then there's another portion we will get later in the year. But that will be obviously a little bit more weighted towards the end of that share repurchase.

Jeff Bernstein - *Barclays Capital - Analyst*

Got it, thank you.

Tom Edwards - *Brinker International, Inc. - CFO*

You're welcome.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Jeff.

Operator

Brian Vaccaro.

Brian Vaccaro - *Raymond James & Associates, Inc. - Analyst*

Raymond, James, thank you. Just wanted to circle back to the comp trends. I understand they improved in September and October, but I'm trying to sort through the impact that you might be seeing due to easier comparisons. Can you comment on the two-year stack trends? Are you seeing improvement there as well in those two months?

And then I was also wanted to go back to that calendar versus fiscal year mismatch on the 53rd week. Would you be able to quantify the headwind we should be expecting in the second quarter, and any other changes or differences in the back half of the year that we should be thinking about? Thanks.

Tom Edwards - *Brinker International, Inc. - CFO*

Brian, this is Tom here. I can talk a little bit about the last item first, the calendar shift. So it was a little more pronounced in the first quarter because of the back to school shift.

When you look at the 52 versus 53 weeks, interestingly, getting that back more towards the end of the year as things normalize. So there's not as much of a shift within Q2 related to that. Q2 we do have a change in when Christmas will now fall in Q2 versus Q3, and Veterans Day is on a tougher day sales wise so there will be a little headwind related to that.

And then, on a comp sales basis, on the two years, August looked -- on a calendar basis, August and September, September is probably a little worse than August just based on last year's numbers. But we would expect when we look at our Q2 numbers or Q1 overall in this basis, that it's probably our lowest quarter in terms of the two year. But it gets sequentially a little bit better as we look ahead.

Brian Vaccaro - *Raymond James & Associates, Inc. - Analyst*

Okay, thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Brian.

Operator

Chris O'Cull.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Thanks, good morning, guys. I may have missed this and I apologize if I did, but, Tom, did you say that the in the second quarter to date the comps are positive?

Tom Edwards - *Brinker International, Inc. - CFO*

We said they are stronger, but for Chili's they were positive.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

For Chili's they were positive?

Tom Edwards - *Brinker International, Inc. - CFO*

Yes.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Okay. I guess the second question would be what comp do you need to keep margin, restaurant margin that is, flat year over year at Chili's?

Tom Edwards - *Brinker International, Inc. - CFO*

The comp we would need would be -- well it's in our range of 0.5% to 2%. It's probably a little bit right in the middle of that range, a little over 1%.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

So if you're guiding towards the lower end of the comp range for the year, is it safe to assume that we will probably be towards the lower end of that range or probably towards the lower -- I guess your restaurant margin guidance for the full year is down 50 basis points. So is that still a reasonable assumption?

Tom Edwards - *Brinker International, Inc. - CFO*

It's still a reasonable assumption. And we just gave around 50 basis points, so Q1, to be clear, was lower than our expectations on the margin side. For Q3 through Q4, we don't anticipate that carrying through so you could adjust from there a little bit.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Okay. My last one, have the Texas locations received the new craft beer program?

Wyman Roberts - *Brinker International, Inc. - CEO*

We are rolling it out on a market-by-market basis. So some restaurants in Texas have, some haven't in the quarter. So it's not -- we didn't necessarily go state by state.

We've got it -- just again based on the folks we have around the country that are regionally implementing this program, it's been more less state and more market. So the answer is yes and no. So half like the rest of the country it's half the state let's assume got it in the first quarter, but everyone everywhere by the end of the second quarter will be fully loaded.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Could the reason the Texas stores have shown sequential improvement be because of the new craft beer program, or is it do you think more related to the economy in Texas or spending in Texas at restaurants improving?

Tom Edwards - *Brinker International, Inc. - CFO*

Craft beer could certainly be helping, and we know that happy hour when we rolled it out last year was a help to traffic in Texas. The other piece is the oil market is sequentially improving, and a good portion of those are in Texas come, as a matter of fact, the majority are in Texas and some in Louisiana and Oklahoma. So I think it's a combination of those items.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Okay, great. Thanks, guys.

Operator

Joseph Buckley.

Joseph Buckley - *BofA Merrill Lynch - Analyst*

Hello, with Bank of America Merrill Lynch, thank you. Curious on the stores getting the craft beer and comping better. Is it strictly the alcohol mix, or are there related food sales to that move that with the overall business?

Wyman Roberts - *Brinker International, Inc. - CEO*

Joe, I think it's a combination. When we put the taps in, we obviously do local marketing around that leveraging our database and digital to let people know, and with that comes the bar menu and some happy hour initiatives as well.

So it's more than just the one aspect. We're really focused on the overall bar experience. And so taps, the menu, the happy hour program, and then we are also, as we said, evaluating other aspects of our bar experience that we can take it to the next level.

Joseph Buckley - *BofA Merrill Lynch - Analyst*

I know you share the oil market spread and that narrowed. If you view Texas as a whole, is Texas still relatively weak but presumably better than maybe not with the same spread that the oil markets in total have? Is that fair?

Wyman Roberts - *Brinker International, Inc. - CEO*

It really is market by market Joe. And again, if you, for example, Houston which is now when we talk oil markets, the early impact that oil markets have into those markets were the fields we. So those smaller South Texas, Louisiana where they are actually drilling for oil, that got the immediate impact.

And we're seeing a little bit of a lag effect as you would expect in some of the more urban markets like Houston where we'll industries and kind of the impact the lag impact of the lower price oil hits them. So we are seeing that there other markets San Antonio, Austin, Dallas that really are not as will impacted and they perform really well throughout this whole time period. So it really is you can't look at Texas, it's just two biggest 82 make a broad statement you almost look market by market and those we've got a lot of restaurants in the state and all those markets. So they are all unique stores.

Joseph Buckley - *BofA Merrill Lynch - Analyst*

Okay, thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks, Joe.

Operator

John Heinbockel.

John Ivankoe - *JPMorgan - Analyst*

Hello, thank you, I am with JPMorgan. Two questions if I may. First on G&A, obviously you guys really controlled G&A in the first quarter and the first quarter is pretty out of sync with the guidance that you gave in FY17. So is it like normal reduction incentive comp, are there other projects that are being delayed or is G&A one of the levers that you are planning on pulling to making your earnings guidance for the year?

Tom Edwards - *Brinker International, Inc. - CFO*

Sure John it is Tom here. There is nothing out of the ordinary in G&A in Q1. It's normal management of expenses, and no real major changes and no changes in incentive comp that are material. What you will see in Q3 through Q4 is where we will have the reaccrual versus prior year of incentive comps. So that will be a change in delta versus prior year that is larger in those quarters. We did not have that adjustment last year in Q1.

So you don't see that change coming through. So that's why the guidance that we gave back in August was to have that material increase in G&A and you will begin to see that in Q2 and beyond.

John Ivankoe - *JPMorgan - Analyst*

Okay. Fair enough. Obviously a lot of conversations around alcohol, a lot of conversations around the bar. I think you just finished or are in the process of finishing taking up the number of taps. But is there anything else in terms of the bar capitalize that you're considering being more attractive to millennials are just people in the bar in general, and if so, how much might those projects cost to really take the Chili's bar to the next generation if you will?

Wyman Roberts - *Brinker International, Inc. - CEO*

John, we absolutely are looking at other aspects of the bar, all the way from enhanced atmosphere elements to different offerings. So obviously operationally looking at what we can do to be more relevant, to be more compelling. So right now it's too early to give you any color on that because we're in the process of trying to determine what is the most impactful thing we can do to continue down this journey of making the Chili's bar experience more compelling and more relevant.

But we aren't done with this rollout of taps, that's just really kind of the start, if you will, of continuing to move this thing forward.

John Ivankoe - *JPMorgan - Analyst*

Are you testing a number of different platforms in FY17? Different levels of spend?

Wyman Roberts - *Brinker International, Inc. - CEO*

Yes we are, and we're fairly far along on several of those. So we hope to have some more color and things to share with you in the not too distant future. As we kind of work through the implications of the spend and the impact to guests and all the other aspects of it on the business. But we're definitely excited about some of the things we are evaluating.

Tom Edwards - *Brinker International, Inc. - CFO*

John, it is Tom. We would definitely need to get a return on this and that's part of the test as we move forward with it. And we will look to see how it then fits into both CapEx and implications free cash flow, but with the history of having spent some dollars on re-image in the past, while still generating strong solid free cash flow definitely a consideration as we manage across -- if it has a return would be a multi year effort.

John Ivankoe - *JPMorgan - Analyst*

Thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks John.

Operator

John Glass, Morgan Stanley.

John Glass - *Morgan Stanley - Analyst*

Thanks very much, it's Morgan Stanley. Just first another dumb comp question, then one on the industry. On the comps, my data would say, or the data I have seen says September was worse than August and you're saying it the got better, so maybe just your share gain, maybe confirm that? And is your improvement in October helped by the industry, is the industry also getting better at October or is this just you outperforming and the industry staying where it is?

Wyman Roberts - *Brinker International, Inc. - CEO*

John, we did get better in September, and I think what we're seeing in October is more unique to us. I don't think the industry is showing a whole lot of improvement over its first quarter trend. Especially late first quarter trend. So we're not seeing that in the metrics.

We're looking at -- it really is more unique to us. And again, just like the first quarter showed, it's been choppy. So we're encouraged by the things we're doing, but we're also aware that it's been a pretty volatile summer, and we'll still how Fall plays out.

John Glass - *Morgan Stanley - Analyst*

You mentioned industry capacity in your comments and weaker player shaking out, so the narrative recently has been there's too much capacity, a lot is still coming into the industry, maybe it's not casual dining but just broader industry capacity. But you're also saying that there is some exiting that could -- in the category and I don't know if that's to come, or if you have actually seen it. Can you talk about maybe specific to your casual dining competitors, are you beginning to see closures that might benefit you? Is it too small to really add up to anything yet, or what's your thoughts on that?

Wyman Roberts - *Brinker International, Inc. - CEO*

I think as we look at it, it is a little bit, it's hard to measure. We don't have great metrics around capital spending in the category. But there are some examples of concepts that are shrinking, and in some numbers that are reasonable. We are talking now in tens and hundreds, so that does make a difference.

We're also hearing from some competitors a dial back, which I think is again encouraging that people are starting to say listen, let's address the overcapacity and slow things down a little bit. And I heard something recently from a competitor that the expectation was that would also maybe take some of the steam off some of the real estate market, which is not really come back in our opinion kind of represented the softer overall economic situation that's out there. Still praying a pretty good premium in this environment, we think, for real estate.

So all of those things I think bode well for getting the economics right and getting this supply and demand situation more in line. So there's always good to be smaller up-and-coming concepts whether they are direct or indirect, that push in, but it's when the big guys start to continue to build big restaurants in the same neighborhoods that I think we start to put a lot of pressure on the comps and the overall viability. So good to see some people started to dial that back down.

Tom Edwards - *Brinker International, Inc. - CFO*

And John, as you look at independence and just looking at some data, maybe MPD [crafts] data, we do see there are a number of restaurants pulling back over the last couple of years. And will be challenged with any number of items going forward, so believe that could be a trend as well that can help the overall situation.

John Glass - *Morgan Stanley - Analyst*

Okay thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks.

Operator

Andrew Strelzik, BMO.

Andrew Strelzik - *BMO Capital Markets - Analyst*

Hello, BMO, thank you. I'm still struggling a little bit with the restaurant low margin guidance. Obviously the first quarter was a little weaker. I think the fourth quarter was supposed to be a headwind with the absence of the 53rd week. Could you just help understand a little bit how you expect to achieve that? I think you said more price income a little bit, you said labor less of a headwind in the second half. Is the fourth quarter, maybe with the progression of comps, going to be less of a headwind or if you could help us understand how you're going to achieve that? I think the math actually implies you need to show margin gains in the middle two quarters of the year. So if you could just help bridge that, that would be great.

Tom Edwards - *Brinker International, Inc. - CFO*

Sure, I'd be happy to. So in the fourth quarter we do lap the 53rd week so that will come out, that was worth about 25 basis points on the full year, when you look at it across the year. What we expect to see is continued favorability on the cost of sales line.

So we are seeing deflation this year. It's gotten a little better than what we expected coming into the year. We do expect across the year some deleverage on the labor line, but that's, like you said, more moderate in the second half. Right now we're running above 3%, it will run below 3% just simply from lapping minimum wage increases that happened this past January. And on the restaurant expense line, we will see higher advertising across the whole year, but some of the other things that impacted us in Q1 are not expected to continue, certainly weren't in the plan and we don't expect those to continue going forward.

So those are the basic building blocks of the margin as we look from Q1 to rest of year. We had always anticipated Q1 was going to be a down quarter for margin just from advertising alone and the fact that it's a seasonally the lowest margin quarter, it was just exacerbated a little by the lower sales.

Andrew Strelzik - *BMO Capital Markets - Analyst*

So with the first quarter the way it played out and in the fourth quarter with the absence of the 53rd week, do you need flat to up margins to hit that guidance number one and number two with the step-up in the ad spending, the little more than 1% comp to maintain restaurant level margins, is that inclusive with the step-up in ad spending or is that just on a normal ad spend basis.

Tom Edwards - *Brinker International, Inc. - CFO*

It doesn't have to be up in the fourth quarter after the 53rd week, nor frankly in the other quarters -- will be expected to be negative and the ad spend is included in that overall statement.

Andrew Strelzik - *BMO Capital Markets - Analyst*

Okay. If I could just squeeze one more in here. At the investor day you were talking about being able to leverage some server data to either improve margins or comps or just general in-store operations. Where are we on that, when can we expect to see that maybe start to contribute or see you leverage that a little bit greater?

Wyman Roberts - *Brinker International, Inc. - CEO*

This is Wyman. We are using that information as we speak, and we are seeing our internal metrics around guest satisfaction improve throughout the year, really month to month. And we anticipate that that's going to continue to help us become a stronger competitor in the market.

It's one of those things that's not a -- you don't flip a switch, it's going to be a gradual movement for a better experience that gets guests back more frequently, but it's a long-term play but we anticipate leaning into that and starting to see that impact really this year. And the first thing we have to do is see guests telling us that their experiences are better and that's happening. So that's kind of how we look at that.

Andrew Strelzik - *BMO Capital Markets - Analyst*

Great thank you very much.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thank you.

Operator

David Palmer, RBC Capital Markets.

David Palmer - *RBC Capital Markets - Analyst*

Good morning, thanks, RBC. I know, and you talked about this today, you believe that there will be an improvement sequentially in sales trends through the year. You mentioned a few different initiatives, less shift to plenty, craft beer, new burgers, higher ad spend. If you had to hang your hat on one or two of these things that are going to really drive the sequential improvement, what would that be, how would you rank them and is that thing really already kicking in in October and I have a follow up.

Wyman Roberts - *Brinker International, Inc. - CEO*

Hello David, I think the more immediate are the media and the value propositions that go along with that. So that's -- we've experienced that in the first quarter to some degree, again we lost a little bit of traction there in the middle of the quarter, but we think that's a critical part of the plan this year, and we're confident that we will get that dialed in.

The bar initiative again, it will be finished this quarter and fully leveragable in the back half so that becomes more impactful in the back half, and those are the two, if I were just to prioritize two things, those are probably the two big opportunities that we're counting on, I will say. I think the one that is kind of an unsown and we're not seeing a lot of pressure on it to deliver is the conversion of loyalty to plenty. That's kind of an unknown entity, nobody has done what we are doing, so we don't know what the upside potential is. We don't think there's a lot of downside risk and so, that could be a marketing vehicle for us that opens up quite a bit of opportunity as we get smarter about how to use it and get people engaged in it, and that's a back half initiative as well.

So those are three big things we are focused on, and we are trying to stay focused on the big things. So I would say those are the three big things we are focused on really through this fiscal year.

David Palmer - *RBC Capital Markets - Analyst*

Thank you for that. One question about the types of users that are going to Chili's. I don't know if you have seen sort of the cohort usage between family parties and individual at the bar initiative will clearly be going after a certain type of user or [need-state] and obviously there's the family users.

It feels like the bar on family occasions is getting higher with entertainment options at home being greater, food quality at fast casual also higher. So it would stand to reason that family occasions and of course casual dining chains over index families would be under pressure. Are you seeing that in the data that you look at? And is that something you are addressing directly or perhaps your kind of attacking the other way, go after the bar to sort of offset that drag? Thanks.

Wyman Roberts - *Brinker International, Inc. - CEO*

The family business is important to casual dining and it's important to us. It is a core equity for us. We have not seen a softening, if you will, in that part of the business that's any more pronounced than any other of the challenges that the casual dining is seen. So we don't think that's the issue. We actually see more people going after that piece of the business competitively. But we've got a strong base in family business and with millennial families we think that's an opportunity to continue to leverage that.

Our business has the uniqueness if you will, that not everyone has to be able to say hey, listen, there is an aspect of our restaurant that's more bar focused and got a little bit of a different energy to it and then there's this other part of the restaurant that's really more family focused and focuses more on what's happening at your table and around the table. And more the food aspect of the menu aspect of it, with the alcohol playing a secondary role. And it works great for us, and I think it works great for our guests and that again is one of those things that allows Chili's to be in a little bit of a unique position. To be able to really work both fairly comfortably.

David Palmer - *RBC Capital Markets - Analyst*

Thank you.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thanks.

Operator

We have no further questions in the queue.

Wyman Roberts - *Brinker International, Inc. - CEO*

Thank you, Kate, and thanks to everyone for participating in the call this morning. I would like to note that our second quarter FY17 earnings call is scheduled for the morning of January 25, 2017. With that, everybody have a great rest of your day. Thank you.

Operator

Thank you ladies and gentlemen, this does conclude today's conference call. You may disconnect your phone lines at this time and have a wonderful day. Thank you for your participation.

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